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A Message from Stephen Moye:

"The dream is alive! Long Live the Dream!"

Are Americans and Their Government Undervaluing the American Dream?

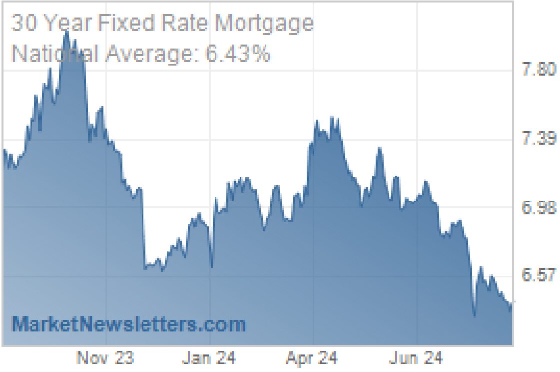
Is homeownership still the American Dream? Should it be? An article published in the Journal of Economic Perspectives argues while the former has long been the case, one strongly supported by government policy, that has changed. Now there is a growing school of thought that the focus should shift toward other aspects of upward mobility. As the recent changes in the tax code might indicate, government policy is shifting with it, towards a view that **homeownership may not be for everyone.**

The article, written by Laurie Goodman, Vice President of the Urban Institute's Housing Finance Policy Center, and Christopher Mayer, Paul Milstein Professor of Real Estate, at Columbia University, examines US homeownership from three different perspectives. The international perspective compares rates in this country with those of other nations. The demographic side correlates changes in the US homeownership with factors like age, ethnicity, education, family status, and income. Finally, they look at the financial benefits of homeownership.

America has **never ranked particularly high** among other high-income countries in homeownership. Even when the US rate peaked in 2005, it was fifth lowest among the 18 countries studied by the authors and well below their average. Subsequent declines have returned it to 1990 levels while 13 of the 18 countries increased their rates. The four others that declined were Bulgaria Ireland, Mexico, and the UK. By 2015, the US ranked 35 of 44 countries with reliable data and was almost 10 percentage points below the mean rate of 73.9 percent.

The US is similar in its age patterns to most countries with the rate peaking at or near retirement. This suggests that home equity often plays an important role in retirement savings although it is accessed mostly through rent-free use of the property.

National Average Mortgage Rates



	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	6.43%	+0.02	0.00
15 Yr. Fixed	5.95%	0.00	0.00
30 Yr. FHA	5.82%	+0.02	0.00
30 Yr. Jumbo	6.62%	0.00	0.00
5/1 ARM	6.28%	-0.01	0.00
Freddie Mac			
30 Yr. Fixed	6.35%	-0.51	0.00
15 Yr. Fixed	5.51%	-0.65	0.00
Mortgage Bankers Assoc.			
30 Yr. Fixed	6.44%	-0.06	0.54
15 Yr. Fixed	5.88%	-0.16	0.68
30 Yr. FHA	6.36%	-0.06	0.85
30 Yr. Jumbo	6.75%	+0.07	0.39
5/1 ARM	5.98%	-0.27	0.65

Rates as of: 8/30

Recent Housing Data

		Value	Change
Mortgage Apps	Aug 28	226.9	+0.49%
Building Permits	Mar	1.46M	-3.95%
Housing Starts	Mar	1.32M	-13.15%
New Home Sales	Mar	693K	+4.68%

		Value	Change
Pending Home Sales	Feb	75.6	+1.75%
Existing Home Sales	Feb	3.97M	-0.75%
Builder Confidence	Mar	51	+6.25%

The authors say determining the reasons behind the differences in homeownership among countries is difficult as each has its own culture, demographics, policies, housing finance systems, and in some cases a history of political instability that favors homeownership. Other studies have pointed a linkage between homeownership and mortgage finance, pensions, and equity participation. "While not definitive, countries like France, Germany, and the Netherlands have both lower-than-average homeownership rates and robust public pensions and private defined-contribution systems." Government tax policy and regulations that encourage or discourage ownership and/or renting appear to have a role as well.

The authors note that both the past increases and decreases in homeownership were more extreme than can be explained by demographics. Part of the run-up in homeownership in 1995 and in 2005 can be attributed to **relaxed credit standards**, new mortgage products, and lowered default rates. Subsequently, in the aftermath of the Great Recession, **homeownership fell with tight credit conditions**, student loan debt, stagnant real incomes, and perhaps a subtle change in attitudes toward homeownership. Racial and ethnic disparities remain pronounced. Rates in black households have fallen every decade, even when controlling for income and demographics.

While homeownership has consistently been highest among older households, when rates fell sharply after the housing crisis, it was the **younger age groups that suffered the steepest declines**. There has also been a shift toward higher education as a determinant of homeownership.

Examining the financial benefits, the authors find that, since 2002, the internal rate of return of homeownership is quite favorable compared to alternative investments, even during the housing crisis when home prices suffered the worst shock since the Great Depression.

While not the only reason, the treatment of homeownership by the **tax code** certainly helps increase its financial benefits although these results vary with the timing of the purchase, the holding period, and location.

For example, the authors were able to conclude that, for the metropolitan areas where data was available, there were higher rates of appreciation in home prices than in the country as a whole, but average lower returns. This also indicates that higher-priced homes have a lower cash yield on investment. In most markets, those who bought in 2007 had lower returns then they would have achieved through an investment in the stock market.

The article also looks at whether a **change in attitude** toward homeownership has changed the dynamic. Surveys by such entities as Fannie Mae, and the National Association of Realtors have found that homeownership is clearly still an aspiration of most, but the surveys don't put a timeline on the purchase or consider the difference between aspiration and ability. Other surveys have found that respondents have a much lower expectation they will be able to buy soon, or perhaps ever. There is also a variance in the aspirations and expectations depending on where the respondent lives both by region and by urban versus rural.

There are two aspects to consider when determining if owning a home makes sense, the financial benefits and the non-financial costs and benefits. There are very compelling reasons for Americans to aspire to become homeowners. But this involves a lot of variabilities such as timing and location of the purchase. Consequently, comparing the financial returns of owning versus renting involves a lot of challenges such as valuing quality differences between a typical rental and an average owner home, maintenance and capital improvement costs, property taxes, and the returns a renter might receive from investing the cash that might be used for a downpayment. There are also challenges in weighing the values of imputed rent and opportunity costs.

The authors' analysis assumes a home purchase in 2002 when home prices were close to a long-term average. They then compared returns for each year of ownership through 2016, using a representative median priced home both in the US and in a selection of metro areas and measured these against the returns from various alternative investments.

Their largest takeaway was that owning a home appears to be **generally financially advantageous** relative to renting, including whether a homebuyer chooses to itemize homeowner tax deductions. The mythical 2002 homebuyer would have earned a higher rate of return on home equity than on bonds regardless of the holding period, and a higher return than on the S&P 500 with a three-year holding period or more, once taxes on the alternative investment are considered.

If the homeowner itemized, his investment would have **outperformed all the alternative investments** in all years. If he did not, there were periods where the investment would have underperformed one of the alternatives during several periods when that investments performance was extremely high. However, the ability to build wealth through homeownership is dependent on holding on to the home during downturns; something lower-income and minority borrowers are less likely to be able to do, and thus they benefit less from homeownership.

The authors say their overall conclusion is that homeownership is a valuable institution, allowing families to build wealth and serving as a measure of financial security. Moreover, the mortgage interest deduction is not the main source of these gains.

They also conclude that while government policies in the 1990s and early 2000s may have put too much emphasis on the benefits of homeownership "the pendulum seems to have swung too far the other way, and many now may have too little faith in homeownership as part of the American Dream."

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