



RESEARCH BRIEF

Setting the Record Straight on Homeownership¹

Homeownership has offered a well-traveled route to economic stability in the United States. With the right mortgage product and even modest levels of appreciation over the long run, it has enabled generations of Americans to build wealth, while providing the owners with a place to live. Homeownership can also confer a host of social benefits to families and their communities.

However, the foreclosure crisis has given rise to debate over the financial merits of homeownership, especially for families of modest means. Some have gone so far as to ask if America is becoming a nation of renters?²

A re-examination is understandable in the wake of the foreclosure crisis and excesses of the subprime boom. Unfortunately, much of the debate is poorly informed or based on theory or simulation. It is important to ask, what does *the evidence* tell us about when homeownership is right and for whom?

While some find homeownership to be an important contributor to household wealth (Holloway 1991; Turner and Luea 2009), others believe that renting is less risky and less costly (Smith and Smith 2007). Researchers have pointed out that the benefits associated with homeownership depend on a number of factors, such as timing, location, condition of the home, use of equity, tax benefits, opportunity costs (Herbert and Belsky 2008) and the ability to hold on to one's home (Duda and Belsky 2001).

Indeed, while homeownership is not appropriate for everyone in all circumstances, it can still be extremely beneficial for the long-term economic prospects of asset-poor households. How do we know this? For 10 years, the UNC Center for Community Capital has tracked borrowers in the Community Advantage Program (CAP),ⁱ a portfolio of more than 46,000 home-purchase mortgages made to lower-income households. We speak annually with more than 2,000 of these homeowners and also track a comparison group of renters.

Who are CAP homeowners?

The median household income is \$30,792,ⁱⁱ 41 percent of households are headed by women and approximately 40 percent of households are minorities. The median loan balance at origination was \$79,000. Fifty-three percent of CAP's borrowers had credit scores less than or equal to 680 when their mortgages were originated, and 72 percent of borrowers made a down payment of less than 5 percent on their homes.

Despite the ostensibly risky profile of the CAP borrowers and the turmoil faced by housing markets since 2008, the CAP portfolio has performed well, with a serious delinquency rate just 60 percent that of prime adjustable-rate mortgages, less than half that of subprime fixed-rate mortgages and a quarter that of subprime adjustable-rate mortgages.ⁱⁱⁱ The lenders involved helped these creditworthy, though nontraditional, borrowers buy homes they could afford with mortgages they could manage: long-term, fixed-rate, self-amortizing mortgages, underwritten for the ability to repay. But what about the outcome for households of similar incomes renting in the same communities?

Using extensive analysis of the real-life experiences of these owners and renters through a period of boom and subsequent bust, we examined a handful of assertions about the financial wisdom of renting versus owning that have risen to prominence since the mortgage lending crisis began. We present here our findings.

Finding #1: Owning has been tough, but renting has been tougher. Homeownership provided a greater economic cushion for lower-income families.

The CAP data show that when low- and moderate-income (LMI) families purchase homes they can afford with mortgages that are sustainable, wealth happens. From loan origination through the second quarter of 2011, CAP owners realized a median annualized return on their equity^{iv} of 27 percent. Such growth was not attainable through other mainstream investments: during that same period, the Dow Jones Industrial Average increased by a median of 2.4 percent

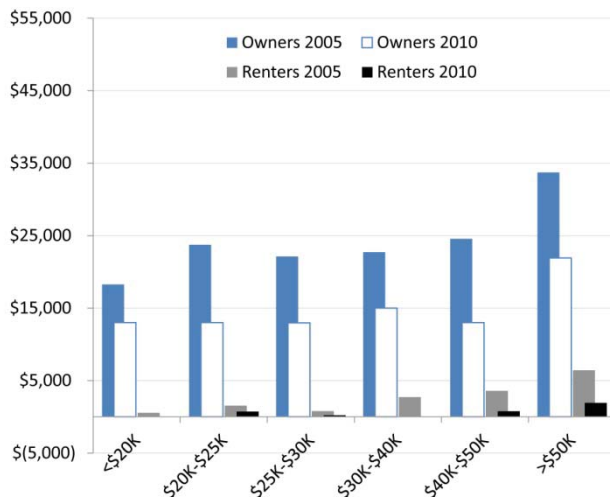
¹ This paper is a condensed version of the following working paper: Freeman, Allison and Janneke Ratcliffe. 2012. "Setting the Record Straight on Affordable Homeownership." Available as a working paper at <http://ccc.unc.edu/documents/Set.Record.Str8.Aff.HO.May2012.WP.pdf>.

² This paper was prepared for a conference of this title; "Are We Becoming a Nation of Renters?" held May 22, 2012, at the Woodrow Wilson International Center for Scholars.

on an annualized basis, and the median annualized return on the 10-year Treasury bill was 5.4 percent.

How does this compare to the renters over this period?^v First, consider owners and renters who were in the same income categories at baseline and how they fared from 2005 through 2010 – essentially from near the peak of the housing market to deep into the recession. As expected, both owners and renters in all income categories lost wealth at the median over that five-year period (Figure 1).

Figure 1: Renter and Owner Median Net Worth by income at baseline



Yet, within each income group, owners ended the period with significantly higher net worth than their renter counterparts. In 2005, before the crisis, owners clearly held far more wealth than renters with similar incomes. Though the owners lost more than renters through 2010, they had much more to lose and they were, therefore, able to retain greater net worth through the crisis.

A perhaps more appropriate comparison is derived by matching owners and renters by net worth in 2005 and seeing how they fared through 2008 and 2010 (Figure 2). Despite having started with comparable net worth in 2005, owners' and renters' net worth diverged greatly by 2010. By that year, all groups of renters who had positive net worth at the beginning of the period saw their net worth fall precipitately. These shifts suggest that homeownership and the housing investment helped buffer CAP's owners from financial devastation during the crisis, whereas the wealth of comparably situated renters was more vulnerable to the financial turmoil inherent in the crisis.

Related to the argument that homeownership is not a reliable wealth-building mechanism for LMI families is the assertion that homeownership is too stressful for lower-income families to bear. Manturuk, Riley and Ratcliffe (2011) look at the impact of homeownership on financial stress (a measure of the extent to which actual financial difficulties in paying for housing, managing money,

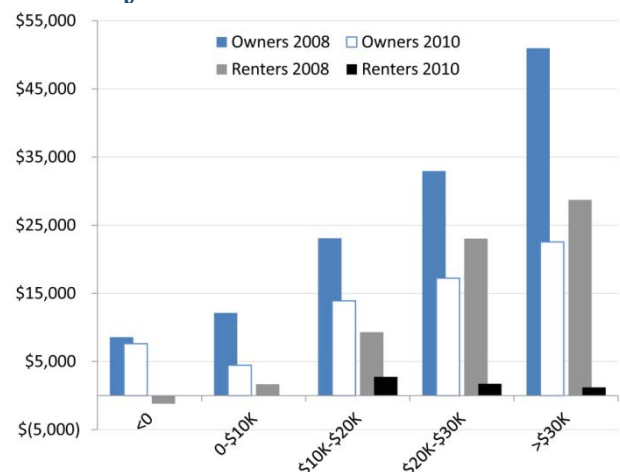
carrying debt loads and saving for retirement are causing people stress), satisfaction with one's financial situation and overall stress (based on a four-item measure of how much people felt in control of their lives). After adjusting for observable differences between the owners and renters, the analyses uncover no significant difference between renters' and owners' actual reported financial stressors, yet they showed homeownership to have a persistent significant beneficial effect on financial satisfaction and overall stress.^{vi} In other words, the owners reported lower psychological stress than comparable renters, despite facing a similar level of financial pressure.

Whether considered against alternative investments or against the financial stress experienced by comparable renters, homeownership appears to be working well for CAP households. Moreover, the evidence shows that on the whole, though renters had no home equity to lose, they were badly buffeted by the recent economic crisis. For these lower-income households, renting did not insulate them from financial loss and stress.

Finding #2: Better to have all your eggs in one basket than to have no hen at all.
Homeownership does not crowd out other investments; comparable renters did not build alternative, diversified investment portfolios.

One criticism of the home as an investment is that it crowds out other investments, leaving households with under-diversified and, therefore, riskier portfolios. This is a potentially serious concern for lower-income individuals, who invest a greater share of their net worth in housing than higher-income individuals do. We ask, absent the home, would lower-income households have well-diversified portfolios?

Figure 2: Owner and Renter Median Net Worth by net worth in 2005



Freeman and Desmarais (2011) examined whether CAP's homeowners restrict their investments in other financial instruments as a result of having concentrated their investing activities in the

home. The goal of the analysis^{vii} was to identify any respondents' adjustments in asset distribution in response to changes in home equity.^{viii} In cross-sectional analysis, the effect is significant but minuscule: with increasing equity, the simulated effect on comparable renters' investment portfolios was a shift of less than one cent. Over time, there seems to be a negative relationship between change in home equity and change in investments, but again the effect is very small. The accumulation of home equity is associated with a moderate decline in non-primary residence equity, implying a trade-off between homeownership and investment in other real estate.

In conclusion, Freeman and Desmarais do not find evidence of significant asset-related opportunity costs to home equity accumulation for the CAP borrowers. They conclude that affordable lending for homeownership "serves as an effective means for promoting stable wealth-building for LMI households through the forced-savings mechanism of equity accumulation" (p. 155).

Finding #3: The house is not used as an ATM. Equity gains did not lead to excessive borrowing.

Another criticism of the home as an investment vehicle is that homeowners, particularly those who are income-constrained, might be tempted to diminish their wealth gains through excessive borrowing. Freeman and Desmarais's (2011) analysis (detailed in the preceding section) also considered the important question of whether CAP's low- and moderate-income homeowners increase their levels of borrowing in response to the accumulation of home equity. They find a modest, positive relationship between home equity and credit card debt, particularly at higher levels of home equity. Specifically, home equity of more than \$150,000 corresponds to an *average* predicted increase of \$1,000 or more in credit card debt.^{ix} The relationship between student loan debt and home equity is small. Notable borrowing directly against home equity occurs only where equity levels are \$100,000 or more, and such borrowing never reaches a scale that would decimate equity-based wealth.

So while there appears to be some association between the accumulation of large amounts of equity (\$150,000 or greater) and increased indebtedness, there is no evidence that debt accumulation by CAP homeowners offsets the wealth-building effect of home equity.

Finding #4: Renting is not necessarily a cheaper option.

The user costs of owning versus renting have been analyzed extensively, but seldom for lower-income households. Riley and Ru (2011) use the CAP data to assess whether CAP's owners would have been better off renting over the period 2003–2010 using owners' ex-post user costs and equivalent rents from the CAP survey data based on property attributes. The authors calculate that the median owners' user cost was \$36,000 for the period 2003–2010, less than the estimated median cumulative equivalent rent of

\$41,000, with the initial period of house price appreciation sufficient to offset the subsequent years' higher owners' user costs. The authors estimate that annual house price appreciation of about 2 percent at the median was necessary to ensure that owning was no more costly for CAP's owners than renting would have been between 2003 and 2010.

In the analysis described above, house price appreciation rates drive the comparison, but there are two key variables not tested in the CAP experience that also affect the overall costs of owning versus renting. The first of these is the type and cost of financing used. CAP borrowers all received similar mortgages: fixed-rate, fixed-payment and competitively priced. Changes in interest rates and different fee structures would yield different results. The second critical factor is the cost of renting, which has recently been on the rise,^x meaning that, provided home prices stabilize, homeownership may actually be gaining relative financial advantage over renting.

Finding #5: Less "skin in the game" does not mean more risk. Even with minimal assets, qualified households with properly underwritten mortgages can successfully make the transition to homeownership.

Down payment requirements have loomed large as part of the discussion over what led to the crisis and how to prevent another one. In May 2011, in an effort to develop underwriting guidelines for qualified residential mortgages – which are exempt from risk retention requirements for privately securitized mortgages under the Dodd-Frank Wall Street Reform and Consumer Protection Act – the Federal Deposit Insurance Corp. and Federal Reserve proposed the institution of a 20 percent down payment requirement.

The experience of the CAP portfolio calls this position into question. CAP's loans are notable for their high loan-to-value ratios: 97 percent is the typical maximum loan-to-value ratio, though some programs issue loans all the way up to 103 percent of house value. Moreover, a substantial portion of CAP's borrowers had help meeting their modest down payment requirements and closing costs: some 38 percent of CAP owners relied on some form of assistance beyond their own savings and assets to buy their homes. Sellers and real estate agents were the source of assistance most frequently cited, followed by family and friends, then grants from community groups, government agencies or other organizations. Two percent of owners used a second mortgage, while another 2 percent used help from a different source altogether.^{xi} Community grants and loans were particularly important for African American borrowers.

Analyses of the CAP data revealed which categories of borrowers needed more help with their down payments. But were homeowners who used help toward their down payment and closing costs more likely to become delinquent or even default? Controlling for a rich array of variables,^{xii} we find that having received assistance toward one's down payment and closing costs has no significant effect whatsoever on CAP homeowners' mortgage performance. This

finding suggests that programs that responsibly help asset-poor borrowers step into homeownership should be fostered, thus putting the financial benefits described above within reach.

Conclusion and Implications

The collective evidence presented here refutes a number of commonly held, but poorly substantiated, claims about the pitfalls of homeownership for lower-income, lower-wealth families. By examining the real-life experiences of LMI households, we find that homeownership has been a beneficial proposition on the whole for those in the CAP program. These findings are particularly noteworthy because they persist through recent market turmoil, which has negatively affected comparable renter households.

There are important caveats to these findings. First, not all owners fared equally well. Some owners who bought late in the cycle in more volatile markets have lost wealth. Second, the experience of the CAP homeowners cannot be generalized to all lower-income borrowers over this same period because the type of financing used is a key determinant of the financial trajectory of investing in a home. All of the owners in the CAP portfolio received fixed-rate, fixed-payment, standardized, competitively priced, long-term mortgages. It is largely due to the durability of their affordable mortgages that CAP's owners have enjoyed the benefits traditionally associated with homeownership, even against a backdrop of economic upheaval. Borrowers who used costlier, riskier products were not as fortunate and many have lost their homes as a result.

A final caveat is that we are not proposing that owning a home is a fail-safe solution to economic turmoil. Owning a home is no substitute for good jobs, affordable health care, a strong economy and a comprehensive social safety net. Many households are better off renting, some households prefer to rent and renting offers advantages that homeownership does not, chief among them ease of mobility.

Still, it is a stark reality that the renters actually fared worse on the whole than similarly situated owners. They did not build alternative assets and they experienced significant wealth losses as a result of the economic crisis. For those who suggest that renting is a better alternative than owning, we urge that they carefully consider the realities facing renters, particularly lower-income renters, in this country.

Without access to homeownership, how else will low-resource households begin to build an economic base? The real-life experiences of the CAP participants demonstrates that homeownership is still a viable and unparalleled route to economic security for working families who are ready to take on the responsibility of owning a home. Yet trends in mortgage lending rules and regulations threaten to close off access to homeownership to the very types of households whose successes we document in this paper. These lessons are particularly important in light of coming demographic changes and the need to help communities most devastated by the foreclosure crisis to recover. Consigning large

segments of the population to permanent renter status will have major consequences. For the housing market, it means stripping off a growing demographic that could be vital to the recovery and long-term vitality of the US housing market. For lower-income households, it means denying them the wealth-building opportunities that the CAP owners have experienced and that Americans have relied on for decades for their economic betterment.

Rather than blocking this classic pathway to the American middle class, the evidence presented here shows that successful lending practices can help households and the housing market begin to recover from the crisis.

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ⁱ All of the evidence presented in this paper comes from analysis of the Community Advantage Program (CAP) data. Self-Help Ventures Fund (Self-Help) launched CAP in 1998 with a \$50 million grant from the Ford Foundation and institutional capacity provided by Fannie Mae. CAP is essentially a risk-sharing mechanism: under the program, Self-Help purchased community reinvestment loans from lenders around the country and sold them to Fannie Mae, while retaining the associated risk. In the early 2000s, the Ford Foundation engaged UNC's Center for Community Capital (CCC) to conduct a long-term study of the program.

ⁱⁱ All statistics in this section come from the CAP generalizability sample.

ⁱⁱⁱ Rates of serious delinquency come from the Mortgage Bankers Association's 2011 *National Delinquency Survey* (Moody's Analytics' Databuffet.com). Figures are from the third quarter of 2011.

^{iv} CAP home values are calculated using a ZIP code–level house price index that is proprietary to Fannie Mae. The Fannie Mae index provides a more accurate estimate of home value than do publicly available house price indices (such as the FHFA index, formerly OFHEO) because it relies on information at the ZIP code, rather than the MSA or state, level.

^v All of the papers relying on the CAP data confront a similar problem, namely bias in sample selection. Because random assignment into homeownership is unrealistic, there is inevitable bias in the studies comparing CAP's owners and renters. As we focus on wealth in particular, it is difficult to say when comparing owners and renters whether the changes in wealth we observe result from homeownership or from particular social, economic, and demographic factors that likely increase both homeownership and wealth. Therefore, each of the papers underlying the current paper

employs advanced statistical techniques to address selection bias. Interested parties should refer to these papers for extensive detail on the various analyses used.

^{vi} For a description of how this score was calculated, see K. Manturuk, S. Riley, and J. Ratcliffe, 2011, "Perception vs. Reality: The Relationship between Low-Income Homeownership, Perceived Financial Stress, and Financial Hardship," *Social Science Research*, 41(2): 276–286.

^{vii} This analysis draws on the two years of CAP data, 2005 and 2008, in which the panel survey included an extensive module related to participants' wealth. Sample sizes are 982 owners and 595 renters matched to owners.

^{viii} In fact, the authors used the joint distribution generated from the copula function to derive the adjustment of each element of the financial portfolio in response to a shift in home equity. They tested all portfolio variables (both asset and debt) at the same time. These variables included: transaction account balances and CDs, investments (stocks, bonds, retirement), equity in non-primary residences and major durables, credit/charge card debt, student loan debt, and borrowing against the home (i.e., the combined value of home equity lines of credit, second mortgages, and cash-out refinance amounts). Asset and debt variables are discussed separately here for ease of comprehension. Interested parties should see, for full details, Freeman and Desmarais (2011).

^{ix} In the interest of conservative inference, Freeman and Desmarais place 99 percent confidence intervals from the simulation around the estimates.

^x Alejandro Lazo, "Rising Rents May Signal a Housing Market Recovery," *Los Angeles Times*, March 13, 2012, <http://articles.latimes.com/2012/mar/13/business/la-fi-rents-20120313>.

^{xi} A. Freeman and J. Harden, 2012: analysis in progress; contact allison_freeman@unc.edu for details. This research employs multilevel logistic regression analysis with random state intercepts to account for unobserved heterogeneity at the state level. The dependent variables, which were measured in 2003, include whether a respondent (1) received assistance in any form, (2) received parental assistance, (3) took out a second mortgage, (4) received assistance from a community grant, and (5) received assistance from a real estate agent. Separate logistic regression models are used (instead of a multinomial model) because the outcomes are not mutually exclusive (i.e., some people received more than one kind of help). Independent variables, also measured in 2003, include: respondent race, gender, age, education, marital status, number of minors living in the home, employment status, and income (scaled by MSA-level median income). Several financial literacy variables are also included: whether respondents' parents had a checking account, whether respondents' parents taught financial skills, and whether respondents prefer to save or spend. Finally, the analysis controls for loan-to-value ratio at origination, respondents' credit scores at origination, and debt-to-income ratio at origination.

^{xii} A. Freeman and J. Harden, 2012: analysis in progress; contact allison_freeman@unc.edu for details. Control variables include age, race/ethnicity, sex, marital status at baseline, education at baseline, relative income at baseline, number of minors in the home at baseline, respondent's employment status at baseline, being a two-income household at baseline, origination loan-to-value ratio, credit score at origination, debt-to-income ratio, whether or not one received assistance for down payment and closing costs, whether or not the respondent's parents held bank accounts when the respondent was young, respondent's assessment of how much his/her parents imparted about managing money, and respondent's attitudes toward spending versus saving money.