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Home-Loan Subsidies Aid Rich, Study Says

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Dow Jones Newswires

The nation's three housing enterprises have helped fuel the red-hot housing sector with policies that primarily benefit wealthier consumers, drive up U.S. housing supply, increase rental prices and lead to higher default rates, according to a study released yesterday by the Federal Reserve Bank of Atlanta.

Staff economist Karsten Jeske and German economist Dirk Krueger found that the federal subsidies received by Fannie Mae, Freddie Mac and the Federal Home Loan Banks in the form of lower borrowing costs aren't distributed evenly throughout society.

"The subsidy leads to an increase in household investment in housing assets and an increase in the construction of real estate. The rental price of housing increases," the authors said. "The results also suggest that households with low wealth prefer to live in an economy without subsidy while high wealth households benefit strongly from it, indicating adverse distributional effects of reform."

Economists at Freddie Mac and the Mortgage Bankers Association criticized the report, saying it was highly theoretical and relied on inaccurate assumptions about the marketplace that skewed the paper's findings. A spokesman for Fannie Mae declined to comment.

"The paper is a useful intellectual exercise, but it is a theoretical construct whose results are driven by the assumptions behind it," said Jay Brinkmann, the vice president of research and economics for the Mortgage Bankers Association, the industry's largest trade group.

Freddie Mac Senior Economist Frank Nothaft said the paper ignores data showing more than half of the loans Freddie buys finance loans to lower-income borrowers and simplifies certain assumptions to make the economic model used by the researchers work.

Fannie and Freddie are for-profit corporations traded on the New York Stock Exchange that were chartered by Congress to free up mortgage money by purchasing home loans from other lenders. The 12 regional Federal Home Loan Banks are nonprofit lending institutions owned cooperatively by the banks, thrifts, credit unions and insurers that borrow low-cost funds from the system.

The working paper builds on a 2002 study by Atlanta economists Scott Frame and Larry Wall that measured the impact of the government-sponsored enterprises' federal subsidies.

The GSEs are used by the federal government to subsidize homeownership by lowering borrowing costs to consumers. Other researchers at the Federal Reserve Board of Governors found that benefit to be minimal, about seven basis points, which is seven one-hundredths of a percentage point. The government subsidizes homeowners through tax breaks and through various federal programs for low-income borrowers.

Fannie and Freddie, in particular, have helped more people qualify for mortgages in recent years by lowering the down payment requirements from the usual amount of 20% to as little as zero for borrowers with good credit. The researchers said lower down payments increase the amount of leverage borrowers are willing to take on and leads to higher default rates and more home purchases.

"Households use far fewer mortgages in the absence of the subsidy partially due to less housing consumption, but mainly due to lower leverage," the working paper said. "As a result, the subsidy has a very strong effect on mortgage default rates, which are substantially lower without the subsidy, as most households are less leveraged."

"Removing the subsidy has even stronger effects on the decision of whether and how high a mortgage to take out," the researchers found. "Without the subsidy, not only are mortgages lower for all household types ... mortgages drop even more than housing, resulting in a decline in housing leverage."

High-income, high-wealth households benefit the most from the GSE subsidy, the paper said. Lower-income borrowers who have plenty of savings in the bank benefit from the subsidy, but to a lesser degree. Low-income households that tend to live paycheck-to-paycheck benefit the least and could even suffer as higher housing costs drive up rental prices.

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