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Economic Commentary

Evaluating Homeownership as the Solution to Wealth Inequality

Daniel Carroll and Ross Cohen-Kristiansen

Homeownership presents an opportunity to accumulate wealth, making it an appealing vehicle for reducing wealth inequality. In this Commentary, we explore the investment side of homeownership. The opportunity for leveraged returns can lead to wealth gains among lower-income households; however, we note that homeownership for low-income homeowners carries three types of risk that are higher for them than for high-income homeowners: location, timing, and liquidity. Thus, policies that incentivize purchasing homes to reduce wealth inequality or close racial wealth gaps should be adopted only after great care has been taken to protect against these risks.

There is a widely held public belief that homeownership is a crucial component of wealth accumulation. It is, after all, a central part of the "American Dream."[1] Buy a house. Pay it off over your working life. Retire with a nest egg from the equity in your home. Proponents of this strategy can point to homeownership's positive relationship in the data with both income and wealth. Roughly nine out of 10 households in the top 20 percent by income own their homes compared to fewer than five of 10 households in the bottom 20 percent.[2]

If buying a house is, in fact, a necessary step in the wealth accumulation process, then there is a case to be made for encouraging homeownership among low-income and low-wealth families. There are also demographic disparities in wealth that homeownership could potentially address. The average wealth levels of Black and Hispanic households are between one-tenth and one-fifth that of white households; and the rate of homeownership is substantially lower among Black and Hispanic households at most levels of income, as shown in Figure 1. These disparities in homeownership (and wealth more generally) in part can be attributed to past discriminatory lending and zoning restrictions in the housing market, otherwise known as "redlining," suggesting perhaps that housing should play a central role in reducing these gaps.[3]

Daniel Carroll is a senior research economist at the Federal Reserve Bank of Cleveland. Ross Cohen-Kristiansen is a research analyst at the Federal Reserve Bank of Cleveland. The views authors express in *Economic Commentary* are theirs and not necessarily those of the Federal Reserve Bank of Cleveland or the Board of Governors of the Federal Reserve System or its staff.

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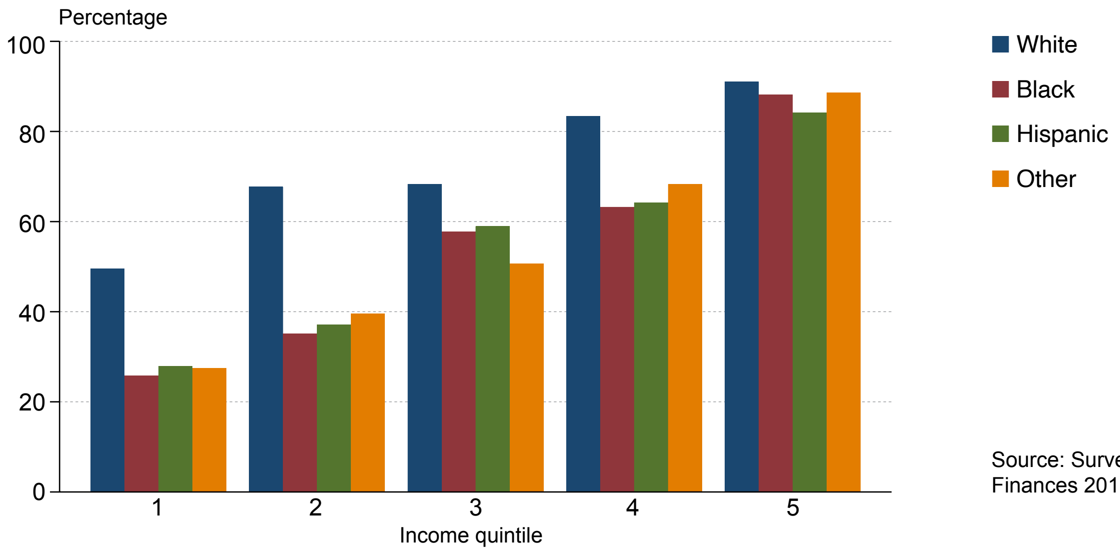
Figure 1: Homeownership Rates by Income and Race



Source: Survey of Consumer Finances 2019

Housing is primarily a consumption good, providing a flow of services, both tangible and intangible. Owning a home may have other economic benefits stemming from its location, as well. Some of the disparities in earnings by race can be traced back to differences in neighborhood resources (Aliprantis, Carroll, and Young, 2019b), and closing gaps in labor earnings can have a profound effect on wealth inequality (Aliprantis, Carroll, and Young, 2019a). Homeownership may also allow access to a neighborhood that offers more economic opportunity, perhaps in the form of job networks or better schools.[4] As Mester (2021) argues, policymakers must remain vigilant against policies aimed at preventing house-seekers who are otherwise qualified from purchasing a home in more affluent communities or that foster restrictive zoning policies that exclude renting or multifamily units. Policymakers should monitor the housing and credit markets for discrimination and act to ensure that mortgage and selling decisions are made fairly so that all households who want a home and have the means to finance one can do so.

Purchasing a home is also an investment: The home is a store of wealth that may generate a positive return over time, although not necessarily in every case. In this *Commentary*, we will focus on the investment aspect of housing by discussing some benefits and risks surrounding homeownership, comparing the performance of housing to other assets such as stocks and bonds, and assessing the efficacy of homeownership incentives for reducing wealth inequality. We will show that the benefits and risks are not distributed uniformly across households: The benefits tend to favor those with higher incomes, while the risks tend to be more severe for those with lower incomes. Given this unequal balance of benefit and risk, we advise caution in regard to promoting homeownership as a measure to combat wealth inequality. While homeownership may have a range of benefits, strategies to reduce wealth inequality by boosting homeownership come with considerable challenges and risks, particularly for low-income households, and policymakers should plan for these challenges and risks.

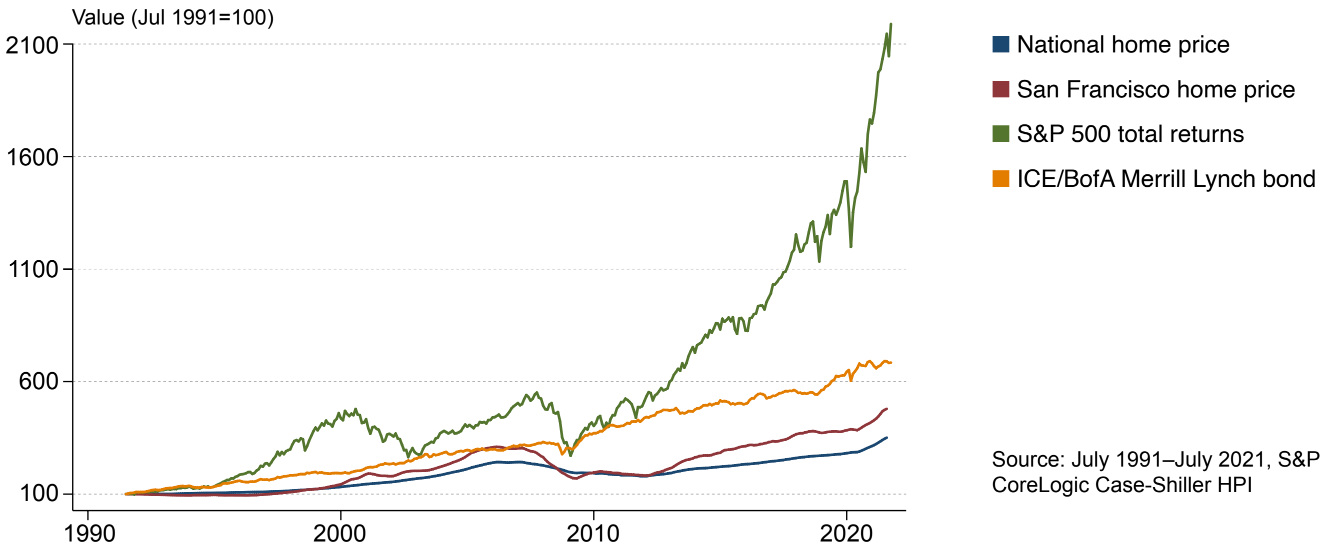
Financial returns from homeownership

The financial return to a homeowner comes from two primary sources: the capital gain on the home (assuming the home appreciates over time) and the owners' equivalent rent (OER), which is the value of rent payments that the homeowner would otherwise have had to make to live in an equivalent shelter.[5] From these returns, there are a number of costs that must be subtracted. The largest cost is generally the mortgage payment,[6] but other significant expenses such as property taxes, maintenance costs, and homeowners insurance also reduce the overall return.[7]

House price appreciation

The primary factor for evaluating the efficacy of using housing as a lifelong wealth accumulation strategy is the expected return. Over time, if a home price rises, the homeowner will receive a capital gain. That said, purchasing a home comes at the opportunity cost of investing in other assets such as stocks and bonds. Figure 2 compares the performance of home price appreciation to the total return on other asset classes over the past 30 years. The figure refers to an overall residential real estate price index for the United States and a price index for San Francisco, California, a city with very high home price appreciation. From 1991 to today, national home prices have grown much more slowly than the S&P 500 and the price of an average investment-grade corporate bond. Even in San Francisco, the home price index has grown less than has a broad mix of investment-grade corporate bonds and far less than the S&P 500. A plan for building long-run wealth should harness the growth potential of the full market. However, households outside of the top income groups tend not to hold stocks despite stocks' high expected returns. This disparity can lead to more inequality, as over time households with greater wealth realize larger returns on their savings.[8]

Figure 2: Indexes of Home Prices versus Total Returns for Stocks and Bonds



Source: July 1991–July 2021, S&P CoreLogic Case-Shiller HPI

Total return on housing

In addition to price appreciation, the return on housing also includes OER, which in practice can be complicated to measure. For this reason, studies on total returns from housing are scarce. But several recent studies have employed different techniques to estimate the return on housing over the past few decades. While not perfect proxies for low-income homeowners, these studies can be useful in providing upper bounds for what we would expect the returns to be. Demers and Eisfeldt (2021) provide an estimate for the return on single-family homes from 1986 to 2014 using the American Housing Survey (AHS) to measure rental values. They find an average nominal return of 9.8 percent for the nation as a whole, with considerable variation across different metropolitan areas. The study considers the return for an institutional investor in single-family homes who optimizes the investment aspect of the home, so their estimate likely overstates the gain that a low-income household owning and living in its own home would achieve.

Using data from Zillow and the AHS, Goodman and Mayer (2018) estimate the overall return from taking out a 30-year fixed-rate mortgage and buying a home in 2002. Including the benefits and costs listed above in their calculation, they estimate an annualized nominal return of 12.3 percent if the home was sold in 2013. Their estimate is probably generous given their assumptions on tax rates, optimal refinancing, and the mortgage interest deduction (MID). For instance, the MID applies only to taxpayers who itemize on their returns, and most people do not itemize. In 2013, more than two-thirds of households took the standard deduction rather than itemizing.[9] Also, itemizers skew toward higher incomes, especially since, more recently, the Tax Cuts and Jobs Act of 2017 doubled the standard deduction and capped the value of state and local income taxes that can be deducted. Less than 5 percent of taxpayers with below-median incomes and less than 10 percent of taxpayers with below the top 20 percent of incomes itemized on their 2019 taxes.[10] Subtracting the tax benefit reduces the annual return to 7 percent.

For comparison to Goodman and Mayer's estimate of an annualized nominal return of 12.3 percent, Table 1 shows the total returns from investing in several portfolios beginning in 2003 and then selling at the end 2013, the same years of Goodman and Mayer's data.[11]

Table 1: Annualized Percent Return on Diversified Portfolio (2003–2013)

All Equity	10.0
All Bonds	4.0
Mixed	6.9

Sources: Yahoo! Finance, authors' calculations

During this period, housing shows no advantage in return over either of the market portfolios containing equities.

Finally, Jorda et al. (2019) estimate the rate of return on housing and on equities through 2015 using more than a century's worth of national-level data. They find that housing and equities have roughly the same return over the full sample but that equities has outperformed housing on average since 1950, particularly in the post-1980 era.[12]

Total return of other investments

Despite offering a higher expected return, diversified equity-based portfolios are not widely held among lower-income households. This puts these households at a disadvantage relative to higher-income households when it comes to growing their wealth. Table 2 illustrates the disparity in stock market asset ownership across income quintiles. Even allowing for indirect ownership through a mutual fund or IRA, less than 17 percent of low-income households own a stock. In the top group of earners, nearly 90 percent hold some stake in the stock market, generally by indirect means rather than holding assets in any given company. Not surprisingly, households in the bottom two income groups typically have little wealth, but what they do have is held disproportionately in low-return durable goods such as cars, home electronics, and appliances that tend to lose value over time rather than gain it. It is possible that there are higher barriers to entry into the financial market for poorer households, and if so, making it easier to direct money toward diversified market savings accounts could support wealth accumulation for these households.[13]

Table 2: Fraction of Households That Own Stocks

Income Rank	Directly	Directly or Indirectly
Bottom 20	5.8	15.7
21–40	7.4	35.6
41–60	12.3	54.5
61–80	16.7	70.8
81-100	34.2	88.5

Source: Survey of Consumer Finances 2019

Risk for homeowners

While housing may not have a higher expected return than certain financial assets over the course of multiple decades, it nevertheless can be a reliable vehicle for wealth accumulation. Before making that determination, one must also consider the risk around the return to homeownership and how those risks affect households at different levels of income distribution. We highlight three broad sources of risk: location, timing, and liquidity.

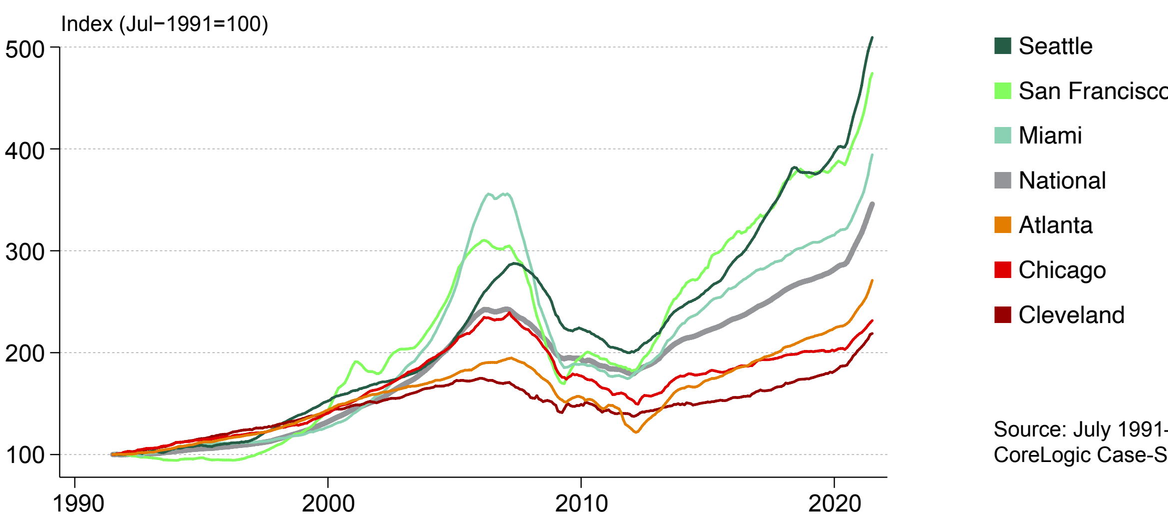
Location risk

Individual homes may not appreciate as steadily as the aggregate market. While it is reasonable to expect some home-price appreciation over a longer period of time, outcomes for specific markets can vary considerably (see Figure 3). Since 2000, homes in high-demand locations such as San Francisco, California, and Seattle, Washington, have appreciated at a much faster rate than the national average, while appreciation of homes in some midwestern and southern cities have lagged well behind. This imbalance means that a homeowner who relies on their house as their primary source of wealth later in life is taking on considerable long-term location risk, and there is no insurance policy that compensates homeowners in the event they purchase a home in a location in which home prices do not appreciate at a desirable rate. Moreover, it is not easy to discern ex ante which places will grow. Notice that during most of the 1990s, Cleveland's and Chicago's house prices outpaced the national average, while San Francisco's lagged well behind.[14] This clearly changed around 2000, underscoring the unpredictability of the housing market in terms of asset growth across a longer period of time.

Timing risk: Ownership duration and purchase date

Location risk is not the only factor causing variation in a homeowner's return. Often a homeowner finds that they need to sell their home, perhaps because they took a job in a new location or because they needed to upgrade or to downsize. The return that they realize on the sale of their home will depend on the time they spent in the home. The return is lower (possibly negative) in the early years because the structure of mortgage financing frontloads fees and

Figure 3: Home Price Indexes in Major Cities



Source: July 1991–July 2021, S&P CoreLogic Case-Shiller HPI interest payments. Over time, the owner's stake in the home grows as a larger fraction of each month's payment goes to pay down the principal so that the initial fees become smaller relative to the homeowner's equity. This duration risk may be more salient for low-income owners because on average they spend less time in their homes before selling or otherwise discharging their mortgage debt. In fact, Wainer and Zabel (2020) compare homeowners in the Panel Study of Income Dynamics and report that low-income households had much shorter durations of homeownership than wealthier households. They also show evidence of another type of timing risk: the date of purchase. Households that purchased in the late 1980s and early 1990s on average had higher yearly wealth gains than similar households that remained renters, while those who purchased homes in the early 2000s showed no wealth difference from their renter counterparts. This risk in purchase timing was particularly important for low-income households.[15, 16, 17]

Liquidity risk

For most homeowners with positive net worth, home equity comprises the lion's share of their wealth (see Figure 4). In the 2019 wave of the Survey of Consumer Finances, home equity share is nearly 80 percent for most households and exceeds 50 percent on average for all but the top earners, whose portfolios comprise more higher-expected-yield assets. Such a high concentration in a single asset means that a homeowner's wealth will be determined primarily by their home value. In other words, changes in home value will drive changes in wealth.

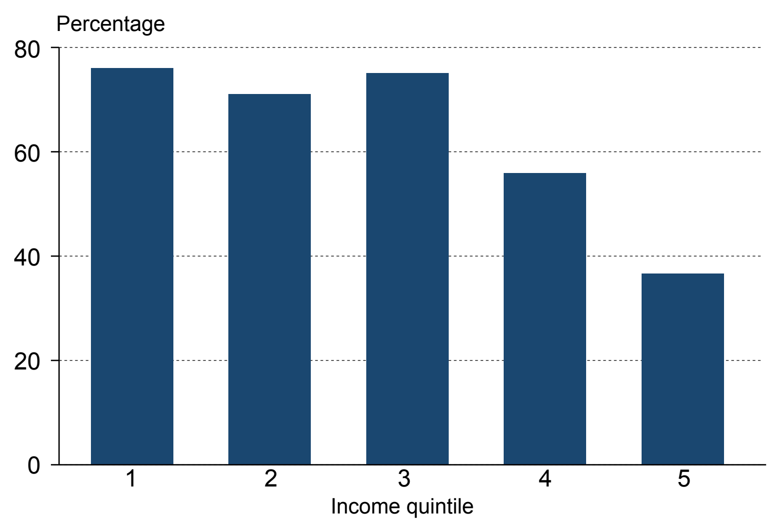
Additionally, home equity is much more illiquid than a portfolio of stocks and bonds. That is, unlike stocks and bonds, which can typically be sold within a few days and converted into cash, housing transactions can take months or longer. It is true that homeowners may set up lines of credit based on their home equity (home equity lines of credit, or HELOCs) or take out home equity loans; however, these methods of extracting home equity come at the cost of interest payments, closing costs, and other fees. Moreover, as credit markets make it easier for the homeowner to borrow against home equity to insure against large expenses, they also make recurring borrowing for general consumption easier, a prospect which undermines the wealth accumulation potential of homeownership.

For homeowners with disposable liquid savings in addition to their housing wealth, the illiquidity of housing presents less of a dilemma. These households tend to have high incomes and so are rarely the target of homeownership programs. Low-income households usually have more volatile income streams and tend to be more exposed to economic downturns in the labor market. This means that they are more likely to miss mortgage payments, a situation which could eventually lead to the loss of their home.[18]

Furthermore, a family with little disposable income, savings, or liquid assets is more susceptible to events requiring a distress sale of its home in which it is unlikely to receive the home's market value. In some instances, the family may be unable to sell at all, in which case the family would return its home to the lender in a deed-in-lieu of foreclosure, forfeiting the capital gains and potentially damaging the owner's credit rating and prospects of buying a home in the future.

These potential risks do not suggest that holding financial instruments such as stocks and bonds is risk free, however. Stock and bond prices fluctuate over time, and there is a risk that prices will be low when the stock or bond owner would like to sell. Stock prices in particular tend to be much more volatile than home prices. As with the timing risk for housing, stocks and bonds also have timing risks, but their advantage is that the return is not affected by where the seller or buyer lives.[19] Stocks and bonds are also much easier to liquidate, and, unlike a home, the entire portfolio does not need to be sold as a single unit, but, rather, can be broken up and sold piecemeal.

Figure 4: Home Equity as a Share of Homeowners' Wealth by Income Group



Note: Includes only households with positive wealth

Source: Survey of Consumer Finances 2019

Increasing homeownership among lower-income households as a policy goal

As we have seen, the benefits of homeownership are not restricted to consumption. As an investment, homeownership offers a potential capital gain and tax-preferenced imputed income in the form of OER. In addition, when purchased with a fixed-rate mortgage, a home is a hedge against unexpected rent increases. These benefits, however, also come with considerable risk, particularly for low-income households. Nevertheless, for a policymaker with the aim of increasing the wealth of lower-income households, mortgages can act as a forced savings plan. While a homeowner makes mortgage payments to enjoy the continued use of their house, they are also potentially building wealth through home equity.

Whether homeownership causally increases wealth relative to renting is quite challenging to uncover from the data. Although it is true that the rate of homeownership rises with income and wealth, it need not be the case that homeownership *leads* to more wealth accumulation than renting. Alternatively, it may be that most people prefer owning to renting for a host of idiosyncratic reasons unrelated to the return on investment. Those with higher incomes and wealth can more easily afford homes. After all, the very wealthy are also more likely than others to own art as an investment, but this art is rarely the cause of their affluence. No serious policy proposal would aim to incentivize art ownership as a means to reduce wealth inequality. Similarly, one must look beyond simple correlations in the data to find evidence for homeownership's ability to build wealth.

Careful studies that compare homeowners to renters over time find that homeowners on aggregate do accumulate somewhat more wealth. This is true for both low-income and high-income households, though the effect is usually relatively smaller for low-income households. However, these same studies still caution against interpreting their results as causal. It could be that people who buy homes tend to be more inclined toward saving in the first place because purchasing a home usually requires a significant down payment. While some households may receive help with a down payment from relatives, many others must save up over time.

Nevertheless, if we assume that homeownership does encourage more saving, policymakers should still exercise care when attempting to harness homeownership to mitigate wealth disparities. Compared to owning a well-diversified portfolio of stocks and bonds, homeownership has, at best, a similar expected return but comes with a considerable number of risks, many of which are greater for households with low income and low wealth than for households in high income brackets and with more wealth. Policies that incentivize purchasing homes instead of renting for the purposes of reducing wealth inequality or closing racial wealth gaps should be adopted only after great care has been taken to protect against location, timing, and liquidity risks. Failure to do this could have the unintended effect of increasing the wealth gap over time.

Footnotes

1. "Homeownership: The American Dream." HUD USER (2018). https://www.huduser.gov/portal/pdredge/pdr-edge-frm-asst-sec-081318.html
2. Data from Survey of Consumer Finances 2019
3. See Aaronson, Hartley, and Mazumder (2017); Rothstein (2018); and Faber (2020).
4. For more information, see: "The Racial Wealth Gap and Access to Opportunity Neighborhoods," Aliprantis et al.; and "Racial Inequality, Neighborhood Effects, and Moving to Opportunity," Aliprantis (2019).
5. Note that owners' equivalent rent is imputed income that is not taxed.
6. Since low-income families rarely have the means to purchase a house in full with cash, we will assume that the house is financed.
7. Most home purchases are financed with mortgages that require a fraction of the sale price as down payment, generally around 20 percent. From an investment standpoint, the homeowner is "leveraged," or in debt, a situation which can affect the total return. While many other assets, such as stocks and bonds, can be purchased with leverage, housing leverage is unique because it is much less risky in comparison. Leverage decreases to zero over the life of the mortgage, so leverage is less of a factor for a household planning to build wealth through its primary residence.
8. Azzolini, McKernan, and Martinchek (2020) argue that matched saving programs, which can capture these higher financial returns, are effective for promoting wealth accumulation for low-income households.
9. "Who Itemizes Deductions?" Scott Greenberg. Tax Foundation. https://taxfoundation.org/who-itemizes-deductions/
10. How Many Taxpayers Itemize Under Current Law?" Scott Eastman. Tax Foundation. https://taxfoundation.org/standard-deduction-itemized-deductions-current-law-2019/
11. From top to bottom, the representative portfolios are Vanguard Total Stock Market Index (VTI), Vanguard Total Bond Index Fund Investor Shares (VBMFX), and Vanguard Balanced Index Fund Investor Shares (VBINX).
12. See Jorda, et. al, (2019) Table 7.
13. Azzolini, McKernan, and Martinchek (2020) argue that matched saving programs, which can capture these higher financial returns, are effective for promoting wealth accumulation of low-income households.
14. For a more complete examination of the idiosyncratic risk around homeownership, see Giacoletti (2021).

15. The authors also find that homeowners with incomes above the bottom 20 percent had larger absolute wealth gains than those within the bottom 20 percent, another example of the benefit of homeownership on wealth's being weaker for the poorest households.
16. Newman and Holupka (2016) find similar timing risk among Black homeowners relative to white homeowners. They also show evidence of significantly lower housing returns for Black families. Shuetz (2020) https://www.brookings.edu/research/rethinking-homeownership-incentives-to-improve-household-financial-security-and-shrink-the-racial-wealth-gap/ offers an excellent overview of homeownership and the racial wealth gap.
17. Rappaport (2010) also finds considerable timing risk for housing returns relative to renting and investing in financial markets.
18. Bayer, Ferreira, and Ross (2016) study the mortgage experiences across racial groups during the Great Recession. They find that low-income, low-wealth Black and Hispanic households had far higher rates of delinquency and default than white households of similar financial status.
19. Here we are assuming that the buyer lives in the United States. Foreign residency may affect the return one receives on a United States asset.

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