Easing of credit created a crash in the housing market

by Randy Bright http://www.tulsabeacon.com/?p=5299

The headline in the New York Times on September 30, 1999, was "Fannie Mae Eases Credit To Aid Mortgage Lending."

The article announced the beginning of a government program that we now know contributed to the housing bubble that finally burst in 2008, about the time when Lehman Brothers failed. The article, by Steven A. Holmes, stated, "In a move that could help increase home ownership rates among minorities and low-income consumers, the Fannie Mae Corporation is easing the credit requirements on loans that it will purchase from banks and other lenders." At first, the program was to include 24 banks, that were to be encouraged to "extend home mortgages to individuals whose credit is generally not good enough to qualify for conventional loans."

A new study has been published by the National Center for Policy Analysis (NCPA) entitled, The Housing Crash and Smart Growth, authored by Wendell Cox, an adjunct scholar for the NCPA.

Cox contends that the easing of credit fueled a high demand for housing that accelerated so quickly that enough housing could not be produced to meet the demand. As a result, housing prices escalated in varying degrees around the country.

After reviewing data for the years spanning 2000 to 2007 from a number of sources including the Federal Reserve, Demographia, the Census Bureau and Harvard University, Cox observed a wide difference in home price escalation, concluding that the housing bubble affected some areas disproportionately more than others:

"In the 10 markets with the greatest rise in prices compared to income, the cost of a house rose by an average of $275,000, relative to incomes. Among the second 10 markets with the greatest price escalation, house prices rose $135,000. By contrast, in the major markets with the least rise in prices, houses increased only $5,000."

Cox observed that the areas that were more greatly affected were areas whose markets were "prescriptively" regulated instead of "responsively" regulated.

A prescriptively regulated market is one that promotes "smart growth" policies designed to prevent urban sprawl and use of the car and that promote those such as urban growth boundaries, growth management, home construction moratoria, excessive development fees, and planning. A responsively regulated market is one with few restrictions or planning, so that the market can respond to market conditions quickly, undeterred by government red tape.

When the housing bubble burst, virtually every homeowner in America suffered some loss in their home's value, but where there were prescriptive regulations, the losses were greater:

“From the peak of the bubble in 2006 to the Lehman Brother’s collapse on September 15, 2008, more heavily regulated metropolitan markets accounted for 73 percent of the aggregate value losses.” From 2006 to 2010, the total values of all homes in America had fallen $6 trillion, and “all prescriptively regulated markets (more heavily regulated markets) accounted for 94 percent losses, or an average of $97,000 per house.”

The conclusion Cox arrives at is quite simple. Developers in areas with prescriptive land regulations were so bound by regulations and had such little access to land that they could not provide enough land to meet the demand for new housing that the easing of credit caused. However, responsively regulated areas, such as Dallas, Houston and Atlanta, experienced only a small fraction of home value declines that areas in highly regulated areas such as California and Florida felt.

Intense and restrictive land regulations created a shortage that drove up the price, not of the home itself, but the land that it was on, creating the illusion of more worth. When the bubble burst, the sudden drop in demand for housing evaporated along with the value of the homes, leaving millions of Americans upside down and in trouble.

And the result of Fannie Mae’s easy credit policies? Holmes article was prophetic: “In moving, even tentatively, into this new area of lending, Fannie Mae is taking on significantly more risk, which may not pose any difficulties during flush economic times. But the government-subsidized corporation may run into trouble in an economic downturn, prompting a government rescue similar to that of the savings and loan industry in the 1980s.”

It is both amazing and perplexing that, even though government knows the certain outcome of heavy regulation, they continue on the same path as others who have failed before them.

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