Homeownership: The Fast Path to Poverty
By Dean Baker
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The Commerce Department reported last month that homeownership among African Americans had dropped to 46.7 percent in the third quarter, three full percentage points below its peak level in 2004. This is a remarkably fast decline. In the last three years, the decline in homeownership among African Americans has destroyed almost half the gains in the decade from 1994 to 2004.

The situation is sure to get much worse. The foreclosure rate in the third quarter of 2007 was double the rate of 2006. At the third quarter foreclosure rate, more than 1.5 million families are on a path to lose their home over the course of the year. African Americans will be a disproportionate share of the home losers.

In looking for scapegoats many people have focused on the mortgage and banking industry. Millions of loans were sold to moderate income borrowers with low teaser rates that reset to unaffordable fixed rates after two or three years. Undoubtedly many of the borrowers failed to appreciate the structure of these loans, which virtually guaranteed they would have trouble meeting their mortgage payments.

But deceptive loans were just part of the problem. The bigger problem was that millions of moderate-income families purchased homes at bubble-inflated prices. There was an unprecedented run-up in house prices in the years from 1995 to 2006, with house prices rising by 80 percent after adjusting for inflation. This increase is truly striking because house prices in the United States have typically just moved in

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step with the overall inflation rate. Over the hundred-year period from 1895 to 1995 there was no increase in inflation adjusted house prices.

No economist has been able to identify any changes in the fundamentals of supply or demand in the housing market in the mid-nineties that could explain such a huge run-up in prices. The one obvious explanation for this jump in prices is that the United States was experiencing a speculative bubble in its housing market that coincided with a speculative bubble in the stock market, just as had been the case in Japan a decade earlier. Of course the defining characteristic of a speculative bubble is that it cannot be sustained: bubbles burst, bubble inflated house prices fall.

The housing bubble was the underlying problem that created the current subprime mess. Lenders didn't care whether borrowers could make their mortgage payments because in a bubble market, every loan is a good loan. Homeowners who face problems making their payments can always borrow against the new equity created by rising house prices or simply sell their home and pocket the gain. The story is different once the bubble stops growing and prices start falling back to earth. That is when foreclosure rates soar and people get thrown out of their home.

There are no good solutions in this story. Proposals by politicians to use Fannie Mae and Freddie Mac to buy up hundreds of billions of dollars of bad mortgages are a great way to transfer tax dollars to stupid investors, but will do little to help subprime homeowners. One policy that would at least allow homeowners to stay in their home is my "own to rent" proposal which would change foreclosure rules to give homeowners facing foreclosure the right to stay in their home as renters paying the fair market rent. This policy would also give lenders a strong incentive to renegotiate mortgages to allow homeowners to keep their homes.

While we should look to try to make the best of a really bad situation we should not forget the people who got us here. The housing bubble itself was attributable to a colossal failure of policy by the Greenspan Fed. However, the social engineering of politicians and ideologues is largely responsible for the fact that millions of moderate-income families got ensnared in the bubble. They promoted homeownership as an end in itself, regardless of whether it made sense at a particular point in time.

Housing policy at all levels of government pushed people into homeownership even as it should have been evident that people were buying homes at bubble-inflated prices. The housing "experts," who should have known better, gave disastrous advice and designed wrongheaded policy that is now having devastating consequences for millions of moderate-income families. These people should be held accountable for the pain their policies have promulgated - at the least they should not be invited back into positions of responsibility in government and elsewhere.

When there is a serious failure of public policy, the standard line in Washington is that "mistakes were made." When millions of moderate-income families were pushed into buying homes in the middle of a housing bubble, really big mistakes were made. And the experts who made these mistakes should suffer consequences.

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