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HOMEOWNERSHIP, FINANCIAL FLEXIBILITY, AND WEALTH

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Home ownership is a central element of wealth accumulation for American households. In 2004, 69 percent of households owned their homes, and for half of those home owners, the value of their primary home accounted for 63 percent or more of all their asset holdings. Also for half of all home owners, equity in the home (home value minus mortgage debt) accounted for at least half of total wealth. This article adds to a growing literature that examines the importance of owner occupied housing as an asset on household balance sheets and as a vehicle of wealth accumulation using the Federal Reserve Board's Survey of Consumer Finances. [1]

In February 2006 the Federal Reserve Board released the latest installment of the triennial Survey of Consumer Finances (SCF). This installment provides detailed information about household balance sheets as of the second half of 2004. The SCF is unique among household surveys and other data sources in its ability to provide periodic and timely information on household asset and debt portfolios. Data in the SCF allow examination of the financial condition of individual households by various demographic characteristics.

While the primary residence is the largest asset for most individual home owners, in the aggregate, the value of financial assets was slightly larger for home owners in 2004. [2] Financial assets are highly concentrated among a relatively small share of households. Table 1 shows major household balance sheet items for 2004 from the SCF. The aggregate value of financial assets was $21.1 trillion. The aggregate value of primary residences was $19.1 trillion. [3]

Subtracting $6.7 trillion of primary home mortgage debt leaves $12.5 trillion in housing equity. The value of total assets (e.g., primary residences, other real estate, vehicles, stocks, bonds, retirement accounts, other financial assets, etc.) was $59.1 trillion. After subtracting all debt, households had a net worth of $50.2 trillion. To help put these figures in perspective, consider that US GDP in 2004 was $11.7 trillion. So total household wealth was more than four times the value of aggregate output, with the asset value of owner occupied housing approaching twice that amount, and housing equity was almost $1 trillion greater than the value of total output. [4] Major categories of assets and debts are shown in Figures 1 and 2.

These statistics indicate that owner occupied housing is a significant component of the aggregate economy, but the financial impact of home ownership is better understood when examined at the household level. Looking at the median values for these balance sheet items provides an individual home owner's perspective. [5] Table 1 includes median values for all households and home owners, as well as the shares of households with holdings of a particular asset or debt. In 2004, the median value of asset holdings for all households was $167,000, median debt was $22,500, and median net worth was $93,000; among home owners, median asset holdings was $289,500, median debt was $70,000, and median net worth was $184,700. [6] For home owners, the median house value, mortgage debt, and home equity were $160,000, $53,000, and $86,000, respectively.

The columns in Table 1 labeled "Shares with Asset/Debt" indicate how widespread ownership of an asset or debt is, and therefore how representative its median value will be. Financial assets, a broad category including checking accounts, stocks, retirement accounts, etc., were held by 93 percent of all households and 97 percent of home owners. Among non-financial assets, vehicles were the most commonly held asset at 86 percent of households. Home ownership (i.e., ownership of the primary residence) was 69 percent in 2004, according to the SCF, and among these home owners, 69 percent had outstanding mortgage or home equity debt. In contrast, some assets and debts are not widely held. Other residential real estate was held by less than 13 percent of households; among those households its median asset value was $100,000. **[7]** Other residential real estate includes second homes, time shares, 1-4 family rental properties, and other types of residential properties. Of these properties, in 2004, second homes and time shares accounted for relatively small shares, roughly 15 percent and 12 percent, respectively, while rental and other properties accounted for the remainder.

The median values and shares improve upon the picture presented by the aggregates, but because wealth variables tend to be so concentrated at the high end of the distribution, calculating balance sheet ratios at the level of the household is particularly instructive. The median values of these ratios are presented in Table 2 with median values for all home owners, as well as home owners arrayed by income categories, where each income category includes roughly one quarter of all home owners. **[8]**

In 2004, the median value of owner occupied housing as a share of total asset holdings was 63 percent. This means that for half of all home owners, the primary residence accounted for 63 percent or more of all assets. In comparison, the median value for financial assets, the second largest component of a household's asset portfolio, was 16 percent. With respect to wealth, the median value of housing equity as a share of total household wealth was 49 percent. These financial ratios provide the most accurate assessment of housing's financial significance on the balance sheets of home owners. **[9]**

The financial ratios by income group show that home value is especially important for lower income home owners. For home owners in the bottom 25 percent of the income distribution, the median value of housing's share of all assets was 82 percent. The median value of financial assets' share of total assets was only 4 percent, and median non-housing, non-financial assets' share of asset holdings was 6 percent. **[10]** Median housing equity was 78 percent of total net worth. These statistics suggests that the primary residence was not only the most important, but virtually the only significant asset for these home owners. In contrast, for the most well-heeled of home owners, the home typically accounted for less than half of all asset holdings and less than one third of total wealth.

Table 2 shows that higher income home owners tend to have more expensive homes, and despite more housing debt, have more housing equity than lower income households. The median house value of $325,000 for the highest income group was roughly four times that of the bottom income group. The $175,000 median value of primary home equity for high income home owners was roughly three times that of the bottom group. Table 2 also shows that despite these higher home values, high income home owners still spend a lower share of their income on their homes. While high income home owners spend a little more than twice their incomes on their homes, the lowest income group spends closer to 5 times their income on their homes. Also, the higher equity in the primary home for high income home owners represents a lower share of income than for lower income homeowners.

In this table, financial assets is a broad category that includes everything from checking and savings accounts to retirement accounts. Isolating retirement accounts and comparing them to housing equity is also instructive. **[11]** Median values for wealth accumulated in retirement accounts show that overall, home owners have accumulated substantially more in home equity than in retirement savings. Further, the bottom half of the income distribution has very little in these accounts. The top half of the income distribution has accumulated some wealth in these accounts, but the amounts are much lower than the value of home equity.

It is also important to note that home ownership is more prevalent than ownership of a retirement account. The overall home ownership rate measured in the SCF was 69 percent in 2004, and this rate rises from 47 percent of households in the bottom income group to 93 percent in the highest group. Ownership rates for retirement accounts are almost 20 percentage points lower, overall, and almost 30 percentage points lower for the bottom income group. These statistics show that while we may think about 401(k)'s and IRA's as primary vehicles for wealth accumulation, housing equity accounts from more wealth for more households.

The importance of housing on household balance sheets is not a new phenomenon. Table 3 shows wealth measures from the SCF for 1989 through 2004. While the dollar values (nominal and real) of housing, equity, assets, and wealth have all grown substantially since 1989, the relative shares of housing and financial assets in 2004 were at roughly the same levels as they were in 1989 through 1995. The stock market's huge gains in the late 1990's and early years of this decade boosted the share of financial assets in household portfolios temporarily, but subsequent stock market declines and increases in home values have returned financial assets' share to pre-bubble levels.

An interesting qualification to this stability is housing equity's declining contribution to total net worth over the period. The stock market's effect explains the exceptional years 1998 and 2001, but the decline from 57 percent in 1989 to 49 percent in 2004 began before the run up in the stock market. What's drove this trend?

With housing and financial assets stable proportions on the assets side, this trend must come from the debt side of the balance sheet. And with housing debt by far the largest component of household debt, it must be an important part of the trend. Comparing median values from 1989 to 2004, it is clear that housing value increased substantially, but also that housing debt grew faster than housing equity on the balance sheet, lowering equity's contribution to net worth. Does this mean that housing's prominence in wealth accumulation is declining?

Not necessarily, in fact, quite the contrary. There are two points to consider. First, the significant increase in home ownership between 1989 and 2004 tended to push down equity. This is because new entrants to home ownership have lower equity than existing home owners. In this case broader home ownership and lower equity should be interpreted as increasing housing's role in generating wealth.

The second point has to do with the role of home equity extraction. Home owners extract equity from their homes with traditional home equity loans or by refinancing existing mortgages and borrowing against built up equity. In 2004, almost 10 percent of home owners had refinanced a mortgage to borrow additional money against their home equity. **[12]** In addition to this equity extraction, the percentage of home owners with home equity loans, home equity lines of credit, or other loans that use the home as collateral, has grown steadily from 8 percent in 1989 to almost 15 percent in 2004. Who are the home owners tapping into their equity?

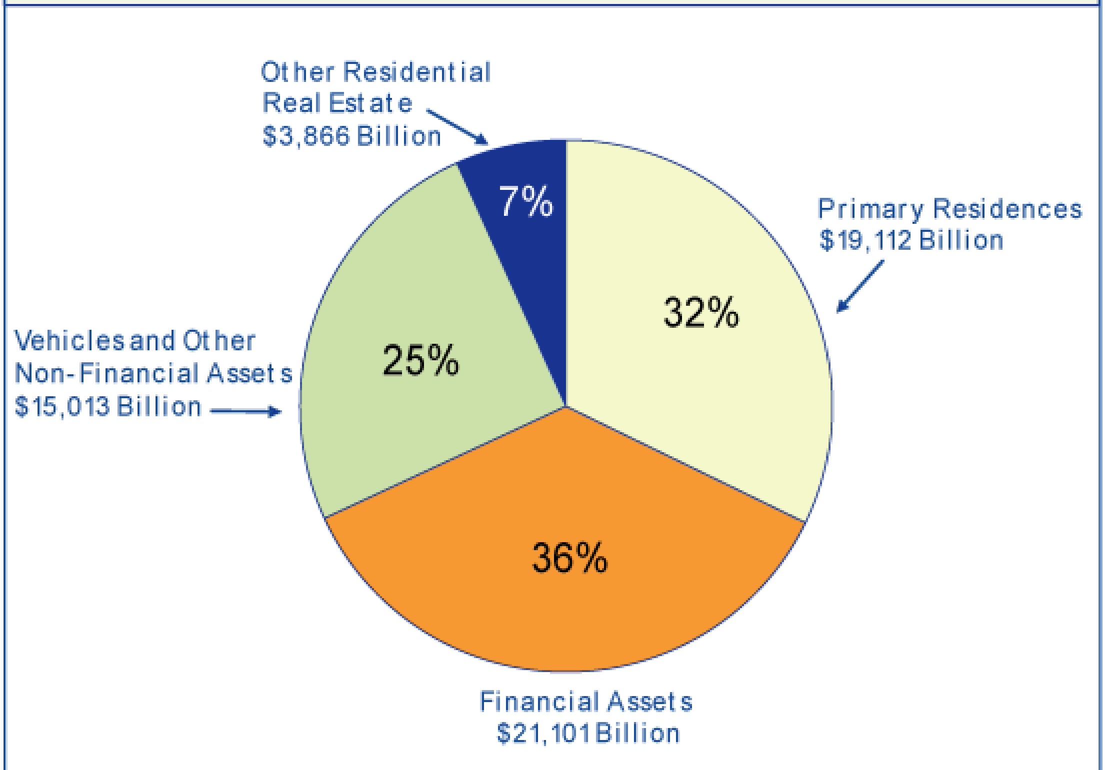
While borrowing has increased among all income groups, the largest increases have been in the top half of the income distribution; equity borrowing has risen from 7 percent to 18 percent of home owners in the third income quartile, and from 17 percent to 23 percent in the top income quartile. In contrast, home equity borrowing has increased from only 4 percent to 7 percent and from 8 percent to 12 percent among home owners in the first and second income quartiles, respectively. Also significant is that 78 percent of outstanding home equity debt was owed by the top half of earners, with 57 percent of the debt in the top 25 percent. This happens to be where most of the house value appreciation took place. The top half of the income distribution captured 76 percent of aggregate house value appreciation between 1989 and 2004, with 54 percent going to the top 25 percent.

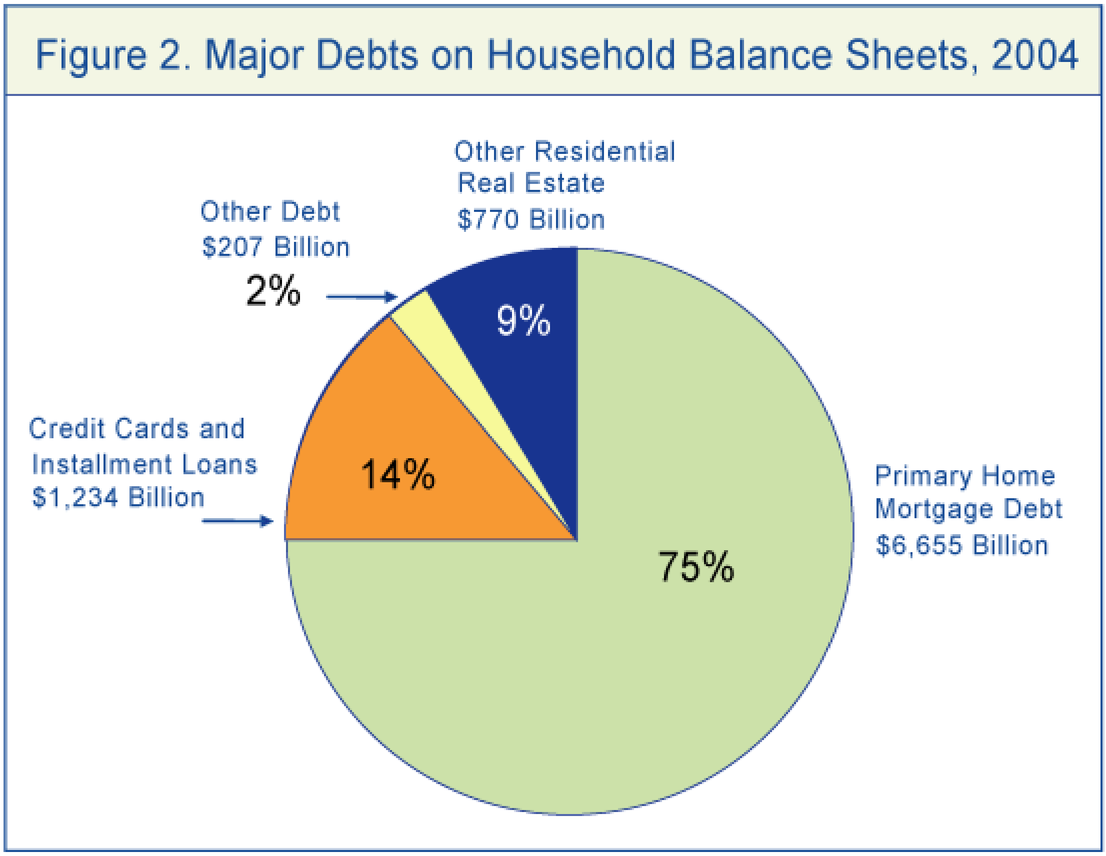
Home equity borrowing has also been encouraged by changes in tax policy. Federal income tax reform in 1986 encouraged the shifting from general consumer debt to home equity borrowing by eliminating the deductibility of consumer debt. The transition for both home owners and lenders has likely taken some years and plays a role in the observed increase in home equity borrowing.

This home equity borrowing suggests that rather than housing declining in importance, increased financial sophistication and rising housing values have enabled home owners to not only accumulate wealth, but to manage that accumulation, tapping into equity when necessary or desired, while still keeping equity and wealth rising.

Overall, home owners have enjoyed substantial increases in wealth and housing equity. For most home owners, the increase in wealth is largely attributable to rising house values and equity. Upper income home owners have benefited from financial assets as well as housing in their portfolios and have made greater use of housing equity borrowing. In both cases home ownership is an important tool in the accumulation and management of household wealth.

Figure 1. Major Assets on Household Balance Sheets, 2004





Footnotes

[1] See, for example, Siniavskaia, Natalia, "Home ownership, Financial Flexibility, and Wealth," Housing Policy, July 8, 2005; Bucks, Brian, Arthur B. Kennickell, Kevin Moore, "Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances" (PDF), Federal Reserve Bulletin, March 2006; Kennickell, Arthur B., "An Examination of Changes in the Distribution of Wealth from 1989 to 1998: Evidence from the Survey of Consumer Finances" (PDF), working paper of Board of Governors of the Federal Reserve System, 2001. Return to Article

[2] Primary residence and owner occupied housing are used interchangeably in this article. Return to Article

[3] This value differs from the Federal Reserve Board's Flow of Funds Accounts measure because of differences in sample coverage and data sources. See Antoniewicz, Rochelle, "A Comparison of the Household Sector from the Flow of Funds Accounts and the Survey of Consumer Finances," October 2000. Return to Article

[4] GDP is the flow of goods and services produced over the course of a year and valued at $11.7 trillion in 2004. Owner occupied housing is a stock of physical capital that was valued at $19.1 trillion in 2004. There is no inconsistency with the value of a stock of assets being larger than the value of a flow of goods and services. Return to Article

[5] The median value is the middle of the distribution, with half of all values lower and half of all values higher. When studying income and wealth, median values are considered more representative than averages because averages can be inflated by a few extremely wealthy households. Return to Article

[6] It is important to note that in the aggregate the accounting relationships of the household balance sheet hold: total assets less total debt equals net worth. However, when examining medians, the median assets, debt, and net worth are not necessarily from the same household, and so the balance sheet concept is illustrative, not technically precise (i.e., median assets less median debt will not equal median net worth). Similarly, the median shares will not sum to 100. Return to Article

[7] The median value for other residential real estate over all households was zero because it was held by less than half of all households. Return to Article

[8] This income distribution includes only home owners and is higher than published figures for the income distribution of all households. The 25th, 50th, and 75th percentiles for all households in 2004 in the SCF are roughly $22,500, $43,000, and $77,000, respectively. Return to Article

[9] Calculating housing's share of the asset portfolio at the aggregate level, that is, as the ratio of the aggregate value of housing to the aggregate value of all asset holdings yields a share of 34 percent. The median value when this ratio is calculated at the individual household level is 63 percent, nearly twice the value at the aggregate level. The analogous figures for housing equity and total wealth are 26 percent based on aggregates and 49 percent calculated at the household level. Return to Article

[10] Non-housing, non-financial assets exclude primary residences and include vehicles, other property, business equity, and miscellaneous tangible items, for example, artwork, jewelry, precious metals, antiques, collectibles, etc. Among these, vehicles were the most commonly held while other property and business equity were most valuable, but not widely held. Return to Article

[11] Retirement accounts include IRA/KEOGH and thrift savings type accounts as well as defined benefit and defined contribution accounts. Return to Article

[12] Data on equity extraction of this type was collected for the first time in the 2004 SCF so comparisons to earlier years are not possible. Return to Article

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