Center for American Progress

For Middle-Class Families, Dream of Own House Drowns in a Sea of Debt

Christian Weller, Ph.D.

Progressive Ideas for a Strong, Just, and Free America

For Middle-Class Families, Dream of Own House Drowns in Sea of Debt

Christian E. Weller, Ph.D.

Center for American Progress

May 2005

For Middle-Class Families, Dream of Own House Drowns in Sea of Debt

Christian E. Weller, Senior Economist, Center for American Progress

On Friday, May 13, 2005, President Bush will address the National Association of Realtors in Washington. The president often cites increased home ownership rates as a key component of his "ownership society" and also as an economic bright spot amid a labor market that continues to struggle in finding its foothold. However, a closer look at the housing market exposes the soft underbelly of our economy and shows disturbing new trends that raise doubts about how beneficial the housing market really has been for America's middle-class families:

KEY FINDINGS

- **The Increase in Home Ownership is Slowing as Housing Costs Increase.** The rise in home ownership rates that began in the mid-1990s has slowed markedly since early 2001, especially for African-Americans.

- **Americans Are Borrowing More Than Ever Against Their Homes to Pay Other Expenses, Reinvesting Less Back Into Their Home Equity.** Households have relied more heavily than ever before on borrowing against the equity in their homes to help them pay their bills. This additional borrowing has allowed families to deal with skyrocketing costs such as health care and education during a period of stagnant labor market and wage growth.

- **Families Own Less of Their Own Homes Than Ever Before.** During this business cycle, families have owned the smallest share of their own homes since the 1950s. Rapidly rising home values were outpaced by even faster growing debt.

- **Historic Increase in Mortgage Debt a Growing Factor in Historically High Personal Bankruptcies.** Mortgage debt has risen higher and faster than ever before during a business cycle, contributing to the economic distress of many families, reflected in record personal bankruptcy rates.

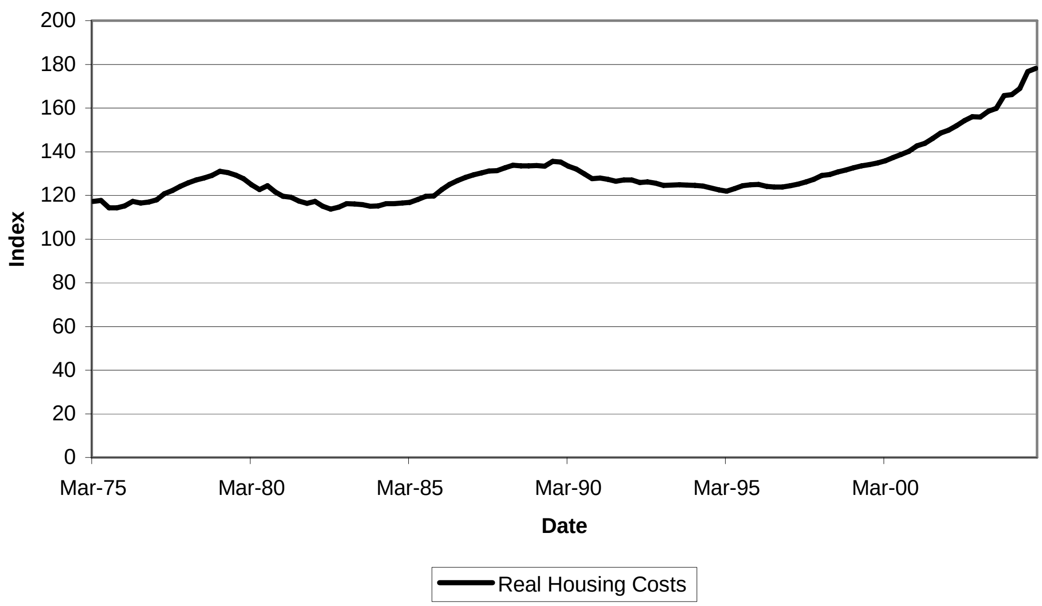
- **Historically Low Interest Rates Not Offsetting the Historically High Borrowing.** Although historically low interest rates have helped increase home ownership, the historic level of borrowing more than offsets any gains made by the low interest rates.

Slow Wage and Jobs Growth Meets Housing Price Inflation

By all measures, the labor market has shown a sub-par performance for the first four years of this business cycle, which started in April 2001. Over the span of four years, employment and inflation adjusted weekly wages were essentially flat, data from the Bureau of Labor Statistics show.

At the same time, housing prices continued to rise faster than overall prices. Starting in the mid-1990s, housing prices rose faster than inflation for the first time in decades. From the end of 1994 to the end of 2004, housing prices rose 46 percent faster than overall inflation (figure 1). In the period of a weak labor market, from March 2001 through the end of 2004, housing prices outpaced overall inflation by 25 percent.

Figure 1: Real Housing Costs



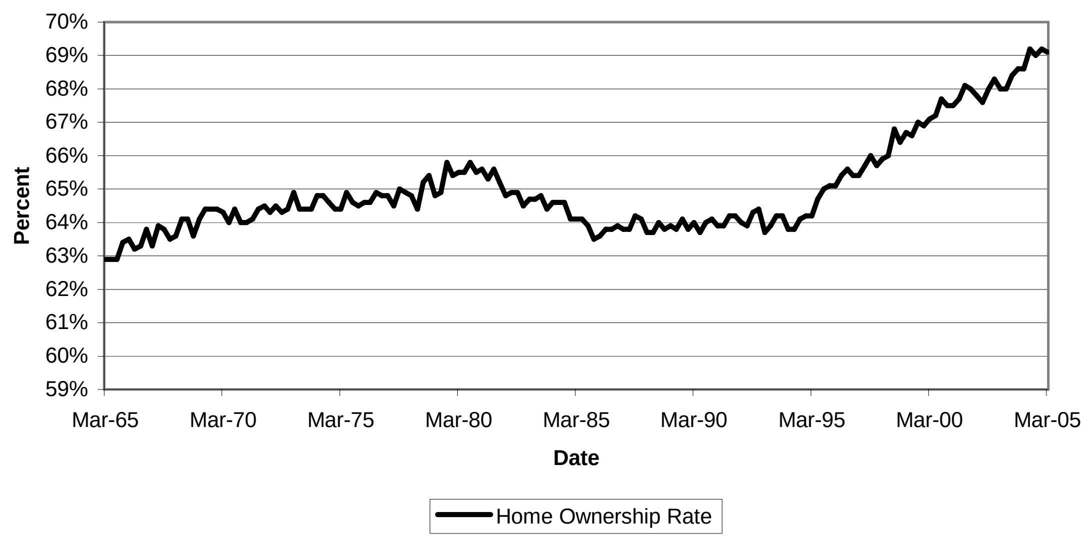
Source: Author's calculations based on Bureau of Labor Statistics, Consumer Price Index, Washington, D.C.: BLS; Office of Federal Housing Enterprise Oversight, House Price Index, Washington, D.C.: OFHEO

Quickly rising home prices have ultimately proven to be an albatross around the neck of the middle class. They have contributed to a slowdown in home ownership growth because higher prices made it harder for people to buy a home. However, simultaneously higher housing prices allowed middle-class families to borrow more money against the newfound equity in their homes. Yet, with more debt amid a weak labor market, families are under more economic stress, mirrored in record bankruptcy rates.

Growth in Home Ownership Slows Amid Weak Labor Market, High Prices

Home ownership rates began to pick up markedly in the mid-1990s, after staying essentially the same for decades. The overall home ownership rate rose from 63 percent in 1965 to 64 percent by the end of 1994. From the end of 1994 through the end of 2004, the home ownership rate grew from 64 percent to 69 percent (figure 2).

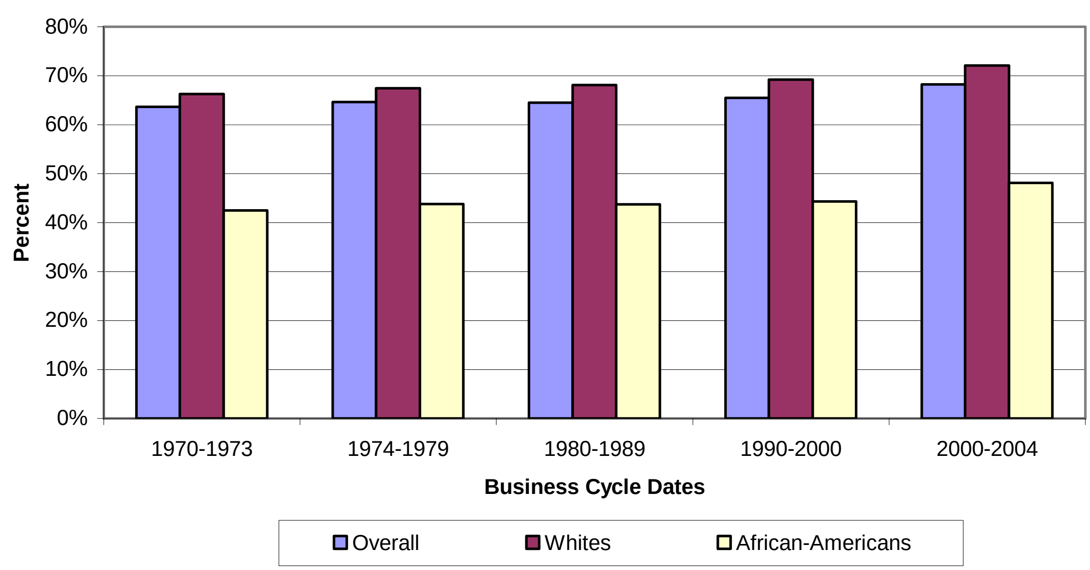
Figure 2: Home Ownership Rate



Source: U.S. Census Bureau, Home Vacancy Rates, Washington, D.C.: Census.

The increases in home ownership held for all groups. For whites, the home ownership rate equaled 72.9 percent, while the home ownership rate for African-Americans still stayed below 50 percent with 49.1 percent in 2004 (figure 3). For this business cycle, the average home ownership rate for African-Americans equaled 48 percent compared to 44 percent in the previous business cycle, while that for Hispanics grew from 43 percent to 47 percent (not pictured) and that for whites rose from 69 percent to 72 percent at the same time.

Figure 3: Home Ownership Rates, 1970 to 2004



Source: Author's calculations based on U.S. Census Bureau, American Housing Survey, Washington, D.C.: Census.

The business cycle averages, though, mask a marked slowdown in the growth rate of home ownership, which is especially pronounced for minorities. Home ownership began to rise markedly in 1995 and thereafter, driven by faster employment, higher wages, and lower interest rates. Over the years 1995 through 2000, home ownership rates grew by an annualized quarterly average rate of 2.3 percentage points for whites, 3.3 percentage points for African-Americans, and 3.4 percentage points for Hispanics. From 2000 to 2004, the rate of growth slowed to 1.7 percentage points per year for whites, 1.8 percentage points for African-Americans, and 1.9 percentage points for Latinos. This meant a slow-down in the growth rate of home ownership by 25 percent for whites, by 42 percent for African-Americans, and by 45 percent for Hispanics (table 1). That is, while home ownership continued to rise, it did so at a much slower pace than in the years preceding the weak labor market of the past few years.

Table 1
Average Rate of Change in Home Ownership

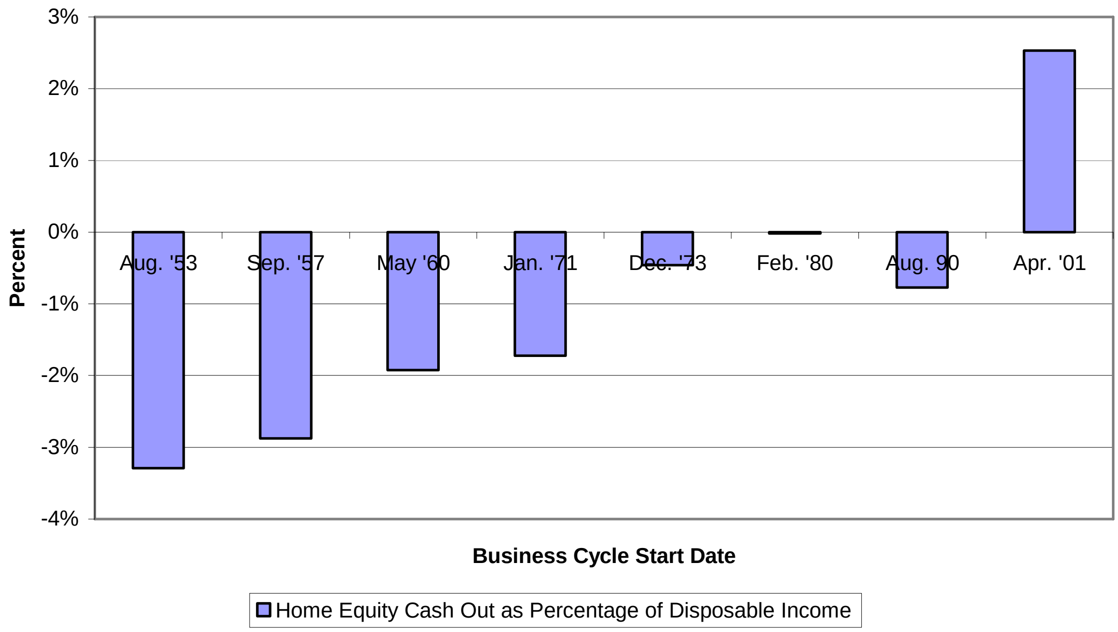
Business cycle dates	Total	Whites	African-Americans	Hispanics
1970-1973	1.50	1.70	1.80	n.a.
1974-1979	0.64	0.80	0.40	n.a.
1980-1989	-0.56	0.40	-0.60	n.a.
1990-2000	1.24	0.62	1.56	2.18
• 1990-1995	0.00	-1.36	-0.48	0.72
• 1995-2000	2.27	2.27	3.27	3.40
2000-2004	1.60	1.70	1.90	1.80

Notes: All figures are average quarterly percentage point changes. Source: Author's calculations based on U.S. Census Bureau, American Housing Survey, Washington, D.C.: Census. "n.a." indicates that data were not available.

Borrowing to Pay the Bills

Households increasingly used their new and value appreciated homes to borrow more money to pay for things other than home upgrades and renovations. In fact, since 2001, families have almost consistently borrowed more money against their homes than they spent for upgrades and renovations. For the first time in any business cycle since the 1950s, households have used their homes as a cash cow. Home equity cash-outs have allowed families to face rising costs for important items, such as education and health care, although job gains and wage growth were flat. Due to home equity cash-outs, families increased their available resources on average by 2.5 percent relative to their disposable income (figure 4). For 2004 alone, this meant that households had an additional $324 billion to spend on items other than their homes.

Figure 4: Home Equity Cash Outs as Percentage of Disposable Income

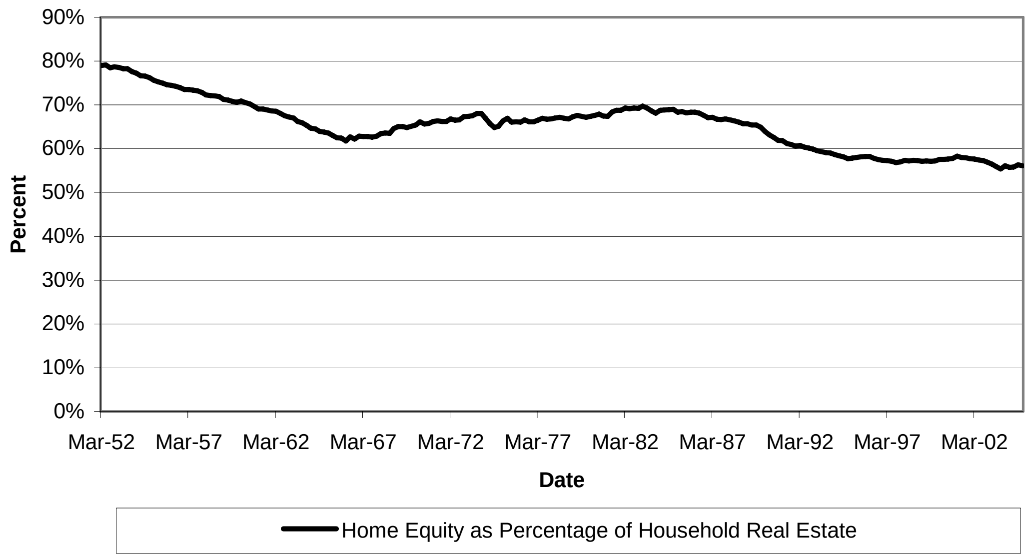


Source: Author's calculations based on data from the Board of Governors of the Federal Reserve System, Release Z.1 Flow of Funds Statistics of the United States, Washington, D.C.: BOG.

Bank Ownership Society

Because households borrowed more and more money against the ever higher value of their homes, mortgage debt actually rose faster than home values. As a result, families owned an ever shrinking share of their homes. By the end of 2004, middle-class families owned 56 percent of their homes' values, down from 58 percent in early 2001 (figure 6) and the lowest value since the Federal Reserve began collecting these data in the 1950s.

Figure 6: Home Equity as Percentage of Household Real Estate



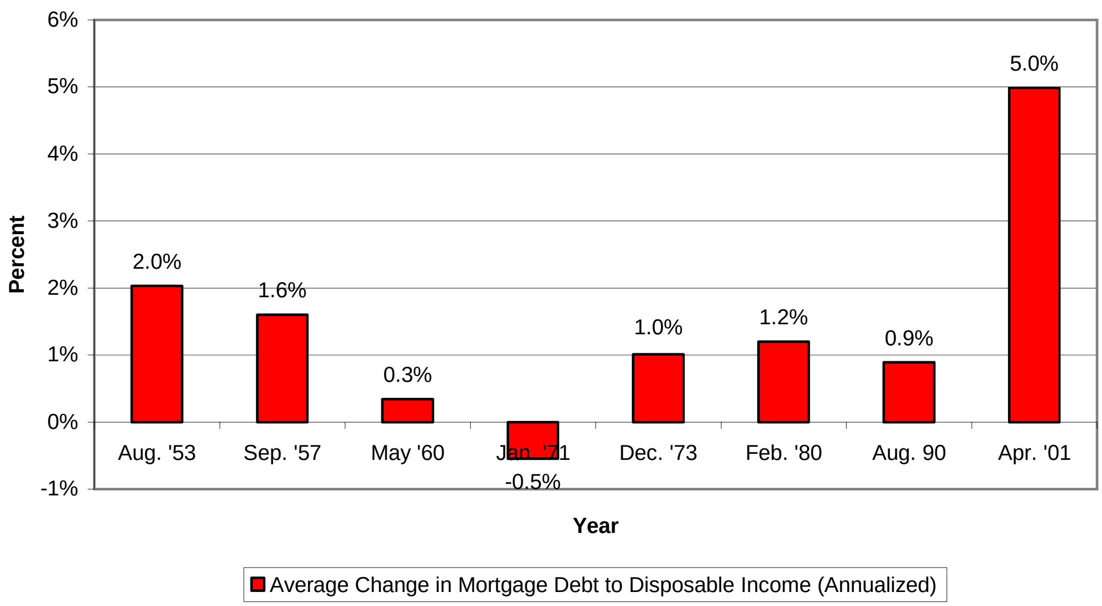
Source: Author's calculations based on data from the Board of Governors of the Federal Reserve System, Release Z.1 Flow of Funds Statistics of the United States, Washington, D.C.: BOG.

Record Debt Takes Toll on Middle Class

Since this rapid accumulation of debt happened amid and because of a weak labor market, households have ended up owing more debt relative to their disposable income than ever before. Mortgage debt amounted to a record high 85 percent of disposable income in late 2004. Importantly, although there has been a general trend towards more mortgage debt over time, the increases in mortgage debt relative to disposable income were more pronounced in this business cycle than in any previous ones (figure 7). From March 2001 through the end of 2004, the ratio of mortgage debt to disposable income accelerated by an annualized average rate of 5.0 percentage points. This was more than twice as fast as the business cycle with the second largest acceleration in the 1960s.

The fact that interest rates approached historic lows and thus appeared to keep payments manageable was only a small panacea. After all, the total amount of debt rose faster for the typical family than interest rates declined. As a result, households still ended up paying a greater share of their incomes for their mortgages. By late 2004, the share of disposable income that homeowners had to dedicate to the repayment of their mortgages amounted to more than 10 percent, according to estimates by the Federal Reserve.

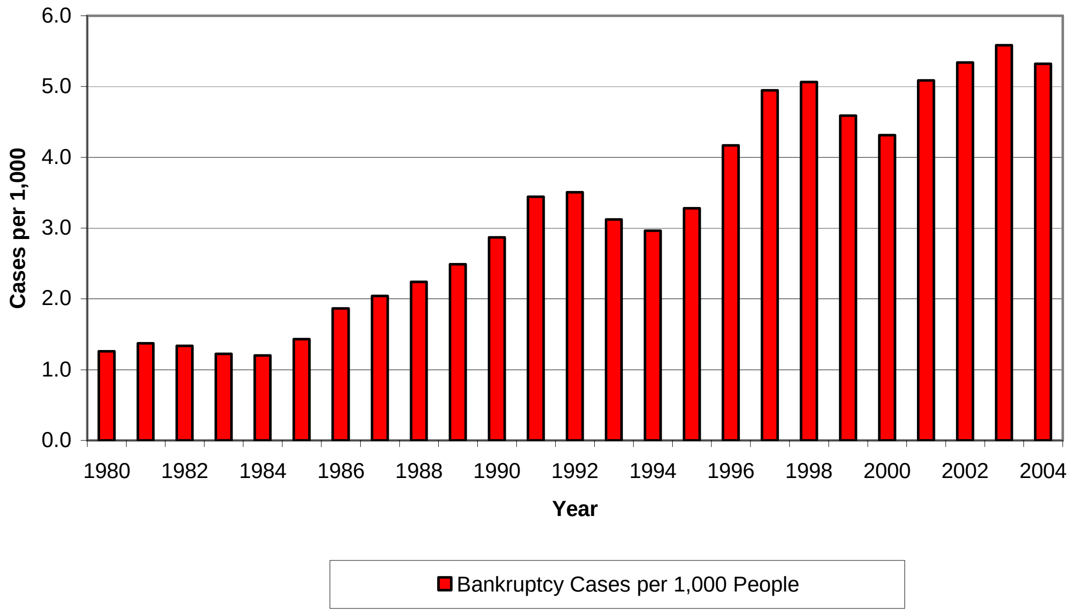
Figure 7: Average Change in Mortgage Debt to Disposable Income (Annualized)



Source: Author's calculations based on data from the Board of Governors of the Federal Reserve System, Release Z.1 Flow of Funds Statistics of the United States, Washington, D.C.: BOG.

The massive amounts of new debt have contributed, together with other large cost items, to the financial distress of America's middle class. From 2000 to 2003, personal bankruptcy rates increased sharply before falling slightly in 2004. Yet, even in 2004, there were more than 5 bankruptcy filings per 1,000 people in the U.S. (figure 8). The combination of a weak labor market and rapidly rising debt has contributed to record personal bankruptcy rates in this business cycle.

Figure 8: Personal Bankruptcy Cases per 1,000 people



Notes: Calculations are based on American Bankruptcy Institute, Non-Business Filings, Washington, D.C.: www.abiworld.org, and U.S. Census Bureau, Population, Washington, D.C.: www.census.gov.

Conclusion

Although home ownership rates have continued to rise in this business cycle, middle-class families get to enjoy less and less the long-term benefits of home ownership. A growing share of their homes is owed to mortgage companies and banks. Despite rapidly rising home values, households have actually shrunk the value of their equity relative to the total value of their homes as their debts rose faster than their home values. This increase in debt was driven by the need of households to pay for ever more costly items, other than their homes, amid a comparatively weak labor market. Not surprisingly, the combination of slow income growth and rapidly rising debt has contributed to record personal bankruptcies in this business cycle.

References:

American Bankruptcy Institute, 2005, Non-Business Filings, Washington, D.C.: ABI

Board of Governors of the Federal Reserve System, 2005, Release Z.1 Flow of Funds Statistics of the United States, Washington, D.C.: BOG.

Bureau of Labor Statistics, 2005, Consumer Price Index, Washington, D.C.: BLS

Office of Federal Housing Enterprise Oversight, 2005, House Price Index, Washington, D.C.: OFHEO

U.S. Census Bureau, various years, American Housing Survey, Washington, D.C.: Census.

U.S. Census Bureau, 2005, Population, Washington, D.C.: Census

Center for American Progress

ABOUT THE CENTER FOR AMERICAN PROGRESS

The Center for American Progress is a nonpartisan research and educational institute dedicated to promoting a strong, just and free America that ensures opportunity for all. We believe that Americans are bound together by a common commitment to these values and we aspire to ensure that our national policies reflect these values. We work to find progressive and pragmatic solutions to significant domestic and international problems and develop policy proposals that foster a government that is "of the people, by the people, and for the people."

Center for American Progress
1333 H Street, N.W., 10th Floor
Washington, D.C. 20005
(202) 682-1611
www.americanprogress.org