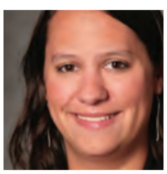
Renting: The New American Dream



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Homeownership has long been the American Dream. It's a status symbol and has been regarded as one of the best long-term investments a family can make. In fact, buying a house can make a lot of sense for communities, too: Much research suggests that the stability that comes with homeownership promotes good citizenship, improves the quality of neighborhoods, and is linked with the academic success of homeowners' children.

But have lessons from the Great Recession changed the way Americans — both borrowers and lenders — think about owning a home? Given the fallout in the housing market, maybe renting will be the new American Dream. And that's something policymakers will have to weigh very carefully.

The Recession's Impact on Housing

From 1997 to 2006, U.S. home prices rose nearly 10 percent a year on average, according to the S&P/Case-Shiller National Home Price Index. A decade was long enough, says economist Robert Shiller in a recent *New York Times* article, "for many people to become accustomed to the pace and to view it as normal . . . . People who owned a home over that period had reason to feel pretty well off and proud of their investment acumen."

Then came the financial crisis. Home values crashed from their peak of almost $23 trillion in 2006 to just over $16 trillion in the first quarter of 2011. And since the crisis, lenders have been tightening underwriting standards, making it tougher for would-be homeowners to get loans. It can also be tough to get government financing, including Federal Housing Administration and Veterans Administration loans, especially for those with credit scores below 600 or without enough money for a 3.5 percent down payment. And those with a foreclosure in their past can't get any type of financing for seven years.

As a result of the housing market fallout, the latest Case-Shiller annual survey of homebuyer attitudes showed people's median expectation for annual home price appreciation over the next decade down sharply, to just 3 percent (versus 7 percent in 2005).

Meanwhile, U.S. homeownership rates have been heading down and rental rates going up. Since the end of 2006, the number of renters has grown faster than the number of owners has declined. This means, says Senior Research Economist Emre Ergungor of the Cleveland Fed, that most new households are renting, whether by choice or by necessity.

When the housing bubble burst in 2007, 31.6 percent of households rented their homes. Now, it's 33.6 percent. Since the crisis, nearly 3 million households have become renters, and at least 3 million more are expected by 2015, according to census data analyzed by Harvard's Joint Center for Housing Studies and the Associated Press. It's hard to know what exactly is behind those numbers—anybody who went through a foreclosure, for example, would probably have to become a renter—but the trend is clear enough.

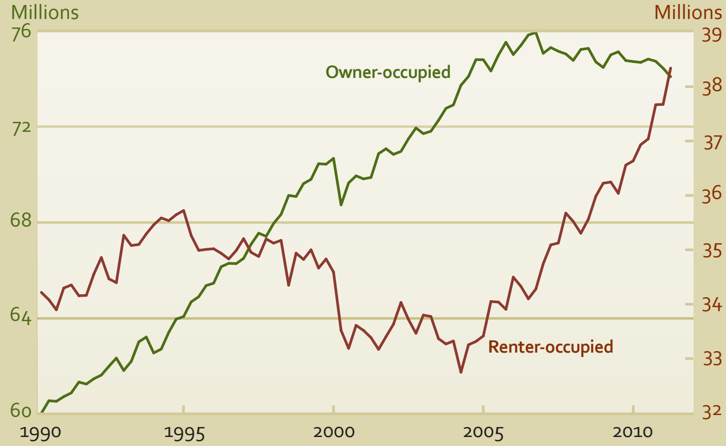
Stubborn Attitudes

Yet the American Dream endures. Homeowners and renters continue to believe that homeownership is a smart decision over the long term. Surveys by Fannie Mae, the National Association of Home Builders, and Pew Research find that a great majority still believe homeownership is a sound investment.

Meanwhile, as Americans cling to their beliefs, economists have been debating some of the ways that the housing market crash has been hurting the economic recovery.

With the glut of empty homes brought on by foreclosure, there's hardly any market for new construction. And many owners are discovering that their homes have proven to be an unreliable form of savings. Unfortunately, this is particularly true in regions where the housing bust has contributed directly to high rates of unemployment through construction job losses.

Total Owner- and Renter-Occupied Housing Units



Sources: U.S. Department Commerce, Bureau of the Census; Haver Analytics.

A new study conducted by faculty at Florida International University and East Carolina University uses data from 1979 to 2009 to propose that renting has been a better investment strategy than buying a home for the past 30 years. The authors reason that it's not actual homeownership that creates wealth but rather the forced savings that come from having an amortizing mortgage. And creating wealth can be done—and done better by more people—through other means.

The Best Investment? Americans Weigh in on Homeownership

- **37 percent** of Americans "strongly agree" that homeownership is the best long-term investment one can make.
  - **41 percent** of homeowners "strongly agree."
  - **31 percent** of current renters "strongly agree."
- **85 percent** of American homeowners at least "somewhat agree" that buying a home is the best long-term investment one can make.
- **85 percent** of current renters want to buy a house at some point.
  - **17 percent** want to continue to rent.

Source: Pew Research Center.

Post-Recession Policies

For many years, the U.S. government has explicitly or implicitly subsidized homeownership through programs such as Federal Housing Administration insurance, the mortgage interest deduction, Fannie Mae and Freddie Mac, and many others. But some policymakers question this approach.

From the former head of the Federal Deposit Insurance Corporation to U.S. Representative Barney Frank, not to mention the Obama Administration, policymakers are proposing many options for keeping neighborhoods viable by boosting rental properties. For example, in August, the Federal Housing Administration announced plans to ask investors for their ideas on how to turn thousands of foreclosed homes into rentals.

Here are a few policies that are now being re-evaluated in the aftermath of the Great Recession:

- Low Income Housing Tax Credit - An indirect federal subsidy used to finance the development of affordable rental housing for low-income households
- Shared Appreciation Mortgages - A mortgage in which the borrower is offered the chance to write down a portion of his mortgage debt, but is required to share future appreciation gains with the lender; currently prevented by U.S. tax barriers
- Mortgage Interest Deduction - A common itemized deduction that allows homeowners to deduct the interest they pay on any loan used to build, purchase, or improve their primary or secondary residence

Regardless of what policy is being discussed, policymakers need to remember that different regions might need to have solutions tailored to their specific markets. Here in the Fourth District, for example, policymakers have to deal with the reality that programs like converting bank-owned (foreclosed) property into rental property may not be economically viable. There already is a large oversupply of housing in this region, and cash-strapped municipalities are underequipped to take on the additional oversight responsibilities associated with such conversions.

Balancing Act

The question for policymakers is how to square two potentially competing forces: a housing market with less-than-certain investment returns and higher barriers to entry for low-income borrowers; and the persistent aspirations of many Americans to own their own home. The ultimate goal is to make sure individual households' needs are met while keeping neighborhoods stable and vibrant.

The collapse of the housing market and subprime crisis remind us that policies to promote homeownership can harm households if those policies encourage unaffordable mortgage commitments. At the same time, we know from experience that American neighborhoods are more likely to thrive when their occupants are owners, probably because of the stability ownership brings. A balance must be struck, and it won't be easy. The next generation may cling to ambitions of homeownership for good reasons, but economic reality may dictate otherwise. ■

Survey data

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