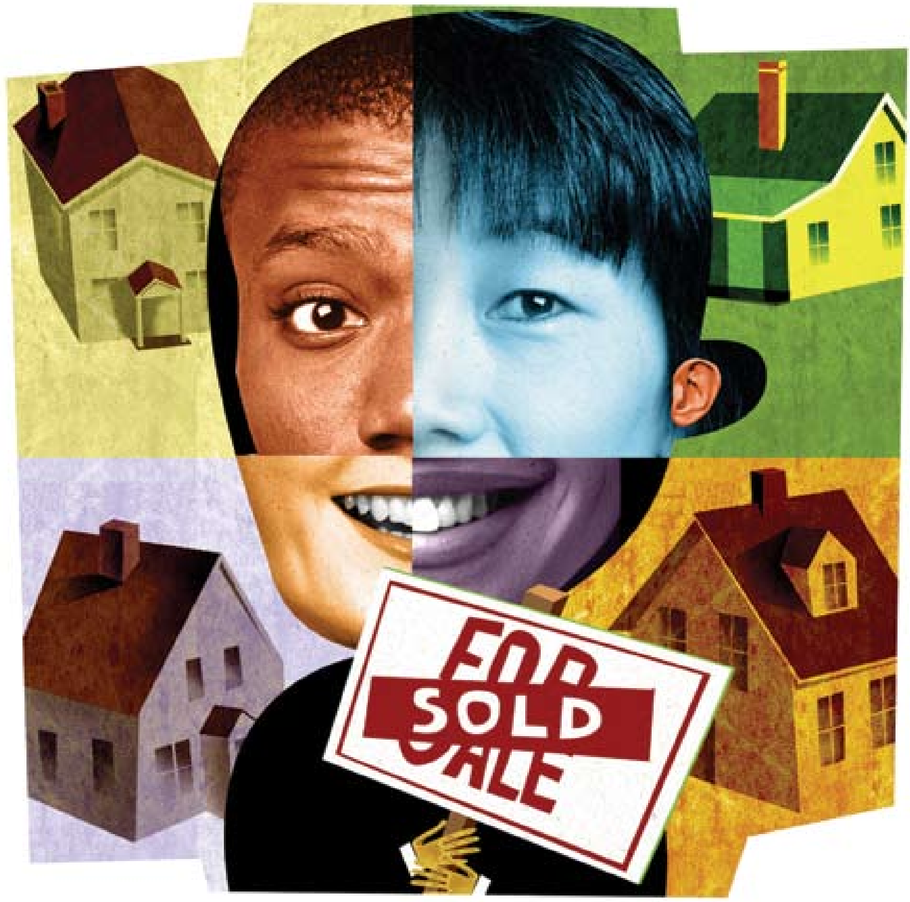
Movin' On Up

By William T. Gavin

At 69 percent, the United States has a relatively high rate of home ownership; only a few countries—Ireland , Spain and Italy—have much higher rates—around 80 percent.[1] Still, one of the stated goals of current and past administrations since the Great Depression has been to increase home ownership. After remaining relatively stable around 64 percent, the rate of home ownership has risen to 69 percent in the past decade. This uptrend has been driven by a sharp rise in the rate of home ownership among young, minority and low-income households.



Old vs. Young

Home-ownership rates vary by demographic groups. The table displays information about home-ownership rates by age. The top row shows that the average U.S. home-ownership rate was 63.9 percent in 1985 and rose by only 1.2 percentage points over the following decade. This relatively flat trend, however, masked considerable divergence among age groups. For the younger age groups in the period 1985 to 1995, home-ownership rates fell. There was no change in the rate of people 55-64. Only for the oldest group, 65 and older, did home ownership rise.

Since 1995, home ownership among the oldest group rose by approximately 3.3 percentage points—a percentage point slower than in the previous 10 years. The home-ownership rates for all the younger groups, however, stopped falling and began to rise. The turnaround was greatest for the two youngest groups, which are dominated by first-time buyers.

Why was there such a large turnaround in the youngest groups? To look for an answer, we considered three factors that, to a casual observer, may have played a role in rising home ownership: the tax code, affordable-housing programs and innovations in mortgage lending that have lowered down payments.

Tax Law

One potential reason for the rise in home ownership may be the tax deduction for mortgage interest. Taxpayers who itemize are able to deduct interest payments on home mortgage loans from their taxable income. The rise of home equity loans allows homeowners to substitute mortgage debt for other types of debt, increasing the value of the deduction.

A recent study by economists Edward Glaeser and Jesse Shapiro, however, suggests that this deduction does not increase home ownership. Rather, they find that the deductibility of the mortgage interest and property tax payments encourages those who are already homeowners to buy larger and more expensive homes.

Taxpayers are also allowed to deduct payments of state and local taxes paid on real property. In addition, since 1997, homeowners have been allowed to take a tax-free capital gain up to $250,000 on the sale of a principal residence every other year. These tax features also encourage homeowners to demand larger and more expensive homes, but this demand would have the effect of raising home prices, thus hurting, not helping, first-time homebuyers.

Affordable-Housing Programs

Another possible explanation for the rise in home ownership among the young may be government affordable-housing programs. The Department of Housing and Urban Development (HUD) has three such programs: HOZ, SHOP and HOME.

The Homeownership Zone (HOZ) program helps communities reclaim vacant and blighted properties, increase home ownership and promote economic revitalization by creating entire neighborhoods of new, single-family homes. Authorizations under this program subsidized about 2,000 new homes in 1996 and another 1,400 in 1997. The program has not been funded since then.

The Self-Help Homeownership Opportunity Program (SHOP) provides funds for nonprofit organizations to buy homesites and develop or improve the infrastructure needed to set the stage for sweat equity and volunteer-based home-ownership programs for low-income families. An example is Habitat for Humanity. Funding for SHOP was about $25 million in fiscal year 2005, a bit less than fiscal 2004 but about the same as fiscal 2003.

The Home Investment Partnerships Program (HOME) was created under Title II of the National Affordable Housing Act of 1990. HOME has become a key funding source supporting HUD's home-ownership goals. In December 2003, President Bush signed into law a new initiative under HOME—the American Dream Downpayment Initiative Act (ADDI). The act authorizes up to $200 million in grants to help first-time homebuyers with the biggest hurdle to home ownership: down payment, closing costs and rehabilitation costs.[2] Bush's administration expects ADDI to fund approximately 40,000 households annually. At this rate, it would take approximately 25 years to increase the home-ownership rate just one percentage point. Note that, on average, about 500,000 renters became homeowners during each year between 1995 and 2005.

Financial Innovations

While changes in the tax law and affordable-housing programs do not seem to account for the dramatic rise in first-time buyers over the past decade, recent evidence suggests that financial innovations do. Economists Matthew Chambers, Carlos Garriga and Don Schlagenhauf have found that a lower down-payment requirement explains the rise in home ownership, especially for young and first-time buyers.

There have been two innovations in mortgage contracts that have allowed for lower down payments. The first is the development of private mortgage insurance (PMI). When the down payment is less than 20 percent of the purchase price, homebuyers using private mortgage companies must buy mortgage insurance. Recently, premiums for PMI have ranged between 0.19 and 0.96 percent of the mortgage loan, depending on the maturity of the loan and the amount of the down payment.[3]

A second innovation, the combo loans—"80-20" and "80-15-5" loans—are quite often less expensive than mortgage insurance. With both types, the buyer takes out two loans. The first loan corresponds to the traditional loan-to-value rate of 80 percent, while the second loan is for the 20 percent down payment. The second loan has a higher interest rate—approximately 2 percentage points higher than the primary mortgage's rate. This mortgage program is frequently cheaper than a program with PMI because the 2 percentage point premium applies only to the second smaller loan. Under the "80-15-5" program, a buyer makes a down payment of 5 percent and takes out a second mortgage for the remaining 15 percent.

A number of private programs also reduce closing costs. These include the Nehemiah Program, the AmeriDream Downpayment Assistance Program, HART Action Resource Trust, Consumer Debt Solutions Inc. and Partners in Charity. The Nehemiah Program, for instance, donates the down payment and closing costs for qualified homebuyers. The donation ranges from 1 percent to 6 percent of the final contract price, depending on the particular needs of the homebuyer. The size of the gift and the home price are limited because the homebuyer's monthly payment for principal, interest, taxes and insurance cannot exceed 29 percent of income. Any home on the market can be a Nehemiah participating home as long as the seller agrees to contribute 3 percent of the sales price of the house to the Nehemiah Corp. and pay a processing fee of $499. The benefits to the seller include access to a wider market of homebuyers and less need to negotiate the selling price. The contribution by the seller to Nehemiah may also be tax deductible as a cost of sale.

Home, Sweet Home

Recent advances in the home-ownership rate have been characterized by a relatively large number of first-time buyers. It is interesting to note that the last large increase in the home ownership rate (from 44 to 64 percent) occurred after WW II. Then, the Veterans Administration guaranteed the payments of principal and interest so that returning war veterans did not have to make a down payment.[4] After 30 years of being stuck near 64 percent, the home-ownership rate has begun to rise again. The explanation is lower down payments, which have allowed more young people to buy homes.

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Home-Ownership Rates by Age

Age Group	% rate in 1985	Percentage-point change in rate of home ownership: 1985 to 1995	Percentage-point change in rate of home ownership: 1995 to 2004	% rate in 2004
U.S. total	63.9	1.2	5.9	68.6
Younger than 35 years	39.9	– 3.3	9.2	42.3
35 to 44 years	68.1	– 4.4	5.4	68.8
45 to 54 years	75.9	– 0.9	2.4	77.0
55 to 64 years	79.5	0.0	2.7	81.7
65 years and over	74.8	4.3	3.3	80.7

SOURCE: Housing Vacancy Survey, Table 15, U.S. Census Bureau, 2005

ENDNOTES

1 See *The Economist*, "Going Through the Roof," March 30-April 5, 2002, p. 65, for a cross-country comparison of home-ownership rates.

2 In 2003, the ADDI appropriation was $74.5 million. In 2004, HUD announced $161.5 million in funding for the ADDI.

3 See the web site of Professor Jack M. Guttentag, University of Pennsylvania, www.mtgprofessor.com.

4 See Colton (2003).

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