Commentary

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Let me start by explaining my perspective on federal housing credit programs. During 2001-05, I served as Federal Housing Administration (FHA) Commissioner at the Department of Housing and Urban Development (HUD) and also Assistant Secretary for Housing. I managed the FHA programs and was, therefore, responsible for half a trillion dollars of mortgage insurance exposure backed by the full faith and credit of the government of the United States. I was also the "mission regulator" for Fannie Mae and Freddie Mac—not the safety and soundness regulator (I need to make that very clear)—responsible for the housing goals, new program approval, and a few other matters.

I was also at HUD during the administration of the first President Bush, running the Office of Policy Development and Research. In that capacity, I was responsible for developing an FHA reform proposal that was enacted in 1990, and also was the regulator for the government-sponsored enterprises (GSEs), regulating both their safety and soundness and public purpose. Earlier, I was chief economist at HUD in the mid-1970s. So, I have a fairly long historical perspective.

Quigley's (2006) paper is well worth reading as an introduction to federal housing credit activities. He has a good sense of what is important. I follow his order in my comments: the FHA's business, the FHA's public purposes, and then similarly for the GSEs. I begin with a general point: Quigley is absolutely right about the path-dependency of housing policy. I've felt that way for years: "present programs can be understood only from a historical perspective" (Weicher, 1980, p. 3). This is even truer now than it was 25 years ago.

THE BUSINESS OF THE FHA

The FHA is a business and a government agency. It is supposed to help people buy homes. It is also expected to operate at a profit. It has competitors in the private sector: the private mortgage insurers (PMIs) on the low-risk side, since the late 1950s; and the subprime lenders on the high-risk side, since the early 1990s. It also competes with the GSEs. The FHA has no protection from this competition. The FHA mortgage ceiling keeps the FHA out of the market for high-balance mortgages; it doesn't keep anybody out of the FHA market. If the subprime lenders or the GSEs can take away the FHA's business, it's theirs.

The FHA has an obvious advantage over PMIs and subprime lenders. FHA insurance carries the full faith and credit of the government of the United States. Conversely, it has the disadvantage of being a government agency—being less flexible and having to obtain congressional approval for major changes in its activities. The net result is that the FHA does serve a market segment that its competitors apparently can't, and it serves that market without losing money.

Quigley states that the FHA's market share has declined systematically since the late 1950s. It is infuriatingly difficult to construct a consistent time series on FHA activity, or the home-mortgage

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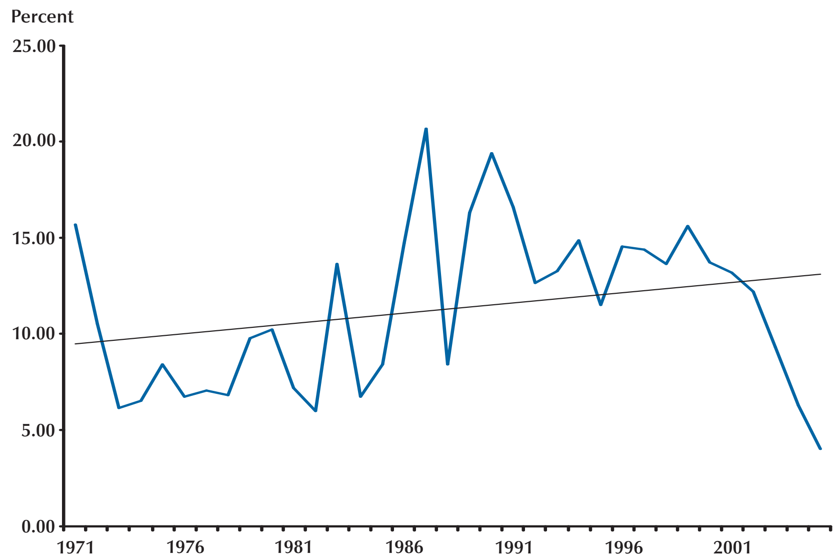
Figure 1

FHA Share of the Home-Purchase Market, 1971-2005



NOTE: FHA purchases during the 1970s exclude homes for low-income families with subsidized mortgages insured under Section 235 of the National Housing Act and include refinances as well as home purchases. Variables are constructed as described in the text.

market for that matter, but Quigley's strenuous effort to overcome the limitations (his Figure 3) misinterprets the trend. FHA's modern period began in the early 1970s, when the Government National Mortgage Association (Ginnie Mae) began issuing securities backed by pools of FHA-insured mortgages; these mortgage-backed securities (MBS) increased investor demand for FHA loans and gave the FHA a new importance in the mortgage market. This is masked in Figure 3 by the peak around 1970 that was caused by the Section 235 subsidized-homeownership program, in which about 500,000 low-income families bought homes with interest rate subsidies on FHA-insured mortgages between 1969 and 1974. In addition, Figure 3 includes refinances as well as home-purchase loans. The FHA's overall market share has a strong negative correlation with the share of refinances in the mortgage market. FHA homeowners take advantage of low rates by refinancing, like other homeowners; but about half of them refinance out of the FHA.

The most appropriate way to measure the FHA's market share is to look at home-purchase loans as a share of the home-purchase market, excluding the Section 235 program. Consistent data for FHA home-purchase loans are available since 1980; consistent data on total FHA endorsements are available since 1971. Figure 1 reports the FHA's share of the unsubsidized home-purchase market since 1971, measured by the number of homes rather than the dollar volume of mortgage originations.[1] For 1971-79, refinances are included and, thus, the FHA's market share in the early years is overstated. Very recently, anecdotal evidence suggests that investors have been active buyers of homes, intending to profit by resale. The FHA

[1] There are two HUD data sources for FHA home mortgages insured from 1971 through 1979: the *1979 Statistical Yearbook* (HUD, 1980) and the quarterly report on *U.S. Housing Market Conditions* (HUD, 2001). Typically the *Statistical Yearbook* reports about 10,000 to 15,000 fewer homes insured. Figure 1 uses the data from *U.S. Housing Market Conditions*, for consistency with later years. New-home sales are estimated by the Census Bureau, and existing-home sales by the National Association of Realtors; both are reported in *U.S. Housing Market Conditions*.

allows mortgage insurance only for owner-occupants. Investor purchases cannot be identified in any data series to my knowledge, so it is likely that the FHA's share in the past two or three years is understated. Throughout the period, homes bought for cash are included in the home-purchase market; such purchases seem to account typically for about 20 percent of all homes, and there does not appear to be a trend.

Since 1971, the FHA's share of the home-purchase market has been rising, not falling—the FHA's share has risen by 0.11 percent of the market annually. This trend is not statistically significant (t-ratio of 1.5), but it exists even though the inclusion of refinances in the numerator during the 1970s and investor purchases in the denominator during the 2000s both bias the trend in a downward direction. A similar but weaker trend exists for the period since 1980.

The FHA's market share has dropped in the past three years; it is premature to say whether this is a trend or a blip or the consequence of investor activity.[2] The FHA's demise has been predicted at regular intervals since at least 1973. I first came to HUD that year and was promptly told that the FHA was on its last legs because of competition from the private mortgage insurers. Since then, the FHA has insured 19 million home mortgages.

Quigley briefly mentions the FHA's multi-family business. He is correct that the subsidized-production programs greatly increased the FHA's role in this sector; even though the last of these was terminated in 1983, subsidized projects still account for about half of the FHA's total current multi-family portfolio. He is not correct, however, in saying that the relative importance of multi-family lending has systematically declined. The FHA's unsubsidized multi-family activity has been growing since 1992. Moreover, the FHA now is able to operate the programs without losing money. This is primarily due to the Credit Reform Act of 1990. Before then, the FHA lost money on its multi-family programs and required an annual appropriation. The Act forced the FHA to operate on a more businesslike basis. It provided the impetus for an effort that began in 1991 and culminated in 2002, when the FHA was able first to break even and then to lower insurance premiums as its revenues continued to exceed losses. By 2004, the premium had been cut to 45 basis points, the lowest in FHA history, and volume was about four times as much as in 1991.

Nonetheless, FHA multi-family insurance is a difficult business. It is complicated—each deal is unique; it is staff-intensive—it constitutes 15 percent of the FHA's portfolio but requires two-thirds of the FHA's staff; it is political—each project is large, and both the project and the developer are locally important; and it is where the HUD scandals most often occur. Twice I've come to HUD in the aftermath of multi-family scandals—the first time knowing that's what I was doing and the second time finding out when I got there.

THE FHA'S PUBLIC PURPOSES

Quigley's main recommendation for the FHA is that it be limited to serving the first-time homebuyer. That's not a new idea; the original public purpose of the FHA was to promote homeownership, especially for young families buying their first home. That still is the purpose and the basic business.[3] The overwhelming majority of FHA home-purchase loans are for first-time homebuyers—for the past seven to eight years they have accounted for 75 to 80 percent of all FHA-insured home-purchase loans. (For the VA, the share is just over 70 percent.) Also, about 35 to 40 percent of these first-time buyers are members of minority groups.

So, the FHA already is largely doing what Quigley recommends. But not entirely, and I don't think it needs to. Quigley seems to be saying that the FHA shouldn't insure refinances. I think

[2] The decline in FHA's business between 2003 and 2005 is paralleled by similar declines for the Department of Veterans Affairs (VA) mortgage guarantee program and for the PMIs. The FHA's total endorsements, including refinances, declined by 62 percent; VA guaranties by 69 percent; and PMI certificates by 37 percent. (Refinances are included for the FHA because home-purchase data are not available for the VA or PMIs.) This may suggest a general decline in the market for mortgage insurance, but such a conclusion is certainly premature; 2003 was the highest year in the past 35 for both the FHA and PMIs and the second highest for the VA.

[3] The VA has gone the other way. Originally a veteran could use his VA entitlement only once; since 1974 it has been extended to homeowning veterans who are trading up.

they should. Most FHA refinances are "streamline" refinances, with no cash out; the homeowner is simply lowering the monthly mortgage payment. That helps the owner and reduces the FHA's risk exposure. The FHA should be available for those FHA borrowers who want to refinance with the FHA.

It is less important, but I don't see any reason to exclude current homeowners from "trading up"—or down, for that matter—through the FHA. Not many do. They generally are owners who don't have a lot of equity in their current home; otherwise they would borrow through the conventional market. They may have a credit problem, which excludes them from the conventional conforming market. But if they meet the FHA's more liberal underwriting standards and are willing to pay for the insurance, I think they should have the opportunity to use the FHA. It is probably better than they can do in the subprime market. Using the FHA makes it more likely that they will continue to be homeowners.

Quigley concludes that the FHA doesn't increase homeownership very much—"by a percent or so," and more for minority groups—and may accelerate it somewhat. I think he may be undervaluing these achievements, particularly the latter. Goodman and Nichols (1997) estimate that most families that qualify only for an FHA mortgage in year one qualify for a conventional loan by year six. They would not be permanently barred from homeownership in the absence of the FHA, they would just buy homes later. I think that accelerating home ownership is an important and valuable accomplishment, for several reasons:

1. We are starting to accumulate evidence that homeownership does have external benefits, particularly for children. If their parents become homeowners five years earlier, the children have five more years to benefit.
2. Homeownership creates wealth. The sooner you own a home, the better off you are likely to be, down the road. Buying a home has been as good an investment as buying stocks—not just during the inflationary 1970s or the past few years, but also at the beginning of the stock market booms of the 1980s and 1990s, even though those were not boom periods for house values. A typical FHA first-time homebuyer probably puts about 3 percent down and pays another 3 percent in closing costs. Such a typical FHA first-time homebuyer in 1982, when the stock market started to rise, would have over the next five years paid off about 1.2 percent of the mortgage—not much, but enough to have raised his or her equity from 3 percent to 4.2 percent, almost by half. In addition, the value of the home would have risen by over one-quarter. That whole increase would have become part of the homeowner's wealth. All told, the equity in the home would have risen more than fivefold. Even after paying a 6 percent commission to sell the house, the investment in the home would have outperformed the Standard and Poor's (S&P) 500. During the 1990s boom, starting in 1992, homes and stocks performed about equally well over the next five years, and from the sixth year on, homes were a better investment. Comparisons using other broad indices are consistently more favorable to homeownership. (See Appendix A for details of the calculations.)
3. From a national perspective, homeownership is a significant factor toward a more equal distribution of wealth. In 1992, the Gini coefficient for the distribution of wealth was about 0.9 if home equity is omitted and about 0.8 if it is included. Similarly, the richest 1 percent of American households owned about 43 percent of all household wealth if home equity is omitted and about 34 percent if it is included (Weicher, 1997, p. 10). Those are large differences.

These seem to me to be valid reasons for a policy and program that accelerates homeownership.

I also differ with Quigley's judgment that most FHA loans are inframarginal with respect to promoting homeownership. The vast majority of FHA borrowers are stretching to buy a home. They make the minimum downpayment, and they have few assets above the amount needed for that downpayment and the closing costs. Further, they do not buy very expensive homes; the typical purchase price for an FHA homebuyer is still only about $130,000. It is certainly possible that these homebuyers might buy a slightly smaller home for $100,000 or so, but I think the FHA's impact is substantially on the margin.

The FHA has also had a public purpose of mortgage-market innovation. As Quigley mentions, the FHA pioneered what is now the standard mortgage—a long-term, self-amortizing loan, with a low down payment and level monthly payments. It also pioneered mortgage securitization, through Ginnie Mae, in the 1970s. These are major changes. The FHA has been less innovative recently. It did not pioneer the adjustable rate mortgage (ARM) or the hybrid ARM. For the past three years, the president's budget has included a proposal for a zero-down-payment mortgage for first-time homebuyers. As FHA commissioner, I believed that we knew how to price such an instrument and how to underwrite it and manage it. Congress has not approved it, at least at this writing. That is the reason for the FHA's less-innovative recent history. It requires an act of Congress to insure a new type of home mortgage. That takes time, often years, for good reasons and less-good reasons. The FHA has some history of getting bitten by its innovations, although that is mostly in its multi-family programs. With the full faith and credit of the government at risk, it is prudent to be cautious. People are always ready to sell you their new perpetual-motion machine. (On the other hand, if someone sells a new perpetual-motion machine to a powerful member of Congress, the FHA could find itself in the perpetual-motion machine business, willy-nilly.) Also, the FHA is required by law to have a certain net worth, as a protection against having to call on the U.S. Treasury. One consequence of this prudence is that the FHA's market share may drop when the market adopts a new instrument and the FHA cannot insure it. Hybrid ARMs are the most recent example. It took two acts of Congress in the past four years for the FHA to be able to insure the most popular type of hybrid ARM.

THE BUSINESS OF THE GSEs

Fannie Mae and Freddie Mac have two lines of business: They buy conventional mortgages to hold in their own portfolios and they securitize mortgages, selling the securities to investors. For both GSEs, the dollar volume of their MBS is larger than their portfolios, but the portfolios are growing more rapidly. Also, for both, their portfolios account for the lion's share of their profits and the lion's share of the risk to the taxpayer. They are apparently also the source of most of their recent financial reporting problems.

The history of the GSEs suggests that they have long recognized the profitability of portfolio lending. Neither was originally expected to be in that business. Fannie Mae was expected to buy FHA mortgages when there was a "shortage" of mortgage credit and sell them when there was a "surplus." But almost since its creation in 1938 as a government agency, it was a net investor in mortgages, except when politically forced to sell, as in 1954. It did not become a securities issuer until 1981, more than a decade after Ginnie Mae and Freddie Mac (U.S. Department of Housing and Urban Development, 1987, Chap. 2). By the early 1990s, Fannie Mae's income from its portfolio accounted for almost three-quarters of its net income (U.S. Department of Housing and Urban Development, 1992, p. 22). That has continued; in 2003, its portfolio accounted for 85 percent of its net income (U.S. Office of Federal Housing Enterprise Oversight, 2005, Table 3).

Similarly, Freddie Mac was expected to help the savings and loan industry (its owners) in the same way, and it did so by issuing MBS. Freddie Mac was created in 1970 and issued its first MBS a year later. It held only a small portfolio; in 1990, the volume of its MBS was about 10 times the size of its portfolio and income from MBS guarantee fees was about three times the income from its portfolio (U.S. Department of Housing and Urban Development, 1991, p. 17). But once it became a publicly owned corporation as a result of the Federal Institutions Reform, Recovery, and Enforcement Act of 1989, it went whole-heartedly into portfolio lending; at present its portfolio and MBS are almost equal. As with Fannie Mae, Freddie Mac's portfolio accounted for 85 percent of its net income in 2003 (U.S. Office of Federal Housing Enterprise Oversight, 2005, Table 13). Thus, there is good reason why the current policy discussion about GSE regulation is substantially focused on their portfolios.

In discussing the subsidy to the GSEs, Quigley suggests that this benefit might go in part to mortgage originators, because they can decide which mortgages to sell to the GSEs and perhaps force the GSEs to pay a premium for the better mortgages. I think any originator that followed such a strategy would face retribution from the GSEs. Differences in loan performance would be observable. The GSEs could charge higher guarantee fees, reduce the price for portfolio mortgages, or refuse to do business with any such originator. Thus, I believe the subsidy goes either to the borrower or to the GSE, mostly the latter.

One of the biggest issues in the current legislation is the House bill provision setting aside 5 percent of GSE profits in an affordable-housing fund. I do not favor this provision, but it is interesting to put it in the context of the subsidy. The Congressional Budget Office calculates that the retained subsidy over the five years from 1996 to 2000 totals about $16.7 billion. The GSEs' profits over those five years total $25.7 billion. The subsidy accounts for 65 percent of the GSEs' profits; the affordable-housing fund would require them to give 5 percent back. That does not seem like an efficient affordable-housing program.

One further point about the advantages of agency status, which Quigley briefly touches on: As a longtime resident of Washington, D.C., I cannot help noting that the local income tax that Fannie Mae has not had to pay would have been enough to balance the D.C. budget, year by year, in the early 1990s, and perhaps the city could have avoided the ignominy of a control board and the loss of some home-rule privileges.

THE GSEs' PUBLIC-POLICY PURPOSES

The congressional acts that chartered the GSEs require the GSEs to "provide ongoing assistance to the secondary market for residential mortgages (including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities)" and to "promote access to mortgage credit throughout the Nation (including central cities, rural areas, and underserved areas)" (Federal National Mortgage Association Charter Act, Sections 301 (3) and (4); Federal Home Loan Mortgage Corporation Act, Sections 301 (b) (3) and (4)).

In 1992, the Federal Housing Enterprises Financial Safety and Soundness Act (FHEFSSA) quantified these purposes by establishing three affordable-housing goals. For two of these goals (low- and moderate-income housing and special affordable housing), the statute defined the goals and empowered HUD to determine the share of GSE mortgage purchases to be devoted to those goals; for the third (underserved areas), HUD was required to both define the goal and establish the numerical target. FHEFSSA also required HUD to consider "the ability of the enterprises to lead the industry in making mortgage credit available for low- and moderate-income families" in establishing the targets (FHEFSSA, Sections 1332 (b) (5), 1333 (a) (2) (D), and 1334 (b) (5)).

After a dozen years of experience, it is clear that the GSEs do not provide market leadership in the goal categories. Instead, the GSEs have generally underperformed the market. (See, for example, Bunce, 2002, and U.S. National Archives and Records Administration, 2004.) That is, the share of GSE purchases that falls into each of the goal categories is typically less than the share of the overall market that falls into those categories. This comparison is limited to mortgages to first-time homebuyers. It excludes refinances because the GSEs' public purpose is to promote homeownership and excludes rental housing because the market calculations are based on Home Mortgage Disclosure Act (HMDA) data. Less-

Table 1

GSE Housing Goal Performance Relative to the Conventional Conforming Market: Share of Single-Family Mortgages within Goal Categories (percent)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Low- and moderate-income housing												
Fannie Mae	29.2	35.0	40.1	37.1	38.5	37.9	39.7	41.0	41.4	42.5	**45.5**	**47.0**
Freddie Mac	28.7	32.3	35.6	33.9	34.5	35.7	38.8	42.3	41.3	40.7	**44.7**	43.5
Conventional conforming market	34.4	38.9	41.8	41.4	42.2	42.1	42.8	44.8	43.9	42.9	44.6	44.6
Underserved areas												
Fannie Mae	18.3	18.2	22.5	22.8	23.3	21.8	21.3	21.3	23.4	24.0	26.0	26.3
Freddie Mac	18.6	17.6	19.2	19.1	19.6	19.7	20.0	21.5	22.2	22.4	25.3	23.4
Conventional conforming market	22.2	21.9	24.3	25.4	24.9	24.8	24.2	25.2	26.2	25.2	26.3	27.6
Special affordable housing												
Fannie Mae	6.3	8.8	11.4	10.5	11.6	11.3	12.4	13.2	13.7	14.6	**16.1**	**16.8**
Freddie Mac	6.5	7.8	9.2	8.9	9.4	10.0	12.2	14.0	14.0	13.5	16.0	15.3
Conventional conforming market	10.4	12.6	14.1	14.4	15.0	15.1	15.4	17.0	16.6	15.6	16.1	15.9

NOTE: Boldface numbers indicate that the GSE matched or led the conventional conforming market in that category for that year. GSE data for 1992-95 are calculated by the purchase year of the mortgage; GSE data for 1996-2003 and market data for all years are calculated by the origination year of the mortgage.

SOURCE: 1992-1995: Bunce (2002, Table A.1); 1996-2003: U.S. National Archives and Records Administration (2004, Table A.16).

precise calculations that include reasonable estimates of the multi-family housing market show the same pattern.

Table 1 compares GSE purchases in each goal category to the conventional conforming market through 2003, the latest available comparision. The market is defined to include manufactured home loans and the top half of the subprime market ("alt-A" and "A-minus" loans), both of which are purchased by the GSEs; it excludes FHA and VA loans and refinances. Data for the market come from HMDA data compiled by the Federal Reserve Board and are limited to metropolitan areas. The table shows that until very recently the GSEs have regularly lagged the market; loans in each goal category constitute a smaller share of each GSE's purchases than they do of the overall conventional conforming market. In 1992, for example, loans to low- and moderate-income borrowers constituted 29.2 percent of Fannie Mae's purchases and 28.7 percent of Freddie Mac's, while they constituted 34.4 percent of the overall conventional conforming market. Other lenders, without the GSEs' agency status, devoted more of their purchases to mortgages for low- and moderate-income borrowers. The same is true for the other categories.

The table also shows that the GSEs have improved their performance over time. Indeed, Fannie Mae led or matched the market in two of the three goal categories in both 2002 and 2003 and Freddie Mac led the market once in 2002. (These are shown in boldface in the table.) Fannie Mae has typically performed somewhat better than Freddie Mac, except during 1999-2000. The GSE data are calculated on the basis of the year the mortgage was originated since 1996 because that is the basis on which HMDA data are reported. Unlike HMDA data, however, the GSE data include mortgages that are purchased after the origination year; thus they may overstate GSE performance relative to the market. (GSE data for 1992-95 are

Table 2

GSE Loans to First-Time Homebuyers: 1999-2003 Average (percent)

	Fannie Mae	Freddie Mac	Conventional conforming market
All races/ethnic groups	26.0	26.2	38.5
All minority households	7.0	5.8	11.8
African-American and Hispanic households	4.3	3.4	8.2

SOURCE: Bunce and Gardner (2004).

reported on the basis of the year the GSE purchased the loan, regardless of origination year. This difference does not affect the trends or conclusions.)

It is important to distinguish "meeting the goals" from "leading the market." With very few exceptions, Fannie Mae and Freddie Mac have met each goal in each year. But they have equally rarely led the market. The explanation is that the goals have always been set "below the market." This dates back to 1992, when FHEFSSA established specific numerical targets for each goal, pending HUD rulemaking. The initial statutory targets turned out to be below the market. The goals have been raised every few years, by regulation; but, at the same time, the market has moved toward more extensively serving borrowers in the goal categories. The latest HUD regulation, promulgated in 2004 for the years 2005-08, does set the goals at the projected market levels, or more precisely within the projected market ranges, rising to the upper end of the projected range by 2008.

That housing goals have been set below the market is the simplest explanation for research findings that the GSEs have minimal impact on mortgage credit or housing outcomes. Quigley offers a different explanation. He cites a very recent unpublished paper by An and Bostic (2006), which argues that the housing goals are ineffective because they merely push the GSEs into competing with the FHA and taking part of the FHA's market. I disagree with this interpretation. An and Bostic look at only one of the three goals (underserved areas) and, in fact, find no impact from the increase in this goal between 1996 and 2000 in the census tracts that are targeted by the goal. Also, An and Bostic argue on theoretical grounds that the FHA would tighten its underwriting standards in response to greater GSE activity in the FHA's market. In fact, the FHA relaxed its standards in 1995, as shown by higher default rates in the early policy years for post-1995 cohorts.[4] More generally, the goals are set on the basis of a definition of "market" that excludes FHA and VA loans, and they include both multi-family and single-family housing. A far larger share of the multi-family market falls within each of the goal categories. The GSEs and conventional lenders have both argued that the impact of increasing the goals for 2005 would be largely felt in the multi-family market.[5]

The GSEs have done a poor job of serving first-time homebuyers, particularly minority first-time homebuyers. Table 2 compares GSE purchases of loans to first-time homebuyers with the share of first-time homebuyers in the conventional conforming markets. The comparison is not limited to metropolitan areas but covers the entire country; the data are derived from both the HMDA and the American Housing Survey. The comparison period ends in 2003 because the American Housing Survey is a biennial survey and the data

[4] Specifics of the relaxation are stated in FHA Mortgagee Letter 95-7, issued January 27, 1995. Year-by-year claim and prepayment data for each cohort are reported in the annual actuarial studies of the Mutual Mortgage Insurance Fund; for example, Deloitte & Touche (2003, Appendix H).

[5] Quigley (2006) actually cites a slightly later version of the paper than I have referenced, but Raphael Bostic informs me that the findings are not substantively different.

at present are available only through that year. While first-time homebuyers constituted just under 40 percent of all conventional conforming home-purchase loans during 1999-2003, they constituted just over 25 percent of each GSE's purchases. In the conventional conforming market, 8 percent of all loans went to African-American and Hispanic households, but less than 5 percent of each GSE's loans went to these households. These comparisons are somewhat biased in favor of the GSEs because their definition of "first-time homebuyer" is more liberal: The GSE definition is that a family did not own a home in the previous three years, whereas the market definition is that a family has never owned a home.

The GSE performance can also be measured through the Residential Finance Survey (RFS), conducted by the Census Bureau in conjunction with each decennial census. This survey includes interviews with both the borrower and the lender about each mortgage in the sample. Data for 2001 are very similar to those reported in Table 2 (Bunce and Gardner, 2004).

The GSEs also generally lag the market in home-purchase mortgages to all minority households, though to a much lesser extent. This means that they do a much better job of serving minority homeowners who are trading up. Fannie Mae at least may lead the market in this category. Once you own a home, the GSEs are more likely to buy the mortgage on your next house than they were to buy the mortgage on your first house. This perhaps gives point to Quigley's recommendation that the GSEs be limited to buying first-time homebuyer mortgages.

The weak performance of the GSEs in serving first-time homebuyers caused HUD to establish home-purchase subgoals in each category for 2005-08. For example, in 2005, the home-purchase subgoal for low- and moderate-income housing is set at 45 percent. This means that, whatever number of home-purchase loans the GSEs buy, 45 percent needs to be for low- and moderate-income families. There is no requirement for the GSEs to buy any particular number of home-purchase loans. If a GSE buys one million home-purchase loans in 2005, then 450,000 would need to be for low- and moderate-income families; if it buys 100,000 home-purchase loans, then 45,000 would need to be for low- and moderate-income families. This subgoal is intended to ensure that the GSEs do focus on financing home purchases for families in the goal categories. It is as close as HUD could come, under FHEFSSA, to establishing a home-purchase goal. More systematic home-purchase or first-time homebuyer goals have been discussed as part of regulatory reform legislation. The value of these home-purchase subgoals is perhaps indicated by a statement from Fannie Mae that it did not quite meet the subgoals for low- and moderate-income homebuyers and underserved areas in 2005 (Greener, 2006). (This is not necessarily definitive; official goal performance is measured by HUD, using the data provided by the GSEs. HUD invariably calculates slightly different numbers than the GSEs.)

I want to conclude with an often-ignored issue. Through their agency status, the GSEs have an advantage not only over private mortgage lenders but also over private firms in other industries. They have used this advantage to move into markets for ancillary services, such as mortgage origination software and automated underwriting systems, and they have tried to move into mortgage insurance, title insurance, and creditor life and disability insurance (U.S. Department of Housing and Urban Development, 1987, pp. 46-50; and Weicher, 2001). Some of these new activities are a far cry from the secondary mortgage market. Most persistently, the GSEs have tried to move closer to originating mortgages, taking advantage of technological change. HUD's current authority to deny approval for new activities is sharply limited by FHEFSSA. This issue is fundamental and needs to be addressed in any regulatory reform legislation, but it is in danger of being overlooked.

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APPENDIX A

Comparative Rates of Return on Homeownership and the Stock Market

Starting date	July 1982	October 1992
Mortgage rate	15.25%	8.50%
Mortgage principal	$48,500	$48,500
Monthly payment	$623	$373
Outstanding principal balance after 5 years	$47,911	$46,313
Addition to home equity	$589	$2,187
House-price appreciation over 5 years	$14,045	$7,042
Home equity after 5 years	$16,134	$10,729
Equity/initial cost	5.378	3.576
Annual rate of return	40.0%	29.0%
Annual return net of 6 percent sales commission	32.6%	19.5%
S&P 500 at starting date	185.834	1,067.052
S&P 500 after 5 years	680.134	2,640.585
Ratio	3.660	2.475
Annual return on S&P 500	29.6%	19.9%

NOTE: The comparison is based on a $50,000 home-purchase price, with a 3 percent down payment and 3 percent closing costs.

SOURCES: Housing data: U.S. Department of Housing and Urban Development (2005, Historical Data tables); S&P 500 Index Total Returns monthly data: www.neatideas.com/data/index.htm.