Homeownership and the Wealth Gap

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Introduction

The growing wealth gap is a problem. The movement we made towards wealth equality in the mid 20th century with the rise of the middle class has been undone and the wealth gap is the largest it's been since the 1920s. More troubling still is that the wealth gap is growing along racial and ethnic lines. In 1963, average white family wealth was $136,221 while the average wealth of non-white families was $18,892, a difference of over $117,000. But in 2013 the average wealth of white families was $677,658 while the average of wealth of African American and Hispanic families was $95,351 and $112,227 respectively (McKernan et al., 2013). That's a difference of over $550,000. The wealth gap between white and non-white families has grown nearly 500 percent over these 50 years.

The wealth gap is particularly pronounced in California. California has been called the nation's most unequal state by CNN (2015). California also ranks 49th in the nation in homeownership (U.S. Census Bureau, 2014). This is not a coincidence. Homeownership is a valuable tool that could address the wealth gap and one that is not being utilized. Indeed, as we will illustrate here, the lack of homeownership opportunities for low-to-moderate income families is the largest driving force of the growing wealth gap.

In a January article this year, the San Francisco Chronicle estimated that 800,000 to one million residential units would be needed to be built in California just to meet the national norms for housing (Thornberg). This is staggering. Lack of supply is the primary obstacle to homeownership as it drives up the prices beyond the reach of all but the wealthiest families. According to Realtor.com, the average price of a home in California is $399,900 while the national average is $215,707. California's average home price is nearly double that of the rest of the nation.

Why isn't California building more homes? One reason is California's environmental regulations. CEQA, or the California Environmental Quality Act, is a broad environmental protection statute passed in 1970 that requires "state and local agencies to identify the significant environmental impacts of their actions and to avoid or mitigate those impacts, if feasible." It has been used to block or delay open land, suburban sprawl, and urban in-fill developments, severely limiting where new homes can be built and increasing the cost of land. Another is California's high construction cost - labor, materials, and government fees are all higher in California than in the rest of the country. In a Legislative Analyst's Office report, California's High Housing Costs: Causes and Consequences, it is estimated that the average cost to build a single-family home in California's metropolitan areas is $50,000 to $75,000 more than in the rest of the country (Alamo, Uhler, & Taylor, 2015). Lastly, California's low property taxes incentivize people to hold on to their homes and function as a disincentive for affordable home building. Prop 13, passed in 1978, limits property taxes to one percent at the time of acquisition and allows a reassessment only when the property changes ownership. It states that as long as the house is not sold, the value of the home cannot increase more than 2% annually. Homeowners in California may be encouraged to rent out their current homes when purchasing another because of their low taxes. Likewise, local governments can make more in taxes by encouraging commercial or luxury developments than by building affordable homes.

The price the state of California will pay for not having enough affordable homes for sale is likely to be steep. We're suffering many of the effects already. Many people are commuting farther to work. We're seeing that core professionals like teachers, nurses, and firemen are often unable to live in the communities in which they work; soon California may be unable to retain them. As more people spend higher portions of their income on housing, California's economy will suffer. Moreover, homeownership is a cornerstone of the American Dream. 92% of people aged 18-39 who are currently renting hope to buy a home someday (Fernald, 2015). Putting homeownership beyond the reach of the average family is to limit upward mobility and solidify class. But promoting affordable homeownership options is not just moralistic; it is rational. And here is why:

Financial Benefits of Homeownership for Families

There are numerous financial benefits to owning a home. A mortgage can function as a "forced savings" plan since every payment will build equity that families can borrow against to pay for medical expenses, home improvements, education, or business loans. Additionally, making timely mortgage payments can build good credit and provide better terms for future loans. Home equity is often used to obtain loans to start new businesses; homeowners are more than three times more likely to hold direct ownership in a business (*Economic Benefits*, 2002). The US government provides financial incentives to homeowners in the form of tax deductions. When itemized, homeowners can deduct the mortgage interest paid to lenders, property and estate taxes. Homeowners also receive the benefit of "imputed rent," meaning that they act as their own landlords without being taxed as such. Under responsible lending practices homeownership provides a path to wealth building for low and middle-income families. Indeed, real estate is named as the top choice or tied for the top choice as the best investment among all age and income groups (Saad, 2015).

Economic Benefits of Homeownership for the State

The economy as a whole also benefits from the building and purchasing of homes. As of the fourth quarter of 2015 Residential Fixed Investment (RFI), which includes the construction of new single-family and multifamily structures, residential remodeling, the production of manufactured homes, and brokers' fees, comprised 3.32% of the GDP. But, historically, RFI has averaged roughly 5% of the GDP (Melman, 2016). With the current housing shortage, affordable home building could provide a boost to the entire economy. Renters spending more than 30 percent of their income on housing are considered "cost burdened." Over 53 percent of California renters are cost-burdened compared to 31 percent nationally and those with a mortgage are faring even worse - more than two-thirds of middle-class families are cost-burdened compared to 40 percent nationally (Thornberg, 2016). These families are spending more on housing and less on other goods and services that would benefit California's economy.

In their April 2015 report, *The Economic Impact of Home Building in a Typical State*, the National Association of Home Builders (NAHB) estimated that the one-year impact of building 100 single family homes in a typical state would generate $30.4 million in income for residents, $6.1 million in taxes, and 419 jobs. These numbers include the direct impact of construction (constructions costs and wages, the sale of the home, the retail and wholesale of components, and the professional services required to build a home and deliver it to its final owner), as well as the secondary impact of those who earned money in the construction spending part of it within the state. NAHB also anticipates the recurring income to residents of the state would be $4.6 million, $1.6 million in taxes, and 78 jobs for the state each year after the first as new homeowners purchase goods and services in the local economy.

Though rental units also provide income for the state, it is important to note that by NAHB's model the one year impact of building 100 rental units generates $18 million less in income for residents, $2.8 million less in taxes, and only 170 jobs as opposed to 419. The annually recurring impacts of building 100 rental units are also significantly less than the recurring impacts of building single family homes. The recurring impact of building 100 rental units generates $1.7 million less in income, $758,000 less in taxes, and 49 jobs as opposed to 78.

Social Benefits of Homeownership for Families

Homeownership is linked to numerous social benefits for families over renting. Children of homeowners have lower rates of teenage pregnancy and are more likely to graduate from high school even when controlling for parental income, education, and social characteristics. Moreover, it is low-income households where the effect is noted most strongly (Green & White, 1997). Green and White, who first noticed this effect of homeownership on children in their 1997 study, revisited their research in 2012 after the housing market crash and confirmed their original findings (Green, Painter, & White, 2012). Homeownership has also been linked to lower childhood behavioral problems (Haurin, Parcel, & Haurin, 2001; Boyle, 2002) and higher math and reading achievement (Haurin et al., 2001). Furthermore, children of homeowners are also more likely to become homeowners themselves (Boehm & Schlottman, 1999).

As for homeowners both with and without children, they report feeling greater life-satisfaction (Rohe & Stegman, 1994). Even among renters, 94% agreed that owning is something to be proud of in Freddie Mac's January 2016 *Profile of Today's Renter*.

Social Benefits of Homeownership for Communities

Communities can also benefit from greater numbers of homeowners. Homeowners are more likely to vote, an effect first noted by Ahlbrandt and Cunningham in A New Public Policy for Neighborhood Preservation (1979) and since noted by Manturuk, Lindblad, and Quercia (2009). They also have greater rates of participation in neighborhood and block organizations (Rossi & Weber, 1996; McCabe, 2013). The sense of permanence and even the sense of pride homeowners feel may be a contributing factor in the greater rates of voter and neighborhood participation. Indeed, the greater sense of life-satisfaction homeowners feel extends to their neighborhoods - homeowners tend to view their neighbors more positively than renters. They reported greater neighborhood satisfaction and greater levels of trust amongst their neighbors in a study on social capital, meaning the resources a person could access through their interaction with others, among low-to-moderate income families (Mantruk et al., 2010).

Homeownership and the Wealth Gap

Homeownership accounts for the largest difference in household wealth. For most families, their home is the largest item in their wealth portfolio and this is especially so for minority families. Homes represent an average of 53 percent of wealth for black families and 39 percent for white families (Shapiro, Meschede, & Osoro, 2013). In a study examining a set of families over a 25-year period, Shapiro, Meschede, and Osoro found that years of homeownership accounted for more than 25 percent of the difference in wealth growth between the white and non-white families. A number of key elements affect how years of homeownership can affect the wealth gap.

Most glaring is the homeownership rate. The homeownership rate for minority families is 25.5 percentage points lower than that of white families according to the State of the Nation's Housing 2015. Even at the same income level, African American and Hispanic families are less likely to own homes than white families (McKernan et al., 2013). Shapiro, Meschede, and Osoro attribute this in part to the historical wealth accumulation of white families. White families are more likely to be able to borrow from family members or to receive an inheritance to help with a down payment. Among homeowners, they found that white families buy homes and thus start building equity an average of eight years sooner than black families. Historical wealth accumulation also means that because white families are able to make larger down payments, they have lower interest rates and lending costs.

Second, lending practices have been a key element affecting homeownership for minority families and thus affecting wealth inequality. Historic differences in the access to credit such as redlining continue to influence minority families seeking loans today. The New York Times reported that during the housing boom, black and Latino families were two times as likely to receive a high interest loan even when taking into account borrower's income and loan amount (2007). Subsequently, minorities fared far worse during the housing bust and recession. Black and Latino families were more than 70 percent more likely to lose their homes to foreclosure than their white counterparts (Merle, 2010). Predatory lending practices, greater foreclosure rates, and the larger portion of wealth tied up in homes meant the recession had a devastating effect on minority families. African American families lost half their wealth between 2005 and 2009; Latinos lost two-thirds of their wealth.

These numbers may be specific minorities but the story is the same for many low-to-moderate income families who are spending more of their income on housing and are finding the dream of homeownership farther and farther out of reach. Taking all the benefits of homeownership into account - the wealth building aspects, the boost to the economy, the benefits to children of homeowners, and the community participation - we see that the lack of homeownership opportunities is relegating families to a cycle of poverty. Homeownership is the strongest means we have to narrow the wealth gap and promote upward mobility.

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Key Facts

California Housing Crisis

- 800,000 to one million residential units would be need to be built in California just to meet the national norms for housing
- California ranks 49th in the nation in homeownership
- Homeownership rates for the US are the lowest they've been since 1994

Perceptions of Homeownership

- 92% of people aged 18-39 who are currently renting hope to buy a home someday
- 82% of people agree that owning makes more financial sense than renting
- Real estate is named as the top choice or tied for the top choice as the best investment among all age and income groups

Financial Benefits of Homeownership for Families

- A mortgage can function as a "forced savings" plan since every payment will build equity that families can borrow against to pay for medical expenses, home improvements, education, or business loans
- Making timely mortgage payments can build good credit and provide better terms for future loans
- Homeowners are more than three times more likely to hold direct ownership in a business
- Homeowners can deduct the mortgage interest paid to lenders, property and estate taxes
- Homeowners receive "imputed rent," meaning that they act as their own landlords without being taxed as such

Economic Benefits of Homeownership for the State

- $30.4 million in income for residents of the state in the first year per 100 homes
- $6.1 million in taxes and other revenue for the state and local governments in the state in the first year per 100 homes
- 419 jobs in the state in the first year per 100 homes
- $4.6 million in income for residents of the state recurring annually per 100 homes
- $1.6 million in taxes and other revenue for the state and local governments in the state recurring annually per 100 homes
- 78 jobs in the state recurring annually per 100 homes
- The first year impact of building 100 rental units generates $18 million less in income for residents than single-family homes
- The first year impact of building 100 rental units generates $2.8 million less in taxes than single-family homes
- The first year impact of building 100 rental units yields only 170 jobs as opposed to the 419 for single-family homes

Social Benefits of Homeownership for Families

- Children of homeowners have lower rates of teenage pregnancy
- Children of homeowners are more likely to graduate from high school even when controlling for parental income, education, and other social characteristics

- Homeownership is linked to lower rates of childhood behavioral problems
- Children of homeowners rate up to nine percent higher in math and seven percent higher in reading among elementary school age children
- Children of homeowners are more likely to become homeowners themselves
- Homeowners report greater feelings of life-satisfaction

Social Benefits of Homeownership for Communities

- Homeowners are more likely to vote
- Homeowners have greater rates of participation in neighborhood and block organizations
- Homeowners report greater neighborhood satisfaction and greater levels of trust amongst their neighbors

Homeownership and the Wealth Gap

- In 1963 families in the 90th percentile for wealth had six times the wealth of families in the 50th percentile. As of 2013, families in the 90th percentile had 12 times the wealth of families in the 50th percentile
- In 1963, average white family wealth was $136,221 while the average wealth of non-white families was $18,892, a difference of over $117,000. But in 2013 the average wealth of white families was $677,658 while the average of wealth of African American and Hispanic families was $95,351 and $112,227 respectively - a difference of over $550,000
- Years of homeownership accounted for more than 25 percent of the difference in wealth growth between white and non-white families
- The homeownership rate for minority families is 25.5 percentage points lower than that of white families
- Even at the same income level, African American and Hispanic families are less likely to own homes than white families
- During the housing boom, black and Latino families were two times as likely to receive a high interest loan even when taking into account borrower's income and loan amount
- Black and Latino families were more than 70 percent more likely to lose their homes to foreclosure than their white counterparts when the housing bubble burst
- For minority families, homes make up an even larger portion of their wealth portfolio than for white families - an average of 53 percent of wealth for black families and 39 percent for white families
- African American families lost half their wealth between 2005 and 2009; Latinos lost two-thirds of their wealth