Mortgaging Household and Global Financial Stability: To What End?

Debt-Financed Homeownership: Its Evolution, Impact and Future
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William R. Emmons and Lowell R. Ricketts

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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.
Negative Equity => 9-10 Million Involuntary Exits from Homeownership
Homeownership Includes Idiosyncratic Catastrophic Risk (e.g., Hurricane Florence)

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

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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)

Leveraged Housing Bubbles Hurt Growth

Five-year 29 percentage-point cumulative loss of per-capita real GDP (17 countries, 1870-2013)
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

Real Value of Mean Homeowners' Equity (HOE) and All Other Wealth by Race and Ethnicity (Index values = 100 in base year)

Source: Federal Reserve Survey of Consumer Finances
Starting Date Doesn’t Matter Much

Real Value of Mean Homeowners' Equity (HOE) and All Other Wealth by Race and Ethnicity (Index values = 100 in base year)

- White HOE
- Black HOE
- Hispanic HOE
- Other-race HOE
- White other wealth
- Black other wealth
- Hispanic other wealth
- Other-race other wealth

Source: Federal Reserve Survey of Consumer Finances

stlouisfed.org/hfs
Starting Date Doesn’t Matter Much

Real Value of Mean Homeowners' Equity (HOE) and All Other Wealth by Race and Ethnicity (Index values = 100 in base year)

Source: Federal Reserve Survey of Consumer Finances

Black other wealth (3)
Hispanic other wealth (6)
Hispanic HOE (7)
Black HOE (8)
Starting Date Doesn’t Matter Much

Real Value of Mean Homeowners' Equity (HOE) and All Other Wealth by Race and Ethnicity (Index values = 100 in base year)

- White HOE
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- White other wealth
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- Hispanic other wealth
- Other-race other wealth

Source: Federal Reserve Survey of Consumer Finances

Black HOE (5)
Hispanic other wealth (6)
Black other wealth (7)
Hispanic HOE (8)
Starting in 2001 Makes It Look Better

Real Value of Mean Homeowners' Equity (HOE) and All Other Wealth by Race and Ethnicity (Index values = 100 in base year)

- White HOE
- Black HOE
- Hispanic HOE
- Other-race HOE
- White other wealth
- Black other wealth
- Hispanic other wealth
- Other-race other wealth

Source: Federal Reserve Survey of Consumer Finances

Hispanic HOE (1)
Black HOE (2)
Hispanic other wealth (4)
Black other wealth (8)
But That Didn’t Last

Real Value of Mean Homeowners' Equity (HOE) and All Other Wealth by Race and Ethnicity (Index values = 100 in base year)

Source: Federal Reserve Survey of Consumer Finances

Hispanic other wealth (3)
Black other wealth (4)
Hispanic HOE (7)
Black HOE (8)
\( \Delta \text{HOE (2007-16)}: \) Hispanic -38%, Black -20%

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

Source: Federal Reserve Survey of Consumer Finances
Non-College Families’ HO Rate: Born in 1970s

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

SCF Predicted: All families
Non-college graduate 1970s families

Source: Federal Reserve Survey of Consumer Finances
Black, Hispanic Families’ HO Rate: Born in 1970s

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

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

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

Source: Federal Reserve Survey of Consumer Finances
### Median Family Net Worth (Thousands of 2016 $): Actual 1970s Cohort vs. Predicted from Entire SCF Sample

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

Source: Federal Reserve Survey of Consumer Finances

Housing Debt/Usual Income (Percent): Actual 1970s Families vs. Predicted from Entire SCF Sample

SCF Predicted: All families
Hispanic 1970s families
Black 1970s families
All 1970s Families
Non-college graduates
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….
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….

“‘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

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
Favlukis, 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.

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.