

Intro:

Today on *Political Economy*, I'm talking with [Tobias Peter](#) about housing: From homeownership rates to construction types, we go over the many factors that play into a healthy housing market and explore what is holding back US homeowners.

Tobias is the codirector of the [Housing Center](#) at AEI. As a senior fellow, his research focuses on housing risk and mortgage markets. Tobias has testified before Congress and has contributed to major publications from the *Wall Street Journal* to Business Insider.

Pethokoukis: Before we talk about housing in America, you're from Germany. I wanted to ask just one or two questions about housing in Germany. What kind of house did you grow up in?

Peter: I grew up, ironically, in a single family detached home. My parents built it back in the '80s, I believe. The whole family came together, the grandparents, and they all built the house. It was pretty common. . . . My wife has six siblings and they all helped each other out building houses. So they were pretty efficient with that, I guess.

So you did not hire contractors, your family built the house.

That's what I've been told. Yeah.

I'll tell you, I didn't know what kind of answer I was going to get to that question.

Apparently, as a small child, I fell into one of the pits on one of their construction sites. I got to hear that story a couple of times.

Well, we're glad you're here. I know the focus of our chat is going to be about the United States, but, just very high level, what would be the main difference between housing in America and housing in Germany?

Two things: One is German housing is generally much denser, especially in the big cities. Much, much higher density, more high rise buildings, mid-rise apartment buildings. The other thing is that the homeownership rate is generally lower because you have these high-rise, multifamily, the homeownership rate is generally lower. And Germans, despite being very frugal and fond of saving, the home ownership rate is surprisingly low.

Is there an obvious reason why that is? Is it just about national character or something in tax law? Is there a reason why that is? Do you happen to know?

I don't know, it's a good question. Maybe home ownership isn't as subsidized as in the United States. I would have to get back to you.

Well, you gave me a wonderful segue into my first question, which is about the homeownership rate here in the United States. I'm looking at a chart, which I cannot show on a podcast, but I think I can briefly give you the gist. I'm looking at the national home ownership rate in the United States since about 1990, where we had about a 64 percent rate in the mid-'90s, climbed about 69 percent at the peak of the housing boom in the late-2000s. Then, of course, we had the financial crisis, housing crash, that rate dropped from 69 down to 63 at its low point around the late 2010s. That has since recovered to about 66 and then, just very recently, has begun to dip a bit towards 65 percent.

So we were at 64, 69, dropped to 63, back between 66 and 65. What does that tell you? Like 65–66 home ownership rate, is that a good number? Is that what it should be? Was America better off when it was at 69 percent? Should it be lower because if it's lower, there's more labor mobility, people aren't tied up? What should I draw from both where we are now in the history of the past 30 years?

So I would say that the 69 percent, that was pretty bad because it was not very sustainable. As you can see from the chart, the homeownership rate was inflated because of loose lending practices in the run-up to financial crisis. And especially many lower income and more minority borrowers got into the game late, like in '05, '06, '07, that's when prices peaked, and they rushed in with relatively little equity. So they really didn't have and high debt-to-income-ratio, so they didn't have the financial wherewithal to withstand the subsequent price decline and also the shock — the quite large shock to the economy and the unemployment rate spike.

I would say anytime you see something like that where the homeownership rate increases pretty quickly, it's not a good sign because it needs to be sustainable. At the [Housing Center](#), we've done a lot of thinking, how we can make homeownership more sustainable. Fundamentally, we need to go back to old principles, which is shorter loan terms that we had before the introduction of the 30-year mortgage. It's not very popular these days, but if you want to build equity quickly to withstand price declines, you need to build equity, and you can only do so with a 20-year mortgage.

Should it be a government policy to build higher homeownership — let's say in a sustainable way, not through loosening lending practices or cutting interest rates to zero or something — but as a broad policy, should government want a greater percentage of Americans to own homes than is currently? This his chart only goes back to about 1990, I'm not sure how that would compare to 1980, but should a government want a higher homeownership rate?

It depends, right? There's pluses and minuses with everything. Homeownership, traditionally it's been the American Dream, and it's also a great way to build wealth, especially for lower income and minority borrowers. There's the forced savings aspect. Sure, you could probably earn the same, even at a greater return in the stock market, but housing where you have to pay back your mortgage every month, there's something to be said for that. We know that, in this country, we have a huge gap in the rate of financial wealth between minorities and whites, and that would certainly, if we could do it sustainably, that would go a long way and go some way in closing that gap.

But on the other hand, if you have a lot of homeowners, the labor force becomes less mobile. Certainly, you want people chasing opportunities, and chasing after jobs, rather than being stuck in the home, as we've seen in the aftermath of the financial crisis where people were underwater but they were not willing to let go to chase opportunities elsewhere and they just stuck it out.

On my little chart, there is that little squiggle where homeownership seems to be dropping. Maybe it's just like a statistical artifact, but is that what you're seeing? Are we actually in a period of, again, a slight decline in homeownership?

If I were a betting man, I would say that, over the medium term, the homeownership rate is probably going to decline somewhat based on current policy where it is much easier to build large multifamily buildings than to build small, single-family buildings. The home ownership rate in these large multifamily buildings rounds to 10 percent or less, versus if you're building more single-family detached or attached housing, the homeownership rate is anywhere from 65 to 80 percent. Those are kind of the trade-offs.

So we're building more multifamily housing, and that's a recent trend?

That's a relative recent trend, especially in larger cities where it's become much easier to build, just because we're running out of land.

When we're talking about housing, in the cities, what counts? Do apartments count? Is this condos? Is this all the above?

So condos have become much harder to build, for various reasons: Condo defect laws where you have lawyers chasing after condo owners and to sue the developer after nine and a half years when the warranty runs out after 10. That's certainly one implication. There's another reason where you have financing. Financing is much harder to get these days for condos.

So the playing field has tilted towards in favor of large multifamily buildings, and oftentimes in very attractive locations, but the downside is that these homes are relatively small — on average, one bedroom — and the homeownership rate, as you mentioned, it's relatively low, and it's great for younger individuals that want to live in an attractive location, but it's not great for families who want to start a family, or grow the family, and build wealth, and that you can really only achieve if you have bedrooms.

Yeah, and that's going to be my very next question after this one, but as you were speaking, I was thinking about a block away, a very long block away from here at AEI, there is a former office building, which is obviously being converted into . . . I have no idea if it's apartments or condos, and I notice where I live, that same thing's happening. How much of that are we seeing where former business retail space is being converted in urban areas now to homes?

That's certainly what everyone is talking about, and it's certainly happening, but I think the housing shortage that we have is so large that just by converting a few office buildings here and there, that's not going to move the needle very far. So we need a larger, broader effort there.

And as you know, leading into that, that it is a huge complaint among Millennials and Gen Zs about a housing shortage — they cannot purchase homes as their parents did, that there is this housing shortage. What are the causes and what are the dimensions of this? These are legitimate complaints from these folks.

Housing has just gotten very unaffordable, and on the supply side, we've just not been building a whole lot, and it goes back, I think there are three main reasons. The first one is, literally a hundred years ago zoning was implemented in this country. Ironically, it came over from Germany.

Thanks for circling back. That's wonderful.

It came over from Germany where it was invented, but it came over with a very nefarious goal of pricing black, and eastern, and southern European immigrants out of more white neighborhoods. And the Supreme Court initially said you could not do it explicitly by race, so they found a workaround through zoning by limiting most of the land to single-family detached housing. They knew if they could just make housing a little bit more expensive, then a lot of these groups that are lower income could not afford to buy into these neighborhoods. So that was number one.

Number two was the rise of the NIMBY — the “not in my backyard” movement — which started in the 1950s where groups of people realized that if we band together and show up at hearings, or pressure our elected officials, we can slow down the process or kill development entirely. And then finally in the 1970s, the rise of the environmental movement, particularly starting out in California where the NIMBYs were given new tools to use to slow down development, but then also these regulations added a lot of costs. And today, the [National Association of Home Builders](#), they're estimating that, in order to build a single family detached home, regulations account for about a quarter of the cost. And it's even more if you want to build a multifamily home.

So what you've described is a problem of not enough supply to meet demand. This is a sort of basic, first-year econ phenomenon. Are there alternate explanations that you hear offered that you think just don't hold up?

Yeah, I mean the one very, very popular one these days is institutional investors — the [BlackRocks](#) of the world —

Buying up everything.

Buying up everything. So we've crunched the numbers, and we found that these large institutional investors that own 100 or more properties, they only account for one percent of the single-family housing stock today. So these large investors oftentimes get lumped together with the mom-and-pop investors. The mom-and-pops, they own about 20 percent, but no one is complaining about the mom-and-pop investors. It's just these small scale-investors that have a bad reputation. It is true, in some neighborhoods they account for a larger share, but nowhere do we find that they account for more than 10 percent of the single-family housing stock in no county.

I'm not sure why some people seem so reluctant to accept this supply-driven explanation.

Yeah, it's also a great way to distract right from the shortcomings of elected officials and also to distract from the NIMBYs — the not-in-my-backyard types — that don't want anything to be built. The straw argument is oftentimes, “Well, I drive around and I see cranes everywhere, or I see there's some construction around the corner. There cannot be a housing shortage.” But it's a really flawed argument. And at the same time, we've restricted supply, but at the same time, especially at the federal government, we have boost demand. And through low interest rate or what we've talked about loose lending practices, all that gets capitalized into higher home prices. Again, Economics 101.

Do some people offer as a solution purely kind of a demand, “Well, gosh, if people can't afford to buy homes, we have to help them afford those homes through some means . . . ?”

Down payment assistance, very popular, and a former presidential candidate actually pitched it in her plan to provide more down payment assistance.

You're just fueling higher prices.

Exactly.

So what problem, as someone who cares about public policy to solve problems — what is the housing problem we're trying to solve? Is it to build more housing? Is it to build more single-family or single-family detached housing? Is it to build all kinds of housing, whether it's single family, whether it's multi-occupant, high density apartment, is it sort of an all-of-the-above problem, or what are you focused on?

It depends. I think we need more housing, period, and we need it quickly. But to the extent that we care about the homeownership rate, we should be building more single-family housing. Single-family detached housing comes with a drawback that it's oftentimes more expensive, so I think the sweet spot is allowing more single-family attached housing. So townhomes need to be built, and those townhomes come on smaller lots. Land is expensive. You shrink the lot sizes, you have a cost saving there, but then if you have a small lot, you're not going to put a huge house on it. So the house shrinks, commensurately, and then you can actually, as our research shows, then you can actually build at an attractive price point for the broad middle class, and if you do that, all the housing is going to filter down.

The filter-down mechanism is one I feel like people don't understand, because . . . people who want to build housing go, “. . . I see cranes in the air and they seem to be building these luxury McMansions, or mansions, or luxury condos!” How does that affect the regular person . . . as far as that eventually creating more accessible housing for them?

When we talk about it, we don't talk about housing because housing breaks people's brains. We talk about something that they can relate to, which is cars, for example. If you explain to people, well, we are building plenty of Honda Civics, Toyota Camrys, those are cars for \$20,000, \$30,000 that the broad middle class can afford. And then people buy these newer cars, they sell their cars that have been driven for three, four years, they sell it to someone lower income, and they buy that car. They sell the even

older car that they've driven for five, six, seven years to someone even lower income. And eventually through this process of filtering, everyone who wants a serviceable car in this country has a serviceable car.

But in housing, we have broken the market, so we no longer can build the Toyota Camrys for the broad middle class, we can only build the housing Ferraris — those are the very, very expensive ones. And of course, if you built these very expensive cars, not many people can afford them. So you're not building a whole lot because you run out of buyers. And in the car market, if we only were to build a few Ferraris, of course, the price of existing cars would skyrocket, eventually, over time, and people would no longer afford to own a car. So we used the analogy on the housing market.

Oftentimes when I hear policy folks talk about housing supply, it seems to me that it's almost purely about density. Like these zoning rules, you can't build giant apartment buildings near subway stations or something like that, which would be super convenient, and they treat single-family housing almost like as that's a problem. They're very happy when something that was zoned for single-family housing becomes zoned for multifamily housing.

But if I understand what you're saying, we need both, but we shouldn't ignore the value of single family housing. It seems like that part does not get mentioned, especially when I hear the center-left Abundance, people talk about housing. To me, it's almost purely about density. I could just be missing it — and for that, I apologize if I am — but I don't hear them talking about single family homes being an important element of their vision.

I think that's true, and I think Abundance types tend to like public transit, so they want to build high rise apartments near public transit, but then from an environmental perspective, they think sprawl is bad, so that's a way of keeping things more contained. But from my perspective, the homeownership aspects, and the wealth building that comes with single-family housing — and the bedroom counts, too, that allows families to grow — is something to be considered. If we only focus on the high rise, we are going to drive down the homeownership rate much lower, and it's going to be harder to start families and have children.

If what you're focused on is building more housing — high density housing — wherever, are we talking about one set of policies, and if you — not that you're necessarily against that — but if you also are concerned about the number of single family homes that we're building in this country, is that a different set of policies?

Yes. We describe it as, it's three legs to the stool. The first one is new residential subdivision. So this is your quintessential sprawl where you going a little bit further out, you have the large builders, the [D.R. Hortons](#), the [Lennars](#), they are building kind of the cookie cutter homes, 100, 200 per subdivision. That's their business model. Then you have the high rise density developers that are building the multifamily homes that are on transit. That's a totally different group of builders.

But then there's the third group of builders that are currently totally out of the picture because it's just not feasible to tear down an existing older single family home in a relatively built-out area, and replace it, and divide the lot into smaller pieces, and replace that with four townhomes on that same parcel. But if you do that, our research has shown that you can actually keep the price point relatively attractive. Instead of building the McMansion where you have to build large homes, you can keep the price point

relatively attractive and about the same as the single family home that you've torn down, plus you're getting three additional housing units.

And to be clear, the reason they can't do that is why?

The big builders, it's not their business model.

Can anybody do this?

Yeah, it's a onesie-twosie business. But those are your lawn care professionals that have the tools already, they have the skills, and for those, it's a relatively small step from becoming an entrepreneur and building homes, or a subcontractor. But in large parts of the country, this is not legal. And so that's

That's because it's zoned for a single family —

Not a townhome.

— not three or four connected townhomes. So what is the political status of reforms that would make that more possible?

Ultimately, this reform needs to happen at the state and local level. I don't want the federal government to get involved in zoning decisions. Zoning, as I said before, that came over 100 years ago from Germany, and it was actually at the behest of the federal government, Herbert Hoover and his commission, the best and brightest, where they've propagated zoning through the fruited plains. That was adopted one after another jurisdiction. I want to avoid that, the federal government coming in with a one-size-fits-all solution.

I want states to recognize the need, and there has been a lot of movement at the state level. California, Washington, Oregon — very deep blue states — have passed reforms. Is it perfect? We'll find out. But there are also red states that have passed reforms like Montana and Texas, and there are also states in between that have tackled this issue of housing affordability. The solution really varies. In Texas, for example, it's more about new residential subdivisions, shrinking the lot sizes in these new residential subdivisions; versus in a California, it is more this infill development where you're allowing a single family home to be torn down, which is going to have higher reward.

How successful do these policies need to be? What is the gap out there that needs to be filled?

We are estimating the housing shortage is about six million homes. There are studies ranging anywhere from four million to eight million, so we've picked the middle point there. But if you follow what we call the “housing abundant success sequence,” so for the government to make it buy right — so take the discretion out of the way, the power of the NIMBYs —

Is that usually a state-level decision?

State and local. But of course at the city level it's a little bit trench warfare. So [with] the state, you can focus on a couple states rather than all these individual cities. You need to keep the rules short and simple. If you make it complicated and try to micromanage the process, these builders are just going to give up. It's just not going to work. And then the third thing is you need to allow a little bit more density: smaller lots, smaller lots, smaller lots. If you allow that, in all these case studies that we've studied is that, if you follow the success sequence, you're going to get a supply response, and the supply response is going to be quite large. We think that, over a decade, we could be closing this housing shortage that we have if we follow this story.

You seem positive that this is an issue with momentum that is going to get fixed, sounds like.

There is a lot of movement at the state level. The states that I mentioned, those are relatively large states. Texas is quite hopeful that this can be solved. If we got movement in Florida, for example, and a couple other southern, larger, faster-growing states, we think in about 10 states or so, if we put the right reforms in place, we could solve this problem over a decade.

Just to give you some numbers on that, the whole country, since 2000, we've been building about 12 million single family homes. They had an average density of 8,000 square feet. If you could go back in time and have an average lot size of 5,000 square feet and throw in a couple townhomes, we would have nine million more housing units today. So it's just one very simple policy fix: allowing smaller lot sizes. That can have a huge reward over 10 years. Then we have these other things, these other solutions where we allow the conversion of all the single-family detached homes to townhomes and building homes in commercial areas, and the problem is solvable.