

For release on delivery  
10 00 a m , E S T  
February 8, 1996

Remarks by

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Chairman, Board of Governors of the Federal Reserve System

before

The National Partners in Homeownership

Washington, D C

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Many of you may not know that Henry Cisneros is an alumnus of the Federal Reserve System. Immediately before joining the President's cabinet, the Secretary served as the Deputy Chairman of the Board of Directors of the Dallas Federal Reserve Bank. He was always generous with his time and expertise, and I am delighted to be able, in some small way, to reciprocate.

I probably do not have to convince this audience that housing plays a central role in the economy and, more important, in the life of every person in our country. Although significant housing problems and challenges remain, the progress this nation has made during the past 50 years in expanding and improving our housing has been enormous. Since World War II we have doubled the number of houses and apartments nationwide. By almost all measures, housing quality has improved and overcrowding has diminished. And the proportion of families and individuals who are home owners has risen from about half to nearly two-thirds.

But the housing progress has not come evenly over the years. The housing sector of the economy has been both an accelerator and a brake for economic growth. Because housing construction is highly cyclical and particularly sensitive to credit conditions, its importance in the economy--and the attention we at the Federal Reserve devote

to it--are greater than its typical 4 percent share of gross domestic product would suggest

Financial innovations and regulatory changes of the past two decades have somewhat eased the burden placed on housing when monetary policy must be tightened to contain inflation "Disintermediation" is a word not often heard in the 1990s The proliferation of new mortgage instruments and the maturation of the secondary mortgage market have reduced the vulnerability of housing demand to interest rate variations and to regional differences in interest rates resulting from geographic mismatches in the demand for, and supply of, home mortgage credit

But the housing finance system has not been trouble-free in recent years One stress point has been in lending for real estate acquisition, development, and construction Readily available credit during the mid-1980s, combined with excessive optimism by developers, contributed to overbuilding, especially of income properties The overbuilding resulted in sharp cutbacks in real estate lending across the board toward the end of the decade During this period some undoubtedly worthy projects--even single-family developments--were denied credit The credit crunch served as a reminder of the burden placed on housing by boom-and-bust cycles Large swings in the pace of activity cause both inefficiencies in production and disruptions in consumers' planning

One positive result from that difficult episode, born of necessity, was that developers broadened their base of financing by seeking out new credit sources and exploring new ways of funding their projects and operations. This broadened base should help provide some added stability to real estate development in the future.

Despite the whole array of improvements in our system of mortgage finance, housing continues to play a disproportionate role in the ups and downs of our economy. For instance, as the nation came out of the recession at the beginning of this decade, housing accounted directly for nearly one-fifth of the total growth in output during the subsequent two years, a share not much different from the average of previous recoveries. Given the long-term nature of a housing commitment and the heavy use of credit, housing remains a sector more dependent than most on financial markets and consumer confidence, two determinants that can change quickly.

To be sure, the past three years have been good ones for housing. Starts exceeded 1-1/4 million each year. Single-family construction--most of which is destined for owner-occupancy--was particularly strong and accounted for an unusually large share of all starts, as the multifamily sector continued to work off the excess supply built up during the 1980s. Indeed, all of the key indicators of the new home market--starts, permits, and sales--have been

running above their averages for the 1980s. The existing home market also has been quite healthy overall, although the story varies some by region.

It is no coincidence that this good time for housing has come when inflation has been moderate and income growth has been reasonably steady. These are precisely the conditions that promote housing affordability, consumer confidence, and healthy lending institutions. Expectations of subdued inflation have held the speculative component of housing demand in check and have contained the inflationary premiums required by mortgage lenders. One result is that the proportion of its monthly income that the typical household must devote to mortgage payments on a new house is now the lowest in more than twenty years. And the steady expansion of the economy has given consumers the confidence they need to be willing to make the long-term commitment typically involved in home purchase.

Along with the housing production gains of the past three years has come an increase in the rate of homeownership. The proportion of all households that own their home, at 65.1 percent late last year, is the highest since the early 1980s.

More than economics comes into play in interpreting the prevalence and changes in homeownership. Surveys have repeatedly found that most Americans aspire to homeownership as a value in itself. Homeownership undoubtedly means

different things to different people. For many, it probably means more space. For others, it means more amenities. For perhaps most, the "pride of ownership" often brings with it a sense of financial security, residential stability, and community status.

While this aspiration underlies the market, economics and demography drive changes in the ownership rate. As you know, the ownership rate dipped during the 1980s, after four decades of gradual increase. The first reason for the reversal was that consumers were less able to buy. Income growth lagged, and interest rates remained high throughout the first half of the decade even after coming down from the peaks in 1980 and 1981. Housing was far less affordable, requiring a bigger commitment of household income. Confidence was down as well. Furthermore, households had less financial reason to buy. Smaller gains in house prices and absolute declines in some major markets greatly diminished the investment return from owner-occupied housing.

In addition to the improvement in the economic conditions for home purchase in the past few years, demography--specifically the aging of the population--also has given a boost to the single-family market. As the baby boomers mature, they anticipate fewer future changes in their jobs, marital status, and family size. This expected stability makes the selection of owner-occupied housing,

with its substantial transactions costs, more appropriate. It is worth noting, however, that despite some recent gains, the ownership rate among younger adults remains below that of their parents, when they were young adults.

Houses remain the single most important store of wealth for much of the population. Consumers view their home equity as a cushion against possible hard times. And many consumers also tap their home equity directly for various purposes, including home improvements, auto purchases, college tuition, and debt consolidation. Home equity lines of credit, rare just ten years ago, are now held by roughly 5 million homeowners.

Even as we work to expand opportunities for homeownership, we need to keep renters in mind, recognizing that they, too, are full partners in our communities. Our population is diverse. Owning is not the right choice for everyone. Someone anticipating a move in the near term or a big change in income--in either direction--probably is well advised to avoid the transactions costs of buying and selling. And owning does involve financial risks. Housing does not appreciate in all places at all times, the risks of capital loss are real. While owning affords stability in some respects, renting offers flexibility, freedom of movement to new job or personal opportunities, and less of a responsibility for monitoring and maintaining the physical plant.

Indeed, the Partnership's action plan extends beyond promoting homeownership. Many of the specifics are intended to expand housing opportunities for both owners and renters. One recurring theme among the 100 specific actions to which you have committed is to take advantage of technological advances. Electronic technology clearly has improved the operation of the mortgage market, enabling the faster flow of more information at much lower cost than in a paper-based industry. Technology has changed the underwriting, originating, and servicing of mortgages and has enabled more efficient pricing of a wider variety of mortgage products tailored for increasingly specialized segments of the market.

Of particular note, technology has aided the measurement and pricing of risk on low-downpayment loans to first-time homebuyers and in this tangible way has broadened the potential market for homeownership. The full and timely flow of information is critical to all participants in this market, and the Partnership's emphasis on this strategy is well-placed. Buying a house and taking out a mortgage is complicated and often intimidating to consumers, especially those of limited means.

At the Federal Reserve, through our regional Reserve Banks, working with community groups, we have long attempted to provide information on the process of home buying and mortgage borrowing. Since 1990, the Federal



Reserve has sponsored or co-sponsored more than 600 conferences, seminars, and informational meetings on affordable housing, fair lending, and related community development. In our own attempt to improve understanding through technology, last year the Board produced and broadcast teleseminars on the basics of homeownership to first-time homebuyers across the country. Today, the information contained in those live broadcasts is available in videotape format to potential homebuyers, financial institutions, and civic and nonprofit groups. And the Atlanta Fed recently developed a software product, called "Partners," that helps bankers determine borrower loan eligibility and pursue creative techniques for qualifying low- and moderate-income borrowers. More than 30,000 copies of the software have been distributed nationwide, and the program recently became available on the Internet.

These efforts, together with the wide range of initiatives of almost all other participants in the mortgage and housing industries, appear to be bearing fruit. In 1994, the latest full year for which statistics from the Home Mortgage Disclosure Act data are available, originations of conventional home purchase loans to lower income households expanded at more than twice the rate of lending to higher income households. Anecdotal information suggests that these gains have continued.

The most far-reaching and lasting way in which the Fed can promote expansion of housing opportunities is by doing what we can to provide a stable platform for economic growth. As I have mentioned, neither inflation nor boom and bust cycles are friends of housing. Steady, sustainable growth in economic output, and thus incomes, provides consumers with the economic means and confidence required for the long-term decisions inherent in housing choices.

Under any conceivable scenario, the housing sector will continue to be critical to the overall performance of the economy. Population projections have been revised upward in recent years. By most estimates, Generation X, augmented by a continuing flow of immigrants, should keep the demographic component of housing demand growing about as rapidly during the next several years as it has since 1980. This impetus is important, because over the long run the number of housing units built depends more on demographics than on financial markets, even though interest rates certainly can and do affect the short-run timing of housing construction.

Among the important issues facing our nation, deficit reduction has particularly significant implications for housing. In the past year, long-term interest rates have moved down as the outlook for deficit reduction has improved and have fluctuated with the ebbs and flows of the

budget negotiations. The stakes for housing--and for long-term growth of our economy--are high. Our economic prospects in coming years will hinge on our ability to increase national saving and to ensure that such saving is invested wisely. Making a serious commitment to balancing the budget within the foreseeable future is an essential first step--but only a first step. Making good on our commitment by resisting the temptation to depart from that path will be a significant challenge.

Budgets of governments at all levels--federal, state and local--seem certain to be under pressure for years to come. Thus, approaches such as the National Homeownership Strategy, with its emphasis on voluntary cooperation among the private, public, and community sectors, are particularly timely. As professionals in the housing and mortgage industries, you know how best to cut costs of production and financing, how best to open markets by reducing regulatory and discriminatory barriers, and how best to expand opportunities through education, information, and technology. I applaud and encourage your efforts.