STABLE HOUSING, STABLE FAMILIES

Thinking Beyond Homeownership

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We face a silent housing crisis in America, and it is becoming worse each year. Nearly 20 million lower-income families spend more than one-half of their monthly income on housing. Another 20 million low-income households also lack access to transit, good schools, and jobs, or are living in concentrated poverty. Most of these families are renters, who have only $565 a month, on average, or $20 a day, to cover food, transportation, medical care, clothing, utilities, childcare, and all the other necessities of life.[1]

The trend is alarming. During the past 50 years, the percentage of those who are cost burdened—defined as paying more than 30 percent of income for housing—has doubled. Households who are extremely rent burdened (defined as paying rent that exceeds half their income) have also been on the rise. Couple the growing rent burden with the extreme financial stress facing households with minimal or negative net worth, and the result is a number of predictable, negative financial outcomes. Healthy, decent, affordable housing is a key determinant of financial security, especially for those living close to the financial waterline.

Take a single mother working two minimum-wage jobs. She would like to build her skills to earn more, but she cannot afford to take time off to get the training she needs. She lives paycheck to paycheck, despite her long hours. To help make ends meet, she looks for the lowest possible rent, but unfortunately, there are few housing options in her price range. The only

1 Joint Center for Housing Studies, "State of the Nation's Housing 2013" (Cambridge, MA: Harvard University, June 2013), p. 31.

apartment she can afford is far from transit and the local schools have a poor reputation. But she can't be too picky—the family has already moved four times in the last seven years. Each time, personal belongings were damaged or left behind and her children had to be pulled out of school.

Every time the kids start over, they feel lost and their confidence drops. As a result, the children do not have the same educational foundation as their peers; they are falling behind and cannot keep up in their classwork. They are unable to focus on their homework or sleep soundly at night because activity around the apartment is chaotic at all hours, and the walls are thin. In the morning, there is not much to eat, so the children arrive at school stressed, tired, and hungry. To the children, school often feels hopeless.

The new apartment is cramped, but the bigger problem is that it is poorly maintained, dark, damp and moldy. The local clinic recently diagnosed the six-year old with asthma. Faced with a difficult choice, the mother decides to pay the heating, electricity, and grocery expenses, which leaves no money for the medication.

For this hypothetical family, it is clear that the lack of decent, healthy, affordable housing is undermining overall financial security. The family is perpetually on the edge of crisis and has little prospect for improving their situation. The mother cannot build her skills to earn more, the children's health problems are likely to escalate (requiring more parental time and expenses), and the lack of classroom attendance (and attention) means that the children are increasingly likely to drop out of school, creating another generation for which financial and housing insecurity is the norm.

That this story is likely familiar in places all over the country suggests that we are on a toxic path that will lead to negative economic outcomes for families, communities, and the nation. This situation also raises important questions about whether housing can be a vehicle to increase financial stability. If secure and stable housing *can* help to create financial well-being, what type of housing is most effective: rental or owner-occupied? And if renting is a valid housing strategy for securing financial well-being, what can we do to bring parity to the financial incentives for renters and owners?

COMPLEX CONNECTIONS: HOUSING SECURITY, HOMEOWNERSHIP, AND RENTING

Housing insecurity—defined by the Department of Health and Human Services as high housing costs in proportion to income, poor housing quality, unstable neighborhoods, overcrowding, or homelessness—affects millions in America. Factors such as race and socioeconomic status play an important role in determining whether an individual or family can establish financial stability and housing security. For example, as of 2013, the median net worth of white households was approximately 13 times higher than that of black households. Between 2010 and 2013, median wealth for black families fell 33.7 percent, while white households experienced an increase in median wealth.[2] Median household net worth of African American renters in 2010 was an appalling $2,100 while Hispanic renters had only $4,500.[3]

Although racial segregation peaked in the 1970s, recent racial tensions amplify the fact that segregation is still very much part of the landscape of American cities. White city dwellers typically live in a neighborhood that is 75 percent white, while black city dwellers, on average, live in a neighborhood that is 35 percent white. Add to this another stark statistic: African Americans with a home mortgage were twice as likely to be affected by the recent foreclosure crisis. This was often because they were sold high-interest, subprime mortgages during the preceding housing bubble. Whatever the cause, the consequences have been disastrous for many African American communities that appeared, at the end of the 1990s, to be on their way to stability. Many factors influence financial stability and housing security, and vice versa. The connections are complex and—as the housing bubble and bust demonstrated—go beyond the simple distinction of whether one owns or rents a home.

America's 42.4 million renting households comprise almost 36 percent of the nation's population.[4] About 65 percent of all renter households are low-income, meaning they earn less than 80 percent of area median

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2 Rakesh Kochhar and Richard Fry, "Wealth inequality has widened along racial, ethnic lines since end of Great Recession"(Washington, DC: Pew Research Center, December 2014).

3 Joint Center for Housing Studies, "State of the Nation's Housing 2013," p. 14.

4 National Multi Family Housing Council, "Quick Facts: Resident Demographics" (February 2014).

income (which in most areas translates to about $50,000 annually for a family of four).[5] A staggering 11.25 million renter households,[6] including approximately seven in ten renters earning less than $15,000 annually (a fair proxy for full-time, minimum-wage work), spend more than 50 percent of their income on housing.[7]

While more Americans are spending an unsustainable amount of their income on housing, the availability of affordable and suitable rental housing to lower-income households continues to shrink. There are only 65 affordable and available rental units for every 100 "very low-income" renters. This represents a nearly 10 percent decrease in the availability of such homes from just a decade ago.[8]

Given these sobering statistics, is homeownership, rather than renting, a primary key to housing security and stability? Not for every household. Of the 20 million families who suffer from housing insecurity in this nation, 8.9 million are severely cost-burdened *homeowner* families. And there are only 29 affordable and available homes for owner-occupancy for every 100 extremely low-income families (earning 30 percent of area median income) in America, many in places far from the population that needs them.[9]

OWNING VERSUS RENTING A HOME: POLICY MUST SUPPORT BOTH

Whether homeownership or rental is a more effective vehicle to build wealth and financial stability is a hotly debated topic. Federal expenditures on housing tilt heavily toward rewarding ownership. But it is not at all clear that spending federal money this way is the most effective use of resources for families or the country. In fact, the choice between rental and ownership may be a false choice. Depending on the stage of life and

5 United States Census Bureau, American Community Survey (ACS) (2012).

6 United States Census Bureau, American Community Survey (ACS) (2013), tables B25003 & B25033.

7 Joint Center for Housing Studies, "State of the Nation's Housing 2013," p. 5 and figure 5.

8 Barry L. Steffen et al, "Worst Case Housing Needs: 2015 Report to Congress." (Washington, DC: Department of Housing and Urban Development,April 2015), Executive Summary.

9 Daniel McCue, "The Burden of High Housing Costs," *Cascade* (Winter 2015). Federal Reserve Bank of Philadelphia.

circumstances of a given household, either choice may be optimal from the standpoint of financial security.

Policies that promote renting and ownership are not zero sum and in fact, effective national rental policies could serve to make homeownership a realistic objective for many families. The availability of affordable rentals is a significant advantage for households that aspire to homeownership, as it provides housing stability while enabling the family to build a financial cushion and save for a down payment. In contrast, households that are spending one-half or more of their income on rent are less likely to be able eventually to buy a home. There is often no money left at the end of the month to save, which in turn is the primary source of a down payment. In addition, a family that is forced to make toxic tradeoffs is a family that is more likely to live in financial crisis. Compromised mental and physical health, job insecurity, and spending on cars and appliances that are near or past their useful life create yet more financial risk. In addition, many families that are rent burdened run into the dual problems of having a poor credit profile while lacking adequate savings for a required down payment.

The fact that our housing policies are so out of balance—for every $1 of federal tax benefit for renters, there are $11 for homeowners—should be a wakeup call that we are failing to prepare millions of aspirational homeowners to achieve their dream. The challenge will only grow worse during the next two decades. An estimated 77 percent of new household formation this decade and an astounding 88 percent of new households in the next decade are expected to be made up of minorities,[10] many of lower wealth; without inspired policy changes, more households will face financial instability and homeownership rates will be pressured.

We must also consider policies that address the physical nature of the housing stock. America looks very different than it did when much of its housing was built. In 1940, only about 7 percent of Americans lived alone. Divorces were less common, men married earlier, and women often stayed with their parents until they were married. Today, social, medical, and economic changes have reshaped the housing landscape. The strongest

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10 Laurie Goodman, Rolf Pendall and Jun Zhu, "Headship and Homeownership: What Does the Future Hold?" (Washington, DC: Urban Institute, June 2015).

growth in housing demand will come from minorities, singles, aging Baby Boomers, new immigrants, and Millennials. Can we alter policies so that these renters and homeowners are not paying for more space than they need? This will be particularly relevant for singles and those who are retired and downsizing. Single seniors are living longer, and more than 25 percent of all U.S. households consist of a single individual. Many neither want nor need housing that was built for a traditional family. How might the federal presence in housing finance, both directly and through the guarantees that are issued by the two largest government-sponsored enterprises, Freddie Mac and Fannie Mae, be used to better align the supply of housing with the emerging demand? How can local governments, who have the largest role in land use decisions, best address these issues? Could smaller, less expensive and more efficient housing be a solution to the affordability gap, allowing lower-income singles to spend less and save more?

Benefits of Homeownership

One of the most commonly cited benefits of homeownership is that it generates savings. The vast majority of home mortgages are amortizing; as regular payments reduce the principal balance and interest payments shrink, equity increases at a faster pace, creating a "forced savings" mechanism. The longer one owns a home, the greater the benefit. The process of accumulating the down payment and demonstrating a commitment to savings confers additional financial benefits to homeowners.

Additional benefits relate to the long-term financial returns of homeownership. For example, a homeowner can borrow against (that is, leverage) equity to generate substantial real returns, even when nominal returns on home values are marginal or do not exceed inflation. For many lower-income homeowners, similar leverage is unavailable for other investments and asset classes. Of course, the leverage also creates downside risks that were all too evident in the last major housing correction.

Homeownership has also historically been an effective hedge against inflation. Although some costs of homeownership rise over time, such as maintenance and property taxes, the mortgage payment is generally fixed. Most housing costs thus remain constant for owners, and over time, housing cost relative to income generally declines. In contrast, renters are likely to experience ongoing rent increases. Although these benefits were lost in some of the bad lending of the housing bubble, reforms put in place after the financial crisis favor fixed-rate mortgages with fair terms and underwriting.

In addition, single-family homes over most, but not all, periods of time generate real returns. The creation of new homes historically has not kept pace with population growth, leading to increased prices for existing houses. The Federal Housing Finance Agency found that compound annual growth rates in home prices exceeded inflation by 0.8 percent nationally between 1975 and 2012, although certain U.S. markets such as the South and the Midwest underperformed the east coast and west coast metropolitan areas. In addition to regional variation in home prices, other factors influence the real returns on homeownership, including the timing of the purchase and sale of a home. These often get masked in national figures.

Lastly, homeownership advocates point to the tax advantage of owning a home. Potential tax benefits include the mortgage interest and property tax deductions, and the ability to exclude from income gains from the sale of a house (up to $250,000 for an individual, or $500,000 in the case of a married couple). However, these benefits are extremely skewed toward upper-income homeowners. For example, almost one-half of homeowners do not itemize their tax returns because the value of the mortgage interest and property tax deductions to the homeowner does not exceed the value of the standard deduction. And senior homeowners who have paid off their mortgage receive no benefit from the mortgage interest deduction.

Risks of Homeownership

Although homeownership creates opportunities for financial security, it also presents significant risks. Thus, for many families, it is important to think of homeownership as an *end*—a goal achieved as the result of having several years of housing security and enough time to build savings—and not as the means to that end. In fact, when we think of housing security as the higher goal, we can easily see that homeownership poses a number of financial challenges, especially to already-struggling families. In some cases, homeowning families may find themselves at even greater risk of housing insecurity than families who rent.

Homeowners who put their life savings into their house have concentrated all their wealth in a single asset, with no ability to diversify their investment risk. As a result, the use of debt leverage is a double-edged sword. It can greatly magnify returns, but the reverse is also true; even modest declines in home values can sizably reduce equity, and a serious market correction can wipe it out entirely. Zillow estimated that nearly 15 million homeowners were "underwater"—they owed more on their mortgage than their home was worth—during the height of the recent Great Recession, when nominal prices were down nationally by more than 25 percent.

The unpredictability and difficulty of "timing the market" also creates risk. Lower-income homeowners typically lack the flexibility to buy and sell according to market fluctuations, and they often lack the mobility to move to more housing-favorable neighborhoods or regions of the country. But even if they could, the high transaction costs typically involved, such as a 6 percent real estate broker commission, could preclude them from doing so. Another homeownership risk is the possibility of unexpected major maintenance and repair costs, such as roof replacements or heating system failures. The failure to keep up with routine maintenance costs over time can cumulatively lead to disrepair and adversely affect the home's value.

All of these risks are exacerbated during economic downturns, when jobs are lost, housing demand declines, and house prices plummet simultaneously. If at the same time, the sale of a home is forced by health problems, job loss, or divorce, the timing can translate to financial calamity. During the most recent housing bubble, even minor financial setbacks led to disaster for many borrowers who took out mortgages with variable and increasing payment terms and did not have enough cash on hand to withstand temporary financial challenges, much less long periods of unemployment or underemployment. In contrast, a renter who invested the marginal savings created by renting rather than buying a house could have potentially established the financial liquidity and investment diversity necessary to weather the storm.

MEASURING THE RETURNS

Calculations of expected returns in housing can be complex and depend on important assumptions. Nobel Prize-winning economist Robert Shiller has argued that over the very long run, housing prices in real terms have barely exceeded inflation, making homeownership a weak wealth-building prospect.[11] He notes that investments in diversified public equities and bonds would have provided a significantly higher real return for the investor.

Belsky and Duda studied four market areas between 1982 and 1999 and found that one-half of the owners who purchased and sold homes had negative returns after figuring in closing costs.[12] They concluded that the timing of the purchase and sale of the home relative to the market cycle was as important as the location.

In a 2010 study, Jordan Rappaport of the Federal Reserve Bank of Kansas City compared the wealth-building results of U.S. homeowners and renters for 10-year periods from 1970 through 1999, and found that homeownership was only slightly more effective at building wealth than renting.[13] During the 2000s, homeowners were at a clear financial disadvantage relative to renters.

A conclusion that renting is preferable in the context of building wealth depends on many variables, including the mortgage market, prices of comparable homes for sale, the need to be able to relocate to another market for employment opportunities, and other issues. As was noted earlier, single-family housing as an asset class has had an uneven record, depending on location. Other investments have produced better risk-adjusted returns. However, those who suggest, such as Robert Shiller, that homeowners might have historically built more wealth by investing in equities rather than by buying their home, rest their premise on the renter having fewer outlays than the homeowner and then having the discipline to invest all of those savings in a diversified basket of securities or an index fund. Some recent studies suggest that discipline can be elusive.[14]

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11 Morgan Housel, "Why your home is not a good investment," *USA TODAY*, May 10, 2014. See also Robert Shiller, "Home Buyers are Optimistic but not Wild-Eyed," *New York Times*, December 13, 2014, Pg. BU7.

12 Eric Belsky and Mark Duda, "Asset Appreciation, Timing of Purchases and Sales, and Returns to Low-Income Homeownership." In *Low-Income Homeownership: Examining the Unexamined Goal*, edited by Eric Belsky and Nicolas Retsinas. (Washington, DC: Brookings Institution, 2002).

13 Jordan Rappaport, "The Effectiveness of Homeownership in Building Household Wealth," *Economic Review* (Kansas City, MO: Federal Reserve Bank of Kansas City, Fourth Quarter 2010). But see Christopher E. Herbert, Daniel T. McCue, and Rocio Sanchez-Moyano, "Is Homeownership Still an Effective Means of Building Wealth for Low-income and Minority Households? (Was it Ever?)," (Cambridge, MA: Harvard University, September 2013).

14 Allison Freeman and Roberto G. Querica, "Low- and Moderate-income Homeownership and Wealth Creation," (Durham, NC : University of North Carolina Center for Community Capital, April 2014).

HOUSING SECURITY SOLUTIONS FOR RENTERS AND HOMEOWNERS

Taking all of these considerations into account, it becomes overwhelmingly clear that neither renting nor homeownership inherently meets the goal of housing security. Rather, it is a combination of many factors, including the price, quality, stability, and location of the home, that determines whether it will enhance a family's economic, physical, and psychological health.

One of the causes of the foreclosure crisis and the broader recession was the lowering of credit barriers for people who were unable to maintain monthly mortgage payments. In response, lending standards have grown tight, and many creditworthy potential homebuyers have been shut out of the market. To begin to reach a better equilibrium, the broader housing community (developers, lenders, owners, etc.) should consider whether new technologies can deliver better tools to help individual homebuyers determine whether renting or owning is the wiser choice given their unique goals, lifestyles, professional choices, and saving habits. Employers use a range of tests when determining which job candidate to hire. We should invest in the technology, statistical models, and basic data already available to provide families with similar tools for making housing choices—tools that go well beyond the often homeownership-biased calculators on many websites today.

Federal and state governments also have a role to play in positively influencing housing and lending markets, and their leadership may be key to stimulating change among commercial lenders, developers, builders, and owners. Today, the federal government alone spends more than $200 billion annually to incentivize housing through appropriations, tax expenditures, and subsidies. The vast majority of these—about 75 percent—are allocated to homeownership, even though homeowners on average have twice the income of renters.

The first step should be to rethink the billions of dollars earmarked for homeownership tax benefits each year. The largest tax subsidy is the mortgage interest deduction (MID), and costs the U.S. Treasury between $70 and $90 billion annually, which exceeds the entire budget for the Department of Housing and Urban Development budget. The MID is available for people who itemize their tax deductions and who have a mortgage balance, but there is no comparable program for renters who save or those who have paid off their mortgage. For such taxpayers, the MID provides no benefit.

Further, for the MID to be worthwhile, it must be more valuable than the standard deduction. Most lower-income families have less expensive homes and smaller mortgage balances; as a result, the MID is no better than the standard deduction. Recent data indicate that more than 80 percent of the MID goes to families earning more than $100,000 annually and one-half of that — fully 42 percent — goes to filers making more than $200,000 each year. Nearly one-half of homeowners who have mortgages, the majority of whom are middle- or lower-income, do not benefit from the MID.[15] It is time to consider addressing this misallocation of tax resources in a way that helps more renters.

Even federal funding programs targeted to housing more generally tend to operate paradoxically. Housing programs are established to benefit people in certain income brackets, communities or target groups, but then these programs proceed to treat all potential borrowers, developers, and homeowners equally. Programs are also typically implemented at the national or state level, ignoring the regional, local, and cultural differences that exist in specific markets.

Many programs also have inappropriate timeframes for implementation. Tax credits for developers are, for example, offered for certain behaviors (such as setting aside a certain number of housing units for low-income tenants), but are accompanied by relatively short income restriction time limits. After the time limits expire, federally funded properties can often be bought and sold at full market value. In fact, more than 2 million rent-restricted units financed by the federal Low Income Housing Tax Credit will be at risk of large rent hikes in the next few years, as their 15-year compliance period expires.

15 Joint Committee on Taxation, "Estimates of Federal Tax Expenditures for Fiscal Years 2014–2018," Prepared for the House Committee on Ways and Means and the Senate Committee on Finance (November 7, 2014), Table 3. Mark P. Keightley, "An Analysis of the Geographic Distribution of the Mortgage Interest Deduction," (Washington, DC: Congressional Research Service, January 30, 2014), Pg. 5.

It is time to reassess and rebalance existing programs and tip them toward those who are most in need, whether this means identifying and assisting certain neighborhoods, cities, states, or economic groups—and directing more of our attention and resources to helping renters and aspirational homeowners. Could some of the incentive disparities between homeownership and renting be addressed by creating more sophisticated options for targeted housing subsidies and government grants? One idea would be to create a tax advantaged account (like an individual retirement account) where the default choice would be a blended and diversified bond and equity fund. This could be used for limited purposes related to housing, such as for a down payment for a home purchase. It could be funded by rebalancing the federal subsidies so that they are targeted to households who want to become homeowners, or renters who need an emergency fund to pay their rent during a crisis.

Could programs be created that encourage developers and owners to offer longer (perhaps five- to seven-year) leases to good tenants at all income levels who commit to staying in a property, given that predictability benefits landlords and tenants alike? Might we develop a sustainable and scalable Rent-To-Own program? Imagine a financial product that uses Federal Housing Administration or state Housing Finance Agency programs for the entity who owns the house while the occupants are renting. The mortgage would be assumable, and the landlord/owner would transfer a portion of the loan to the tenant/homebuyer when they are able to accumulate the necessary 3.5 percent down payment from the carved out rental payments and meet other underwriting criteria. The transfer would come with predictable costs to the buyer, and there would be visibility for both parties to the transaction.

Finally, creating strategies to deal with unforeseen financial emergencies, whether caused by a boiler failure, job loss, or an illness, could make an enormous contribution to reducing financial stress, which often compounds risks to household wealth. Managing those risks for homeowners and renters is one key to financial stability. Is it time to create a public incentive to either private mortgage insurers or employers to offer safe and affordable "rainy day" insurance products to low-income households? The insurer would be eligible for tax credits in return for extending limited and capped insurance against certain financial emergencies, such as housing repairs, a death in the family, or a sudden reduction in income. Getting past such an emergency without wiping out savings, or worse yet, going into a debt spiral, is essential to household stability and wealth accumulation.

CONCLUSION: FOCUSING ON HOUSING SECURITY—NOT TENURE—IS ESSENTIAL

Housing is synergistic. A stable, healthy affordable home helps families organize themselves to be successful and to effectively confront life's inevitable challenges, whether educational, health-related, or financial. Individuals and families who lack that stable foundation are far more likely to fall between the cracks.

We can do so much more to help promote housing security and create financial well-being for all. Certainly, there are many issues and challenges that must be addressed: racial disparities and regional, cultural, and social differences; financial literacy; resistance and inertia among established government entities, lawmakers, and real estate industry participants; well-established tax policies; privacy concerns; and the delicate balance between the needs and goals of renters, landlords, developers, and buyers.

We must, however, overcome these challenges if we wish to see advances in the financial well-being of families and improved economic performance of the country. If we have the will, we will find the way.

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