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Mortgaging Household and Global Financial Stability: To What End?

Debt-Financed Homeownership: Its Evolution, Impact and Future
October 12, 2018

William R. Emmons and Lowell R. Ricketts

These views are ours alone and not necessarily those of the Federal Reserve Bank of St. Louis or the Federal Reserve System.



Mortgaging Household and Global Financial Stability: To What End?

- Why do policies support highly leveraged homeownership?
- Household-level impacts: *Ex ante* vulnerable groups poorly served (young; no college; African American and Hispanic).
- Macro-financial impacts: Bursting of leveraged housing bubbles creates long, deep, damaging recessions/crises.
- Leveraged homeownership makes sense for some people; but for many others, we need a different policy mix.



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Negative Equity => 9-10 Million Involuntary Exits from Homeownership



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Lumberton NC



Homeownership Includes Idiosyncratic
Catastrophic Risk (e.g., Hurricane Florence)

Pawleys Island SC



Bucksport SC



Photos by Victor J. Blue for the *New York Times*



Is Housing a Good Investment?

- Yes, according to Jorda, Knoll, Kuvshinov, Schularick and Taylor (2017*).
 - In a long international sample, average housing returns were as good or better than equity returns with lower risk.
- Not necessarily, say Piazzesi and Schneider (2016**), because idiosyncratic housing risk is very high.
 - Idiosyncratic housing risk is 4X housing-index risk
 - Housing Sharpe ratios are exaggerated in the literature

* Jorda, Oscar; Knoll, Katharina; Kuvshinov, Dmitry; Schularick, Moritz; and Taylor, Alan M. "The Rate of Return on Everything, 1870-2015," NBER working paper, Dec. 2017.

** Piazzesi, Monika; and Scheider, Martin. "Housing and the Macroeconomy," *Handbook of Macroeconomic 2* (2016), pp. 1547-1640.

How Does Homeowner Policy Incorporate Risk?

- Do homeownership policies take risk into account at all?
 - “The prices of individual houses are highly volatile. Moreover, a large component of this volatility is idiosyncratic.” (Piazzesi and Schneider, 2016*, p. 1603)
 - “A related question is whether the government should promote homeownership in the first place, given that it involves a large undiversified investment and potential welfare costs in default.” (Piazzesi and Schneider, 2016, p. 1628)

* Piazzesi, Monika; and Scheider, Martin. “Housing and the Macroeconomy,” *Handbook of Macroeconomic 2* (2016), pp. 1547-1640.

U Leveraged Housing Bubbles Hurt Growth W

(Jorda, Schularick and Taylor, "Leveraged Bubbles," 2015)

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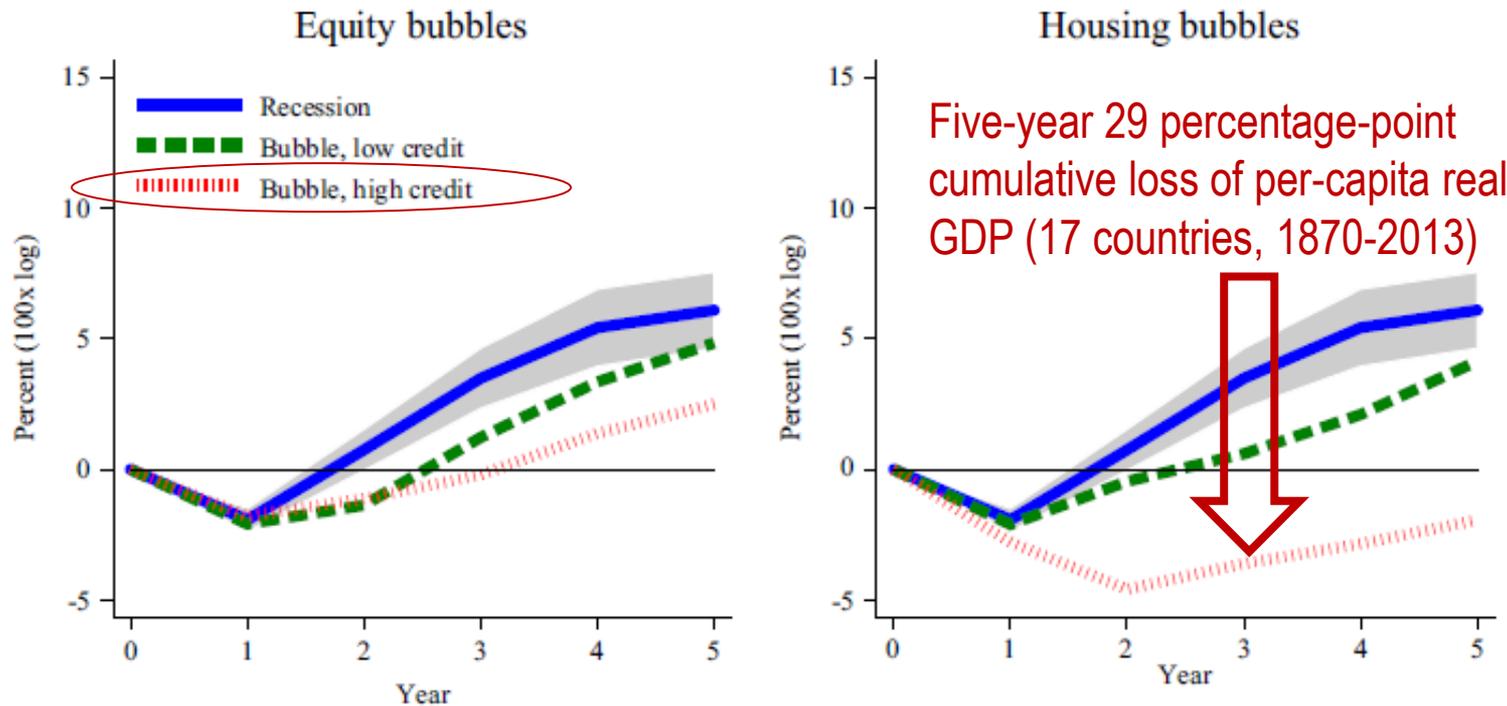
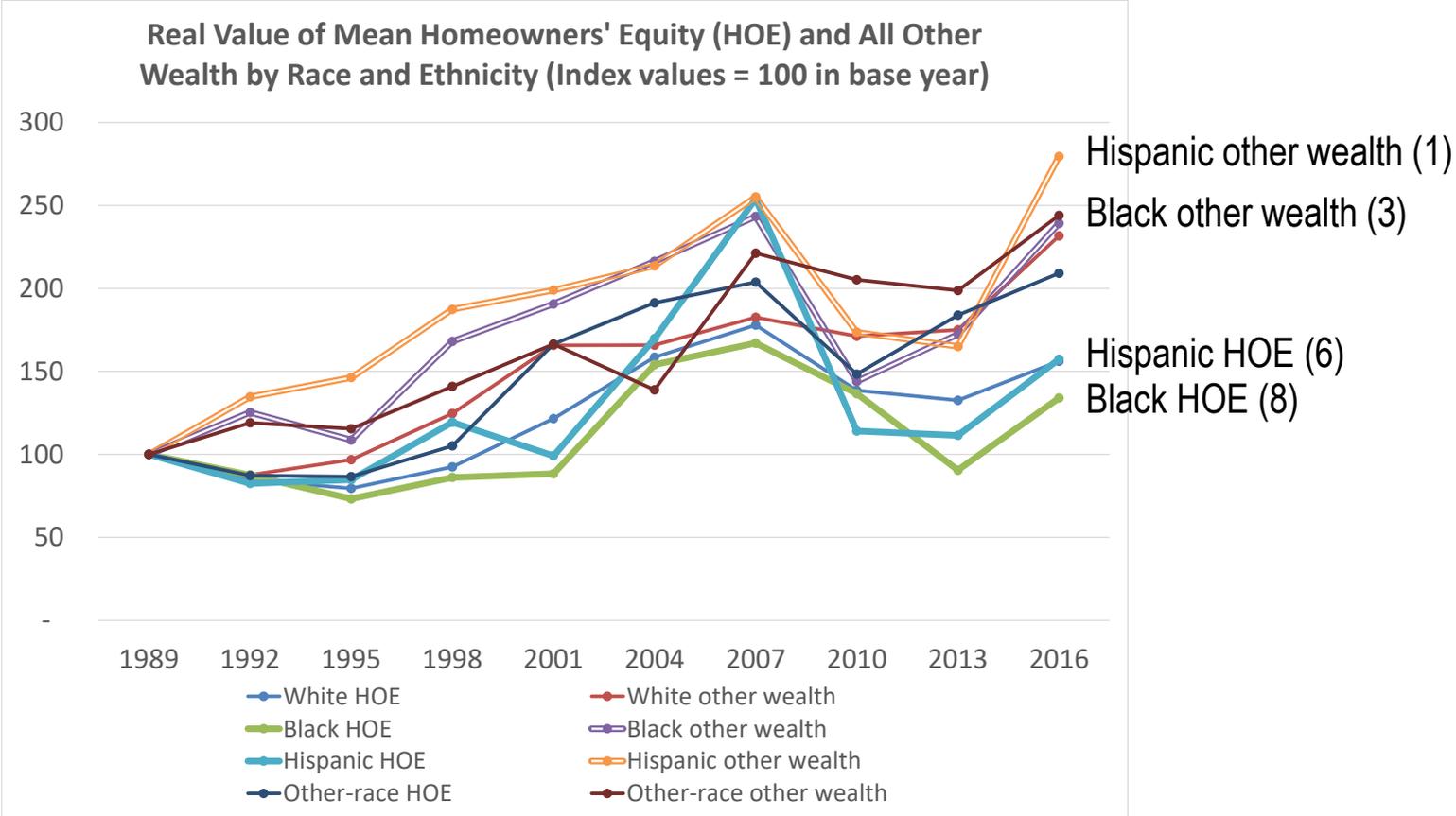


Fig. 6. Recession and recovery paths: the role of bubbles and credit, no controls, full sample. Notes: The figure displays the coefficients reported in Table 5. The solid blue line reports the average no-bubble path. The grey area represents the 90% confidence region around the average path. The green dashed line is the sum of the average no-bubble path and the bubble coefficient when credit is below the mean, whereas the dotted red line is the sum of the average no-bubble path and the bubble coefficient when credit is high. Full sample: 1870–2013, excludes the World Wars and a window of 5 years around them. (For interpretation of the references to color in this figure caption, the reader is referred to the web version of this paper.)

Policies Encourage Leveraged Homeownership

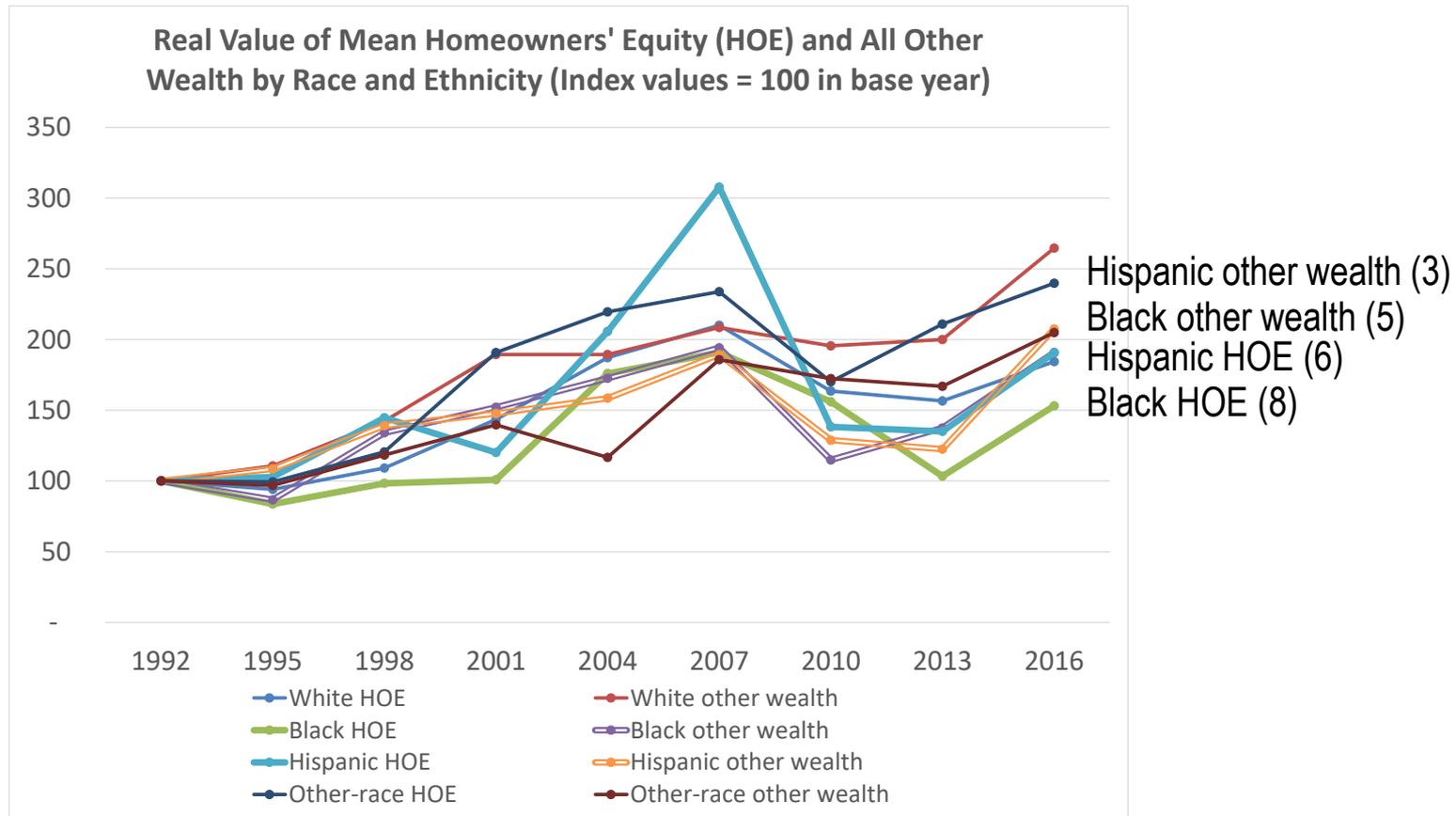
- Why homeownership?
 - Wealth accumulation; strong communities; economic growth
 - Evidence is mixed; don't forget role of strong vested interests
- Why debt?
 - Adverse selection, moral hazard (this actually makes sense)
- Why high LTVs?
 - Marginal buyers are poor
 - Tax incentives encourage infra-marginal leveraging

Hispanic & Black Families *Haven't* Accumulated



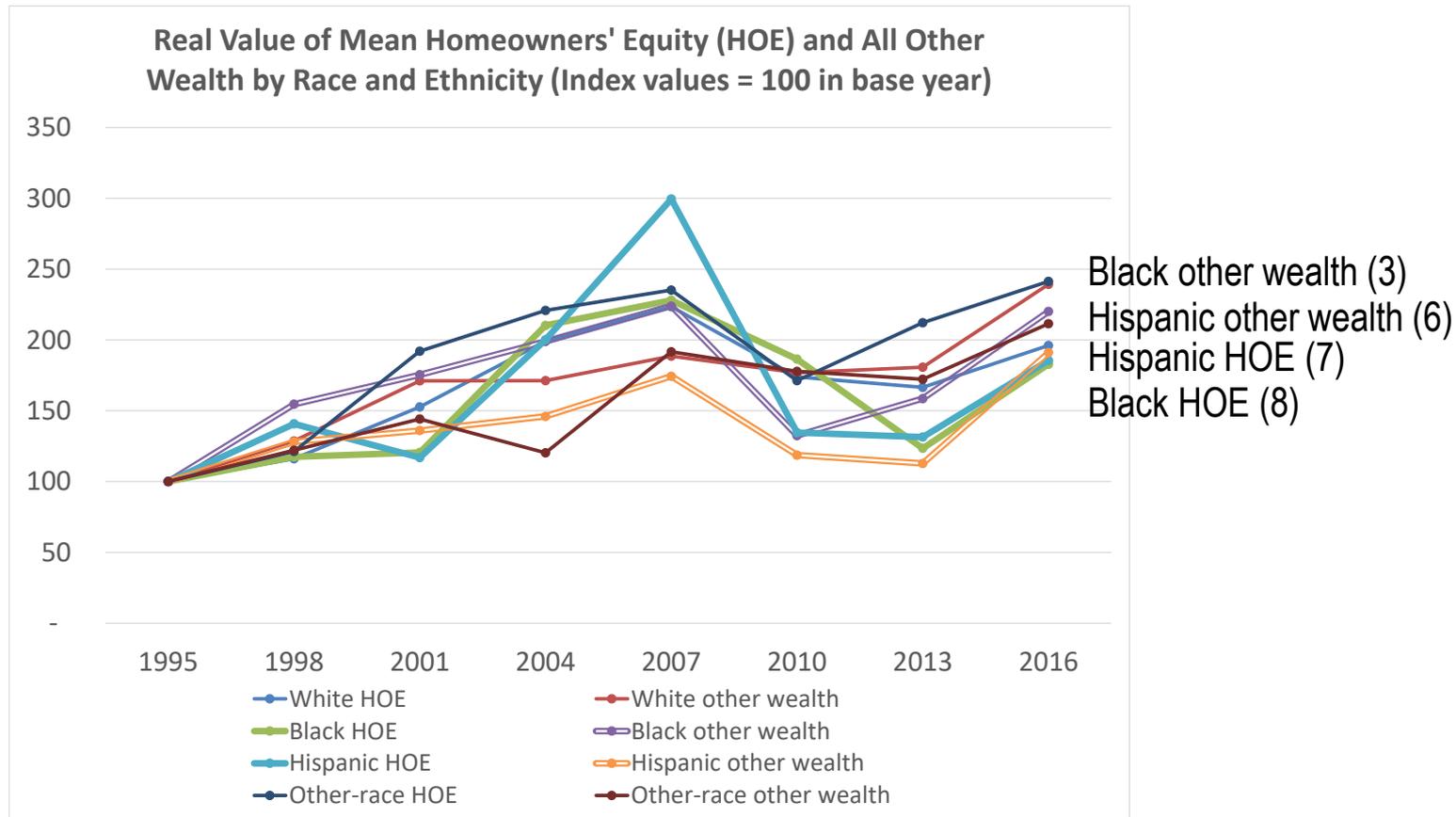
Source: Federal Reserve Survey of Consumer Finances

Starting Date Doesn't Matter Much



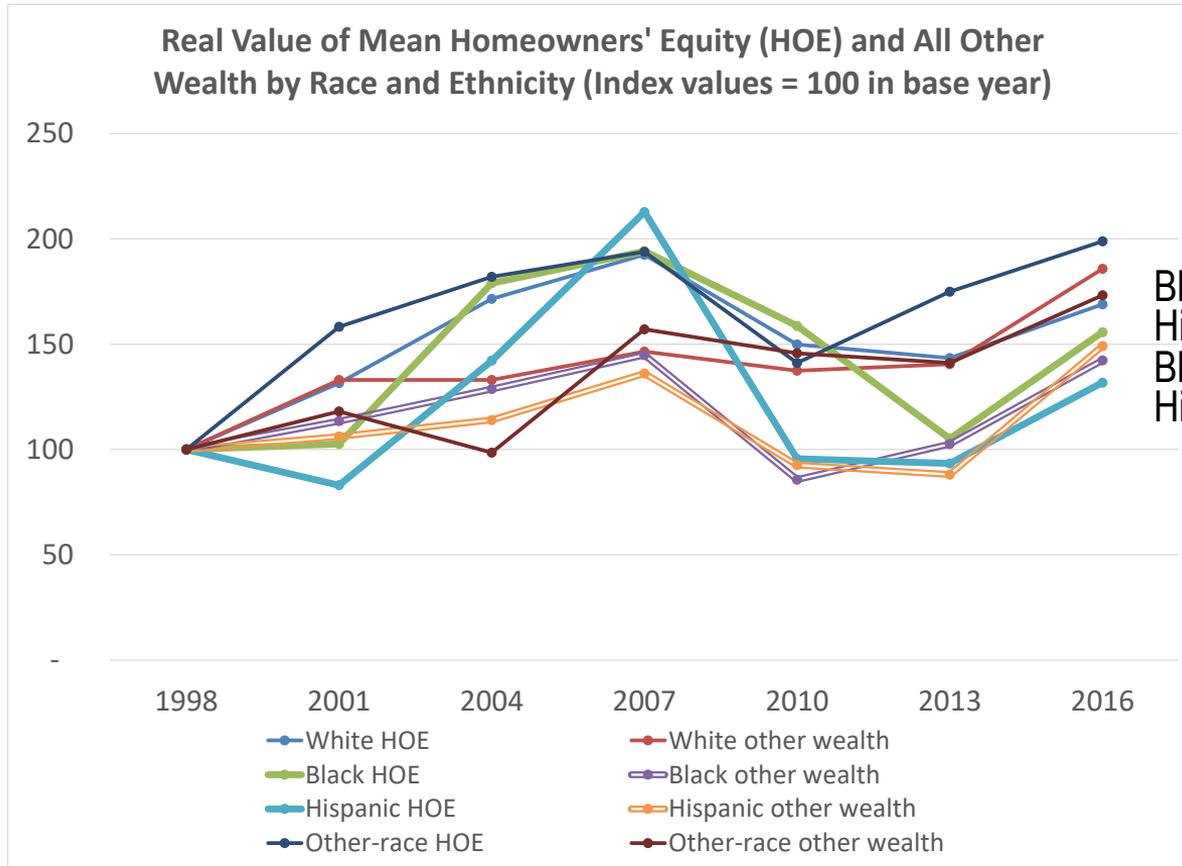
Source: Federal Reserve Survey of Consumer Finances

Starting Date Doesn't Matter Much



Source: Federal Reserve Survey of Consumer Finances

Starting Date Doesn't Matter Much

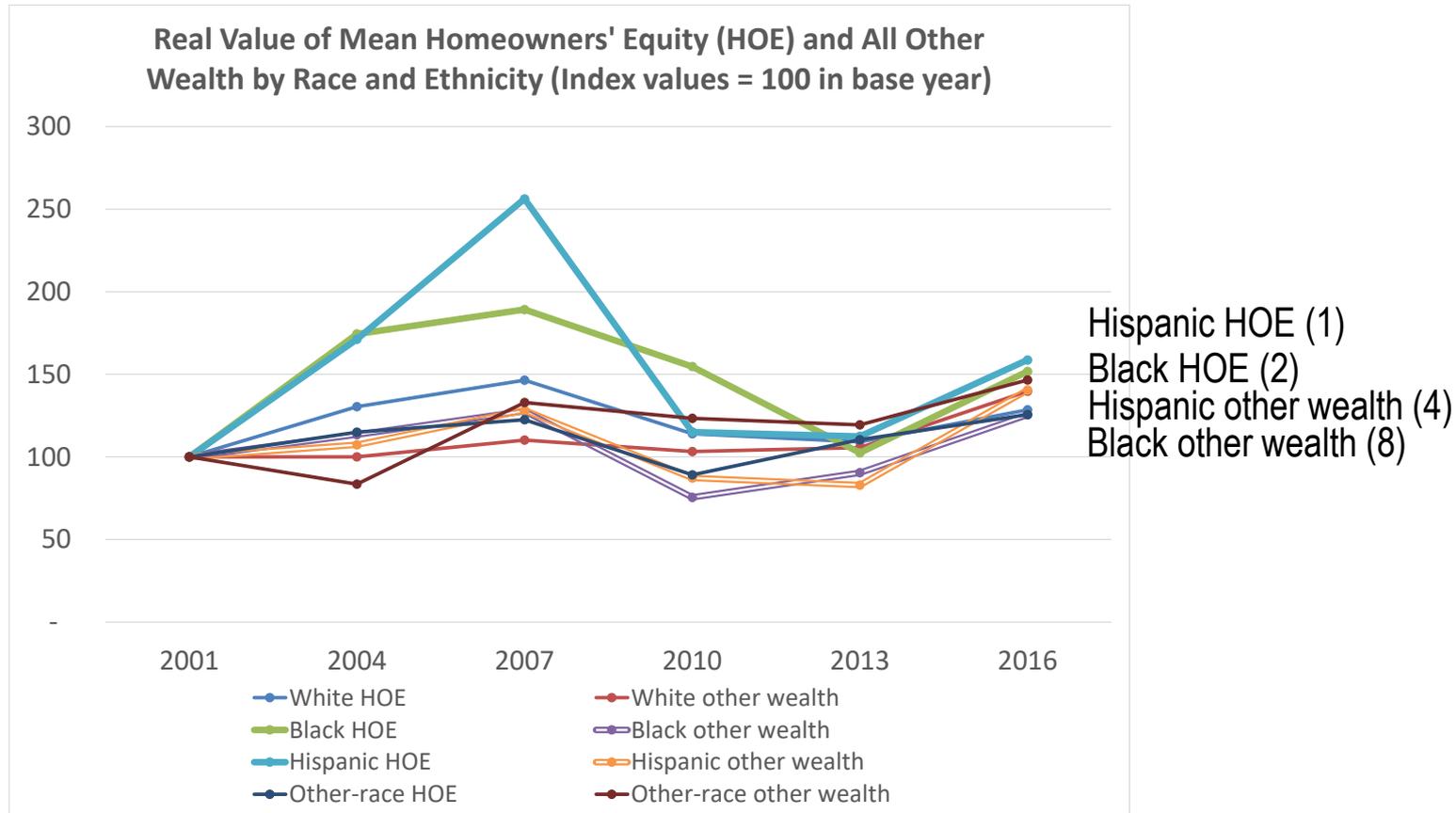


Black HOE (5)
 Hispanic other wealth (6)
 Black other wealth (7)
 Hispanic HOE (8)

Source: Federal Reserve Survey of Consumer Finances

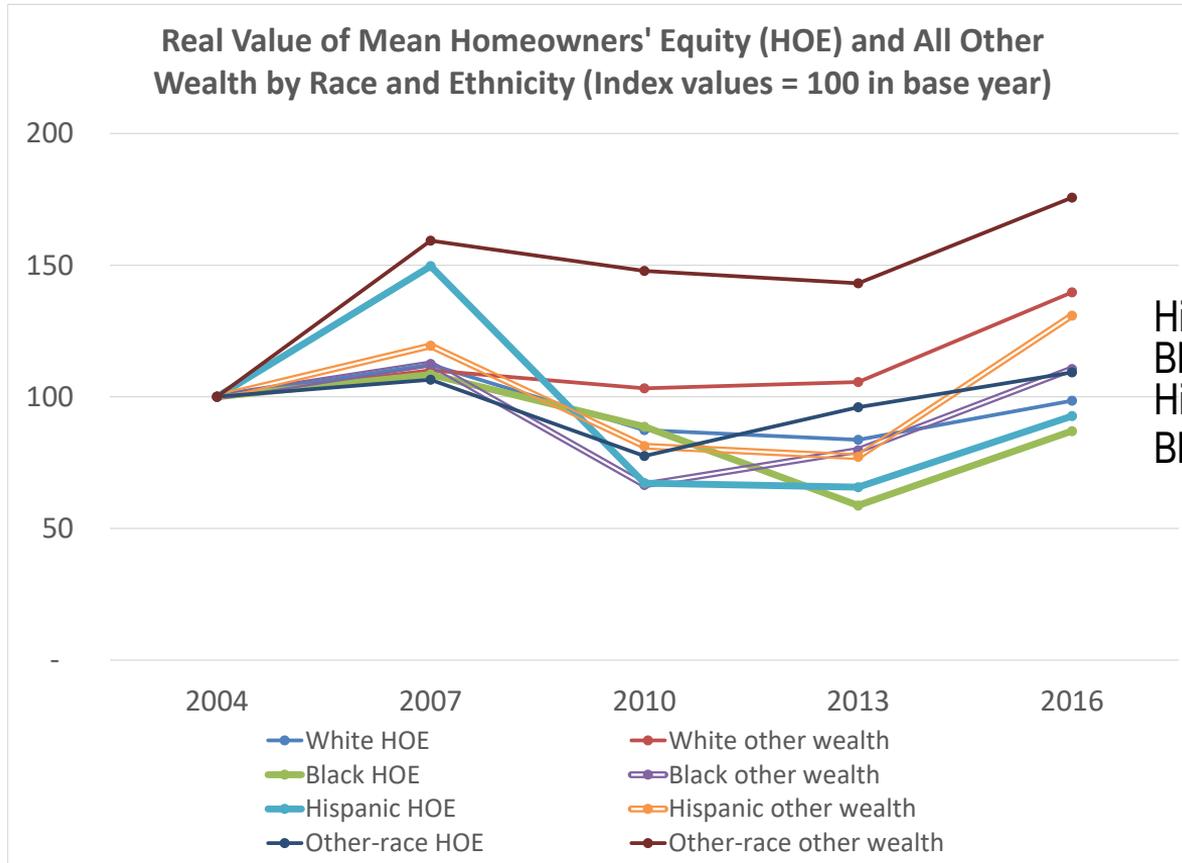


Starting in 2001 Makes It Look Better



Source: Federal Reserve
 Survey of Consumer
 Finances

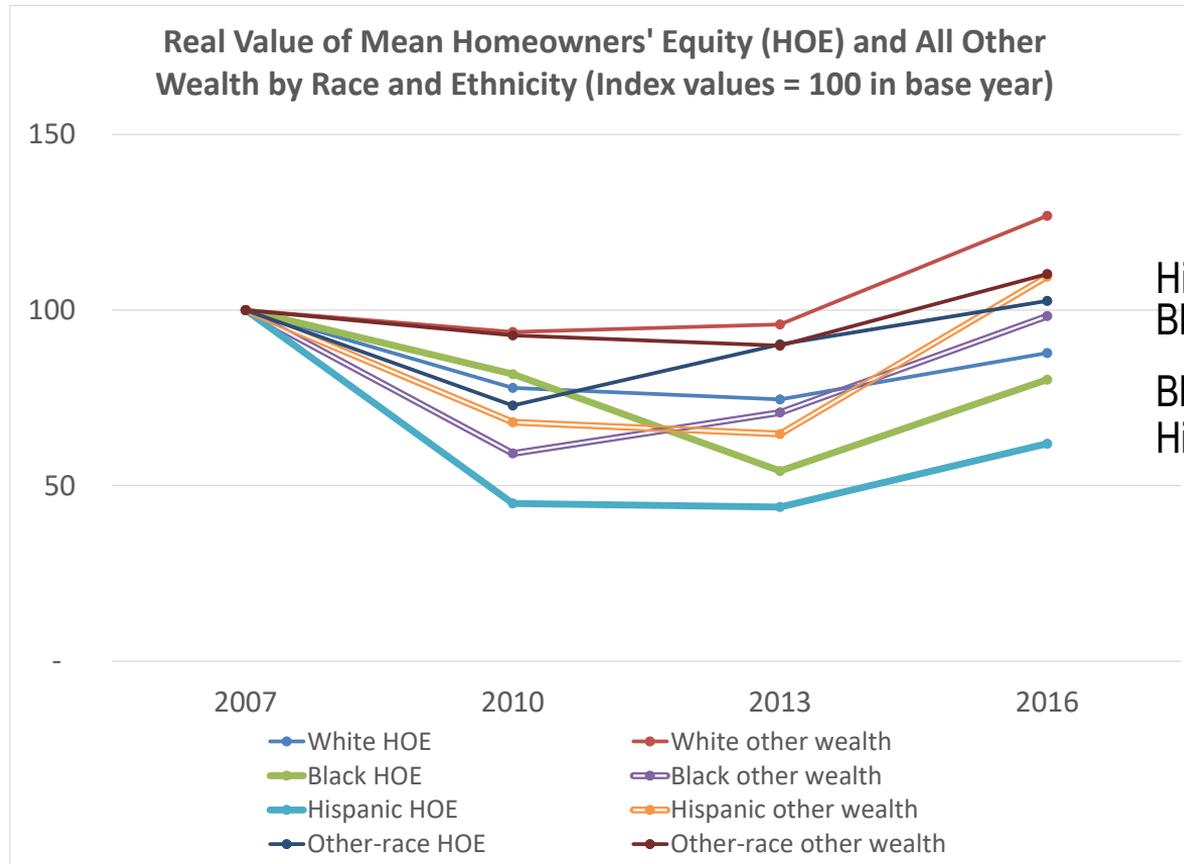
But That Didn't Last



Hispanic other wealth (3)
 Black other wealth (4)
 Hispanic HOE (7)
 Black HOE (8)

Source: Federal Reserve
 Survey of Consumer
 Finances

ΔHOE (2007-16): Hispanic -38%, Black -20%



Hispanic other wealth (3)
 Black other wealth (5)
 Black HOE (7)
 Hispanic HOE (8)

Source: Federal Reserve
 Survey of Consumer
 Finances

Weak Wealth-Building from Homeownership

ΔHOE (1989-2016): Hispanic 57%, Black 34%

ΔOther NW (1989-2016): Hispanic 107%, Black 91%

ΔHOE (1989-2016): White 56%, Other 109%

ΔOther NW (1989-2016): White 132%, Other 144%

ΔHOE (2007-16): Hispanic -38%, Black -20%

ΔOther NW (2007-16): Hispanic 10%, Black -2%

ΔHOE (2007-16): White -12%, Other 3%

ΔOther NW (2007-16): White 27%, Other 10%

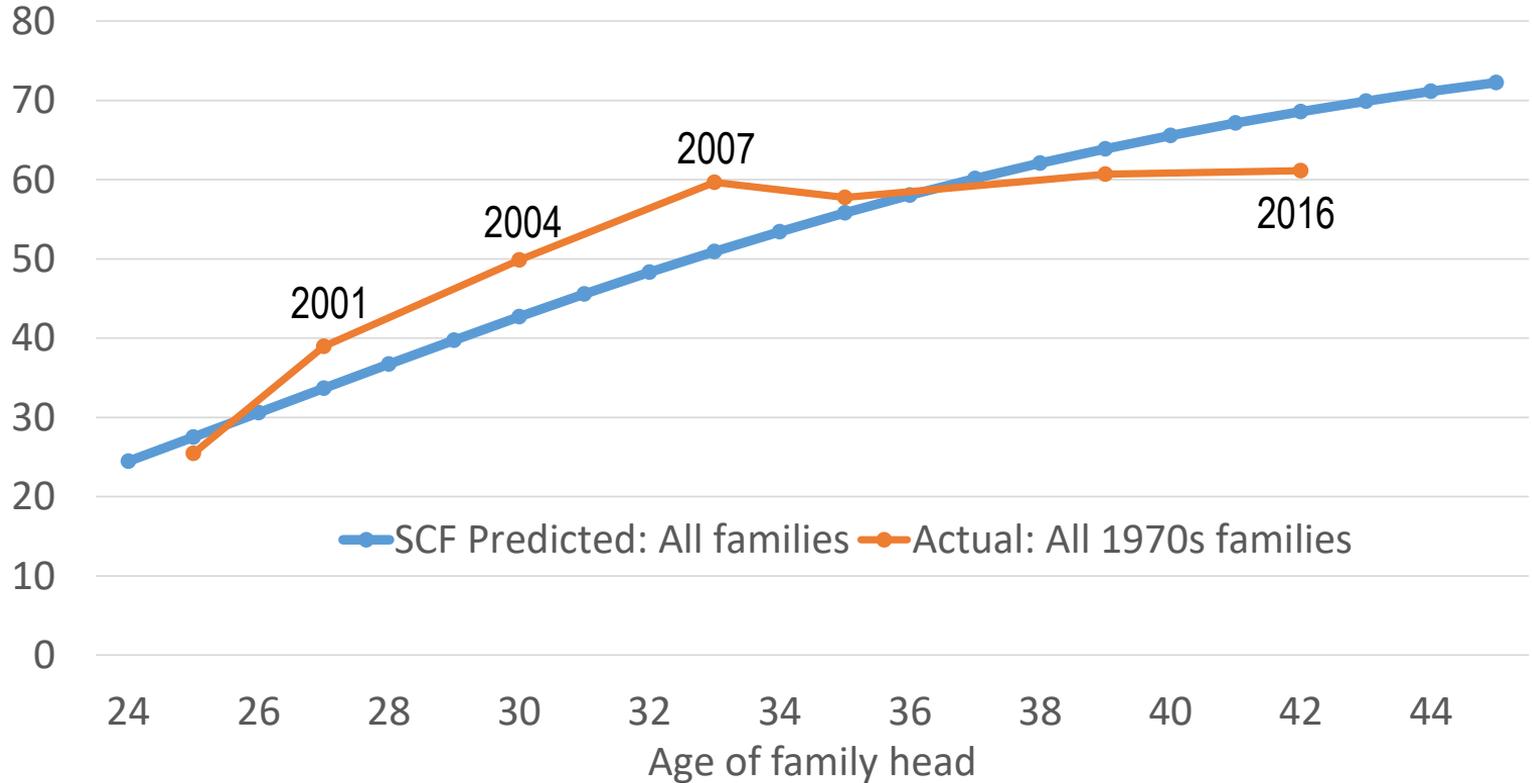


Housing Crash Hit Vulnerable Families Hardest

- Young
 - For example: Family heads born in the 1970s
 - Ages 28-37 in 2007 (median 33); 34-43 in 2013 (median 39)
- No college
 - Vast majority of families have less than a 4-year degree
- Non-white
 - Hispanic
 - African American

Young Families' HO Rate: Born in the 1970s

Homeownership Rate (%): 1970-79 Birth-Year Cohort vs. Predicted



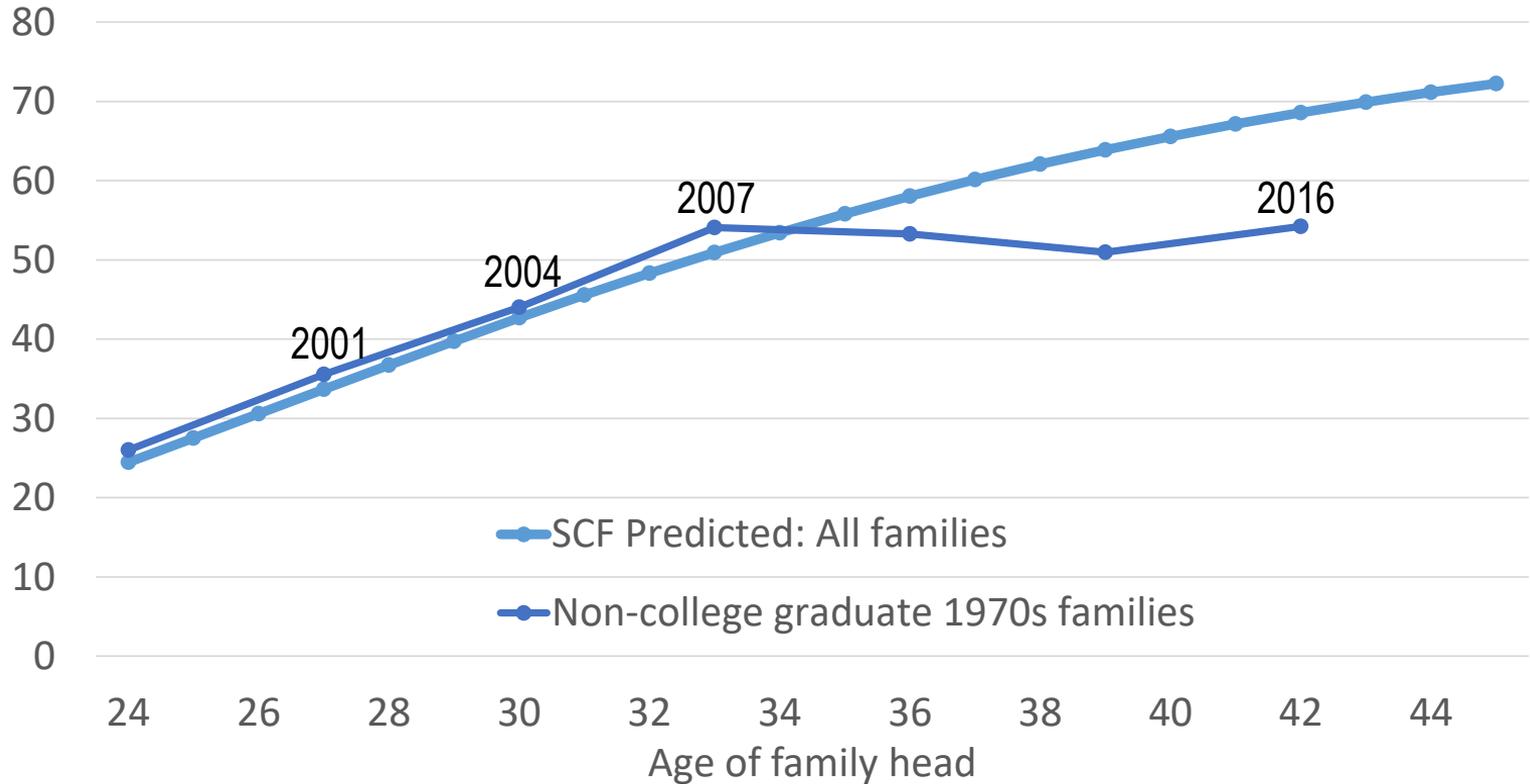
—●— SCF Predicted: All families —●— Actual: All 1970s families

Source:
Federal
Reserve
Survey of
Consumer
Finances



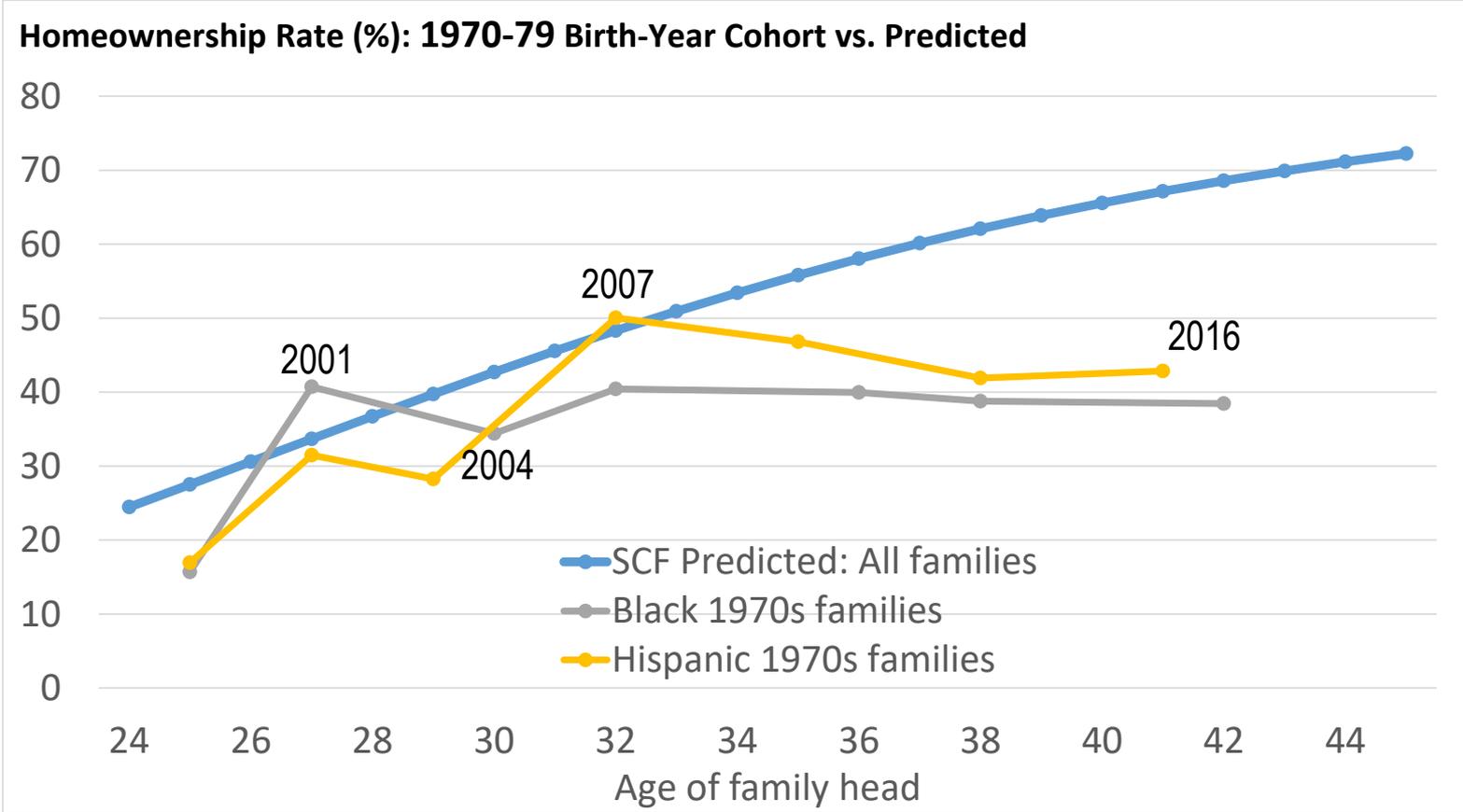
Non-College Families' HO Rate: Born in 1970s

Homeownership Rate (%): 1970-79 Birth-Year Cohort vs. Predicted



Source:
Federal
Reserve
Survey of
Consumer
Finances

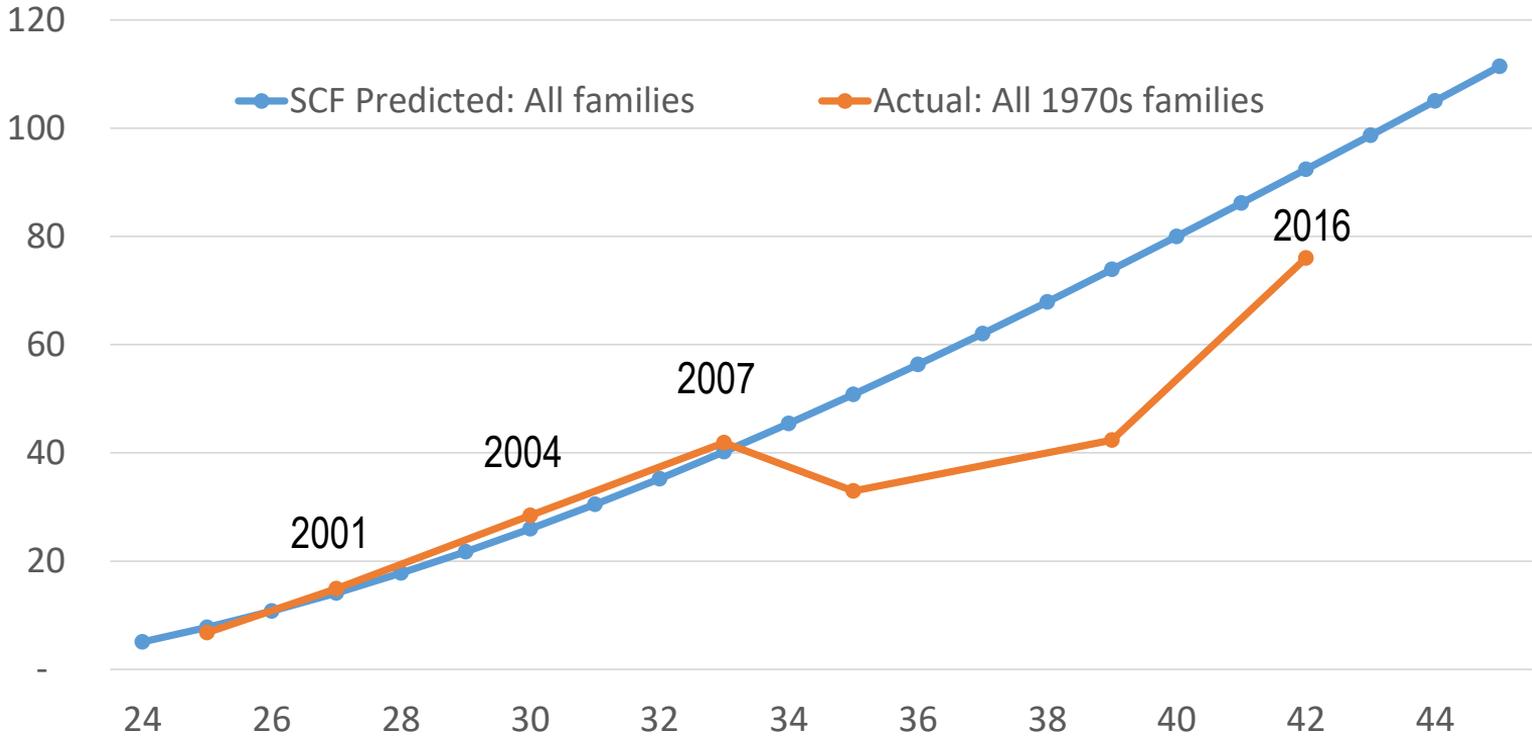
Black, Hispanic Families' HO Rate: Born in 1970s



Source:
Federal Reserve Survey of Consumer Finances

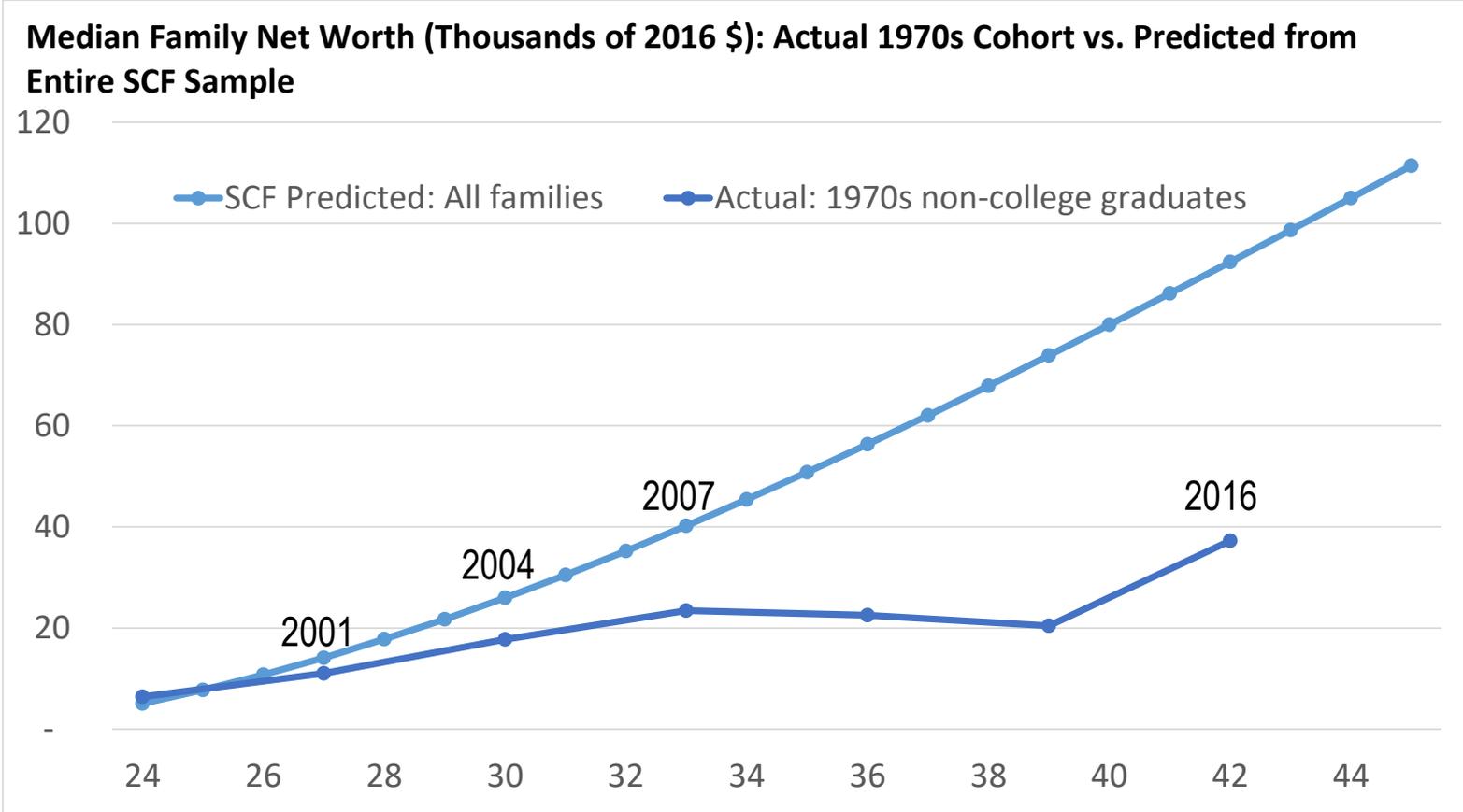
Young Families' Median NW: Born in the 1970s

Median Family Net Worth (Thousands of 2016 \$): Actual 1970s Cohort vs. Predicted from Entire SCF Sample



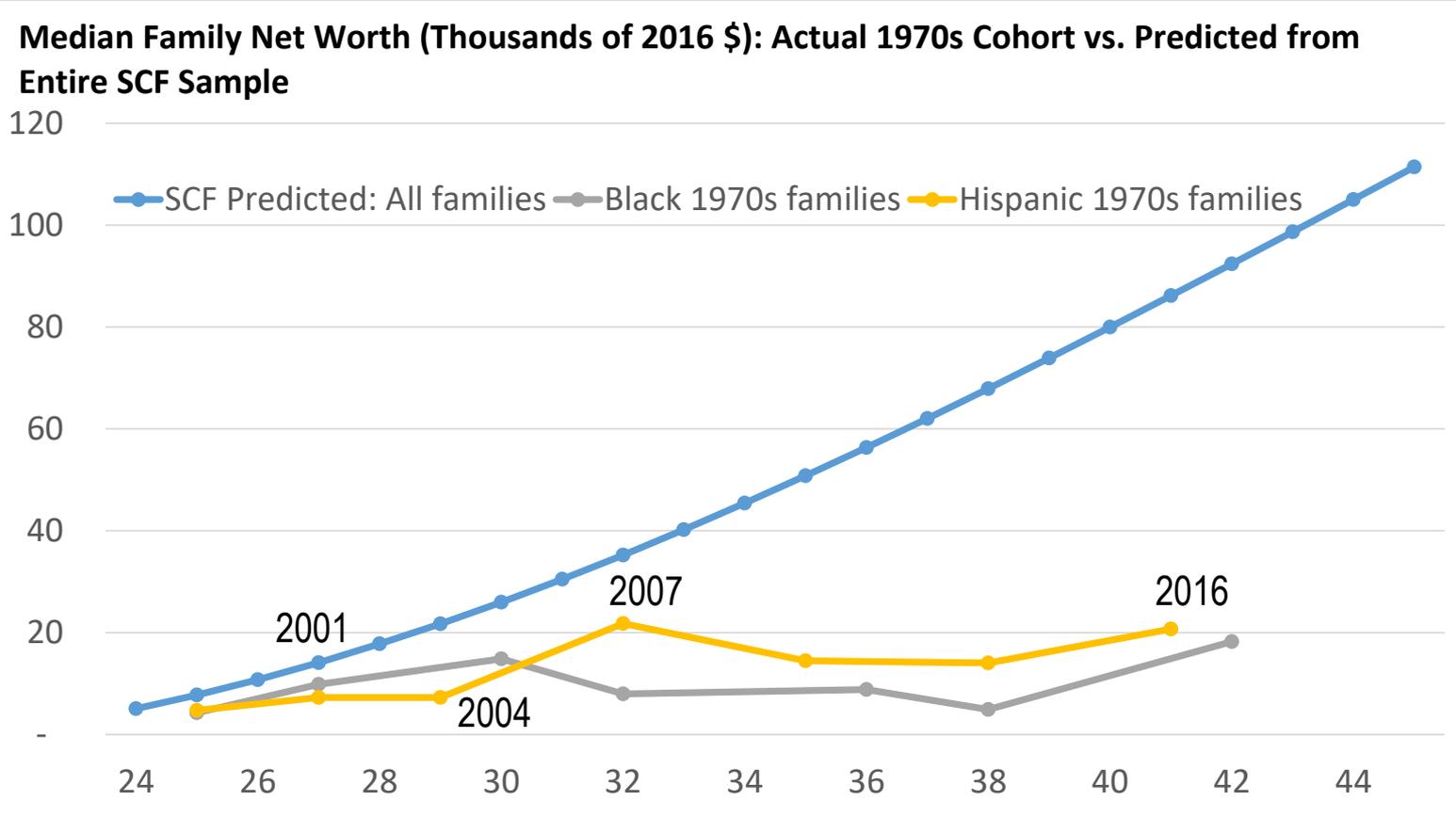
Source:
Federal Reserve
Survey of
Consumer
Finances

Non-College Families' Median NW: Born in 1970s



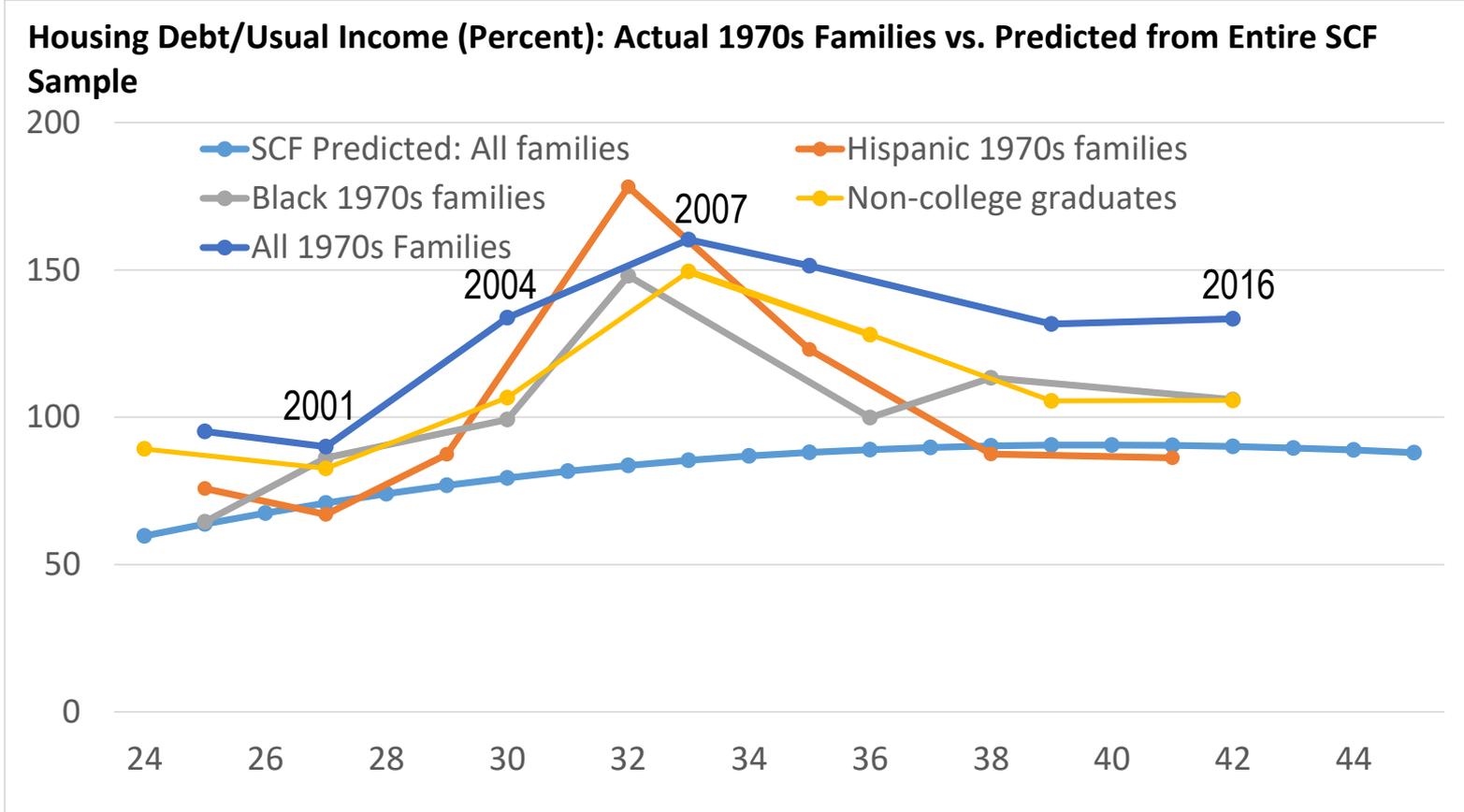
Source:
Federal Reserve
Survey of
Consumer
Finances

Black, Hispanic Families' Median NW: Born in '70s



Source:
Federal Reserve
Survey of
Consumer
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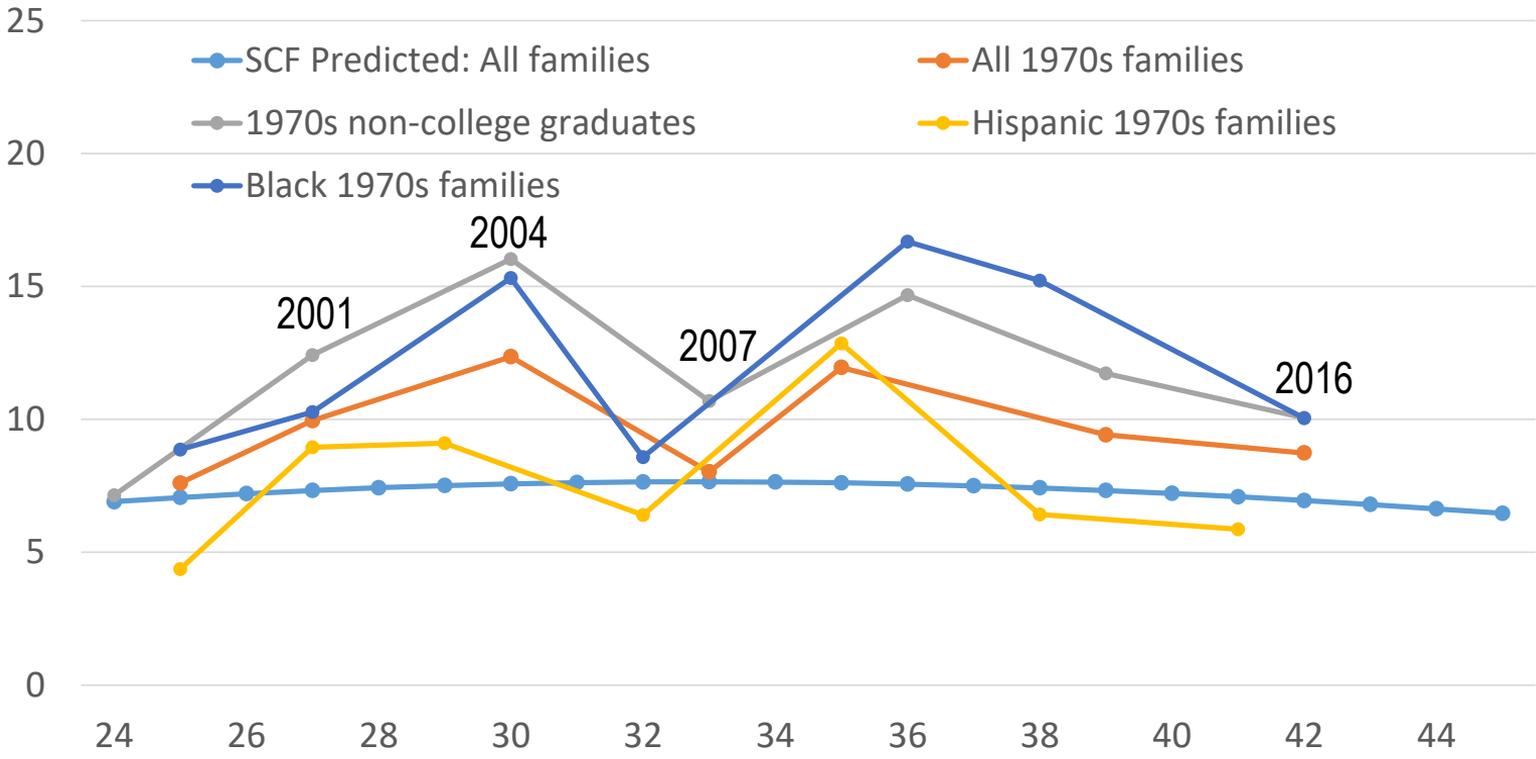
Young Families' HD/Y Ratios: Born in the 1970s



Source:
Federal Reserve Survey of Consumer Finances

Young Families' 60+DQ Ratios: Born in the 1970s

Share of Families with a Serious Delinquency (60+ Days Past Due; Percent): Actual 1970s Birth Cohort vs. Ratio Predicted from Entire Sample



Source:
Federal Reserve
Survey of
Consumer
Finances

The “Big-Picture” View of Housing Bubbles

“Demand for a new investment bubble began months ago, when the subprime mortgage bubble burst and left the business world without a suitable source of pretend income....”

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“Demand for a new investment bubble began months ago, when the subprime mortgage bubble burst and left the business world without a suitable source of pretend income....

“Every American family deserves a false sense of security,’ said Chris Reppto, a risk analyst for Citigroup in New York. ‘Once we have a bubble to provide a fragile foundation, we can begin building pyramid scheme on top of pyramid scheme, and before we know it, the financial situation will return to normal.’“



The Onion, “Recession-Plagued Nation Demands New Bubble to Invest In,” July 14, 2008.

Leveraged Housing Bubbles Very Damaging

- Jorda, Schularick and Taylor (2015*) evidence
 - Annual data on equity and housing markets, bank credit growth; 17 countries, 1870-2013
 - Asset bubbles + credit => Worse recessions, financial crises?
- Conclusions
 - Bursting stock-market bubbles make recessions worse
 - Bursting credit-fueled housing bubbles create financial crises
 - Policymakers ignore them at the economy's peril

* Jorda, Oscar; Schularick, Moritz; and Taylor, Alan M. "Leveraged Bubbles," *Journal of Monetary Economics* 76 (2015), pp. S1-S20.

Low Interest Rates vs. Financial Liberalization

- Sommer, Sullivan and Verbrugge (2013*)
 - Changes in “fundamentals” (interest rates, collateral requirements (max LTV), income growth) can account for 50 percent of the price-rent ratio increase, 1995-2006.
 - Lower real interest rates => House-price boom
 - Higher LTV ratios => Homeownership boom
- Large remaining role for “overly optimistic expectations” about house-price growth—i.e., a bubble.

* Sommer, Kamila; Sullivan, Paul; and Verbrugge, Randal. “The Equilibrium Effects of Fundamentals on House Prices and Rents,” *Journal of Monetary Economics* 60 (2013), pp. 854-70

The Onion Made A Good Point...

- Favilukis, Ludvigson and Van Nieuwerburgh (2017*)
 - Conclusions from GE model: Financial liberalization was more important than lower real interest rates (from global capital inflows) for house prices *and* homeownership increases.
 - A housing bubble (perceived as permanent) fulfilled a need for greater risk-sharing—many wealth- and liquidity-constrained families used housing debt to smooth lifetime incomes.
- Underlying problems: 1) Marginal homebuyers are poor, 2) Before 2007, we didn't understand mortgage/housing risks.

* Favilukis, Jack; Ludvigson, Syndey C.; and Van Nieuwerburgh, Stijn. "The Macroeconomic Effects of Housing Wealth, Housing Finance, and Limited Risk Sharing in General Equilibrium," *Journal of Political Economy* 125 (2017), No. 1, pp. 140-223.

The Future of Leveraged Homeownership

- The future of homeownership—never hit 69% again?
 - Rebalance policies to support all tenure choices.
- Role of mortgage debt—worst financing except all others.
 - Why not eliminate tax preferences for debt?
- An old idea—Henry George’s land-value tax (1879).
 - Housing bubbles actually are land bubbles.
 - If we’re doomed to recurrent housing bubbles, why not raise tax revenue from them with an LVT? Might also damp them.