GSE Activity Report

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Home, Risky Home?

Summary

New economic commentary from the Federal Reserve Bank of Cleveland assesses several recent studies on homeownership from an investment perspective. Contradicting the traditional political narrative about the importance of homeownership to wealth accumulation, it concludes that homeownership is fine if you've got some wealth, but may well be risky for lower-income and -wealth homeowners.

Analysis

This study has no new quantitative conclusions, basing its qualitative findings on prior studies that abandon traditional representative-agent approaches to look heterogeneously at homeownership. It thus builds on prior economic-equality focused analyses that challenge the traditional assumptions that more homeownership means more of a prosperous U.S. middle class. Key points of the study are:

- Homeownership's risk to lower-income households includes location risk (difficult ex ante neighborhood house-price value), sales timing and liquidity risk, and negative returns.
- Home purchases come at the opportunity cost of investing in other assets such as stocks and bonds, which are said to present lower risk.
- National home prices have grown much more slowly over the past 30 years than the S&P 500 and the price of an average investment-grade corporate bond, but households outside of top income groups tend not to hold stocks despite their higher expected returns.

Whether homeownership causally increases wealth is difficult to determine based on available data. Although rates of homeownership rise with income and wealth, it may be that most people prefer owning to renting for idiosyncratic reasons unrelated to investment and, since those with higher incomes and wealth can more easily afford homes, ownership rates are higher among higher income and wealth households.

Based on these findings, the study warns that policies incentivizing homeownership as a means to reduce wealth inequality or close racial wealth gaps may have the opposite effect. Instead, low-income and -wealth households may be better served by investing in a well-diversified portfolio of stocks and bonds, likely to have has a similar expected rate of return as homeownership but may present lower risk. Thus, if policymakers are to incentivize home purchases to reduce inequality, great care must be taken to protect against all of the risks noted above. However, the study does not detail desired protections such as the downward ARMs detailed in prior Fed work.

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