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Affordable Housing Finance in the US

Introduction

This chapter surveys housing markets, housing stress, and housing finance in relation to the US experience, before and after the credit crunch. The chapter also reflects on the current debate in the US about housing.

With the 2008 credit crunch and housing correction, the US market has gone through the biggest cyclical downturn in decades. This is not the first time house prices have fallen. Between 1992 and 1996, there had been a drop in US housing prices. That episode also saw high default rates on subprime mortgages, but the difference in that case was these instruments were still a small fraction of the market. From 1996 to 2006, prices rose sharply and the US experienced a housing boom. During this period, despite the increasing share of subprime mortgages, default rates were low because house values kept rising. As the market innovated and grew more confident, subprime mortgages were increasingly securitized, and sold widely around the world.

That brings us to the subprime credit crisis of 2008. The correction in the market saw total home sales fall sharply. Existing dwelling sales fell 13 percent, and sales of new homes fell 26 percent, in the space of a single year in the midst of the downturn, as reported by Harvard University’s 2008 State of the Nation’s Housing report. Housing construction also nosedived: new housing starts and permits both fell from around 1.5 million per month in mid-2007 to just 0.5 million by end-2008, according to Commerce Department figures.

In the crisis year of 2008, for the first time since record keeping began in 1968, the national median single-family home price as reported by

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the US National Association of Realtors (NAR) fell, by 6.1 percent, to US$2,17,900. Similarly, the S&P/Case Shiller US National Home Price Index registered a decline of 8.9 percent. Out of a total of 144 metro markets, sales prices during the downturn year fell back to 2006 levels in 12 cities, to 2005 levels in 35 cities, to 2004 levels in 19 cities, and to 2003 or earlier levels in 16 cities. And this was not the bottom; prices declined further after these figures were collated.

While these cyclical movements are significant, we need to look behind them to the root structural causes in US housing, and beyond them to the lessons we can learn for the future, especially in relation to affordable housing finance.

**US housing markets and policy**

The United States (US) has a long tradition of government-supported financial assistance for affordable rental and home purchase utilizing sophisticated market techniques. Figure 4.1 provides an overview.

The role of the U.S. Department of Housing and Urban Development (HUD) is expanding home ownership, increasing access to affordable housing, fighting housing discrimination, eliminating chronic homelessness, and improving communities. HUD also works to increase public awareness of fair housing laws.

The Federal Housing Administration (FHA) provides mortgage insurance on loans made by FHA-approved lenders for single family and multifamily homes, and is the largest insurer of mortgages in the world. Over 34 million properties have been insured since its inception in 1934, when Congress created the FHA under the National Housing Act. The goals of the organization are to improve housing conditions, to provide an adequate home financing system through mortgage insurance, and to stabilize the mortgage market. The FHA became a part of the Department of Housing and Urban Development’s Office of Housing in 1965. The FHA is the only government agency that operates entirely from its self-generated income and costs the taxpayers nothing. The proceeds from the mortgage insurance paid by the homeowners are captured in an account that is used to operate the program entirely (HUD, 2009).

FHA mortgage insurance provides lenders with protection against losses as the result of homeowners defaulting on their mortgage loans. The lenders bear less risk because FHA pays a claim to the lender in the event of a homeowner’s default. Loans must meet certain requirements established by FHA to qualify for insurance. Unlike conventional loans