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What's Wrong with American Housing?

In 2004 and 2005, American homebuilders created over two million new housing units per year, including mobile homes. Then housing construction plummeted to under 600,000 new units per year, a record fall of 70 percent, and home prices fell drastically too.

Housing will not help lead the U.S. economy out of this recession, as it has done many times in past recessions. A major reason is that America's housing industry suffers from nine deficiencies that limit its ability to meet our housing needs. Some of these deficiencies are not widely recognized or are even considered advantages by the housing industry. Until its problems are better and more widely understood, that industry will continue under-serving U.S. housing needs. This article summarizes those nine deficiencies and then analyzes them in more detail.

The Nine Deficiencies

1. **The biggest deficiency is the lack of households willing and able to buy homes.**

2. **A combination of falling home prices, losses of jobs by millions of Americans, and low-quality home mortgages sold to home buyers led many home owning households to default on their mortgage payments.**

3. **The federal government has tried several times to enable foreclosed home owners to remain in their homes, but its efforts have been limited because both banks and other mortgage lenders have fought taking any "haircuts" in their loan amounts to make that possible.**

4. **The deduction of mortgage interest payments from the taxable incomes of home owners is a large government subsidy that provides most of its benefits to the wealthy owners of costly homes.**

5. **Control over what types of homes are permitted within each community is completely exercised by that community's local government, but many suburban governments are pressured by homeowners to exclude housing affordable to lower-income households.**

6. **In each year, homebuilders construct as many new units as they can sell during that year. But doing so in prosperous periods requires selling into housing demands oriented towards the future.**

7. **Many thousands of individuals and low-income households are essentially homeless.**

8. **The measures of home prices used by the housing industry and major media distort what really happens to home prices.**

9. **Bankers and other parties who normally provide loans to potential homebuyers have adopted stringent requirements for persons trying to qualify for home loans.**

The 2008-2009 Recession Has Drastically Reduced the Ability of Households to Buy Homes

The most essential ingredient for stimulating American housing construction is strong demand from households able and willing to purchase new or existing homes. But that demand has been crushed by the negative economic impacts of the recent recession. In millions of households, key earners have lost their jobs, suffered slashes in the values of both their homes and their other savings, are unable to get new jobs, and are even suffering foreclosures on their existing homes. The unemployment rate in the entire U.S. was 4.4 percent in May 2007, but then shot up to 9.8 percent in September 2009, and remained at 9.1 percent in July 2011. Even in households where all adults are still employed, the value of their assets has been greatly reduced by declines in both housing prices and financial assets.

Housing construction is not likely to revive until unemployment rates fall, household savings begin to recover in value, and the massive number of foreclosed housing units on the market declines greatly. Those developments are likely to take several more years.

Foreclosures Are Suppressing Any Major Recovery in Housing Construction

Sales of foreclosed dwellings have increased greatly since 2006, from about 400,000 to almost two million in 2010. Foreclosure sales comprised a large percentage of all home sales in 2010, and will do so again in 2011. It is difficult to determine exactly how many foreclosed homes have been sold monthly during any of the years from 2006 through April 2011. Realty Trac estimates that total housing foreclosure filings in each year were as shown in the accompanying table “Calculating Normal and Foreclosure Sales and Prices, 2006-2010.” It usually takes considerable time for each filing to result in seizure of the home by lenders and subsequent sales to buyers. Roughly 25 percent of filings in any year result in foreclosure sales within that year; another 35 percent occur as sales in the following year; the remainder are settled in some other way.

The National Association of Realtors (NAR) publishes the number of homes sold each year and estimates their median prices. By subtracting the number of foreclosure sales from total sales, one can estimate the number of homes sold that were ***not*** foreclosed. Realty Trac estimates the number of foreclosure filings each year and the discount at which actual foreclosures are sold below “normal” prices. These inputs were used to construct the accompanying table “Estimating Foreclosure and Normal Home Sales Prices by Trial and Error, Matching Estimates to NAR Housing Data, With 30% Foreclosure Discount.”

Estimating Foreclosure and Normal Home Sales Prices by Trial and Error, Matching Estimates to NAR Housing Data, With 30% Foreclosure Discount

ITEMS	2006	2007	2008	2009	2010
Total Filings Per Year (Realty Trac)	1,036,692	1,283,928	2,334,414	2,824,641	3,396,000
Foreclosure Sales That Year (25%)	259,173	320,982	583,603	706,160	984,000
Foreclosure Sales From Prev.Yr.(35%)	225,163	362,842	449,374	817,044	988,624
All Foreclosure Sales (FS)	484,336	688,824	1,032,977	1,528,204	1,972,624
NAR Total Sales	5,677,000	5,652,000	4,913,000	5,156,000	4,907,000
NAR Aver. Overall Price	$241,645	219,000	198,100	172,500	196,607
Total NAR sales volume (Vol. * Aver. Price)	**1,371,818,665,000**	**1,237,788,000,000**	**973,265,300,000**	**889,410,000,000**	**964,750,549,000**
% Foreclosure Sales as % of total no. of sales	**8.53%**	**12.19%**	**21.03%**	**29.64%**	**40.20%**
Total Foreclosure Sales Volume (FV)	117,037,372,720				
No. Of Normal Sales (Total - Foreclosure)	5,192,664	4,936,176	3,880,023	3,627,796	2,934,376
Total Normal Sales Volume (Total-Forecl.)	1,254,781,292,280				
Est. Normal Sales Price (Volume/No.)	248,000	$228,400	$211,500	$189,335	$223,560
Foreclosure Discount	30.00%	30.00%	30.00%	30.00%	30.00%
Foreclosure Price	$173,600	$159,800	$148,050	$132,535	$156,492
Foreclosure Sales Volume	84,080,729,600	110,074,075,200	152,932,244,850	202,540,517,140	308,699,875,008

Trial and Error Method of Estimating Foreclosure and Normal Sales Prices

Dollar volume of all foreclosures	84,080,729,600	110,129,181,120	152,932,244,850	202,539,753,038	308,699,875,008
Dollar volume of all non-foreclosures	1,287,780,672,000	1,127,422,598,400	820,624,864,500	686,868,755,660	656,009,098,560
Dollar volume of all home sales of all types	1,371,861,401,600	1,237,551,779,520	973,557,109,350	889,408,508,698	964,708,973,568
Average NAR price times NAR home sales	**1,371,818,665,000**	**1,237,788,000,000**	**973,265,300,000**	**889,410,000,000**	**964,750,549,000**
Foreclosure sales times foreclosure price (est/)	84,080,729,600	110,129,181,120	152,932,244,850	202,539,753,038	308,699,875,008
Normal sales times normal price (est.)	1,287,780,672,000	1,127,422,598,400	820,624,864,500	686,868,755,660	656,009,098,560
Dollar volume of foreclosure and normal sales	1,371,861,401,600	1,237,551,779,520	973,557,109,350	889,408,508,698	964,708,973,568
Estimated normal sales price	248,000	228,400	211,500	189,335	223,560
Estimated foreclosure sales price	173,600	159,880	148,050	132,535	156,492
DISCOUNT %	0.3	0.3	0.3	0.3	0.3
Foreclosure sales volume as % estimated sales	***6.129***	***8.897***	***15.713***	***22.772***	***31.998***

This table shows that the percentage of all home sales each year consisting of foreclosure sales rose from 8.53 percent in 2006 to 40.2 percent in 2010. **This huge increase in the share of all home sales coming from foreclosures has greatly reduced the average price of all home sales together. Yet none of the three major home price indicators explicitly takes into account the influence of the rising share of discounted foreclosure sales upon either the average overall price or the price of normal, non-foreclosed home sales. As a result, all three price measures over-estimate the price declines of non-foreclosed homes.** In fact, in 2010, as best I can estimate, the sales prices of non-foreclosed homes actually rose slightly at the same time that the three most commonly used price measures showed a slight decline in average housing prices (including foreclosure sales).

Why has the number of foreclosure sales risen so much? One factor is the immense loss of wealth among almost all households in the stock market crash of 2008-2009. A second factor is the sharp rise in unemployment from 4.6 percent in 2007 to 9.1 percent in 2011. Those two factors created a large decline in home prices after 2006. A third factor is that many households who bought homes from about 2003 onward were not required by mortgage lenders to have enough financial assets to survive a significant drop in home prices and still make their mortgage payments. As a result of those three factors, millions of home owners were unable to keep making required mortgage payments. Other owners were willing to walk away from their mortgage liabilities because of their diminished resources or the much lower asset values of their homes. As a result, delinquencies on mortgage payments skyrocketed, causing to a similar skyrocketing of foreclosures.

An additional factor has been a long delay in the foreclosure process that allowed many delinquent homeowners to remain in their homes, often without making mortgage payments. This delay was caused by banks and other lenders trying to process huge numbers of foreclosure filings through sloppy reviews of each property. Their carelessness caused courts to force many lenders to do it over again. This delay further postponed the sale of homes stuck in the foreclosure process.

These factors hugely undermined the willingness of possible home buyers to purchase homes. That offset the decline in home prices that might otherwise have increased home buying incentives.

Three additional factors reinforced the unwillingness of many households to buy a home. One was the large inventory of unsold homes, constantly replenished by additional home foreclosures. Potential buyers are reluctant to buy if they believe home prices might fall farther. Another factor was competition from speculative investors who were willing to pay all cash to buy homes – especially foreclosed homes being sold at large discounts. Such investors hoped to rent the homes they bought out and later sell them at a profit after the economy recovered. A final factor was the greater restrictions banks were requiring to make home purchase loans.

All those factors reduced the willingness of households to buy homes for their own use, in spite of continuing U.S. population growth. The resulting major drag on the housing market is not likely to disappear until (1) the rate of new foreclosure filings falls greatly, (2) employment opportunities substantially improve, (3) banks are more willing to extend home mortgages to potential buyers, (4) the current high inventory of homes for sale declines notably, and (5) the three widely-publicized measures of home prices more accurately take account of the influence of foreclosures on the prices of non-foreclosed homes for sale. Meeting those requirements may take many years to return the home building industry to its traditional levels of activity.

The Federal Government Has Tried Enabling Foreclosed Households to Remain in Their Homes by Reducing Mortgage Amounts, But Banks and Other Mortgage Lenders Have Fought Accepting Any "Haircuts" in Their Loans

The HAMP (Home Affordable Modification), HARP (Home Affordable Modification), and HOPE (Hope for Home Owners) programs were designed to help home owners by reducing their mortgage payments if their mortgages met certain conditions. Under HAMP, the home owner's loan is cut to no more than 31 percent of its gross monthly income; under HARP, the owner's current mortgage balance must be less than 125 percent of the home's current market values; and under HOPE, the owner can refinance to a 30-year fixed interest rate mortgage. In May 2011, the House of Representatives voted to kill the HAMP program because in two years it had aided only 600,000 owners instead of the 3 to 4 million originally envisioned. Although the Senate has not acted on HAMP, these programs continue to face major obstacles. Few mortgage lenders are willing to accept significant cuts in the sizes of their loans—and complex rules to qualify discourage many foreclosed home owners from participating. Also, the federal government cannot afford to finance these programs at large enough scales to greatly reduce the number of foreclosed households being pushed out of their homes.

The Mortgage Interest Deduction Is a Costly Federal Subsidy That Mainly Benefits the Wealthiest Homeowners But Does Little for Those Needing Help Most

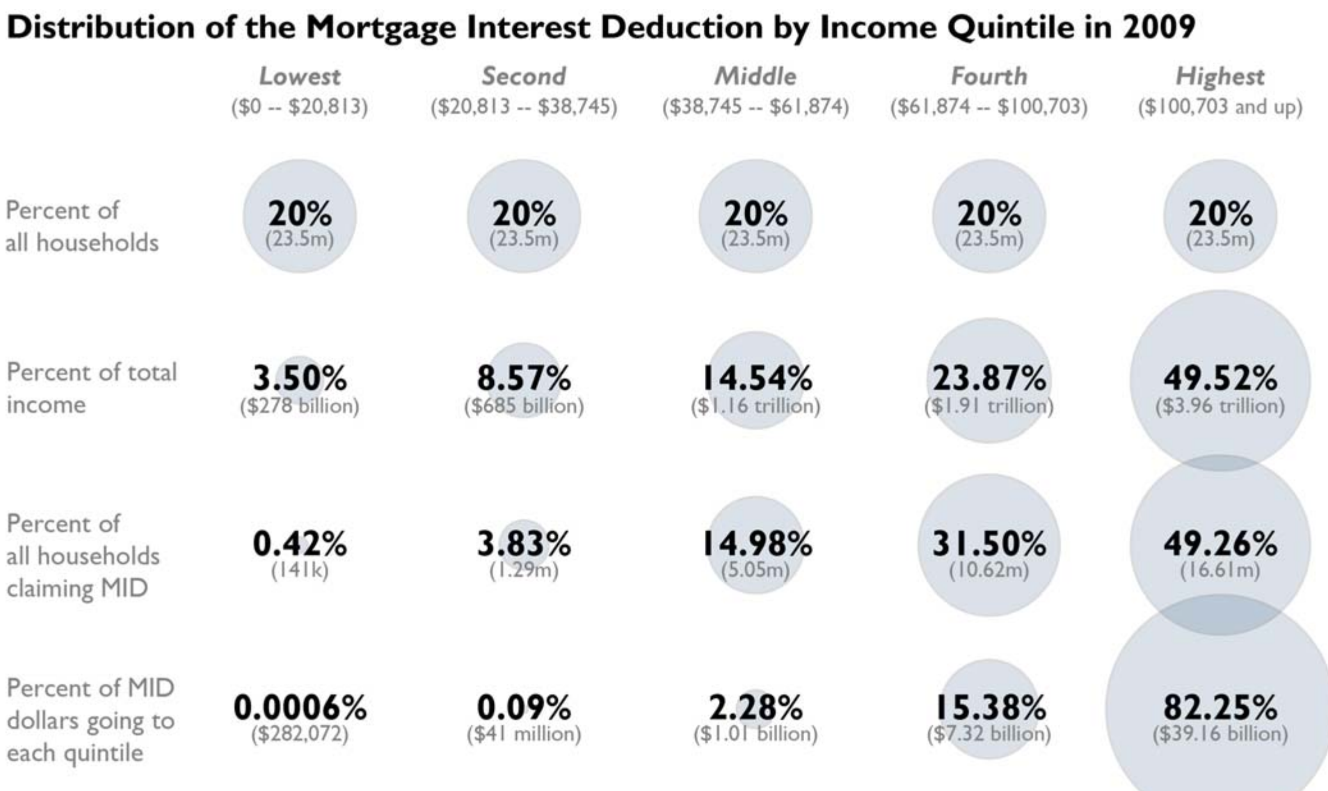
Many home owners receive a major financial subsidy from the federal government in the form of the mortgage interest deduction (MID) they can apply against their income tax. A home owner can deduct the entire amount of interest he or she pays against his or her income tax liability, including interest paid on a second home owned. This reduces the cost of both buying and maintaining one or two homes. This saving is known as a “tax expenditure” by economists. Why? Because it reduces the amount of tax revenue received by the federal government. It is as though the government were paying that amount directly as a subsidy to home owners.

This MID subsidy to home ownership results in a large loss of revenue to the federal government. According to a study jointly carried out by the Bureau of Labor Statistics and the Census Bureau for 2009, the total MID subsidy was $47.6 billion. In 2011, it is estimated to be about $88 billion. In the next 10 years, the MID will cause the federal government to lose at least $880 billion dollars in revenue, adding that amount to the nation’s total debt.

Furthermore, the MID subsidy is very unevenly distributed among income tax brackets, for two reasons. First, it is available only for home owners who itemize their tax deductions. Most low-income home owners do not itemize deductions because the standardized deduction is easier to use and provides satisfactory tax reductions. Second, the MID subsidy is much more valuable ***per dollar of mortgage interest*** to households in high tax brackets than to those in low brackets. Consider two households who pay the same mortgage interest each year equaling $5,000. As of 2011, the household in the lowest income bracket gets to reduce its tax liability by 10 percent times $5,000, or $500. The household in the highest income tax bracket gets to reduce its liability by 35 percent times $5,000, or $1,750. That is more than three times the benefit received by the lower-bracket household, though both pay the same mortgage interest annually.

Moreover, most tax payers in high brackets have larger homes than those in low brackets; hence they get even larger benefits from using the MID. In 2009, the average income among households in the lowest quintile (20 percent) of incomes was $11,900, while the average income in the highest quintile was $168,334—or fourteen times as high. If a home owning household in the lowest quintile had a mortgage of $1,500 per year, then a household in the highest quintile might have a mortgage interest 10 times as great, or $15,000 a year. In that case, the tax benefits would be $150 per year for the lowest-quintile household, but $5,250 per year for the highest-quintile households, or 35 times as large.

Considering the total distribution of the MID subsidy among income groups, the advantage of the highest income earners is even more spectacular, as shown in the table “Distribution of Mortgage Interest Deduction by Income Quintile in 2009.”



Source: Current Population Survey

Among the 23.5 million households in the lowest 2009 income quintile, only 141,036 (.0006 percent) used the MID for a ***total*** subsidy benefit of $282,072, or $2 per user. In contrast, among the 23.5 million households in the highest income quintile, 16.614 million (70.7 percent) used it for a total MID subsidy of $39.162 ***billion***, or $2,357 per user. Thus, the total MID of $47.6 billion in 2009 was divided with 0.06 percent going to households in the lowest quintile but 82.25 percent going to households in the highest quintile. Moreover, the average benefit to those in the highest quintile using the MID was 1,178.5 times larger than the average benefit to users in the lowest quintile!

The National Association of Realtors (NAR) has been lobbying Congress to maintain the MID in its present form. NAR claims that the MID is essential to maintain home ownership in the United States. But the United Kingdom, Australia, and Canada are three advanced countries that do not permit any mortgage interest deductions; yet the percentages of their households who were home owners in 2002 (69 percent in the United Kingdom and Australia, and 67 percent in Canada) were about the same or slightly higher than that in the United States (68 percent – now lower). NAR claims that housing prices would fall by an estimated 15 percent if the MID were changed in any way. Yet most economists believe that the main effect of the MID is not to cause more home ownership, but to allow households to buy costlier homes than they would otherwise.

The best way to change the MID would be to eliminate it altogether, thereby reducing the federal deficit and ending the unfair distribution of its subsidy mainly to the wealthiest households. But since over 60 percent of American households own their own homes, it may be politically impossible to get Congress to take such action. However, if the MID was merely shifted from the present ***tax deduction*** (which varies the subsidy per dollar of mortgage interest paid with each household's tax bracket) to a ***tax credit*** (which provides the same tax benefit per dollar of mortgage interest paid, regardless of the taxpayer's tax bracket), that would at least reduce the immense iniquity of the present system. In addition, the ability to deduct mortgage payments on second and third homes from taxable income should be abolished.

It is likely that elimination or substantial reform of the MID would cause some decline in home prices, mainly among the wealthiest home owners with the most costly homes. But such a reform would have almost no impact on home ownership in the United States. It is a scandal that the MID soaks up more revenues from the federal government each year than it spends on the entirety of the Department of Housing and Urban Development. If left unchanged, the MID would continue that egregious bias of American housing aid towards benefitting the very wealthiest households the most while almost ignoring the poorest households who need assistance most.

Many Communities Deliberately Exclude Low-Cost Housing

Control over what types of housing can be built within any given community is normally vested in that community's local government. These governments pass zoning laws and other regulations that determine required lot sizes, whether homes can be rented out, whether rental apartment buildings and small units added to existing homes can be constructed and where, and other elements of home building.

But many local governments, especially those in the suburbs of larger cities, are politically controlled by the home owners in each community, since those owners normally outnumber renters by a wide margin. For most home owners, their homes are their largest asset and they want to maintain or even raise the market values of their homes to protect their financial interests. Therefore they regularly oppose the construction near their own homes of any new homes that are either priced well below their own homes, or are rental apartments in multi-story buildings. They fear that allowing such lower-occupancy-cost dwellings to be built near them, or even anywhere within their communities, will put downward pressure on the market values of their own homes, or at least restrict any upward movement in their homes' prices. Many also do not want their children to be going to schools along with children from homes with much lower incomes than their own.

To prevent that outcome, suburban home owners in many communities have historically exerted strong pressure on their elected officials to adopt restrictive zoning and other laws that make it either impossible or too costly for developers to build lower-cost homes in those communities. Numerous nationwide studies of zoning practices reveal that such exclusionary zoning is widespread across the nation, especially along both the Pacific and Atlantic coasts. It results in a deliberate division of communities by incomes because of the higher home prices in such suburbs. In 2008, according to the U.S. Census Bureau, 13.2 percent of all Americans had incomes below the poverty level. That share was 18.3 percent in primary cities in large metropolitan area, but 9.5 percent in their suburbs and 16.8 percent outside of metropolitan areas. Such deliberately planned spatial separation of middle- and upper-income households from most lower-income households reduces the amount of suburban affordable housing available to the latter.

This spatial division of households by incomes has a major negative impact on the educational training of young people who will be a large share of America's future workforce. The number of Hispanic students in the nation's public schools continues to expand rapidly. According to the Census Bureau, Hispanic students represented 10 percent of public school students in 1990, 13.3 percent in 2000, and 17.2 percent in 2008, and will represent 20 percent by 2015. Yet Hispanic students are not being as well-educated as the children living in exclusionary suburban communities. Hispanic children have already become a majority of all children in California's public elementary and high schools, and comprise rising shares of public school enrollment in many other states.

The difference in educational opportunities for minorities between large cities and suburbs is shown by the high share of minority students in the nation's largest school districts. Those districts are mainly within large cities. The nation's 20 largest public school districts contain a total of 5.3 million students, or about 11.3 percent of all 48.8 million public school students in 2006. Minority students make up 78.3 percent of those enrolled in the 20 largest school districts but make up only 37.6 percent in all other school districts. In the nine school districts with the largest total enrollments, the cumulative minority percentage is 79 percent, as shown in an accompanying chart.

That means the preponderant majority of students from minority homes in those cities will attend schools in which minorities are by far the dominant groups. But years of experience show that minority students in such schools – unless they are from Asian households – typically get less effective educations than minority students attending schools in which they comprise less than half the total enrollment.

Minority Enrollment in the Nine Largest U.S. School Districts in 2003

As a percentage of total student enrollment

Source: U.S. Department of Education

The efforts of many suburban communities to make it difficult for low- and middle-income families to live within their communities tends to concentrate such excluded families – including many minority families – within large cities with high fractions of minority students, or in a few suburban communities where such students are concentrated, as in Prince Georges County outside of Washington, DC. As the overall share of minority households – especially those from Hispanic families -- continues to rise within the United States, this situation will reduce the ability of minority households to get high-quality educations for their children. That bodes ill for the future technical abilities of the U.S. workforce, which will consist of higher and higher fractions of Hispanic minority-group members. **Leaving control over what types of housing can be built in suburban communities entirely to their local governments is gradually undermining the ability of the American economy to remain competitive in a globalizing world economy.**

A few areas have tried to change this situation by shifting more of the legal authority over what types of housing can be built in suburban communities to state or metropolitan area governments, including Portland, Oregon. But such legal changes are extremely rare, mainly because they are strongly opposed by home owner groups who politically dominate most suburban communities.

This is a major flaw in American housing development and management that shows no signs of any notable improvements in the foreseeable future.

The Tendency of Homebuilders to Generate Cyclical Movements in Housing Construction

The American home building industry has repeatedly demonstrated a remarkable inability to provide a steady flow of new home construction over many years. Since the end of World War II in 1945, home builders have consistently overbuilt their markets in periods of relatively easy credit and strong economic growth in order to maximize their current profits. Each time housing starts exceeded two million in one year or in two consecutive years, new starts plummeted in the immediately following years. This pattern can easily be seen on the chart "U.S. Housing Starts, 1968-2009."

Total U.S. Housing Starts, 1968 -- 2009

Including mobile and manufactured homes, there were four occasions when total starts would have equaled or exceeded two million units in one or two consecutive years. Each time, starts then plunged because builders had been selling into what would "normally" have been considered future demand. In some years, this fall was also influenced by rising interest rates, as in 1983-1986 when Federal Reserve Board Chairman Paul Volcker was fighting inflation, or by nation-wide gyrations in income and production not caused by home builders. Those repeated peaks and sharp declines are documented in the following table, which includes new mobile homes.

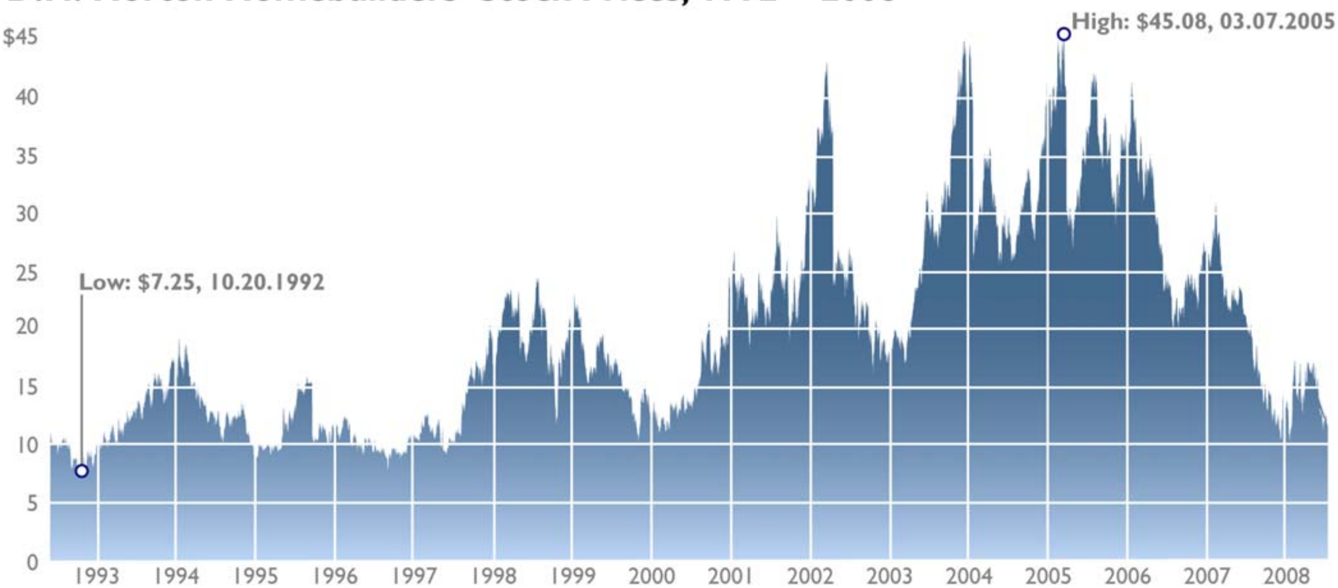
Years From Peak to Trough	High Point (000s)	Low Point (000s)	Decline in Starts (000s)	Percent Decline	No. Years	Avg. Yearly Decline (000s)	Avg. Yearly Percent Decline
1950-1960	2,078.0	1,356.2	721.8	34.7%	10	72.1	3.5%
1978-1982	2,295.2	1,301.0	994.2	43.3%	4	248.6	10.8%
1986-1991	2,050.1	1,184.6	865.5	42.2%	4	216.3	10.6%
1999-2001	1,989.6	1,795.9	193.7	9.7%	2	96.9	4.9%
2005-2009	2,215.0	583.0	1,632.0	73.6%	5	326.4	20.0%
Averages	**2,125.6**	**1,244.1**	**881.4**	**40.7%**	**5.0**	**192.1**	**21.8%***

* The 21.8% average was computed from other averages in the same row. If it had been computed as the average of the percent declines in the vertical column, it would be 10.0%.

Even before the dramatic collapse of housing starts after 2005, it should have been obvious to home building firms that they were in for a downward ride after starts surpassed two million in both 2004 and 2005. Those years of peak production led to an oversupply in 2006 that started driving nationwide median home prices downward for the first time since 1968. That overbuilding then helped generate the chain of events that led to the lending freeze of 2008-2009.

This repeated tendency of home builders to overbuild their markets to maximize short-run profits at the expense of future profits has also been reflected in the stock prices of public home building firms. This is shown by a chart showing stock prices for the D.H. Horton home building firm from 1992 to 2009. Horton's stock price gyrated repeatedly in that period, peaking at least seven times, and falling sharply after each peak. Similar gyrations in home builder stock prices occurred among almost all publicly-traded home builders.

D.H. Horton Homebuilders' Stock Prices, 1992 -- 2008



Homelessness in the United States

In almost all modernized or modernizing societies, many people at the bottom of the income distribution – including whole families – cannot afford to pay for what their society as a whole considers "decent" living accommodations. Many homeless people are physically disabled, suffering from mental illness or addiction, or are the victims of domestic violence. Others are too elderly to work, new immigrants who have just arrived, families just foreclosed out of their homes, or simply unable to find employment under trying economic conditions. As a result, they must either live on the street or under bridges, by squatting in abandoned housing or in cars, in publicly-provided shelters, or with family members or friends. They comprise the homeless, and they are found in all modern societies.

In a large and spread out society like the United States, it is hard to determine just how many people are homeless at any given moment, or over the course of an entire year. One method is to estimate how many are homeless on a specific date all over the nation. A study by USA Today estimated that 1.6 million people were using transitional housing or public shelters on the day of the study. A study done by the National Law Center on Homelessness and Poverty stated that approximately 3.5 million people, 1.35 million of them children, are likely to experience homelessness in a given year (National Law Center on Homelessness and Poverty, 2007). However, many homeless persons do not remain homeless over long periods. Another study done by the U.S. Conference of Mayors in 2008 estimated that homelessness had increased significantly in half of the 25 cities surveyed. The impacts of the 2008-2009 recession, including huge numbers of housing foreclosures, have certainly increased the American homeless total. The Urban Institute estimated that about one percent of the nation's population was homeless over a year, or about 3 million, of which 38-39 percent were children.[1]

What can, and should, be done about homeless people? Because their number has undoubtedly increased since 2007, this is not a trivial issue. The National Coalition for the Homeless believes that poverty is the most important cause of this problem. The American Community Survey conducted by the Census Bureau in 2009 estimated that 42.9 million people in the United States were living in poverty in 2009, or 14.3 percent of the total population.[2] The estimate for 2009 was 3.5 million higher than for 2008. If the Urban Institute's estimate of about 3 million homeless people is accurate, that means about 7 percent of poor people were homeless in 2009. That number had undoubtedly increased because of the recession and the resulting housing foreclosures. Those impacts of economic downturn are a second cause of today's homeless population.

Another cause of homelessness was the shift in the 1990s from welfare payments to families with dependent children (AFDC) to temporary assistance to needy families (TANF). That change notably reduced the flow of federal funds to families with children. Also, the minimum wage has not kept up with increases in the cost of living; hence workers who receive only the minimum wage cannot afford decent apartments in many cities. In fact, rents have risen much faster than the wages of most low-skilled workers.

Not all homeless people are without income. A 2007 a survey performed by the U.S. Conference of Mayors found that 17.4 percent of homeless adults in families were employed, while 13 percent of homeless single adults or unaccompanied youth were employed. But their employment did not pay enough for them to meet the basic necessities of living, including occupancy of a decent dwelling.

In every modern society, there are two basic types of homeless persons. One is a group incapable of working to raise enough money to pay for their own shelter or other necessities. They are the disabled, the severely addicted, the very elderly, and the mentally limited. They are unable to pay for their very existence by themselves. To live in "decent" dwellings, they need some type of publicly-provided living quarters, usually funded by federal or local governments or by local citizen groups, or health care organizations.

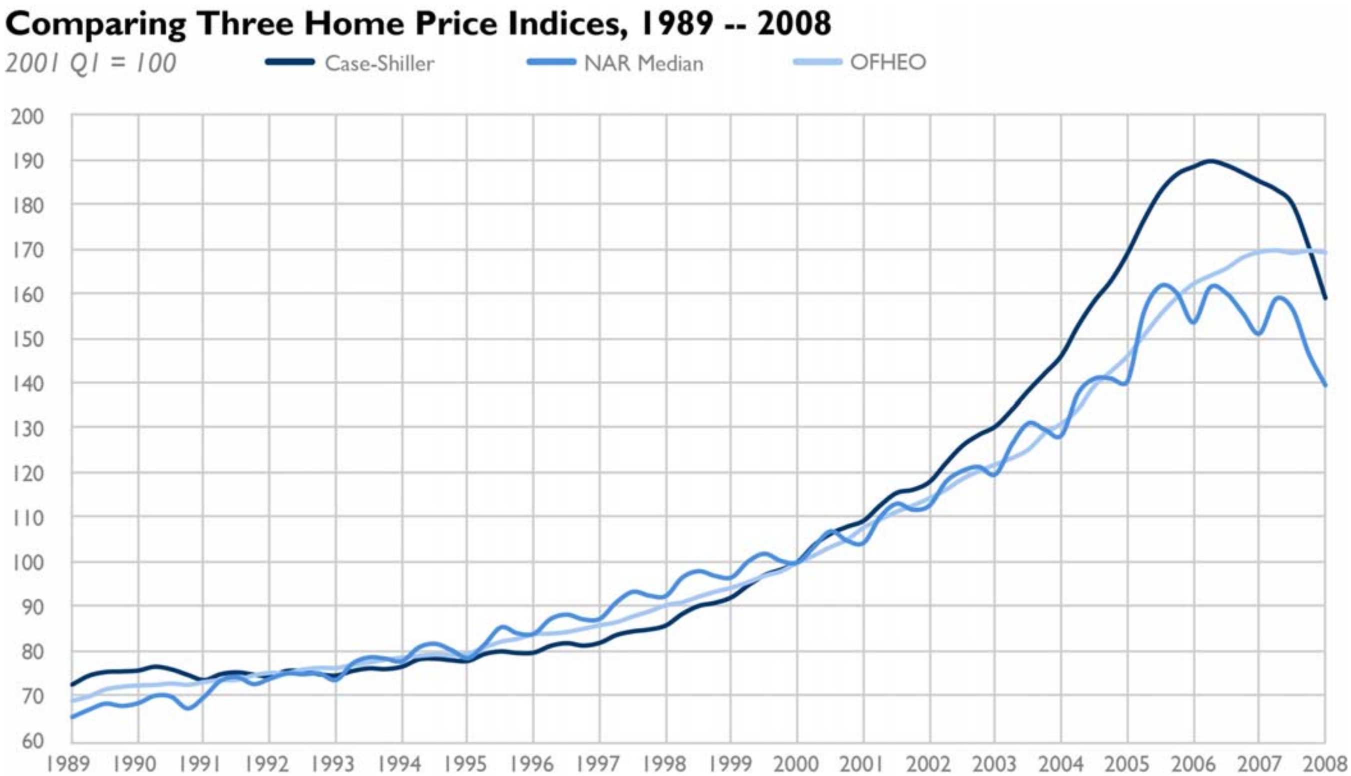
A second group of homeless consists of individuals transitioning from living on extremely low incomes to achieving financial stability. These include new immigrants from abroad, people fired from jobs because their firms went broke, or those fired because the overall economy is shrinking, as in 2008 and 2009. They need temporary assistance but can ultimately escape homelessness. Every society needs to have some type of very low-cost housing available to these individuals so they can survive while looking for a way out. Such low cost housing almost always fails to meet legal minimum safety standards for "decent" dwellings in order to get its costs down to where these people can afford living there. Yet such housing is a necessity in every large nation. The slums and tenements of New York and other large cities were where most such people lived in the nineteenth century. It often took them long periods to get out.

When there is a severe economic downturn, such as that after 2008, the transient group of homeless people increases in number much faster than the very low cost housing supply can expand. Yet today the federal government and most state and local governments are too financially strapped to expand that supply. In short, there are very few ways to overcome this type of homelessness. One is encouraging private church groups and other citizen organizations to create shelters for the homeless paid for outside of government funding. Another is for local governments to encourage homeowners to build accessory apartments onto their own homes and rent them to persons who are working but paid low rates. Usually these tactics are insufficient until a major economic recovery begins and unemployment declines. That is about the situation American housing is in today.

The Major Measures of U.S. Housing Prices Provide Misleading Information About What Is Actually Happening to Such Prices

There are three major sources of information about current housing prices in the United States: the Case-Shiller Index, the National Association of Realtors (NAR) data, and the Federal Housing Finance Agency (FHFA) Index.

The Case-Shiller Index, owned by Standard and Poor's, is the home price measure most often cited in the media. It uses matched pairs of two sales of the same homes over time to measure price changes accurately, not distorted by comparing prices of different quality homes. However, it gathers data from only 20 major metropolitan areas in the United States, despite the fact that in 2009 the Census Bureau stated that there were 366 metropolitan areas (each with 50,000 or more residents). The 20 metro areas included in the Case-Shiller Index contained 104.9 million residents, or 40.78 percent of the entire U.S. metro population in 2009. Since the total U.S. population was 307.745 million in 2009, Case-Shiller covered only 34.4 percent of the total U.S. population, omitting two-thirds. Moreover, the 20 metro areas in the Case-Shiller Index included most of those that had the largest home price increases from 2000 to 2006. Hence they showed much greater home price increases from 2000 to 2006, and much larger declines from 2006 to 2010, than were true of home sales in the entire nation. This can be seen in the accompanying chart entitled "Comparing Three Home Price Indices, 1989-2008." It clearly shows that the Case-Shiller Index rose much faster than the other two from 2000 through June 2006, then fell faster than the other two through about May 2009.



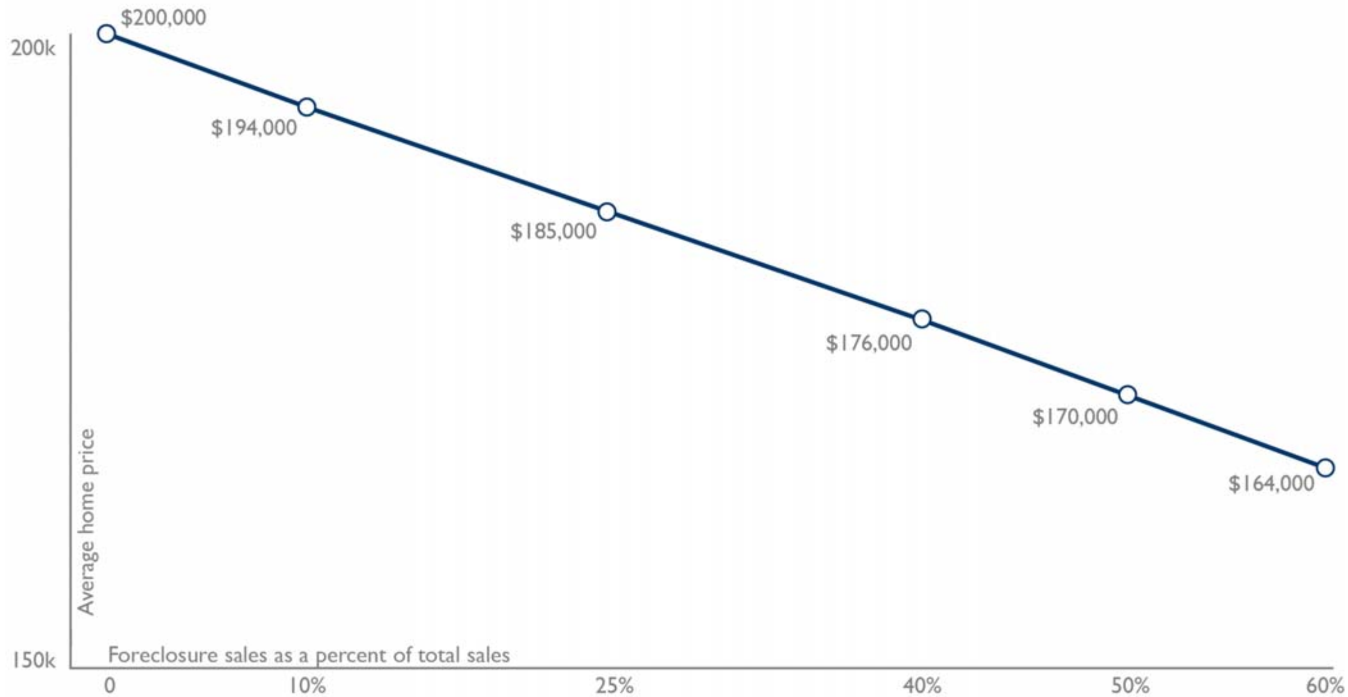
The second home price index is the NAR monthly or quarterly publication of home prices from a sampling of transactions in over fifty metropolitan areas across the nation. From these data, the NAR computes the median sales price for all these areas combined. However, the NAR price estimate suffers from two problems. First, it uses median prices for each area and for the nation as a whole, rather than average prices. Second, it does not correct for shifts in the sample of home types involved in sales during each period—so the median price actually computed for sales in one period can be influenced by a change in the mix of types of homes sold from one period to the next. On the other hand, since NAR uses data from a much larger number of metro areas than Case-Shiller, errors caused by shifts in the types of homes being sold in each period are in part offset by the larger sample of actual sales in far more locations.

The third index is the Federal Housing Finance Agency's estimate of home sales prices. Its sample is confined to purchase transactions eligible for financing by Fannie Mae or Freddie Mac. But it also uses data from many more metro areas, grouped by regions of the country. And it uses the same matched pair analysis as the Case-Shiller Index to protect from errors caused by changes in the types of homes that are sold in each period.

None of these indexes distinguishes between sales of foreclosed homes and sales of "normal" homes not involved in foreclosures. But foreclosed homes typically sell at much lower prices than the same homes would if they were not foreclosed. Realty Trac estimates that the average foreclosure discount is 20 to 30 percent. Therefore, as the share of foreclosed sales rises in the total number of sales – as has been happening for several years – the overall prices based on both types of transactions combined tends to decline, even if the sales prices of "normal" (that is, non-foreclosed homes) are not falling at all. Based on data from Realty Trac, I estimate that the share of foreclosed sales in total home sales has risen from about eight percent in 2006 to over 40 percent in 2010. For every 10 percent rise in the share of foreclosed homes in total sales above zero, the price of all sales combined declines by one-tenth of the discounted price of foreclosure sales compared to normal sales. This can be seen from the accompanying chart entitled "Relation Between Foreclosures and Overall Price Declines." The chart shows foreclosures are sold at prices 30 percent less than normal sales. Hence for every 10 percent rise in the share of foreclosure sales, the overall price of all sales will be 3 percent lower than it would be without foreclosure sales. Thus, if foreclosure sales reached 40 percent of all sales, the overall price of all sales would be reduced by 12 percent below normal sales (3 percent times 4). The Case-Shiller Index shows that home prices of all homes sold from the fourth quarter of 2007 to the first quarter of 2008 declined by 12.06 percent. That drop in the overall price could have been caused by a rise in the share of foreclosed sales in all homes, rather than a genuine decline in actual home prices, including prices of normal (non-foreclosed) homes sold. This assumes that foreclosed sales are discounted 30 percent below normal sales.

Relationship Between Foreclosures and Overall Price Declines

The average home price in a given area falls by 3% for each 10% increase in the number of foreclosure sales. The chart below illustrates this effect on homes with a normal sale price of $200,000 and a foreclosure discount of 30%.



The price change reports of all three indexes would be both more accurate and more useful if separate data were kept for foreclosed homes and normal homes. Yet to date, these indexes have not been willing to adopt this improved method of reporting home price changes. This is a serious error built into present home price reporting.

Tighter Lending Requirements by Banks and Other Lenders

A major cause of the financial crash of 2008-2009 was the willingness of banks and especially other lenders to make poor quality loans to potential home buyers. The poor qualities included low or no down payments, failure to check on borrower incomes, deliberately misleading borrowers about what would happen in the future to initially low interest rates, accepting loans with payments that exceeded traditional fractions of the borrower's overall income or debt, obtaining high credit ratings based on poor due diligence by rating agencies, and packaging multiple loans in complex instruments like Collateralized Debt Obligations (CDOs) that were sold to investors who did not really understand what they were buying. After the massive crash in home prices and employment in 2008-2009, banks, mortgage brokers, and other creators of loan terms were rightly criticized and new regulations were passed to change those behaviors. However, many banks have over-reacted by adopting much more stringent requirements that borrowers must meet than are called for by the new regulations. These include much higher down payment requirements (often 20 percent), more complete checking of borrower incomes, tighter limits on the borrowers' share of total income absorbed by the proposed mortgage, and more checking on the borrowers' past debt repayment records. All of these requirements are sensible, but they are often intensified beyond what is truly necessary for prudent lending.

As a result, it has become difficult for many potential home buyers to obtain mortgages from these banks. This has restricted the number of home sales to borrowers below what might be possible with good, but somewhat less stringent, requirements.

Is There Anything Right About American Housing?

The preceding material implies that there is not much right about American housing, considering how much there is wrong about it. But that would be a false conclusion. There are many right things about American housing. However, most of them are the obverse sides of things that are wrong. For example, one right thing about American housing is the diversity of housing types that American builders produce during periods of prosperity. Builders typically create small and large neighborhoods with homes of many types and sizes – single-family detached, single-family attached, and multi-family attached (to a much lesser extent). And there is a lot of competition among builders working within each metropolitan area. This gives potential home buyers a wide choice of home sizes and types from which to choose. But this desirable diversity is the obverse side of the tendency of builders to over-produce during periods of prosperity.

Also, strong competition among builders within a metropolitan area usually involves creating new neighborhoods on the outer edges of the area, which leads to more suburban sprawl. Many urban economists think suburban sprawl is undesirable because it generates more driving, which creates more greenhouse gases that contribute to undesirable climate change. On the other hand, suburban sprawl is one way to cope with the rising American population, which in turn enables America to avoid the aging of its population that is going to weaken many European economies and also the economies of both Japan and China.

So it would be incorrect to focus solely on all the things that are wrong about American housing while ignoring those many important things that are right.

How Can the Current Deficiencies in American Housing Be Overcome?

The nine current deficiencies in American housing are preventing that industry from moving closer to its implicit goal of providing adequate housing to all American households. Overcoming these deficiencies will not be easy, and in many cases may not be possible at all. To explore possible means of reducing these deficiencies, I have set forth an accompanying diagram showing five aspects of each deficiency: its name, its degree of importance in holding down new home construction, necessary changes to present conditions in order to reduce each deficiency, the political likelihood of making those changes, and an estimate of the time in which those changes might actually occur. Clearly, the entries in this diagram represent my own best judgments concerning what are the most accurate statements I can think of. Others may have quite different entries for each box; I urge readers to create their own entries.

How the Nine U.S. Housing Deficiencies Might Be Reduced

Deficiency	*Severity*	*Needed Changes*	*Likelihood of Changes*	*Likely Timeframe*
Lack of demand	**Critical**	Lower unemployment, improved household incomes, stable home prices	Governments are not aware of better ways to achieve these goals	Five to six years
High levels of foreclosure	**Major**	Fewer foreclosures, faster fore-closure processing enforced by courts	Foreclosures will decline if U.S. incomes rise and inventories fall	Three to five years
Lender resistance to loan modification	**Minor**	Much greater federal funding of aid to foreclosed home owners, and pressure on lenders	Not likely since Federal funding is missing and lenders resist	Not likely to occur
Mortgage interest deduction	**Minor**	Change Federal law to shift from tax deduction to tax credit	Strongly opposed by realtors, builders	Could be part of deficit reduction activities in five years
Exclusionary zoning in suburbs	**Major**	Have states draft more anti-exclusionary laws for suburban cities	Most states will not pressure suburbs to change local laws	Twenty years, if then
Cyclical overbuilding	**Major**	Tax profits on very high levels of construction by individual firms	Congress unlikely to interfere with home builders' behavior	Not likely to occur
Homelessness	**Minor**	Have private interests support more homeless facilities	Hard to finance under current economic conditions	Private efforts will not greatly reduce homelessness
Distortion in home price indices	**Minor**	Adopt Federal laws requiring separate data for foreclosure and normal home sales	Congress unlikely to change private index measures; housing agencies might suggest this	At least three years
Excessive requirements for home loans	**Major**	Have Federal Reserve review bank lending terms and pressure for fairer treatment	New consumer agency might take this action soon	Could occur in two years if not blocked by Congress

My estimates of how long it might take to overcome these deficiencies are set forth in the right-hand column. I estimate that it will take five to six years from 2011 to overcome the most important deficiency: lack of demand among potential home buyers. High levels of foreclosures should be greatly reduced within three to five years. Concerning the other three deficiencies I have labeled of major importance, I do not believe two will be remedied at all (exclusionary zoning in suburbs and less restraint towards overbuilding in prosperous years by home builders), and the third could be reduced within two years if the new consumer protection agency is not prevented from acting by Congress. Concerning the three remaining minor deficiencies, homelessness will not be anywhere nearly fully remedied, distorted measurement of home prices is unlikely to be remedied (though it could be within 3 years), and the mortgage interest deduction will probably at most be shifted to a change to a tax credit as part of attacks on the nation's deficits.

These estimates may seem discouraging, but I have tried to be as reasonable and accurate as I can. The estimates imply that the U.S. housing industry will not fully recover – back to levels of 2006 and 2007 – until 2016 or 2017. That would mean the recession of 2008-2009 will keep the level of American housing below its "normal prosperous" level for 8 to 9 years, two of which have already occurred. This long recovery compares with the crash of 1929-1930. Its effects lasted 11 years until the beginning of America's entry into World War II finally overcame the impacts of that crash.

Other observers may make quite different estimates of how long it will take the U.S. housing industry to fully recover. However, I believe my list of housing's deficiencies really is quite accurate, and probably longer than many other observers would set forth.

I hope this lengthy analysis will be useful to other observers of the housing industry, at least by setting forth all the deficiencies I have noted. I do not believe the conclusions I have reached are sure to be borne out by time; no one can accurately predict the future that far in advance. But at least those conclusions should stimulate useful thinking by others concerned with the future of the American housing industry.

End notes

1. These estimates were set forth a study entitled "How Many People Experience Homelessness?" published by the National Coalition for the Homeless, July 2009.

2. U.S. Census Bureau, "Poverty 2008 and 2009," ACSBR 09-1, September 2010.