

Essay on Homeowning for UC-Irvine Conference

Draft

Richard K. Green

University of Southern California

February 6, 2009<sup>1</sup>

One might wonder whether America's attitude toward ownership has changed over the past 24 months. Encomiums to homeowning were longstanding, ubiquitous and found expression in serious and popular culture. One finds them in Tocqueville, who in 1835 wrote:

"nations are less disposed to make revolutions in proportion as personal property is augmented and distributed amongst them, and as the number of those possessing it increases."

One also finds them in Capra's script for "It's a Wonderful Life;" Peter Bailey explains that his Building and Loan exists:

"To satisfy a fundamental urge...deep in the race for a man to have is own roof, walls and fireplace."

Despite the fact that having an "ownership society" was a centerpiece of the Bush Administration, and that homeowning was the central strategy for owning, the ownership rate in the United States, having risen sharply in the earlier part of the decade, has receded back to its 2000 level.<sup>2</sup>

For the many households whose mortgage balance exceeds their property value, owner-occupied housing may now seem more like a trap than a means for scratching Peter Bailey's

---

<sup>1</sup> Thanks to Kathryn Owens for excellent research and editorial assistance.

<sup>2</sup> See <http://www.census.gov/hhes/www/housing/hvs/qtr407/q407press.pdf> Accessed February 5, 2009.

fundamental itch. And yet it is also true that we do not see large numbers of households seeking to escape homeownership unless economic circumstances force them to do so.

This essay will attempt to outline how recent events have policy implications for how we think about homeownership. Part of this will involve looking at the literature on the implication of tenure choice for certain outcomes. Dietz and Haurin (2003) wrote a fine summary of this literature, but the consequences of the subprime crisis merit a revisiting of this review, particularly with respect to consideration of the channels through which ownership might affect outcomes. Dietz and Haurin review the impact of tenure choice on household wealth and portfolio choice, mobility, labor force participation, urban structure and segregation, home maintenance, political and social dynamics, health, demographics, self-esteem and child outcomes. I will rearrange the topics a little bit and discuss briefly tenure choice and community stability; tenure choice and wealth accumulation; and tenure choice and child outcomes. We also need to consider exactly what it means to be a homeowner. To foreshadow the discussion of this point, let me suggest that ownership requires paid in capital.

Having reviewed the implications of ownership, I then move on to policy issues, particularly with respect to housing subsidies, tax policy, and mortgage policy, as well as the potential efficacy of innovations such as shared-equity schemes.

### **Tenure Choice and Community Outcomes**

One of the claims advocates for owner-occupied housing advance is that it leads to stable communities. Three potential channels through which tenure choice could produce community stability include home maintenance, long tenure, and civic engagement.

Henderson and Ioannides (1983) used a principal-agent framework to argue that renter-occupied households might not maintain optimally. Renters would have less incentive to live lightly within their houses than owners, because they do not bear the costs of depreciation.<sup>3</sup>

The theoretical prediction raises two issues: the magnitude of the difference between optimal maintenance and the extent to which optimal maintenance has neighborhood spillover effects. The results are mixed on both counts: Grigsby (1963), Sternlieb (1966), Sternlieb and Burchell (1973), Peterson et al. (1973), and Galster (1983) find evidence that owners maintain their houses better than renters. Ozanne and Struyk (1976), on the other hand, find that after appropriate controls are put into place, differences between owner and renter maintenance vanish. Gatzlaff, Green and Ling (1998) found that while owner-housing appreciated significantly more rapidly than rental housing, the significance was driven more by the large data set that they used and less by the magnitude of the coefficient on tenure: the coefficient they measured was small and precisely estimated.

As for neighborhood externalities, Ioannides (2002) finds spatial autocorrelation in home maintenance: when one person maintains her home at a higher level, her neighbors are more likely to do so. This does not necessarily imply that owners maintain better than renters, thereby creating neighborhood spillover effects, Gatzlaff, Green and Ling (1998) find no relationship between neighborhood tenure shares and neighborhood appreciation rates. Presumably, well maintained neighborhoods will appreciate more (or depreciate less) than poorly maintained neighborhoods.

---

<sup>3</sup> Fu (1991) found an error in the work, but the nature of the error did not contradict the conclusion that there was a “rental externality” that made owning socially preferable to renting at equilibrium prices.

In short, with respect to physical neighborhood conditions, it is hard to make a policy case that owner housing dominates renter housing, and should therefore be subsidized.

Length of tenure is an equally problematic issue. Haurin, Parcel and Haurin (2003) argue that length of tenure per se creates benefits for the simple reason that stability arising from the likes of social networks creates benefits. Homeowners have much longer tenure than renters (according to the 2007 American Housing Survey, the median length of tenure for renters is less than 2 years, while for owners it is 9 years). But the selectivity problem with respect to tenure type and length of tenure is large: those with a predilection for remaining in a place for a long time are more likely to become owners than those who expect to be mobile. Flatau et al. (2007) find that in Australia ownership per se has little impact on labor mobility; Green and Hendershott (1999) obtain a similar result using Panel Study on Income Dynamics data in the US. While this is only one type of mobility, it contradicts the idea that homeownership per se causes tenure stability.

The most convincing and straightforward case that homeownership leads to neighborhood stability comes from the research on civic engagement. From Tiebout (1956) on, we have strong evidence that households sort themselves into communities based in part on service and tax packages. In light of this, households have an incentive to make sure that services are provided efficiently, because it will be capitalized into the value of their houses. Fischel (2009) is adamant that governments in general and schools in particular perform better when they are funded through local revenue. He finds the property tax particularly attractive because households have a financial incentive to make sure that their local governments perform well.

In light of this, it is not particularly surprising that homeowners are more likely to be civically engaged, in the sense that they are more likely to know the names of their public

officials, and are more likely to belong to civic organizations (DiPasquale and Glaeser 1999). Moreover, unlike other potential benefits of homeownership, the civic engagement benefit is one that seems to be particularly attached to homeownership. But it also shows the folly of inframarginal subsidy programs for owners: those most likely to be owners in the absence of subsidy (the well educated and the affluent) are more likely to be civically engaged anyway.

### **Tenure Choice and Wealth Accumulation**

For most households, the largest repository of wealth is equity in owner-occupied housing. According to the 2004 Survey of Consumer Finances, the median homeownership household had a net worth of \$289,900, of which \$160,000 was in housing equity. In contrast, Renters had a net worth of about \$4,000.<sup>4</sup>

This begs the question, whether owner-occupied housing is the best method for typical households to accumulate net worth. Brueckner (1997) and Flaven and Yamashita (2002) show that because of the dual nature of housing as a consumption and investment good, households tend to have too much housing in their portfolios relative to a market portfolio. Goetzman (1993) shows returns to housing do not compare favorably to returns to equities (although his analysis fails to take into account the value of imputed rent, and was completed before the recent volatility and decline in equities markets).

Nevertheless, one could certainly make an argument that households would be better off renting and placing savings into financial investment accounts, rather than housing equity. Perhaps the most compelling argument for housing as a means of wealth accumulation is that it gives households a default mechanism for savings. Behavioral research shows that default

---

<sup>4</sup> Property values rose for about three years after 2004, and have since fallen. According to the OFHEO house price index, national house prices in the fourth quarter of 2008 were still 13 percent higher than in the fourth quarter of 2004.

mechanisms are effective at inducing households to save. For instance, employees that work at companies that provide default deductions into retirement plans do save more than those who work at companies that offer 401(k)s and their equivalents but do not have the default deductions (Choi, et al. 2006). This implies that while ownership may be an effective mechanism for encouraging savings, alternative mechanisms may be just as effective.

## **Child Outcomes**

Green and White (1997) found that children of owners were more likely to stay in school and less like to have children of their own while under the age of 18 than children of renters. We were surprised at the result, but we also found that the length of tenure and the homeownership variables interact with each other, so that longer tenure mitigates the adverse effect of renting on the probability that youths stay in school. Thus stability seems in part to be the channel via which ownership produced better outcomes for children than renting. Haurin, Parcel and Haurin (2003) reach a similar conclusion. Aaronson (2000) and Barker and Miller (2009) suggest that it is the wealth accumulation channel that leads to better outcomes for children.

Yet across a wide range of data sets and model specifications, even after controlling for length of tenure, ownership in itself seems to produce better child outcomes. While Green and White (1997) use a simultaneous equation model to correct for selectivity bias, such models depend on assumptions about appropriate instruments (in our case, we instrumented ownership via the relative cost of owning and renting) and distribution functions.

It is not a stretch to think that households who could obtain mortgages were more disciplined, had lower personal discount rates, etc., were therefore more likely to raise children who stayed in school and avoided pregnancy. Mortgage underwriting before the subprime era used to sort households; thus those who could obtain mortgages were fundamentally different from those who couldn't. Part of the sorting was pernicious: lending discrimination has been with us since quite recently, and it is not entirely clear that it has gone away (Ross and Yinger, 2002). But most of the sorting was not pernicious at all—it divided households into those who could reasonably be expected to repay their mortgages, and those who could not.

Because underwriting was often absent from subprime lending, the mortgage process ceased to sort. In an ideal world, research going forward should examine the differences between child outcomes for households who obtained prime mortgages and households who obtained subprime mortgages, controlling for socioeconomic conditions. Alas, I cannot think of a data set that would allow this comparison, unless the Panel Survey of Income Dynamics begins to include questions about subprime lending.

### **Housing subsidies, Mortgage Policy and Homeownership**

Households face at least four major potential impediments to homeownership: an inability to afford a monthly mortgage payment; an inability to accumulate a downpayment; an impaired credit history; and an insufficiently long job history for lenders to feel comfortable that they will be repaid. The first two of these problems are naturally addressed through subsidy; the other two are addressed with other policy responses.

The most straightforward way for government to solve the payment problem is to reduce interest costs. The most popular method for doing this is through the tax code, via the mortgage interest deduction and the non-taxation of imputed rent. We will discuss this separately under tax policy. Government can also set up specialized financial institutions whose purpose is to reduce the interest cost to borrowers. Fannie Mae, Freddie Mac and the Federal Home Loan Bank System are the institutions chartered by Congress to make mortgage credit readily available and inexpensive. However, while these institutions were quite successful at promoting liquidity in the mortgage market, it is not at all clear that they provide their borrowers with substantially lower mortgage rates. Passmore (2005) and Passmore et al. (2005) argue that the GSEs passed through almost none of the benefits they received from borrowing at below market

rates. I do not find their results to be credible, in part because of measurement issues. The Congressional Budget Office (CBO), however, produces a credible estimate of the extent to which benefits are passed through to buyers: they find that the existence of the GSEs lowered borrowing costs by about 25 basis points. The CBO moreover finds that about 50 percent of the subsidies received by the GSEs are passed through to borrowers.<sup>5</sup>

In the end, however, this lower cost of borrowing seemed to have little impact on the homeownership rate. Work by An, Bostic, Deng and Gabriel (2007) demonstrates a weak relationship between the presence of GSE business and flow of mortgage credit to minority neighborhoods. At the same time, HUD has found that Fannie Mae tends to just match the market, and Freddie Mac tends to lag the market in providing mortgage funds to first time borrowers and minority homebuyers. Fannie and Freddie might argue that as secondary market purchasers, they have little control over the geography of where they do business. That said, it is difficult to make much of a case that they enhance homeownership.<sup>6</sup>

Part of the reason that Fannie and Freddie did little to increase homeownership is that high payments are less of a constraint for homeownership than wealth accumulation. Linneman and Wachter (1989) showed that the downpayment constraint was far more binding than the payment constraint as a barrier to homeowning.

In the post-War era, the federal government and the GSEs have both attempted to mitigate the impact of the downpayment constraint on access to owning. Programs that have sought to do this include the FHA program, where downpayments could reach as low as 3

---

<sup>5</sup> See <http://www.cbo.gov/doc.cfm?index=2841&type=0&sequence=6>. Accessed Feb 5, 2009.

<sup>6</sup> This is not to say that Fannie and Freddie did not bring any social benefits to the market. The development of a robust mortgage backed securities market in prime mortgages was a magnificent achievement, and one could argue that they were and remain important providers of liquidity in times of stress.

percent; the VA program, which has no downpayment requirement<sup>7</sup>, the FHA 235 program, where downpayment could be as small as \$200. Fannie Mae and Freddie Mac also dropped their downpayment requirements from 5 percent to 3 percent in the early part of this decade. Some Freddie Mac economists took the view that its mortgage delinquency model was sufficiently precise that the firm could offer low-downpayment loans safely (Gates, Waldron and Zorn 2004). Most recently, FHA allowed borrowers to obtain the small downpayments required of them through downpayment assistance programs, meaning that borrowers might have no “paid-in” capital for the house.

The results of these programs have been mixed, to say the least. The delinquency rate on VA mortgages in the 1950s was often twice the rate of FHA mortgages (Table 1). During that time, FHA mortgages required higher downpayments than VA loans. The Section 235 program was roundly deemed to be a failure<sup>8</sup>. Not only did the small equity requirements (and negative amortization features) of the program lead to astonishingly high levels of default, they also facilitated fraud, for much the same reasons as subprime mortgages.

As for Fannie and Freddie’s low downpayment programs, we can get a sense of their success by examining the performance of “credit enhanced” loans (i.e., those with downpayments of less than 20 percent) with non-credit-enhanced loans. According to the two firms’ monthly volume summaries for December 2008, the 90-day delinquency rate for the low-downpayment book was more than three times the rate for the lower LTV book.<sup>9</sup>

To this point, research on the effects of homeownership has implicitly assumed that title, whether heavily mortgaged or not, potentially bestowed social benefits. What the ongoing crisis

---

<sup>7</sup> See [http://1stcmc.com/VA\\_mortgages.htm](http://1stcmc.com/VA_mortgages.htm). Accessed February 5, 2009.

<sup>8</sup> See Welfeld (1992) for a history of the FHA Section 235 program.

<sup>9</sup> See <http://freddiemac.com/investors/volsum/pdf/1208mvs.pdf> and <http://www.fanniemae.com/ir/pdf/monthly/2008/122908.pdf>, accessed February 5, 2009.

may teach us is that it is paid-in equity at risk, however small, may be the mechanism through which owning bestows benefits.

Economic theory tends to discount the importance of sunk costs, but papers grounded in behavioral economics, including Stein (1995) and Genesove and Mayer (2001), imply that sunk costs—or paid in capital—matter more than equity obtained through house price appreciation. Genesove and Mayer find, for instance, that at any point in time, households that could sell their house for more than they paid would be more likely to sell than those that would be forced to sell at a loss relative to how much they paid.<sup>10</sup>

This consistent with Kahneman and Tversky's (2000) work on framing. If a household has invested X dollars in a house, their frame of reference is the X dollars. This creates profoundly different implications for different types of underwater households. For those that have little to no money invested, the consequence of default seems smaller than they do for those who have substantial capital invested.

Some of the benefits of owning described above—neighborhood stability, optimal maintenance, civic engagement, stability for children—are at least in part a function of commitment. If “homeowners” have little to no money at risk, homeownership may not be quite as salubrious as the literature suggests.

Indeed, one could argue that policies that remove nearly all barriers to homeownership could create negative externalities. Just as Henderson and Ioannides showed that owner-occupied housing produced a superior maintenance outcome to renter-occupied housing, households with current mortgages have better incentives to maintain properly than households that are delinquent. Indeed, Spiegel and Strange (1992) use a theoretical model to show that a household's mortgage position could have an important impact on maintenance. Recent papers

---

<sup>10</sup> They find that this remains the case even when households have positive equity.

by Immergluck and Smith (2006) and Been, Ellen and Scheutz (2008) show that in both Chicago and New York City, even after taking into account simultaneity issues, foreclosures reduce surrounding property values. While one must be careful to generalize results from New York, if future work shows similar dynamics in other markets, it may well be the case that it is socially optimal for many households to remain renters.

This suggests that homeownership policy should not necessarily push for low downpayment mortgages. Indeed, it is striking that many countries around the world, such as Spain, Greece and Italy have higher homeownership rates than the United States despite the fact that low downpayment mortgages are not generally available.

Yet a pernicious fact remains about homeownership in the United States: that the ownership rate among minorities is about two-thirds the level among white Americans, and that this difference has persisted over a long period of time (see Figure 1). While part of the difference across races reflects differences in household composition and economic status (about which we will say more later), past studies have shown that even after controlling for measured household characteristics, African-Americans and Latinos are less likely to be homeowners than non-Hispanic whites.

As Oliver and Shapiro (1997) note, one of the reasons for this is that intergenerational wealth among white Americans is much higher than it is among African-Americans. Part of the reason for this is that until recently, discrimination in the labor and housing markets prevented African-Americans from accumulating income and wealth. Part of the reason is that African-Americans may have actively been stripped of their wealth, in part because of nefarious transactions, particularly in the American South (Mitchell 2001) and in part via lending discrimination, which forced African Americans to pay more for credit than white Americans.

For a very long time, this discrimination was sanctioned by the US government, which discriminated against African-Americans in both the FHA program and the Farmers Home Administration home loan program.<sup>11</sup>

Beyond all of this, discrimination continues to be part of the housing market (Turner et al. 1998). Interestingly, the most recent studies suggest that housing discrimination is more rampant in the renter market than the owner market, which might actually tilt minority borrowers toward owning. However, the fact of discrimination, and in particular steering, could lead minorities to purchase housing in neighborhoods with lower prospects for appreciation, although the evidence on this is mixed (Kim 2000; MacPherson and Sirmans 2001)

Returning to the theme of wealth accumulation and access to credit, whites have across generations had a substantial advantage when it comes to obtaining funds for a downpayment. But it would appear that allowing African-Americans to purchase houses using subprime loans with little or no equity does little to relieve their disadvantage in the long, or even medium, run.

I therefore come to two conclusions that produce contradictory implications. The first is that very low downpayment mortgages do not seem to be an effective path to homeownership. The events of the past eight years or so suggest that an obsession with homeownership can lead to dislocations for households and communities. Even for families facing foreclosure in the aftermath of putting little equity at stake, eviction is eviction, and the event is traumatic. The second is that the ownership gap between minorities and whites is unacceptably high, in part because barriers have been erected that prevent minorities—and African-Americans in particular—from accumulating a down payment.

---

<sup>11</sup> Predatory lending also may have stripped African Americans of equity. The literature on this is still evolving, but the findings in Fix and Turner 1998 suggest this has furthered the disparity between African Americans and whites.

Two policy possibilities might resolve the dilemma. First, we might consider designing better low downpayment programs. Self-Help, an advocacy group in North Carolina, has developed a program to fund mortgages for households with low downpayments and middling FICO scores. Households that participate in the program receive intense, face-to-face, financial counseling. The loans are also heavily serviced; a mortgage need be only 30 days delinquent for intervention to take place. Through December 2004, these loans performed better than FHA loans<sup>12</sup>, suggesting that intervention at both the front end and back end of potentially risk mortgage can improve mortgage performance. This is consistent with findings in Ellihausen, Lundquist and Staten (2003), who show that in-person counseling is more effective than other methods.

Nevertheless, the North Carolina program is small, and one wonders about whether it would work if it were scaled up. Participants in the program, moreover, are not randomly selected, meaning that the program's success may reflect self-selection bias.<sup>13</sup>

An alternative is to consider how to make it easier for households to accumulate downpayments. For the time being, let us ignore that fact that poor performance of the equities market has done nothing to help the downpayment accumulation process, and has in fact surely reduced the number of households with sufficient funds to make, say, 20 percent downpayments.

As already noted, one way in which African-Americans have been placed at a disadvantage is their lack of intergenerational wealth. Antonovics (2002) shows that even if discrimination were to disappear, differences in intergenerational wealth across races mean it would take many generations for African-Americans and non-Hispanic whites to be on a level playing field. While the reparations movement is controversial, to say the least, to the extent one

---

<sup>12</sup> See Stegman et al. (2007).

<sup>13</sup> Manski (1995) discusses how experimental programs rarely predict outcomes for fully implemented programs because of scales issues and "reflection" bias issues.

could specifically identify the magnitude at which African-Americans have been stripped of wealth—even *since the end of slavery*—one could estimate an appropriate reparation amount to the heirs of those who were originally stripped. This policy has been attempted in other contexts. For example, the families of Japanese-Americans who were interned during World War II received reparations in response to the government’s unjust treatment of their forbearers.<sup>14</sup>

Beyond the issue of intergenerational wealth, it is difficult for even median income households in large American coastal cities to accumulate savings because housing is expensive. For example, the median household income in the City of Los Angeles is \$36,687<sup>15</sup>, while median contract rent for is \$957 per month. The median income Angelino thus would spend 31 percent of income each month if consuming a median apartment. That same Angelino also typically drives a long distance to work (the median commute is 28.5 minutes, according to the 2002 American Community Survey). The combination of housing and transport cost makes savings difficult.

Arguably one of the great impediments to ownership is the fact that Section 8 is not an entitlement. Only about 1.4 million households nationwide have vouchers or certificates, while California alone has more than one million renter households whose incomes are less than 30 percent of median<sup>16</sup>. At the same time, because many landlords are not willing to rent to Section 8 tenants, only about 90 percent of vouchers actually get used.<sup>17</sup> Reducing rent burdens, perhaps combined with more robust income enhancement programs for all who work, would perhaps allow underserved communities to have access to homeownership—if they wish it—sooner and more effectively than other programs.

---

<sup>14</sup> See <http://query.nytimes.com/gst/fullpage.html?res=950DE1D8123EF933A0575AC0A96F948260>. Accessed February 5, 2009.

<sup>15</sup> See <http://www.la Almanac.com/employment/em12.htm>. Accessed February 5, 2009.

<sup>16</sup> See Comprehensive Affordable Housing Strategy Data, 2000.

<sup>17</sup> See <http://www.cbpp.org/housing-factsheets.htm>. Accessed February 5, 2009.

## **Tax Policy: Imputed Rent and the Mortgage Interest Deduction**

Nearly every country in the world uses tax policy to encourage homeownership. One method is passive: equity owners of housing earn imputed rent, which is rarely taxed. One could argue that such treatment makes sense from the standpoints of transparency and simplicity, but would be difficult to explain to taxpayers. The CBO includes non-taxation of imputed rent as a tax expenditure. Furthermore, the Bureau of Labor Statistics has difficulty measuring the owner-housing component of the Consumer Price Index. Indeed, the fact that the CBO estimate of the tax expenditure on imputed rent is smaller than the tax expenditure on the mortgage interest deduction (about which I will say more below) shows how difficult such a measurement is. Until 2007, the value of home equity in the United States was higher than the value of mortgage debt outstanding<sup>18</sup>, and returns to equity should be higher than returns to debt. The implication is that imputed rent should be larger than mortgage interest. Because taxes are most transparently and simply levied on things that are easily measured, imputed rent is not taxed.

In any event, it is easy to understand why imputed rent is not taxed, but the fact that a form of gross income (imputed rent) goes untaxed while an expense (mortgage interest) is deductible is something of a puzzle.<sup>19</sup> It is in fact the case that many Anglo-countries (Canada, Australia and the United Kingdom) do not allow homeowners to deduct mortgage interest. That mortgage interest deduction was designed to spur homeownership is something of a myth: it is actually a residual of the 1913 Income Tax Code, which allowed all consumer interest to be deductible. The predecessor proposals to the Tax Reform Act of 1986 would have eliminated the deductibility of all consumer interest. Brilliant lobbying on the parts of the National Association of Realtors, the National Association of Homebuilders and the Mortgage Bankers Association

---

<sup>18</sup> See Federal Reserve, **Balance Sheet of Households and Nonprofit Organizations**, <http://www.federalreserve.gov/releases/z1/Current/z1r-5.pdf>.

<sup>19</sup> Landlords can deduct mortgage interest, but they also pay tax on the rental income they receive.

convinced Congress that the Mortgage Interest Deduction was crucial to maintaining and increasing the homeownership rate in the United States (Birnbaum and Murray 1987).

Little if any evidence suggests that this is so. The countries listed above that lack a Mortgage Interest Deduction have homeownership rates similar to the US (in Australia it is 71 percent, in Canada it is 65 percent, and in the UK it is 69 percent. Proxenos 2004). Simulations I have done with Andy Reschovsky (2004) imply that the ownership rate would fall by a miniscule amount if the mortgage interest deduction were eliminated. Kerry Vandell and I (2001) showed that a targeted tax credit would be a far more effective method for encouraging homeownership than the current mortgage interest deduction.

The largest problem with the mortgage interest deduction is that it provides virtually no benefits to below median income households. Such households, even when they own, may not take the mortgage interest deduction at all, because for them the standard deduction will be more valuable than itemized deductions, including one for mortgage interest. And even if they do itemize, the marginal benefit of the deduction, relative to the standard deduction, will be quite small, meaning that it will provide little incentive for ownership. At the same time, the deduction provides disproportionately large tax relief to those at the upper end of the income distribution (Follain and Ling 1988). Finally, the mortgage interest deduction encourages households to take on debt. Canadians and Australians are just as likely to be homeowners as Americans, and they use mortgages, but they pay their mortgage balances more quickly, meaning their households are less levered and therefore less vulnerable. Only a limited number of economists (Weicher and Woodward 1989 and Glaeser and Shapiro 2002) have kind things to say about the mortgage interest deduction.

Despite the fact that many policy analysts have issues with the mortgage interest deduction, the last time it was threatened was during the debate over the Tax Reform Act of 1986. Gyourko and Sinai (2003) show us that the policy has concentrated benefits and diffuse costs and thus substantial lobbying support. They estimate the net benefits of the Mortgage Interest Deduction by Congressional District. They find that if the proceeds from the Mortgage Interest Deduction were returned as lump sum payments to taxpayers, the majority of districts would benefit by a small amount. Yet, the minority of districts that benefit from the Mortgage Interest Deduction would lose large amounts. Thus regardless of the agreed upon issues with the mortgage interest deduction its elimination is rarely considered.

In the wake of the financial crisis, homeownership may have lost part of its sacred cow status and thus the mortgage interest deduction might be more vulnerable. Unfortunately, given the current state of the US housing market, it is almost certainly a bad time to make the after-tax cost of housing more expensive. Tax policies do have capitalization effects, and eliminating the mortgage interest deduction would doubtless further depress house prices in the short term. But the impact would be attenuated over the long term as Americans would likely become more like Canadians and Australians and finance their houses more with tax-preferred equity. As the Obama Administration has indicated its desire to come to a grand bargain with Republicans over long-term budget stability, a phasing out of the mortgage interest deduction over time might become part of that bargain.

## **Discrimination**

While one can argue the merits of obsessing over homeownership, there is a clear policy problem to the extent that minorities and the disabled are discouraged from becoming

homeowners. Evidence of continuing discrimination is cited above, and yet certain basic indicators show that the US government does not take its responsibility to enforce fair housing laws seriously.

In 2007, HUD made only 31 charges of discrimination.<sup>20</sup> Civilrights.org notes that, “two GAO studies concluded that many potential complainants were poorly treated and that staff did not move quickly and thoroughly to identify and file genuine complaints to begin an investigation.”

I will not say more here, as this ground has been well-covered elsewhere. Nevertheless, any policy strategy for ownership must place the problem of discrimination and its prevention prominently.

### **Putting it together**

In a sense, homeowning has been very good for me professionally. My time in real estate began with my work for the Wisconsin Realtors Association more than 20 years ago, and my paper with Michelle White on the benefits of homeownership to child outcomes is my most cited paper.

That said, among my favorite quotes from Keynes is “When the facts *change*, I *change my mind*. What do you do, sir?” Recent facts suggest that an obsession with homeowning has not served public policy well. A justification for subprime lending was that it would increase homeownership. Government policy—unsuccessful as it was—placed pressure on Fannie Mae and Freddie Mac to finance affordable housing. The FHA program lowered its downpayment

---

<sup>20</sup> A charge is a finding that there was a reasonable likelihood that discrimination occurred. Data are from <http://www.civilrights.org/publications/reports/fairhousing/enforcement-hud.html>.

requirements. And the upshot was that the ownership rate in 2008 dropped back to its 2000 level. With more foreclosures yet to come, it will likely fall even lower.

In the meantime, the benefits of homeownership seem to run through two channels: stability and wealth accumulation. But stability almost certainly arises in part because of equity contributions, and wealth accumulation almost certainly arises in part because of the amortizing feature of traditional mortgages, which are in effect a default savings mechanism. Many of the proposals to encourage homeownership--low or zero downpayment loans, interest only and even negative amortization mortgages—failed to create the channels through which homeownership is beneficial. It is moreover the case that amortizing mortgages are not the only mechanism through which households might get default savings mechanisms. If firms (or the government) had default savings plans from which households could only actively opt out, savings, and therefore wealth, would almost certainly rise for lower and moderate-income households.

The low ownership rate among minorities is disturbing. But instead of having homeownership programs per se, it might make more sense to attack the problem of minority ownership directly. The first thing the US Government could do is rigorously enforce fair housing laws. The second thing it could do is to compensate minorities in cash for past, unjustified expropriations of wealth.

One final potential mechanism for encouraging homeownership is some sort of shared appreciation or shared equity mortgage. Under such a mortgage, homebuyers would still need to produce a downpayment, but would make lower monthly payment in exchange for sharing future appreciation. Such a scheme would help relieve high payment burdens, and would also allow owners to build some home equity and (perhaps) to have more money to invest in other types of equity. Caplan et al. 2007 have demonstrated the potential utility of such a scheme, but they

have yet to catch on in the market place. As the mortgage market gets remade in the months and years to come, a shared equity arrangement is worth reconsideration.

Finally, in 2000, the United States had in one dimension a spectacularly high homeownership rate. According to the US Census, the ownership rate for those aged 55-64 was a shade under 80 percent. This, of course, is just the rate within the age bracket; some people in that age group had at one point been owners and had reverted to renting. In short, an astonishingly high percentage of Americans are homeowners at some point in their lives, and this was true before we went down the path of large numbers of very low downpayment mortgages that we saw in the first years of the 21<sup>st</sup> century. Perhaps we should have been largely content with tenure arrangements as they were. In any event, it is ex post difficult to make the case that policy attempts to goose up the ownership rate were welfare improving.

## References

Aaronson, Daniel (2000) "A Note on the Benefits of Homeownership," *Journal of Urban Economics* 47(3), May 2000, pp. 356-369.

An, Xudong, Raphael Bostic, Yongheng Deng and Stuart Gabriel (2007) "GSE Loan Purchases, the FHA, and Housing Outcomes in Targeted, Low-Income Neighborhoods," *Brookings-Wharton Papers on Urban Affairs*, pp. 205-240.

Antonovics, Kate (2002) "Persistent Racial Income Inequality," working paper.

Barker, David R and Eric Miller (2009) Homeownership and Child Welfare, *Real Estate Economics*, in press.

Birnbaum, Jeffrey and Alan Murray (1987) *Showdown at Gucci Gulch*. Vintage Press.

Brueckner, Jan K. (1997) "Consumption and Investment Motives and the Portfolio Choices of Homeowners," *Journal of Real Estate Finance and Economics* 15, pp. 159-180.

- Dietz, Robert D. and Haurin, Donald R. (2003) "[The social and private micro-level consequences of homeownership](#)," *Journal of Urban Economics*, Vol. 54(3), pp. 401-450.
- Caplin, Andrew, Carr, James H., Pollock, Frederick, Tong, Zhong Yi, Tan, Kheng Mei and Thampy, Trivikraman, Shared Equity Mortgages, Housing Affordability, and Homeownership. Fannie Mae Foundation Special Report, 2007. Available at SSRN: <http://ssrn.com/abstract=983100>
- Choi, James, David Laibson and Brigitte Madrian (2006) "[Reducing the Complexity Costs of 401\(k\) Participation Through Quick Enrollment\(TM\)](#)," *NBER Working Papers* 11979, National Bureau of Economic Research, Inc.
- DiPasquale, Denise and Glaeser, Edward (1999) "Incentives and social capital: are homeowners better citizens?" *Journal of Urban Economics*, Vol. 45, pp. 354–384.
- Ellehausen, Gregory E. Christopher Lundquist, and Michael E. Staten (2003), "The Impact of Credit Counseling on Subsequent Borrower Credit Usage and Payment Behavior," paper presented at "Seeds of Growth - Sustainable Community Development: What Works, What Doesn't and Why?"
- Fischel, William (1999) The Median Voter and School-Finance Reform: How Tax-Base Sharing Undermines the Efficiency of the Property Tax. Working Paper.
- Fix, Michael and Margery Austin Turner (1998) *National Report Card on Discrimination in America, the Role of Testing*. Urban Institute Press.
- Fu, Yuming (1991) "A Model of Housing Tenure Choice: Comment," *American Economic Review*, January 1991, 81, pp, 381-83.
- Flatau, P.R., Hendershott, P.H., I. James, R. Watson and G. A. Wood (2007), 'Leaving the Parental Home in Australia Over the 20th Century: Evidence from the Household Income and Labour Dynamics in Australia (HILDA) Survey', *Journal of Population Research*
- Flaven, Marjorie and Takashi Yamashita (2002) "Owner-Occupied Housing and the Composition of the Household Portfolio," *American Economic Review*, Vol. 92, No. 1, pp. 345-362.
- Follain, James and David Ling (1988) "Another Look at Tenure Choice, Inflation, and Taxes," *Real Estate Economics*, Vol. 16, Issue 3, pp. 207-229.
- Galster, George C. (1983) "Empirical evidence on cross-tenure differences in home maintenance and conditions," *Land Economics* 59, pp 107–113.
- Gates, Susan Wharton, Cynthia Waldron, and Peter M. Zorn (2003) "Automated Underwriting: Friend or Foe to Low-Mod Households and Neighborhoods," Paper presented at the Symposium on Improving Financial Services in Low Income Communities, Harvard University Joint Center for Housing Studies, November 18-19, Cambridge, MA.

- Gatzlaff, Dean, Green, Richard K. and Ling, David C. (1998) "Cross-Tenure Differences in Home Maintenance and Appreciation," *Land Economics*, Vol. 74, No. 3.
- Genesove, David and Mayer, Christopher (2001) "[Loss Aversion And Seller Behavior: Evidence From The Housing Market](#)," *The Quarterly Journal of Economics*, MIT Press, vol. 116(4), pp 1233-1260, November.
- Glaeser, Edward and Jesse Shapiro (2002) "The Benefits of the Home Mortgage Interest Deduction," NBER Working Papers 9284, National Bureau of Economic Research, Inc.
- Goetzman, William (1993) "The Single Family Home in the Investment Portfolio," *Journal of Real Estate Finance and Economics*; 6(3), May 1993, pp 201-22.
- Green, Richard K. and Hendershott, Patric H.,(1993) "Demographic Factors and Real House Prices," NBER Working Paper No. W4332.
- Green, Richard K. and Andrew Reschovsky. 2004. "The Impact of Tax Policy on Homeownership: Does Race Matter?" Unpublished paper, March.
- Green, Richard K. and Kerry D. Vandell. 1999. "Giving Households Credit: How Changes in the U.S. Tax Code Could Promote Homeownership," *Regional Science and Urban Economics* 29 (July): 419-444.
- Green, Richard K. and Michelle White (1997) "*Measuring the Benefits of Homeowning: Effects on Children*," *Journal of Urban Economics*, Vol. 41, Issue 3, May 1997, pp. 441-461.
- Grigsby, William G. (1963) *Housing Markets and Public Policy*, Univ. of Pennsylvania Press, Philadelphia, 1963.
- Gyourko, Joseph and Todd Sinai (2003) "The Spatial Distribution of Housing-Related Tax Benefits in the United States," Zell/Lurie Center Working Papers 332, Wharton School Samuel Zell and Robert Lurie Real Estate Center, University of Pennsylvania.
- Haurin, Donald R., Toby L. Parcel and R. Jean Haurin (2002) "Does Homeownership Affect Child Outcomes?," *Real Estate Economics*, American Real Estate and Urban Economics Association, vol. 30(4), pp. 635-666.
- Henderson, J Vernon and Ioannides, Yannis M (1983) "[A Model of Housing Tenure Choice](#)," *American Economic Review*, American Economic Association, Vol. 73(1), pp. 98-113.
- Ioannides, Yannis M. (2002) Residential neighborhood effects, *Regional Science and Urban Economics* 32, pp. 145– 165.

Immergluck, Dan and Geoff Smith (2006). The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values. *Housing Policy Debate* 17(1): 57-79.

Kahneman D. and A. Tversky (2000) *Choices, Values and Frames*. Cambridge University Press.

Kim, Sunwoong (2000) "Race and home price appreciation in urban neighborhoods: Evidence from Milwaukee, Wisconsin." *Review of Black Political Economy* 28:9-28

Linneman, Peter and Susan M. Wachter. "The impacts of borrowing constraints on homeownership." *AREUEA Journal* 17 (Winter 1989): 389-402.

MacPherson, George and D.A. Sirmans (2001) "Neighborhood Diversity and House Price Appreciation," *Journal of Real Estate Finance and Economics*, Vol. 22, No. 1, 2001.

Manski, Charles (1995) *Identification Problems in the Social Sciences*. Harvard University Press.

Mitchell, Thomas W. 2001 "From Reconstruction to Deconstruction: Undermining Black Landownership, Political Independence, And Community Through Partition Sales of Tenancies in Common", *Northwestern University Law Review* 505 - 580, 505-511

Oliver, Melvin and Thomas Shapiro (1997) *Black Wealth, White Wealth: A new Perspective on Racial Inequality*. Routledge.

Ozanne, Larry and Raymond Struyk (1976) "Housing from the existing stock: comparative economic analyses of owner occupants and landlords," Working paper 221-10, The Urban Institute, Washington, DC.

Passmore, Wayne (2005) "The GSE Implicit Subsidy and the Value of Government Ambiguity," FEDS Working Paper No. 2005-05.

Passmore, Wayne, Shane Sherlund and Gillian Burgess (2005) "The Effect of Housing Government-Sponsored Enterprises on Mortgage Rates," *Real Estate Economics*, [Volume 33 Issue 3](#), pp. 427 - 463.

Peterson, G.E. A. Solomon, H. Madjid, W.C. Apgar (1973) *Property Taxes, Housing and the Cities*, Lexington D.C., Heath, Lexington, MA.

Proxenos. Soula (2002) *Homeownership Rates: A Global Perspective*. *Housing Finance International* (December).

Ross, Stephen L. and John Yinger (2002) "Looking the Other Way: A Critique of the Fair-Lending Enforcement System and a Plan to Fix It," *Center for Policy Research Policy Briefs* 24, Center for Policy Research, Maxwell School, Syracuse University.

Schuetz, Jenny, Vicki Been and Ingird Ellen (2008) "Neighborhood Effects of Concentrated Mortgage Foreclosures," [\*NYU Law and Economics Research Paper No. 08-41\*](#)

Stein, Jeremy C (1995) "[Prices and Trading Volume in the Housing Market: A Model with Down-Payment Effects](#)," [The Quarterly Journal of Economics](#), MIT Press, vol. 110(2), pp. 379-406

Sternlieb, George (1966) *The Tenement Landlord*, Rutgers Univ. Press, New Brunswick, NJ,.

Sternlieb, George and Robert Burchell, (1973) *Residential Abandonment*, Rutgers Univ. Press, New Brunswick, NJ.

Stegman, Michael Roberto G. Quercia, Janneke Ratcliffe, and Lei Ding and Walter Davis (2007) Preventive Servicing Is Good for Business *and* Affordable Homeownership Policy Housing Policy Debate, 18:2.

Tiebout, Charles (1956) "A Pure Theory of Local Expenditures," *The Journal of Political Economy*, Vol. 64, No. 5. pp. 416-424

De Tocqueville, Alexis (1835) *Democracy in America*

Turvey, Ralph 2004. "**What a Consumer Price Index Cannot Do**," [World Economics](#), World Economics, Economic & Financial Publishing, PO Box 69, Henley-on-Thames, Oxfordshire, United Kingdom, RG9 1GB, vol. 5(3), pages 37-42,

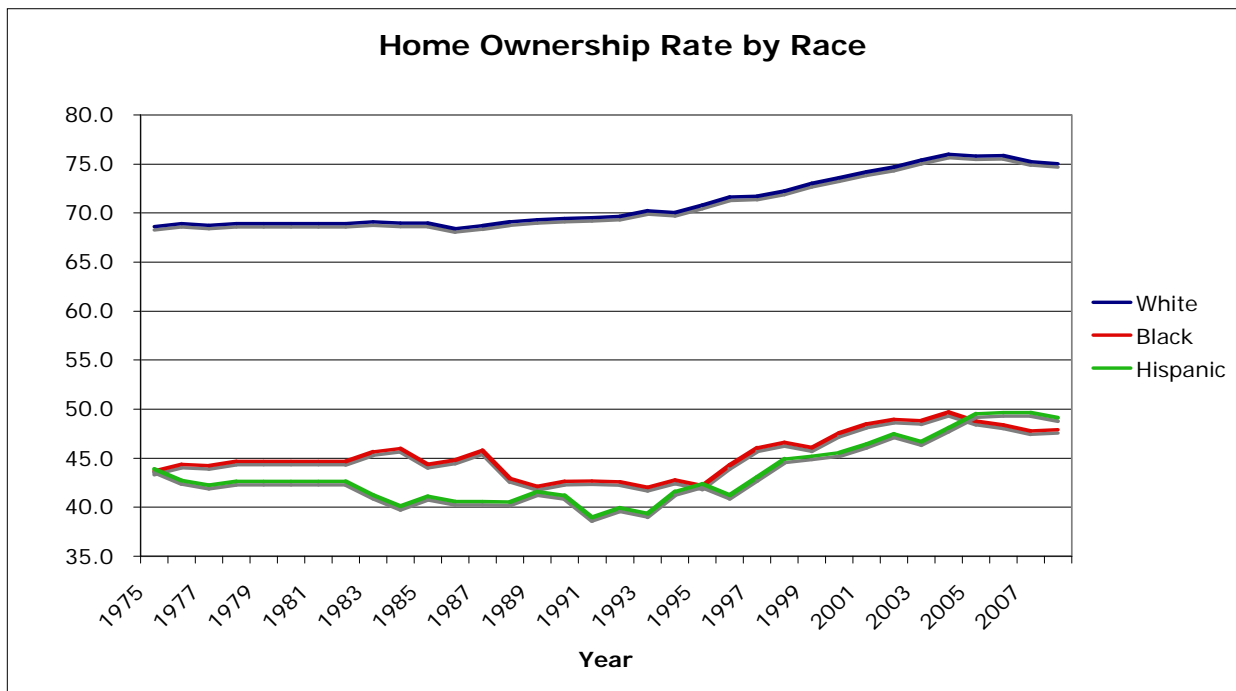
Weicher, John and Susan Woodward (1989) "Goring the Wrong Ox: A Defense. of the Mortgage Interest Deduction," *National Tax Journal*, 42, pp. 301-314.

**Table 1**  
**Default and Delinquency Rates, VA and FHA, 1950-1966**

Year	VA	FHA
1950	1.12%	1.98%
1951	1.09%	1.71%
1952	0.59%	1.35%
1953	0.56%	1.05%
1954	0.81%	1.14%
1955	0.70%	0.97%
1956	0.54%	0.94%
1957	0.45%	0.98%
1958	0.56%	1.24%
1959	0.59%	1.16%
1960	0.87%	1.28%
1961	1.23%	1.47%
1962	1.33%	1.45%
1963	1.41%	1.55%
1964	1.54%	1.48%
1965	1.57%	1.53%
1966	1.42%	1.43%

Source: US Department of Housing and Urban Development

**Chart 1**



Source: Current Population Survey, Bureau of Census