Socioeconomic and racial disparities in the financial returns to homeownership

Tom Mayock a,∗, Rachel Spritzer Malacrida b

a UNC Charlotte and Office of the Comptroller of the Currency, Belk College of Business, Department of Economics, 9201 University Center Boulevard, Charlotte, NC 28223, USA
b Santander Holdings USA, Inc., USA

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ABSTRACT

In this study we utilize data from over a million ownership spells between 1990 and 2013 in 9 metropolitan areas - Boston, Chicago, Detroit, Los Angeles, Miami, New York, Pittsburgh, San Diego, and San Francisco - to provide what we believe to be the most extensive analysis of the variation in the financial returns to homeownership along racial and socioeconomic dimensions. Holding constant a buyer’s purchase price, property type, neighborhood, and purchase and sale timing, we find that capital gains have been systematically lower for low-income and minority homebuyers in every market in our sample. In some cases, the unconditional returns realized by these buyers were higher, a phenomenon driven by their higher propensity to purchase lower-priced homes that experienced high levels of appreciation. Taken as whole, our findings call into question the widespread claim that encouraging homeownership for low-income and minority households is a panacea for addressing wealth inequality.

1. Introduction

The distribution of wealth and income in the United States has long been characterized by inequalities across race and income classes.1,2 Noting the importance of home equity on U.S. household balance sheets and low homeownership rates among minorities and low-income households, academics, policymakers, and politicians from across the political spectrum have advocated for more widespread homeownership with the hope that reducing the homeownership gap will reduce wealth inequality. During National Homeownership Week in 2001, commenting on the racial differences in homeownership rates, President George W. Bush remarked: “these [homeownership] numbers are troubling because homeownership lies at the heart of the American Dream. It is a key to upward mobility for low and middle income Americans. It is an anchor for families and a source of stability for communities. It serves as the foundation of many people’s financial security” (Bush, 2001). In a 2013 speech in Phoenix in which he discussed socioeconomic mobility, President Barack Obama referred to homeownership as “the most tangible...
cornerstone that lies at the heart of the American Dream” (Obama, 2013). Thomas Shapiro, a leading scholar on racial wealth inequality, argued “homeownership is an appropriate strategy to attack the racial wealth gap” (Shapiro, 2006, p. 1). Such attitudes regarding the presumed link between homeownership, socioeconomic mobility, and wealth generation have served to support a wide variety of policies designed to encourage Americans to purchase homes, such as the mortgage interest deduction and the implicit and explicit support that the federal government provides for the mortgage market. In light of the tremendous loss of housing wealth that occurred during the Great Recession - which was heavily concentrated among minority households (The Poverty and Inequality Report, 2014; Gorbachev et al., 2016) - one might think such policy prescriptions would now fall on deaf ears. However, attitudinal survey evidence suggests that this is not the case: a 2011 Pew Research survey conducted at the nadir of the most recent housing cycle found that 81% of adults still believed that buying a home is the best long-term investment that a person can make (Five Years After the Bubble Burst: Home Sweet Home. Still., 2011).

Two important but largely untested assumptions underlie the claims that encouraging more widespread homeownership can reduce wealth inequality. First, homeownership must be more economically costly than owning a home. If this is not the case, the transition of low-wealth households to homeownership could impede the accumulation of higher-yielding financial assets, stunting wealth growth. Second, even if homeownership is financially superior to renting, an increase in the homeowner-ship rate may fail to reduce the wealth gap if the financial returns to holding real estate for low-income and minority buyers are systematically lower than those of homeowners with higher wealth levels. The goal of this paper is to assess the validity of these two assumptions using a database of more than one million completed homeownership spells that occurred between 1990 and 2013 in 9 Metropolitan Statistical Areas (MSAs): Boston, Chicago, Detroit, Los Angeles, Miami, New York, Pittsburgh, San Diego, and San Francisco.

In our primary analysis, we utilize a regression decomposition to study differences in average capital gains by race and income level. Three branches of the existing literature suggest that disparities in capital gains across different types of buyers may exist. Price discrimination in the housing market has been shown to increase the price minorities pay when purchasing housing and reduce the price minorities receive when selling housing, resulting in lower financial returns to homeownership relative to non-minority households (Ihlanfeldt and Mayock, 2009). Second, previous research established the existence of housing submarkets within metropolitan areas that appreciate and depreciate at different rates. Divergence in the returns to real estate across racial and socioeconomic groups can thus arise due to sorting into specific submarkets. Lastly, recent research suggests that the values of low-quality homes are significantly more sensitive to changes in credit conditions than the values of high-quality homes (Landvoigt et al., 2015). The concentration of minority and low-income households in the lower end of the housing value distribution may thus give rise to supernormal returns for these populations when credit conditions are easing and supernormal losses when credit conditions tighten.

In the context of our decomposition exercise, these three mechanisms imply that observed differences in returns across buyer subpopulations are attributable to two distinct sources of variation: between-group variation that can be explained by differences in observed transaction characteristics (e.g., purchase timing) and differences in returns across buyers of different types (e.g., income levels) with otherwise observationally identical homeownership spells. To our knowledge, no previous work has attempted to explain how these factors influence variation in the returns to homeownership across buyer subpopulations; filling this gap in the literature is thus the primary contribution of our paper.

Holding constant a buyer’s purchase price, property type, neighborhood, and purchase and sale timing, we find that capital gains have been systematically lower for low-income and minority home buyers in every market in our sample. This finding suggests that even when taking very similar risks in the housing market, the financial return to homeownership for low-income and minority households is lower than that of high-income and White homeowners; this result should be of significant concern to those supporting the expansion of homeownership as a way to reduce wealth disparities.

Conditional on socioeconomic status or race alone, however, we find significant variation in the relative gains to low-income and minority homeownership across markets. In 8 of the 9 markets, capital gains conditional on income alone were inversely related to the buyer’s income quintile at the time of purchase, while in Detroit the converse was true. Conditioning on race only, average capital gains for Black households were higher than those of White households in 4 markets, lower than those of White households in 3 markets, and no different from those of White households in 2 markets. The results for the relative gains of Hispanic households are equally mixed, with average Hispanic returns lower, higher, and equal to those of White households in 5 markets, 2 markets, and 2 markets, respectively. Our decomposition results suggest that much of this heterogeneity in relative returns can be explained by systematic differences in the quality of the homes and purchase and sale timing of different buyer types.

Because our data does not contain information on a household’s non-housing wealth, we cannot directly assess how differences in the returns to housing have impacted wealth accumulation. Data from the 2013 Survey of Consumer Finances (SCF), however, suggests that our findings have important implications for the wealth dynamics of minority and low-income homeowners. In Table 1 we summarize the composition of household balance sheets for households that own their primary residence and have a positive net worth. In the spirit of Flavin and Yamashita (2002), we express asset values as a fraction of the household’s net worth. These fractions can be interpreted as portfolio weights. At the mean and the median, Black and Hispanic households have significantly higher fractions of their wealth concentrated in their primary residence and are far more leveraged than other homeowners.

The same holds true for lower-income households relative to high-income homeowners. Because of this combination of leverage and minimal diversification, the balance sheets of minority and low-income homeowners are highly sensitive to even minor changes in housing values. The differences in the returns to homeownership described above could thus potentially have outsized impacts on measures of wealth inequality. For instance, whereas a 1% change in the value of the average White homeowner’s primary residence would result in a 2.4% change in net worth, a similar change in the housing values for the average Black and Hispanic homeowners would result in wealth changes of

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3 Political fascination with homeownership is not a recent phenomenon. In the 1920s, Herbert Hoover proclaimed that owning a home “may change the very physical, mental and moral fibre of one’s children”. Katz (2009, p. 3) For more on the history of U.S. policies promoting homeownership, see Shay (2006).

4 As has been noted elsewhere, the cost of such programs is not negligible. In a 2011 study, Carroll et al. (2011, p. 2) estimated that the annual housing tax subsidies in the U.S. are roughly $304 billion, a figure that includes the foregone tax revenue on imputed rental income as well as the value of deductions for mortgage interest and property tax payments. This estimate excludes the economic costs associated with support for the Federal Housing Administration and the Government Sponsored Enterprises.

5 The desire to encourage more minority homeownership was frequently cited as the justification for the financial innovation in the mortgage market in the early 2000s (Brandlee, 2011; Timiraos, 2008; Gabriel and Rosenthal, 2005).

6 In the absence of estimates of the total financial costs associated with foreclosure, in our principal analysis we limit our data to spells that did not end in foreclosure. The full financial costs of foreclosure include any lost equity, the cost of moving to new housing, as well as the cost of having severely impaired credit over a long period of time. To our knowledge, no study has attempted to estimate all of these costs.

7 Our capital gains measures are constructed assuming transaction costs of 2 percent when purchasing and 6 percent when selling.
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