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Home ownership

Shelter, or burden?

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The social benefits of home ownership look more modest than they did and the economic costs much higher

Illustration by Bill Butcher



IN A scene from the film “It’s a Wonderful Life”, a happy couple is about to enter their new home. Jimmy Stewart, whose firm has sold them the mortgage, reflects that there is “a fundamental urge...for a man to have his own roof, walls and fireplace.” He offers them bread, salt and wine so “joy and prosperity may reign for ever”.

That embodies the Anglo-Saxon world’s attitude to home ownership. Owning your own roof, walls and fireplace, it is thought, is good for householders because it helps them accumulate wealth. It is good for the economy because it encourages people to save. And it is good for society because homeowners invest more in their neighbourhoods, engage more in civic activities and encourage their children to do better at school than do renters. Home ownership, in short, benefits everyone—not just the homeowner—and the more there is of it, the better. Which is why it is usually encouraged by the government. In America, Ireland and Spain, homeowners can deduct mortgage-interest payments from taxable income.

Yet the worldwide crash was bound up in this supposed miracle of social policy. The disaster began with defaults on American subprime mortgages, a financial instrument designed to spread home ownership among the poor. It gathered pace after the failures of Fannie Mae and Freddie Mac, two government-sponsored enterprises that provide cheap home loans. As a result, the home-ownership rate in America has fallen for four years, the first time that has happened in a quarter of a century. In 2008, 2.3m families lost their homes or faced foreclosure—double the average before the crisis—reducing the home-ownership rate from 69% in 2004 to 67.5% at the end of 2008. The number of owner-occupied dwellings also slipped in Britain in 2007-08 for the first time since the 1950s.

Subsidised castles

So attempts to expand home ownership have contributed to the wider economic crisis without succeeding in their own terms. How does that affect the arguments for supporting home ownership? Should it still be deemed a public good?

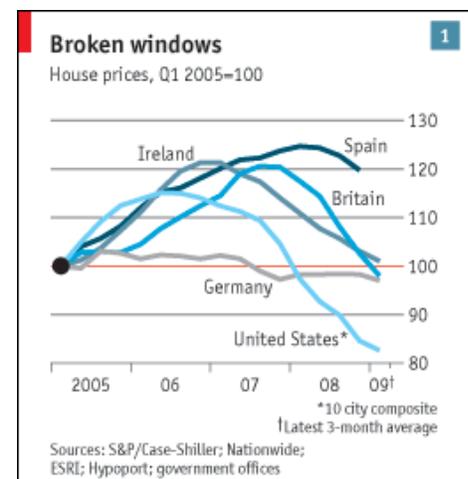
No, say several economists and commentators. "Given the way US policy favours owning over renting," writes Paul Krugman, 2008's Nobel laureate in economics, "you can make a good case that America already has too many homeowners." Edward Glaeser, an economist at Harvard University, talks about "the madness of encouraging Americans to bet everything on housing".

So far, policymakers are unmoved. In mid-February Barack Obama proposed a \$275 billion plan to support America's housing market. Outside the Anglo-Saxon world Nicolas Sarkozy, who campaigned for the presidency to turn France into a property-owning democracy, has expanded zero-interest housing loans for the poor.

The main economic argument for home ownership is that, in the words of Thomas Shapiro of Brandeis University, "it is by far the single most important way families accumulate wealth". This argument now looks as weak as house prices.

In Britain prices have fallen 21% since their peak in October 2007. Prices in America have fallen more slowly but further, down 30% since their peak in mid-2006 (see chart 1). This has reduced the total value of the country's housing stock from over \$22 trillion in 2007 to \$19 trillion at the end of 2008. In the past few weeks, housing markets on both sides of the Atlantic have seen signs of life, but there is every chance that prices have further to fall before they finally reach their low.

The collapse in house prices matters most directly to two overlapping groups: those who bought property at the peak of the market and now face "negative equity"; and those (in America) who took out subprime mortgages. Roughly 10m Americans are in negative equity—ie, the cost of their mortgage exceeds the value of their home. In Britain about 3% of households are in negative equity. For homeowners, negative equity makes houses more like a trap than a piggy bank. Those who cannot meet their payments lose their house, their savings and (in America, usually) their credit rating for seven years.



The other area of concentrated distress is subprime mortgages, which increased their share of the American mortgage market from 7% in 2001 to over 20% in 2006. According to the Mortgage Bankers Association, the delinquency rate was 22% in the fourth quarter of 2008, compared with only 5% for prime loans. Many people have concluded that, in Mr Krugman's words, "home ownership isn't for everyone." However, a study by the Centre for Community Capital, part of the University of North Carolina, Chapel Hill, casts some doubt on that conclusion. It compared a group of people who took out subprime loans with a group of borrowers from the Community Advantage Programme (CAP), a government-backed scheme that lends to the sort of people who might have had a subprime mortgage. The default rate for CAP borrowers was only a quarter what it was for subprime mortgage holders, even though the incomes and backgrounds of borrowers were similar. Since the real problem lay partly in the mortgages, rather than the borrowers, this suggests the subprime crisis was a financial-market mess, as well as a housing one.

Does that also imply that home ownership has the economic benefits that its proponents claim? Two pieces of evidence seem to support such a view. The first is that housing has fared better in the crisis than other assets. Share prices are around 50% below their peaks in many countries, so compared with shareowners, homeowners have not done badly. However, home ownership in a downturn has one big disadvantage: most people buy shares outright but homes on margin (ie, they put down a small stake, if anything). If share prices fall by 10%, you lose 10%; if house prices fall by 10%, you may lose your entire savings. The value of American homeowners' equity in their own houses has slumped from a peak of \$12.5 trillion in 2005 to just \$8.5 trillion at the end of 2008. This undermines one claim that homeownership is economically beneficial.

The other piece of evidence for home ownership's benefits is that the house-price fall has so far spared most existing homeowners from absolute losses. In America, for example, house prices have fallen back only to where they were in 2004. There were roughly 29m house sales in the United States between 2004 and 2007,

compared with 115m households, and anyone who bought before then is probably sitting on a nominal profit. However, as Harvard University's Martin Feldstein points out, if house prices rise, people feel richer and borrow and spend more. If they feel poorer, they may cut back even if the price of their house has not fallen below what they paid for it.

Subsidies to home ownership have thus increased economic volatility. They boosted consumption, as homeowners used their houses as collateral to finance consumption or investment. In America mortgage-equity withdrawals reached \$9 trillion between 1997 and 2006—equal to more than 90% of disposable income in 2006. This gave homeowners more to spend in the good times but less in bad ones. In Britain home-equity withdrawals added the equivalent of 3% of post-tax income to households in the fourth quarter of 2007 but subtracted 3% a year later. So changes to house prices aggravate the economic cycle. Recent research by the IMF finds that a quarter of the 100-odd recessions since 1960 have been associated with house-price busts and that these contractions “are deeper and last longer than other recessions do”.

Subsidies to home ownership have also weakened financial services. They encouraged more people to buy houses (which was the point), but, logically enough, also encouraged lenders to take greater risks with housing. This was fine while house prices were rising, but the fall exposed how vulnerable banks' balance sheets had become.

Moreover, if public policy aims to create wealth, there are other ways of doing it. People could invest their savings in the stockmarket and rent their homes, for example. Had they done so in the past two years, they would have done worse than homeowners. But for three decades before that, equity prices easily outstripped property prices (see chart 2), so in the long run equities have been a better bet than houses. (Admittedly, this strips out the effects of share dividends and imputed rents, which favour property.) Housing suffers from two further weaknesses as an investment. It sucks up disproportionately large amounts of money, falling foul of the idea that investors should diversify: in America the equity tied up in houses accounts for 45% of the net worth of the average householder. And it is illiquid. If you need to raise money, you cannot sell a room or two, whereas you can always sell a few shares. It is hard to argue houses are the best asset for building wealth.



“Perhaps the most compelling argument for housing as a means of wealth accumulation”, argues Richard Green of the University of Southern California, “is that it gives households a default mechanism for savings.” Because people have to pay off a mortgage, they increase their home equity and save more than they otherwise would. This is indeed a strong argument: social-science research finds that people save more if they do so automatically rather than having to choose to set something aside every month.

Yet there are other ways to create “default savings”, such as companies offering automatic deductions to retirement plans. In any case, some of the financial snake oil peddled at the height of the housing bubble was bad for saving. Subprime, interest-only and other kinds of mortgage instruments allowed people to buy their homes without a down-payment and without building up equity. “Negative amortisation” (neg-am) mortgages even let people pay only part of their interest each month and to add the rest to the principal, increasing their debt, not their savings. Home-equity loans had the same effect.

Where the heart is

The main arguments for home ownership, though, are not primarily economic, but social. Home ownership, argue those who want to expand it, benefits society because it encourages stable, more law-abiding communities; it makes people more likely to vote in local elections and join clubs; and it benefits future generations because, it turns out, the children of homeowners do better at school and have fewer behavioural problems than children of renters.

On the face of it, the evidence for these claims is strong. In America homeowners are less likely to move than renters, so areas with a lot of homeowners are more stable. According to the 2007 American Housing Survey, homeowners stay where they are for about nine years whereas renters move every two.

More stable neighbourhoods are more law-abiding. According to a study of New York City, the home-ownership rate was second only to income as an explanation for different crime rates.

The link between ownership and political participation is stronger still. In America in the early 1990s, 69% of homeowners voted, compared with only 44% of renters. Homeowners are more likely to know who their representatives are; more likely to support local causes or parent-teacher associations and (this being America) more likely to go to church.

Perhaps the most surprising link is between ownership and children. One study in America found that, in 2000, the mathematics scores of the children of homeowners were 9% higher than those of renters' children; reading levels were 7% higher. This had nothing to do with income: the research controlled for that. In another study homeowners' children were 25% more likely to graduate from high school and more than twice as likely to go to university. Their teenage daughters were also less likely to become pregnant.

These studies, though, are not the last word. They find a link between children's education and homeowning. But is this because, as some suggest, home ownership requires parents to possess managerial or financial skills that they pass on to their children? Or is it because the people with those skills help their children at school and also buy houses? No one knows.

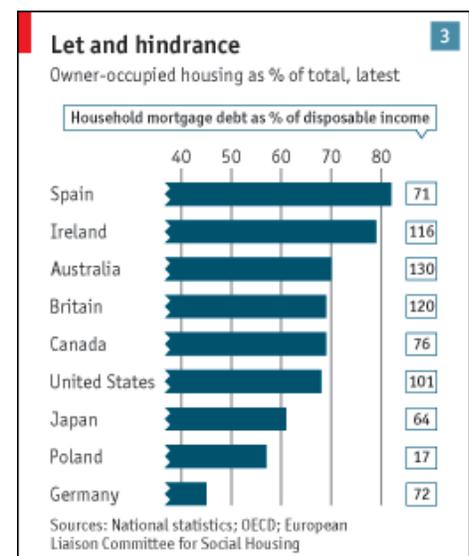
Nor is it certain that owners always take better care of their neighbourhoods than renters do. Some studies claim that the effect in fact depends on a few public-spirited people willing to set an example. Renters can be public-spirited too. In America areas with lots of renters tend to be transient because the typical rental period is short. In Germany, though, people rent for years. Stable neighbourhoods and widespread home ownership can go together but do not need to. As Bill Rohe of the University of North Carolina, Chapel Hill puts it, "evidence regarding the societal benefits of home ownership is highly conjectural."

Still, on balance, home ownership gives people a stake in the state of their surroundings. Thriving streets increase the value of properties, giving owners incentives to improve them further. Renters get no such benefit; they may even have to pay more if the neighbourhood improves.

Whether stability is such a good thing in a downturn, though, is a different matter. A decade ago Andrew Oswald of Warwick University argued that owning your own home makes you more reluctant to move, so labour markets tend to become more rigid as home ownership increases. He claimed that increases in the level of home ownership (though not necessarily the level itself) are associated with rises in unemployment. Ireland, Greece and Spain all saw large increases in home ownership in the 1980s and 1990s, and had relatively high unemployment. America and Switzerland had stable ownership rates, and escaped the long-term rise in joblessness.

His argument remains controversial. Critics point out that many things other than home ownership might prevent people from moving (children's schools, friends and so on). Anyway, liquid housing markets should make it possible for people to move, if they want to. It is also possible that, even if people were trapped in distressed areas, jobs should move there to take advantage of the willingness of homeowners to accept lower wages.

All that said, Mr Oswald's arguments seem especially powerful at the moment. The recession in America is bearing down most heavily on two groups of states: Florida, California and Nevada, which had the largest house-building booms in the 1990s; and Michigan, New Hampshire, Delaware, West Virginia and Mississippi, which have the highest home-ownership rates. People are not, in fact, moving as frequently as they used to: the share of those moving house in 2007-08—11.9% of the population—was the lowest since records began. So labour markets look less flexible than they were. Negative equity exacerbates immobility because people are reluctant to move if it means selling at a loss. Researchers at the Wharton School reckon that people in negative equity are only half as likely to move as those who are not. In all these ways, high home ownership may prolong and deepen a recession.



The problem remains of how to weigh the economic costs against the social benefits of home ownership. There can be no easy judgment about this but the recent rise and fall of house prices suggests both that the costs are greater and the benefits smaller than once thought.

If owning were such a boon, you would expect neighbourhoods with lots of owners to have done better than those with lots of renters during the boom years. That does not seem to have happened.

What has happened, though, is that above a certain level, foreclosures have done a lot of damage during the bad years. Recent studies of New York and Cleveland find that, if lenders foreclose on 3-4% of properties in an area, local prices fall even faster and further than average. Rows of For Sale signs almost certainly have the same effect in Britain. In other words, ownership can sometimes be worse for a neighbourhood than renting.

A shelter—for your money

Lastly, and perversely, the decade of obsession with expanding home ownership may actually have reduced neighbourhood stability. Nicolas Retsinas, the director of the Joint Centre for Housing Studies at Harvard University, suggests that, until the crash in 2008, Americans were coming to see their homes as financial investments rather than as places to live. That is true in other countries. Neg-am mortgages in America and buy-to-rent arrangements in Britain were based on the assumption that houses were primarily investments.

As a result, people seem to have started to buy and sell homes more frequently. Between the mid-1990s and mid-2000s, the number of new houses sold almost doubled in America, from just over 600,000 to over 1.2m in 2006.

Perhaps that made labour markets more mobile, but it was certainly not what policymakers were aiming for when they set out to increase home ownership. Their efforts in the past few years seem to have weakened, though not destroyed, the best arguments for treating home ownership as something to be encouraged: that it increases people's savings and creates better neighbourhoods for everyone. But perhaps you should not be surprised by that. As Adam Smith wrote in "The Wealth of Nations" two centuries ago, "a dwelling-house, as such, contributes nothing to the revenue of its inhabitants."

Illustration by Bill Butcher

