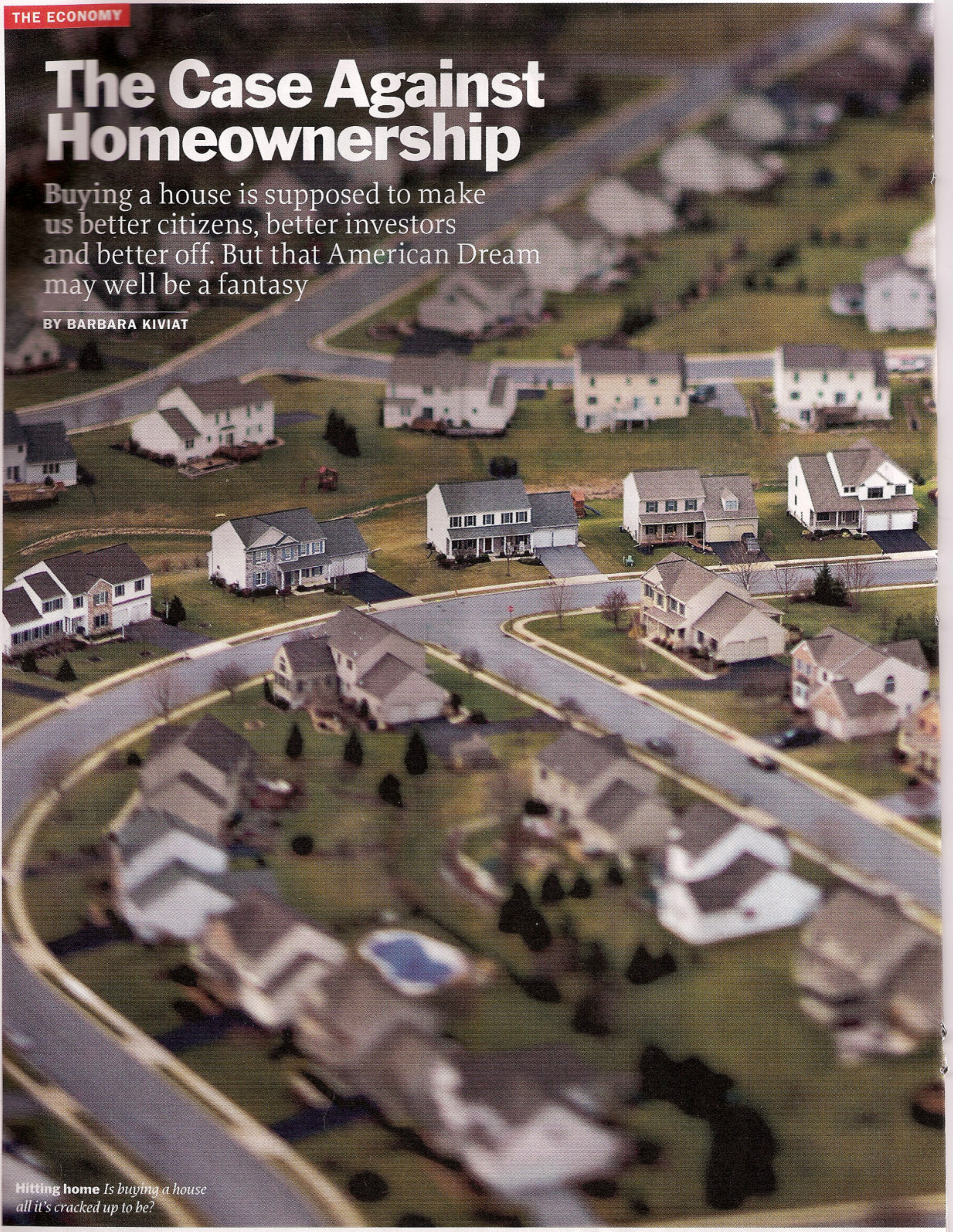
The Case Against Homeownership

Buying a house is supposed to make us better citizens, better investors and better off. But that American Dream may well be a fantasy

BY BARBARA KIVIAT



Hitting home *Is buying a house all it's cracked up to be?*

HOMEOWNERSHIP HAS let us down. For generations, Americans believed that owning a home was an axiomatic good. Our political leaders hammered home the point. Herbert Hoover argued that homeownership could "change the very physical, mental and moral fiber of one's own children." Franklin Roosevelt held that a country of homeowners was "unconquerable." Homeownership could even, in the words of George H.W. Bush's Secretary of Housing and Urban Development (HUD), Jack Kemp, "save babies, save children, save families and save America." A house with a front lawn and a picket fence wasn't just a nice place to live or a risk-free investment; it was a way to transform a nation.

Houses owned by the people who lived in them, we believed, created social and financial stability—more-involved citizens, safer neighborhoods, kids who did better in school. No wonder leaders of all political stripes wanted to spend more than $100 billion a year on subsidies and tax breaks to encourage people to buy.

But our leaders, with our encouragement, went much too far. The dark side of homeownership is now all too apparent: foreclosures and walkaways, neighborhoods plagued by abandoned properties and plummeting home values, a nation in which families have $6 trillion less in housing wealth than they did just three years ago. Indeed, easy lending stimulated by the cult of homeownership may have triggered the financial crisis and led directly to its biggest bailout, that of Fannie Mae and Freddie Mac. Housing remains a drag on the economy. Existing-home sales in July dropped 27% from the prior month, exacerbating fears of a double-dip recession and accelerating the accompanying slide in stock that took the Dow Jones industrial average to a seven-week low. And all that is just the obvious tale of a housing bubble and what happened when it popped. The real story is deeper and darker still.

For the better part of a century, politics, industry and culture aligned to create a fetish of the idea of buying a house. Homeownership has done plenty of good over the decades; it has provided stability to tens of millions of families and anchored a labor-intensive sector of the economy. Yet by idealizing the act of buying a home, we have ignored the downsides. In the bubble years, lending standards slipped dramatically, allowing many Americans to put far too much of their income into paying for their housing. And we ignored longer-term phenomena too. Homeownership contributed to the hollowing out of cities and kept renters out of the best neighborhoods. It fed America's overuse of energy and oil. It made it more difficult for those who had lost a job to find another. Perhaps worst of all, it helped us become casually self-deceiving: by telling ourselves that homeownership was a pathway to wealth and stable communities and better test scores, we avoided dealing with these formidable issues head-on.

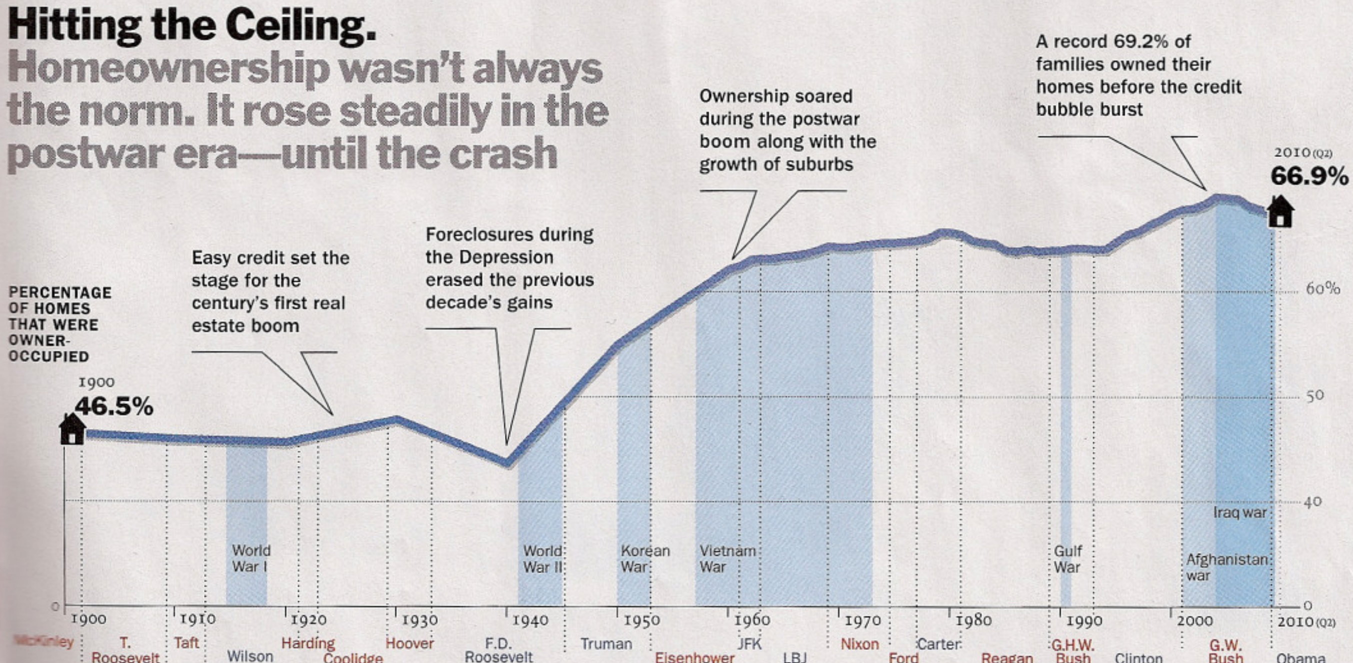
Now, as the U.S. recovers from the biggest housing bust since the Great Depression, it is time to rethink how realistic our expectations of homeownership are—and how much money we want to spend chasing them. As members of both government and industry grapple with re-envisioning Fannie Mae, Freddie Mac and the rest of the housing finance system, many argue that homeownership should not be a goal pursued at all costs. "There is this notion that being housed well is synonymous with being a homeowner," says Raphael Bostic, assistant secretary for policy development and research at HUD. "That narrative has got to change."

The Homesteaders

THE CONCEPT OF MASS HOMEOWNERSHIP seems an inseparable part of American mythology. The U.S., we tell ourselves, has always been a nation of bootstrapping immigrants, a place where, in the 19th century, anyone with enough endurance could head West and collect a homestead.

Hitting the Ceiling.

Homeownership wasn't always the norm. It rose steadily in the postwar era—until the crash



Source: U.S. Census Bureau

Yet it wasn't until the 20th century that Washington started throwing major resources at turning everyone into a homeowner. In 1919 the government took over the Own Your Own Home campaign that the National Association of Real Estate Boards (the present-day National Association of Realtors) had launched. As Secretary of Commerce, Herbert Hoover was a booster, declaring that "maintaining a high percentage of individual homeowners is one of the searching tests that now challenge the people of the United States."

The Great Depression didn't make that test easy. As the economy collapsed and foreclosures swept the nation, first Hoover, elected President in 1928, and then Franklin Roosevelt signed a series of laws to get banks lending again, including legislation creating the Federal Housing Administration to insure mortgages and the Federal National Mortgage Association (Fannie Mae) to buy them up, thus freeing banks to lend even more. These new agencies went hand in hand with the establishment of a new sort of loan, one lasting for 30 years at a fixed rate of interest. The 30-year mortgage was a revolution, a stark contrast to the short-term loans that had been the norm until then; it put homeownership within the reach of many more families. It made perfect sense. At a time when 25% of workers were jobless and a third of the lost jobs were in construction and related trades, kick-starting housing was a smart piece of economic stimulus.

Yet even when the economy had regained its footing after World War II, Washington's encouragement of homeownership continued. At first, homeownership was a handy way to prompt a transition to a higher standard of living: from cold-water flats in cities to tree-lined cul-de-sacs in the suburbs. But with each new Administration, some fresh advantage appeared, and rarely was the benefit questioned. Bill Clinton set out to create 8 million homeowners, and George W. Bush another 5.5 million. In 2002, Bush said, "If you own your own home, you're realizing the American Dream"—though when historian James Truslow Adams coined that term in 1931, he didn't say anything about owning a house. Still, "before the bubble burst, homeownership was a win for everyone," says historian Vincent Cannato, a professor at the University of Massachusetts at Boston. Whether you were looking to promote personal responsibility, ease the postwar housing shortage for returning veterans, help the poor establish a financial foothold or drum up jobs in a labor-heavy industry, homeownership was the answer.

As a consequence, Washington lavishes homeowners with special treatment. When they file their income taxes, they can deduct mortgage interest and property taxes. When they sell, they don't have to pay tax on the first few hundreds of thousands of dollars in profit. In 1986 the tax code was rewritten, disallowing the deduction of interest from consumer loans like credit card debt, but an exception was made for the interest paid on a mortgage—a caveat that cost the government some $80 billion in lost revenue in 2009.

Then there is the mortgage market. In the 1930s, the government wanted private investors to start a secondary market for the buying and reselling of mortgages to bring stability and lower rates to the market. When no one did, the government created Fannie Mae and, later, Freddie Mac. The agencies provide a great service to the American home buyer—those 30-year fixed-rate mortgages, which are awful for lenders, might not exist in great numbers without them. But the way these outfits have been configured in recent decades is flawed: they are aggressively profit-seeking yet implicitly backed by the government. That allowed Fannie and Freddie to borrow funds cheaply—and helped keep mortgage rates low—but meant there was little incentive for investors to monitor what the agencies were doing, even if it was so risky that their eventual bailout in September 2008 would cost more than $150 billion.

'Before the bubble burst, homeownership was a win for everyone.'

—VINCENT CANNATO, PROFESSOR OF HISTORY, UNIVERSITY OF MASSACHUSETTS AT BOSTON

One Nation, Stuck in Place

STAR KORAJKIC, ONE OF AMERICA'S NEWEST homeowners, doesn't particularly care about all this history. What she cares about is being able to paint her daughter's room purple without asking anyone's permission.

Until February, Star lived in a rented apartment in Burlington, Vt., with her husband Danijal and daughter Alina, 6. Now the family lives in a modest Cape Cod, which they own. Danijal works 11-hour shifts as a truck driver, and Star works two jobs in order to make the mortgage, but the sacrifice, she says, is worth it. "It's amazing. We can do whatever we want. We can plant a garden. We can sit outside and have music and a cookout. We can live a normal and nice life."

No doubt, for many American families, buying a home is a smart choice. On paper, putting nearly all your liquid assets into a single piece of property may look foolish, but in practice it often works out beautifully, with the mortgage paid off just before retirement, leaving a couple with a cheap place to live in old age. The point of questioning the virtues of owning a home isn't to question the decisions of families like the Korajkics; it is to take into account the trade-offs involved.

One major trade-off: mobility. Being free to move around the country easily means that people can go where the jobs are. Fifteen years ago, Andrew Oswald, a professor of economics at the University of Warwick in the U.K., was one of the first to note that places with high homeownership rates seemed to have high rates of unemployment as well. Indeed, some of the U.S. cities with the highest rates of homeownership have stagnant Rust Belt economies: Detroit; Allentown, Pa.; Rochester, N.Y.; Akron, Ohio. "The economy is changing all the time, and we need people to be mobile in order to drop into the right job slots," Oswald says. Where most people own their homes, rentals are sparse, which makes it tougher for workers—especially young, nimble ones—to redeploy.

The inflexibility that pervasive homeownership brings to labor markets has a cost. Lawrence Katz, an economist at Harvard University, notes that Americans, compared with other nationalities, are more prone to move in the wake of downturns. In a classic 1992 study, Katz and Olivier Jean Blanchard, then at the Massachusetts Institute of Technology, found that it takes U.S. regions about six years to recover from a local spike in unemployment, and during those six years the same number of people who have lost their jobs leave the area. "It's not that the jobs that disappeared come back," says Katz, "but that people move on to new areas with new opportunities." In a typical year, some 40 million Americans move—and nearly 20% do so for a job.

Unless, of course, they can't. And that is the case for many now. In the wake of the April expiration of a short-term tax incentive to buy, existing home sales are again falling. With property values depressed, some 11 million homeowners now find themselves owing more on their loan than their house is worth. Even if a likely buyer appears, a sale is not a sure thing. Jenn Hartzell looked into selling her family's house in Glen Burnie, Md., when her husband retired from the Air Force and came across his "dream job"—working as a radio program director—in San Diego. But the value of the house was less than the amount the couple still owed on their mortgage. "We couldn't do it," says Hartzell. "We couldn't leave."

In today's economy, mortgages can be a millstone. That's new. Time was, workers expected to stay with one company for decades and see a steady rise in annual income. But these days, being in the workforce is a game of constant reinvention. Workers expect to change companies, even professions, multiple times. Households are much more likely now than in the past to see income dip dramatically—even if only temporarily. In the late 1960s, about 7% of households experienced a decline in income of 50% or more over a two-year period, according to Brookings Institution economist Karen Dynan. In the mid-2000s, some 12% of households saw such a drop. Yet a mortgage, typically a homeowner's largest expense, is as rigid and unforgiving as ever. For homeowners, quickly adapting to new financial realities is rarely an option. Homeownership may provide a sense of stability to families, but stability in today's economy isn't always a virtue. What families need in order to maintain income is the flexibility that homeownership works against.

Solving or Causing Problems?

EARLIER THIS YEAR, FANNIE MAE CONducted a survey on homeownership. The top reason people gave for buying: "It means having a good place to raise children and provide them with a good education." The second: "You have a physical structure where you and your family feel safe."

The belief that owning a home is the gateway to safer neighborhoods and better schools is deeply embedded in the national psyche. Remember what Jack Kemp said: Homeownership can save babies. Yet the evidence that homeownership actually brings other benefits is decidedly mixed. On the surface, the results are often impressive. In 1997 academic economists Richard Green and Michelle White found that children of homeowners stay in school longer than children of renters and that daughters of homeowners are less likely to become teenage mothers. A 1999 study by Denise DiPasquale and Edward Glaeser concluded that homeowners are more likely to vote in elections and be involved in community organizations.

Yet the researchers who conduct such studies often warn about taking the findings too far. Just because two qualities show up at the same time doesn't mean one is causing the other. DiPasquale and Glaeser, for instance, attribute a big part of their findings to the fact that homeowners move less frequently: they have more time in a community than renters do to get involved. A 2009 study in the journal *Real Estate Economics* found that kids living in owned homes are less prone to drop out of high school, but whether a family owned a car had an even stronger correlation. Should we give cars the credit? Or should we instead realize that both home and car ownership are probably markers of something else, like a stable family life or living in a nice neighborhood?

There is really only one effect that seems consistently caused by homeownership: owners invest more time and money in the physical upkeep of their homes. They are more likely to make repairs. They are more likely to garden.

In the U.S., homeownership typically goes with living in single-family detached dwellings. Eighty-nine percent of standalone houses are owned, while just 17% of apartments are. There is a logic to this: for a landlord, an apartment building provides an economy of scale that a suburban development doesn't. But that means that a system that glorifies and subsidizes homeownership pushes people to live in suburbs, where they, or developers, can find more-affordable patches of land on which to build. Of course, it's fine to choose to live miles from a city, but that choice comes with broader consequences. People who live in detached houses use 49% more energy—like electricity and natural gas—

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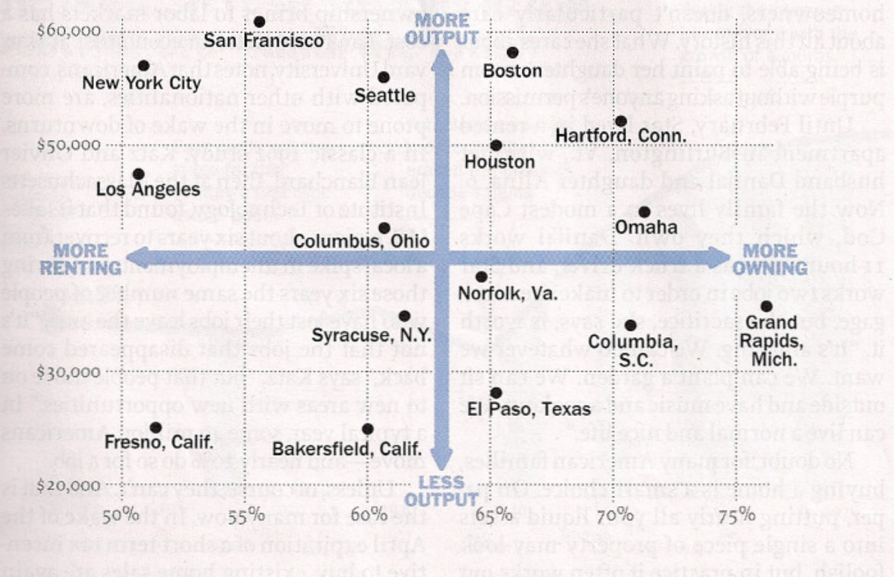
—LAWRENCE KATZ, ECONOMIST

Home Advantage? Plenty of lower-ownership cities have vibrant local economies, as measured by economic output per capita



Sources: Bureau of Economic Analysis; U.S. Census Bureau. Data for 2008, metro areas

The joys of renting *As homeownership loses its luster, could urban areas—hotbeds of rental housing—gain in popularity?*

than people who live in buildings with five or more apartments, according to data from the Energy Information Administration. Suburban living requires driving a car practically everywhere, which in turn means that U.S. energy policy prioritizes cheap oil—whatever the geopolitical and environmental consequences.

There are reasons people like living in leafy green suburbs. In *Crabgrass Frontier,* the 1985 classic on suburbanization, Columbia University historian Kenneth Jackson traces America's centuries-long idealization of agrarian life. Cities accumulated industry and disease and accidents. Who wouldn't want to escape to a home and yard of their own? But these days, Cleveland's Cuyahoga River doesn't catch fire, Pittsburgh has clean air, and fish markets and docks don't ring the island of Manhattan—bike paths and baseball diamonds do. Cities aren't for everyone. But maybe they would be for more people if we didn't all feel as though at some point we were supposed to move to the suburbs and buy a house.

Own a Home? Here's Some Cash

SINCE THE BENEFITS TO SOCIETY OF OWNING a home are hazy, you might conclude that individual families should be left alone to decide whether to rent or buy. Yet Washington throws more than $100 billion a year in tax breaks and subsidies at buyers through the mortgage-interest and property-tax deductions, the capital-gains exclusion and Fannie Mae and Freddie Mac, which help keep home loans cheaper than they would be otherwise.

None of this is particularly fair: there are no blanket subsidies for the tens of millions of American families that rent either because they choose to or because they have to. Nor are these tax breaks efficient economic policy. In 2001 the Congressional Budget Office estimated that only half the benefit of the government's implicit backing of mortgages through Fannie Mae and Freddie Mac was passed along to borrowers in the form of lower rates. The other half went to the companies' shareholders and to banks as higher profits.

The mortgage-interest tax deduction provides an even sharper case study. Nearly half the people in the 2010 Fannie Mae survey said tax benefits were a "major reason" to buy a house. Yet the mortgage-interest deduction isn't even claimed by many homeowners. To get it, you have to itemize on your taxes, and more than a third of homeowners don't. The bulk of the benefit goes to wealthier households that probably wouldn't have trouble buying a home without the deduction. According to a 2010 analysis by James Poterba of the Massachusetts Institute of Technology and Todd Sinai of the University of Pennsylvania, the 2.8 million homeowning families with an annual income of more than $250,000 save $15 billion a year thanks to the deduction. Meanwhile, the 19 million families making from $40,000 to $75,000 save $10 billion. For those middle-class households, the average annual tax break is worth $542, or $1.48 a day. Are legions of middle-class families able to buy houses because they save $542 a year? Doubtful. The U.K. got rid of its mortgage-interest deduction years ago, and its homeownership

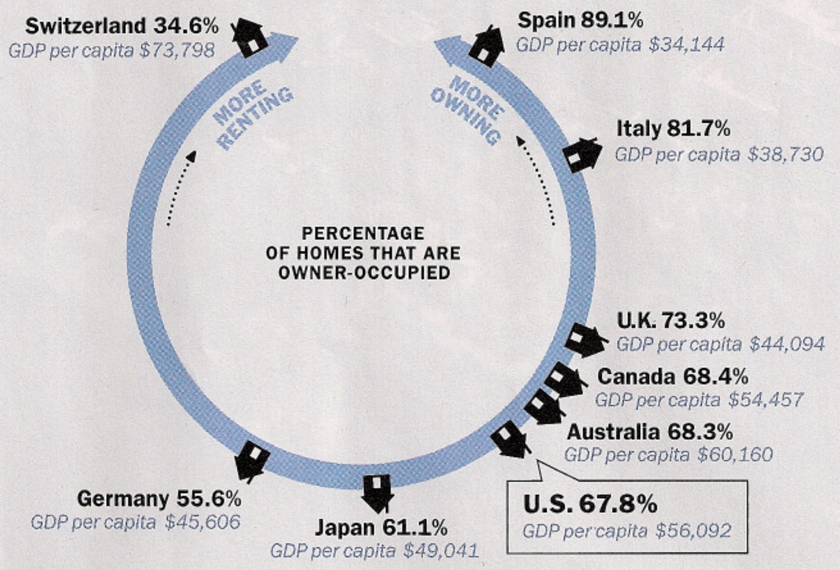
VINCENT LAFORET

rate is still higher than that of the U.S.

More unsettling yet is the way the mortgage-interest tax deduction entices people to borrow big: you get the deduction for the interest on the loan, not for owning the house or paying down the debt. Sinai, a self-described "pro-ownership guy," recalls how his accountant once suggested he buy a larger house in order to get a better deduction. "I nearly bit his head off," says the normally mild-mannered economist. "We conflate the idea of homeownership with extravagance."

But even if the government were to change the extent and the ways in which it underwrites homeownership, we would still be stuck with a stock of housing that has very largely been shaped by the bias toward owning. When Kirtie Lo, a newly minted hand surgeon, called up a real estate agent in Hutchinson, Kans., (pop. 40,000) to find a place to rent, the agent told her she'd want to buy. Lo was moving from Connecticut on a one-year contract, and she actually didn't want to buy, but she quickly understood what the agent meant about the city. "They do have apartments," says Lo, pausing to find the right words. "But they're not luxury apartments."

Ownership Worldwide. Tax policy and cultural identity, as well as supply and demand, influence ownership rates. The U.S. falls in the middle



Sources: IMF 2010 World Economic Outlook; Australian Bureau of Statistics; Eurostat; Japan's Ministry of Internal Affairs and Communications; Statistics Canada; Switzerland's Federal Statistical Office; U.S. Census Bureau. Data for 2008 except Canada (2006) and Switzerland (2000)

That, often, is what people mean when they say their top reason for owning a home is to have a good place to raise children. They want to live in nice neighborhoods, and in the U.S., that often means you have to buy. In an ideal world, the way you pay for your shelter shouldn't reflect your socioeconomic status. In Switzerland, one of the world's richest nations, two-thirds of all families rent. Yet in the U.S., whether you own or rent says something about who you are—and often limits where you can live.

Here again the hand of government is evident, but this time at the city and county level. Harvard economist Glaeser has looked at how local governments, often spurred on by existing homeowners, restrict housing type. Of the 186 towns and cities within 50 miles (80 km) of Boston, 34 forbid multifamily dwellings such as townhouses and apartment buildings, and another 81 allow them on less than 10% of the available land. People who don't buy stand-alone houses—for the most part, renters—are not welcome. And that doesn't just happen around Boston. "In many parts of the country," says Glaeser, "renters are zoned out."

Some demographers predict that the attitude that most areas should be the exclusive province of single-family homes on big tracts of land will change as Baby Boomers tire of four-bedroom houses with lawns to mow and big property-tax bills. That would be a huge adjustment, one that is at times hard to imagine. But there is reason to try.

The Cost of Easy Credit

WHAT IS PERHAPS THE WORST SIDE OF THE homeownership fetish is dark indeed: for many years, the fact that our house prices were rising enabled us to ignore deep structural changes taking place in the American economy. For decades, income inequality has been growing, and middle-class wages have been stagnant. In the eyes of at least some academic observers, cheap credit, especially when used to buy ever-larger houses, has been a way to get people to feel O.K. with their lot. "Cynical as it may seem, easy credit has been used as a palliative throughout history by governments that are unable to address the deeper anxieties of the middle class directly," writes Raghuram Rajan, an economist at the University of Chicago, in his new book *Fault Lines*. "The expansion of homeownership—a key element of the American dream—to low- and middle-income households was the defensible linchpin for the broader aims of expanding credit and consumption." Pumped up on credit-card debt and home-equity loans, we kept spending away and felt richer than we actually were.

If the U.S. is ever to break that cycle, we will have to go through a well-known list of changes: save more, invest in people through better education and training, and use the levers of government to help create high-quality jobs—the sort you can raise a family on—instead of coaxing people into becoming homeowners.

That is no small order. But if there ever were a time to start weaning America off the idea that homeownership cures all our ills, now—after the worst housing crash in 75 years—would be it.

Stuck in her house in Maryland, unable to move for her husband's dream job in California, having spent thousands of dollars and countless hours on various home repairs, Jenn Hartzell reflects on their decision to buy a house. "It's been a really big learning experience," she says. "I would say I'm glad that I did it." Then she stops. "I think I am. I'm not sure." When her friends tell her they're considering buying a house, she says, "You know, it's not what we were raised to think it would be." ■