Economic Downturns and the Prospects for Home Ownership

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Introduction

At the time of writing the best selling housing text on the Amazon website is *The Coming Crash in the Housing Market: 10 Things You Can Do Now to Protect Your Most Valuable Investment* by John Talbott. Talbott reflects on the false sense of security among US home owners who have experienced rising house prices for over a decade and have been able to borrow at low rates of interest. He offers advice to homeowners about ways to avoid 'underwater mortgages', or negative equity, when the crash comes. Readers offer various reviews of the book online. One reader comments "*This book helped me decide not to buy a new house*, Another states that "*As a home owner in the most expensive housing market (SF Bay Area) this book scared me to death*." Another reader takes the view "*Who of us knows what the future is going to bring? I don't nor does the author of this well written book*".

Talbott's pessimism is in sharp contrast to the views expressed in a survey of US home owners carried out in 2002 by Case and Shiller (2003). They found that home owners typically regarded property purchase as a better investment than the stock market and that the long running housing boom was much more likely to provoke optimism than pessimism about future price trends. For example, 90-per cent of buyers in Orange County believed that house prices would continue to rise "over the next several years" and that the increase in value would be in double digits (p.14). Patterns of expectation did vary over time and region but in every circumstance optimists far outnumbered pessimists.

In a similar vein, policy and political debate in the UK is preoccupied with the apparently unstoppable surge in house prices. There are daily and contradictory commentaries on the inevitable property crash which is looming in the context of growing consumer debt fuelled by an ever rising stock of home equity. In September the International Monetary Fund pointed to the appreciable risk of an impending property crash. This warning about the potential risks of spiralling property prices coincided with the UK's biggest mortgage lender announcing a 23 per cent increase in prices over the previous year.

At the global level, the 2002/3 report from the Bank for International Settlements (BIS, 2003) highlights the residential property market as a critical feature in its rather uncertain assessment of economic prospects. Despite reduced corporate investment, household spending has been sustained in great part in the advanced market economies by house price inflation and remortgaging. And in some Asian economies the easing of monetary policy has fuelled a boom in house prices and a "rapid growth in household credit". In its overview of the economic situation, the BIS report observes that "solid global growth performance" could be seriously compromised unless corporate sector investment increases to counteract a possible weakening in consumer spending "given rising consumer debt levels, potentially weaker housing prices and rising unemployment".(p.9)

If there is a message from all this it is one of uncertainty, contradictory predictions and an unevenness of experience between regions.

Home Ownership: Changing Meanings and Changing Contexts

From a western perspective the promotion of home ownership by governments has, until comparatively recently, been seen primarily as a social project. Home ownership has been associated with achieving greater social stability and social cohesion and as a natural outcome of rising affluence and rising expectations. The economic and financial dimensions of a rising home ownership rate in the mainstream housing policy literature were explored mainly in relation to access to mortgage finance and potential household wealth effects.

Lending institutions were scrutinised for the fairness of their lending practices, particularly in relation to issues of ethnicity and gender. Achieving home ownership status was the key ingredient in becoming middle class- an active participant in the American Dream, the Australian Dream, Britain's property owning democracy or some other national version of the same package. Home ownership was seen to deliver real social benefits for the individual and society as a whole. Extreme versions of this perspective on the tenure can be found in commentaries such as Dietz's (2003) recent review of social science literature for the US Homeownership Alliance in which he concludes *inter alia* that the positive social outcomes associated with the tenure include "social involvement, local political participation and activism, environmental awareness, child outcomes, health, crime and community characteristics" (p.14) This is not the place to enter into a discussion about the contingent nature of these kinds of linkages. The point is that this has been the traditional terrain for housing policy debates often associated with an individualistic neo-liberal political project.

The stress on the social and political dimensions of home ownership are not, of course, confined to a western context. Lee Kuan Yew reflected in his autobiography "My primary preoccupation was to give every citizen a stake in the country and its future. I wanted a home owning society." (p.96) And while that stake in the system had an important financial element he was clear that the primary benefits were ones of political stability, national pride and social cohesion.

The associations between housing provision and the macro economy have, however, always been much more evident in East Asian debates.. Unlike many Western societies, the rise of individual, mortgaged home ownership (as opposed to more historical rural forms) is a comparatively recent phenomenon in many parts of Asia with rates of urban home ownership at a very modest level until the 1970s. Moreover, its development path was closely linked to the rapid economic growth of the 'tiger economies' and to the so-called productivist logic of developmental statism and more often than not involved a strong dose of direct state orchestration and assistance. (Lee et. all., 2003). In East Asia housing provision has been more explicitly part of economic development than in the older western housing systems. And the whole real estate sector and associated institutions has been more central to the wider economic fortunes of these societies (Henderson,1999). This linkage was most dramatically exposed with the Asian financial crisis (AFC). As Herring and Wachter (1998) noted, "One striking feature of the Asian financial crisis is that the most seriously affected countries *first* experienced a collapse in property prices and a consequent weakening of their banking systems *before* experiencing an exchange rate crisis. While this sequence does not necessarily imply a causal link, the collapse in property prices is of central importance to the current problems." (p.2)

The social impact of the AFC (and the more longstanding problems of the Japanese economy) in relation to falling property values, negative equity, institutional insolvency, possessions and arrears have been documented elsewhere.(for example, Forrest, Izuhara and Kennett, 2000) The crisis prompted calls for reforms in lending practices and a shift in attitudes and expectations among current and prospective owners. It also focused much greater attention on the wider macro effects of rising home ownership levels. As I have suggested, however, this latter focus is much less novel in an East Asian context than in the west.

House price volatility has shifted policy and analytical attention more generally towards the wider economic consequences of the vicissitudes of the residential property market and the aggregate impacts of home owners` decisions. The balance of policy and academic interest in home ownership has shifted from issues of social status, social mobility and the private sphere of the home to concerns with the underlying economic dynamics. Home ownership is big business and a key sector of all (post) industrialised economies. The state of the residential property sector acts as a bellweather of the general health of national economies.

A depressed housing market is likely to be associated with a general downturn in consumer and business confidence and symptomatic of wider economic problems. An analysis of house price busts by the IMF concludes that falling residential property markets have more severe impacts on the wider economy than falling stock and shares. " Private consumption fell sharply and immediately in the case of housing price busts while the decline was smaller and more gradual after equity price busts. These findings are consistent with recent research which found larger short term (impact) and long run effects of changes in housing wealth compared with equity wealth." (IMF, 2003, 14-15). Housing markets may be essentially local in terms of who they serve, search behaviour and key institutions. But the contrasting fortunes of different property markets are increasingly interconnected as funds flow across the globe with investors seeking better alternatives to stocks and shares. There is little doubt, for example, that significant overseas investment has contributed to London's housing boom as both stock and property markets in other parts of the world, and notably in East Asia, have offered low or negative returns.

From upbeat to downbeat scenarios

The policy discourse around home ownership has become more permeated by pessimism than optimism. We seem to be in a situation where housing markets are either coming out of a recession, in a recession or bound to be about to experience one. That may not be the lived experience of home owners but it is certainly a dominant preoccupation of policy analysts and media pundits. Why is this? A number of factors have combined to produce more cautious or even apocalyptic assessments of prospects for home ownership sectors. Whilst acknowledging significant regional variations in circumstances we can point to the following key issues:

- *Greater volatility*

The first and most obvious reason is that the last two decades has seen more booms and busts in the residential property market (Kennedy and Martin 1994). Specific examples include Japan with house prices rises of around 75 per cent between 1985 and 1990 and a fall of around a third since then. In Finland prices rose by more than a half from 1986 to 1989 and then fell by more than 40 per cent over the next four years (OECD,2000) A UK Treasury Report (2003) surveying trends over the last 25 years observes that "UK house prices have been significantly more volatile than in France and Germany but compared with the EU as a whole, the UK's experience has not been particularly unusual" (p.29). Most recently it was the AFC which produced the most dramatic collapse in residential property values. In Thailand, after 1997, some condominium prices fell by up to 50 per cent (Kritayanavaj, 2002). Seoul's house price index fell from 103.5 in 1997 to 89.8 in 1998 (Blankenship, 2002) and in Hong Kong and Singapore residential prices fell by 50 and 37 per cent respectively. But the timing and severity of house price cycles also vary from one country to another reflecting the collision of local factors with more general global processes. The AFC had a very specific regional effect but also impacted in a highly differentiated manner within different countries (Lee et.al.,2003).

- *Financial Deregulation*

The general trend towards higher levels of individual home ownership has been paralleled (and indeed fuelled by) financial deregulation, the internationalisation of capital markets and the integration of mortgage finance into global capital markets. It has been argued that the former stability of national housing finance systems has been compromised by these developments (Fallis, 1995). Moreover, lending practices in deregulated environments have often involved higher loan to value ratios and thus higher risk exposure for both households and institutions.

- *Labour market changes and greater insecurity*

The ideal conditions for the expansion of home ownership are where real incomes are rising, job security is growing and employment is expanding. Trends, however, appear to be in the opposite direction with a rise in part time, casual and short term employment, divergent income trajectories and growing inequalities (Horsewood and Doling, 2003). An income gap is developing between the least and most skilled and the middle classes have not been immune from economic restructuring and flexibilisation. These trends create new problems for existing home owners and also point to limits to its further expansion. Policymakers increasingly refer to <u>sustainable</u> rather than <u>extendable</u> home ownership referring in most cases to social rather than environmental factors. Moreover, even where the evidence points to an exaggeration of these trends (Doogan,2001) there is a powerful narrative of insecurity permeating most national psyches. Even those in long term employment apparently feel less secure.

- *Demographics*

Shifting demographics produce new market dynamics and new uncertainties for both supply and demand in home ownership sectors. Many societies face rapidly shrinking populations and significant societal ageing. Baby boom generations have flowed across the life course during a period of economic expansion producing strong and shifting demands for home ownership. In some countries the cohorts which are following are both smaller and more differentiated in their income and employment prospects Factors such as longer periods in full time education and the rising costs and debts associated with this development are also important issues in this context.

- *The problems of diversity*

The social fissions between those who rent and those who own are becoming more blurred as home ownership levels rise. The development of more accessible forms of mortgage finance, state assistance to gain access to home ownership via low cost loans or other indirect forms of financial aid and various privatisation policies have involved a recruitment of households in a wider variety of economic circumstances. Home ownership now embraces a wider cross section of populations. A larger home ownership sector inevitably means that economic shocks impact more directly on more households compared to a situation where mass state rental housing may have accommodated a large section of the population and those in home ownership were a more financially secure minority.

- *Exhausted privatization policies*?

Where direct state provision has been historically important policy options have been available such as highly subsidized tenant purchase schemes to draw new households into the tenure. The typical pattern has been an initial recruitment of more affluent tenants in the most desirable properties. As such policies progress the scope for tenant purchase becomes more limited as state rental sectors become more residualised in terms of property types and households-basically, a progressively higher proportion of what remains consists of less marketable properties and more financially vulnerable households. Moreover, expansion of home ownership through this route changes the nature of home ownership sectors adding a new area of risk in terms of the future marketability of some properties and the ability of some households to sustain their position in the sector.

Cohorts and Convoys: The Prospect for Home Owners

In discussions of the impacts of booms and busts on the home ownership sector it is important to recognise that home owners are in a wide variety of circumstances in terms of their housing market histories and trajectories. In any housing system it is likely to be a highly differentiated tenure with a layered accretion of households and dwellings which have been absorbed into the tenure under different policy regimes and economic conditions (Forrest, Murie and Williams, 1990). Even the term itself conceals enormous definitional variations across societies (Proxenos, 2002).

We can differentiate, for example, between those who own outright, new entrants with a significant outstanding debt and longerstanding purchasers with low debt and high equity. Even among home owners with negative equity in a severe downturn, the extent to which it represents a real and immediate problem will vary according to a wide range of contingent factors including job security, household income, life course stage and whether moving house or apartment is a pressing need or a lifestyle preference. Analysis of household experiences of negative equity during the early to mid 1990s downturn in the UK, for example, revealed a variety of attitudes and consequences. Most households expected to merely wait for better times to come. Negative equity was most prevalent (and the levels of unsecured debt highest) among professional households but it represented the greatest difficulty for more marginal owners in lower paid and less secure employment. Those with the smallest amount of negative equity often faced the most pressing problems (Forrest et. al. 1999).

It is thus extremely difficult to generalise about the social and economic impacts of property market downturns on home owners themselves. Different cohorts in any population will have experienced highly varied social, policy and economic environments during their housing histories. These cohorts effects vary over both space and time. We can contrast, for example, a cohort entering the housing market under conditions of real income growth, strong state intervention, growing employment opportunities and high house price inflation. Under those conditions of entry one might expect a generally strong upward trajectory in their housing careers. Opportunities for house purchase might have been complemented by a relative abundance of public or non-profit housing accommodating many of the housing needs of both low and middle income households. With direct and indirect financial support for both renters and purchasers, the risks of job loss or unexpected and damaging changes in financial or personal circumstances for this cohort are mitigated by a relatively high degree of security in housing.

We can contrast the experiences of this cohort with a group further back in the convoy. They may encounter a less benign environment with greater competition for jobs, a more uneven pattern of income growth within and between employment sectors, less state assistance for both renting and purchase within a general ethos of financial stringency and state cutbacks and a property market which rapidly goes from boom to bust. Under those conditions, the prospect is of a more fragmented and unpredictable pattern of housing histories and trajectories, greater social and spatial divisions and less secure housing circumstances to mitigate adversity in other aspects of life. These contrasting sets of circumstances describe the kind of differences which are associated with cohorts which moved through many housing systems during the period of general economic expansion-and a later cohort which has experienced the more deregulated, privatised and deflationary late 1980s and 1990s. There are, of course, major variations between societies with similar cohorts passing through very different policy regimes and economic transformations.

These differences involve significant intergenerational contrasts in housing experiences. In more mature home ownership systems there is a cohort of ageing home owners which has probably accumulated significant housing equity. At the other end of the life course, new entrants to the housing and labour market may confront fewer job opportunities, less assured income progression and may adopt quite contrary housing strategies through choice or constraint. This is evident in the falling levels of residential property ownership among younger people in Japan. (Forrest, Kennett and Izuhara, 2002; Hirayama, 2003) On the one hand, youth are becoming more independent in their attitudes and social norms but in relation to housing opportunities (and Japan is not exceptional), there would appear to be an increasing dependence of a younger generation on the accumulated assets of their parents or grandparents.

Depreciating assets for one cohort can also represent a new set of opportunities for another. Notwithstanding the common observation that home ownership is most attractive when it is least affordable, a significant downturn may enable access to home ownership for types of households previously excluded. In this context Hirayama (2002) notes that lower property prices in Japan have eased the entry of single, professional women into home ownership. An economic downturn may thus contribute to greater diversity within the sector and reflect and require new product development by relevant financial institutions.

Home ownership and the prospect of economic downturns

When steep falls in real residential property prices have occurred in the past, attention has tended to focus primarily on the impact on households and lending institutions. From a social policy perspective, the visible consequences of bankruptcies among mortgage lenders or real estate agents and household payment difficulties occasioning eviction and, in some cases, homelessness demanded some form of government response. Home ownership had promised a secure investment and rising property values-something to pass on to children or grandchildren. Falling nominal house prices and negative equity on any significant scale and for a any significant period challenged the dominant belief system that house prices go up, not down. Needless to say, policymakers have found it difficult to formulate an appropriate response to the plight of home owners caught in an economic downturn.
As stressed earlier, however, not only has there been a growth of interest in the relationship between home ownership and the macro-economy within the policy community, the interest has increasingly been in the reverse direction-namely, the pro or countercyclical effects of household borrowing fuelled by rising property values, lower nominal interest rates and more liberalised financial sectors. The global significance of this relationship pivots around recent trends in the US economy. Whilst borrowing against housing equity has grown in a number of countries (Thorp and Ung, 2000; Aoki, Proudman and Vlieghe, 2002)), it is has been particularly notable in the US. The Bank for International Settlements Annual Report for 2002 (BIS,2002) emphasises the surprising strength of household spending across OECD countries during the 2001 downturn and points to rising real estate values and cheaper borrowing as a key part of the explanation. In the US, falling stock values reduced overall household wealth but a massive surge in mortgage refinancing sustained household spending.

In 2001, some 11.2 million mortgages were refinanced in the US. "Mortgage refinancing seems to have played a significant role in keeping US consumption unusually bouyant through the recent downturn. Assuming that 54% of refinanced mortgages generated a net cash payout and that the full median appreciation of property refinanced in 2001 of $25,000 was cashed out, one arrives at an estimate of $150 billion of discretionary cash flow from household equity extraction." (Deep and Domanski, 2002). Deep and Domanski point to the novel nature of this development as possibly heralding a new era in which households increasingly regard their dwelling as a source of liquidity to be accessed "to smooth fluctuations in income and wealth". Of course, household will find themselves in widely varying circumstances as regards the amount of equity available to extract and the ability to do so will also vary from country to country according to different regulatory regimes and institutional structures. Moreover, the countercyclical possibilities for equity extraction from housing depend to a great degree on the movement of house prices during an economic downturn. Typically, house price increases have tended to slow down or go into reverse in a recession. In the US in 2001, house prices surged during the recession which began in mid-2000.

Whatever the explanations for this apparent paradox in the US (and similar trends can be observed elsewhere), various international economic bodies have noted a worrying rise in household debt levels and a related fall in housing equity. Mortgage debt, the main element of household debt, has grown by some $850 billion in the US over the past two years. And the BIS notes a general increase in household liabilities across G7 countries. The home ownership sector appears to be playing a critical role in the health of the global macro economy but is also at the heart of what the BIS refers to as "An uncomfortable soft spot". Essentially there are more home owners and higher levels of borrowing and therefore a more pervasive vulnerability to shifts in interest rates and labour market changes.

New Times for Home Ownership?

It is exceedingly difficult to generalise about the dynamics of home ownership sectors. Demographics, the nature of the built form, policy histories, overall rates of individual ownership, lending regulations, tax regimes and general economic and social conditions all play a significant part in price undulations, the degree of price volatility and the social and institutional impact of downturns. Moreover, there are significant variations at subnational level (see, for example, Tu. 1996) with different cities experiencing different rates of appreciation or depreciation during booms and busts. And within cities there are signs of a greater divergence of asset appreciation and depreciation. References to *hot spots* and *cold spots* has joined the home ownership lexicon-a phenomenon indicative perhaps of greater caution and selectivity among consumers and of subsectors of housing markets subject to qualitatively different demand pressures. But after every downturn in residential property markets there is talk of changing attitudes from both households and institutions. Memories, however, are short and when prices begin to rise the herd instinct tends again takes root.

Financial institutions are, however, already adapting to the new times with a greater emphasis on credit risk policy, mortgage insurance and financial products with greater flexibility. The prospects are for more varied forms of home ownership to suit individual circumstances in an environment in which households take on more of the risks. It is also an environment in which the promotion of home ownership as a social project by governments is likely to be tempered by new economic realities. This could involve reduced access for some households and a greater unevenness of housing opportunities. Talbott may be right about an impending crash in the US residential market with its inevitable ripple effects across the global economy. There are, however, few examples of accurate predictions of imminent booms or busts. But whatever the direction and timing of economic change the housing market generally, and home ownership specifically, is clearly deeply implicated.

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