UNITED STATES OF AMERICA

MACROECONOMIC BACKGROUND

The USA is the largest economy in the world accounting for more than a fifth of world GDP (IMF, 2004). This share has not altered significantly in the last 10 years. USA's output is valued at more than $10 trillion and GDP per head (in PPP terms) is approximately $38,000. Average GDP growth over the last 10 years was 3.3%, but this masks the boom of the 1990s and recession in 2001, and the impact of the terrorist attacks in September of the same year. The economy is now recovering stimulated by cuts in interest and tax rates, boosting consumption and housing markets. Interest rates fell from 6.4% in 2000 to a 45 year low of 1% in mid 2003. The budget and current account deficits, uncertainties in the Middle East and the depreciating dollar are risk factors for the economy and hence the housing market, going forward.

DEMOGRAPHICS

The population of the USA was estimated at 290 million in 2003 – approximately 5% of the world population. One third is under 25 years of age but the median age is 35 reflecting the bulge in the population from the 'baby boomers'. The total number of households in 2004 is estimated at 108 million with an average of 2.57 persons per household. This is hardly changed from the 2.62 ten years earlier. The annual rate of growth of households over the last five years was around 1%.

HOUSING MARKET

The US Census bureau estimated the total number of housing units in Q3 2004 to be 122 million. 87% of these were occupied full time and 13% unoccupied for various reasons such as holiday letting, awaiting sale etc. The homeownership rate at the same point in time was 69%, having grown from 63% in 1965. There is some variation in this proportion across the country with slightly higher homeownership rates in the South and Mid West than in the North East and the West. There has been a substantial increase in the rate of home-ownership amongst younger households over the last decade, the ownership rate for married couples under 35 was 56% in 1994, growing to 62% in 2001.

Over the last ten years an average of 1.5 million homes were constructed each year, with higher levels in the last three years reflecting greater housing demand stimulated by low interest rates. The average annual rate of growth of construction is 2.8% - much higher than the growth in households, which, if it continues, could raise oversupply issues. The number of home sales (new and existing) grew at an average rate of 5% per year over the last ten years but accelerated to 10% in 2003.

The average price of a single-family house in the US was $243,400 at the end of 2003. The average growth in the price of single-family houses between 1995 and 2004 was 6% compared with 4% in the previous 10 year period. 2003 marked the fourth consecutive year in which house prices rose more than 7.5%, on average, across the nation. This is significantly above the general rate of consumer inflation during the same period of about 2.5%. This strong growth is even more notable given the recession in 2001 but again reflects the significant impact of low interest rates on the housing market. Some indices estimate that the average price of American homes jumped by 13% in the year to the third quarter 2004 - the fastest increase on record in real terms. Such rapid house price inflation and the massive increase in turnover are seen as evidence of a housing bubble as speculative activity takes hold.

HOUSING FINANCE

Total outstanding residential mortgage debt in the USA at the end of 2003 was $7.8 trillion. This accounts for 69% of US GDP. This is significantly higher than in Europe where the comparable statistic is only 46%. Taking farms and commercial lending into account the overall level of mortgage debt to GDP in the states was 84% at the end of 2003. These have increased from 49% and 61% respectively compared with ten years ago showing the significant increase in US indebtedness, particularly since 2001. Per capita mortgage debt is approximately $27,000 and by household $74,000.

Gross mortgage lending reached record levels in 2003 at $3.8 trillion, an increase of one third in one year. A significant proportion of the increase in lending in recent years has been refinancing which accounted for about two thirds of single-family mortgage originations in 2003. This is because falling interest rates have encouraged borrowers to refinance onto lower rates. Lending has also been swelled because higher house prices have allowed borrowers withdraw equity to finance consumption, and low mortgage rates have made this affordable.

Despite rising prices, lower financing costs have meant that housing has remained affordable. Mortgage rates in 2003 were at record low levels. The average rate for 2003 was 5.7% compared with more than 7% ten years earlier. The typical loan to value (LTV) ratio in 2003 was 73.5% on an average loan for a single family house costing £234,000. The LTV ratio is surprisingly lower than ten years ago, but 20% of all loans are at LTV's of above 90%. The vast majority of mortgage loans in the US are fixed rate and the typical mortgage term 27 years. Neither of these ratios has changed significantly in the last decade.

The housing finance system in the US relies heavily based on the secondary market. Mortgage companies (usually subsidiaries of commercial banks), commercial banks, credit unions, thrifts, life insurance companies, and pension funds originate loans and sell them to raise funds for the next batch of lending. They are also involved in loan servicing.

The secondary market, where securities backed by mortgage loans are bought and sold is dominated by the Government Sponsored Agencies (GSEs) Fannie Mae and Freddie Mac who account for about 40% of the market. These institutions either buy loans from mortgage lenders which they fund from the sale of bonds in the market or offer a securitisation function where securities based on a specific mortgage pool are issued and then sold by the *originating* institution to raise funds for future mortgage lending. Loans purchased or securitised by the GSEs have to fulfil very strict criteria including an upper loan limit set each year by the federal government. The combined mortgage portfolios of the GSEs in 2003 were $1.5 trillion. Their combined total book of business - mortgages securitised and held on the balance sheet was $3.6 trillion – about 47% of the total residential mortgage debt outstanding at the end of 2003 of $7.8 trillion.

GOVERNMENT POLICY AND OBJECTIVES

The US government has historically been very supportive of home ownership. Indeed the GSEs carry a public mandate of helping low and moderate income Americans, minorities, and Americans in underserved areas to realize home ownership. Housing receives favourable tax treatment in the US. The imputed rent of owner-occupied housing is not taxed as is the case in many European countries. There is no tax on capital gains after a two-year holding period. In addition mortgage interest and real estate taxes are tax deductable for owner-occupiers at the marginal rate (on loans of up to $1 million). However, housing is heavily taxed by local government and is one of the most heavily regulated sectors of the economy.

There is a well-developed market for mortgage insurance in the US. Lenders usually require borrowers to take out private mortgage insurance for LTV ratios over 80%, and there is a regulatory limit of 90% of the loan is not guaranteed. For mortgages taken out since 1999, PMI is automatically cancelled when the LTV falls to 78%. Unemployed borrowers are not eligible for state benefits to cover mortgage payments.

SUMMARY DATA FOR USA 1994 - 2003

	2003	2002	2001	2000	1999	1998	1997	1996	1995	1994
Real GDP growth	3.0%	1.9%	0.8%	3.7%	4.4%	4.2%	4.5%	3.7%	2.9%	2.9%
Unemployment rate	6.0%	5.8%	4.8%	4.0%	4.2%	4.5%	4.9%	5.4%	5.6%	6.6%
Consumer Price inflation	2.3%	1.6%	2.8%	3.4%	2.2%	1.5%	2.3%	2.9%	2.8%	2.6%
Residential mortgage debt outstanding, $ billion	7,818	6,951	6,184	5,606	5,156	4,694	4,278	4,008	3,754	3,571
Residential debt /GDP Ratio	69%	65%	60%	56%	54%	52%	51%	50%	50%	49%
Residential mortgage debt per household $	73,566	65,915	59,265	54,298	50,487	46,457	42,798	40,544	38,413	36,904
No Households, millions	1,077	1,063	1,055	1,043	1,032	1,021	1,010	1,000	989	977
Home ownership rate	68.4%	68.3%	68.0%	67.5%	66.9%	66.4%	65.7%	65.4%	65.1%	64.2%
House price index (1980=100)	295.2	275.8	257.7	238.7	223.2	212.5	202.1	195.3	188.7	183.8
Annual house price growth	7.0%	7.0%	7.9%	6.9%	5.0%	5.1%	3.5%	3.5%	2.7%	1.8%
Typical LTV	73.5%	75.1%	76.2%	77.8%	78.5%	78.9%	79.4%	79.0%	79.9%	79.9%
Housing starts (000s)	1,848	1,705	1,603	1,569	1,641	1,617	1,474	1,477	1,354	1,457
Home sales (000s)	7,185	6,539	6,204	6,029	6,085	5,856	5,186	4,953	4,479	4,616
Mortgage interest rates (incl fees)	5.7%	6.5%	7.0%	8.0%	7.3%	7.1%	7.7%	7.7%	7.9%	7.5%
Mortgage originations $ bn	3,812	2,854	2,243	1,139	1,379	1,656	834	785	639	769
Refinance share	66%	62%	57%	21%	36%	52%	29%	29%	23%	28%
MBS outstanding $ billions	2,073	1,779	1,512	1,283	1,217	1,115	1,055	1,021	972	947

Sources; Mortgage Bankers of America, IMF, Federal Housing Finance Board, HUD, OFHEO

January 2005

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