Housing and the Great Recession

October 2012

The Russell Sage Foundation and **The Stanford Center on Poverty and Inequality**

INGRID GOULD ELLEN, NEW YORK UNIVERSITY
SAMUEL DASTRUP, NEW YORK UNIVERSITY

KEY FINDINGS

- Since the first quarter of 2006, U.S. households have lost over $7 trillion in home equity. In the four prior recessions of the last 40 years, the effect on home equity was comparatively minor; indeed in some recessions home equity even continued to increase.
- For Black and Hispanic households, the equity losses have been particularly severe, as have been declines in homeownership. The proportion of low-income households who are severely rent-burdened (i.e., pay more than 50% of their incomes for rent) has also increased during the Great Recession.
- The housing crisis may have various indirect costs, including rising homelessness, deteriorating health among those experiencing foreclosure, and declining educational performance among affected children.

The story of the Great Recession cannot be told without addressing housing and, in particular, the dramatic decline in housing prices that began in late 2006. A distinctive feature of the Great Recession is its intimate connection to the housing sector; indeed many would argue that the Great Recession was triggered by the widespread failure of risky mortgage products. Whatever the sources of the Great Recession may have been, the housing sector is still deeply troubled and is a key contributor to our ongoing economic duress. This recession brief lays out the main features of the downturn in the housing sector.

We begin by taking on two simple but important questions of fact. We first ask whether the downturn in the housing sector has been as extreme as is commonly believed. Is all the publicity about the housing sector truly warranted and on the mark? We then consider who has been especially hurt by the downturn in housing. In the popular media, there are two narratives frequently pressed, one that expresses how widespread the pain is, and another that focuses on the extent to which some sectors of the population have been especially vulnerable to the downturn in housing. We will present some simple facts on differences in housing outcomes by region, race, and age.

Next, we'll explore the hidden costs of the downturn. Although some of the costs have been obvious and well publicized, others haven't been as well appreciated even though they're arguably as troubling. We then conclude the brief by considering how we might find our way out of the downturn. The especially close relationship between the housing and labor markets makes it difficult, we'll suggest, to find an exit strategy.

How Bad Is It?

It would be hard to argue that the downturn in the housing sector has been exaggerated by the popular media. In most parts of the country, house prices have yet to recover, and many households across the country have lost much of the wealth they had accumulated through homeownership or invested as down payments. As figure 1 shows, both the growth in equity between 2000 and 2006 and the losses experienced since then are unprecedented in the post-war period. Since the first quarter of 2006, U.S. households have lost over $7 trillion in home equity. As a result, CoreLogic estimates that 22 percent of homeowners with mortgages are now "underwater," or have an outstanding mortgage balance that exceeds the value of their home.

Notably, such a housing collapse is not a typical recession experience. We see in figure 1 that, in the four prior recessions, there was either a slight downturn in home equity or a slight reduction in the rate of increase. None of these prior recessions comes close to the precipitous downturn in home equity experienced in the Great Recession.

For further purposes of comparison, we've also presented in figure 1 the trends in unemployment for each of the five recessions of the last 40 years. The Great Recession, like previous recessions, has obviously brought about a sharp increase in unemployment, but one of its truly distinctive features is the severe housing crisis layered on top of all the labor market problems.

The combination of a housing and employment crisis also makes this downturn especially difficult to reverse. Because of high unemployment rates and heightened job losses, a growing number of households have found it difficult to make mortgage payments. This combination of negative equity and weakened household budgets has pushed many homeowners to default on their mortgages, as they can no longer afford monthly payments and are unable to sell their home to pay off their loan balance. There are other causes of foreclosure, of course. For example, high-cost mortgages and adverse events like divorce and illness make loan payments difficult, and some borrowers may strategically default on their underwater mortgages.

Whatever the mix of causes may be, figure 2 shows that the rate of foreclosure starts increased fourfold during the recession, a spike again much larger than any increase observed in the three other recessions since the start of the data series in 1980. While foreclosure starts have been declining since the fall of 2010, rates are still high, and the reductions may partly reflect a slowing down of the foreclosure process, rather than any greater financial stability on the part of borrowers. Very large shares of borrowers are now late on their mortgage payments and at risk of default in the near future. The Mortgage Bankers Association reports that 7.9 percent of all mortgages were seriously delinquent (at least 90 days past due) at the end of the second quarter of 2011.

In short, there is little doubt that this is a housing crisis of unprecedented magnitude.

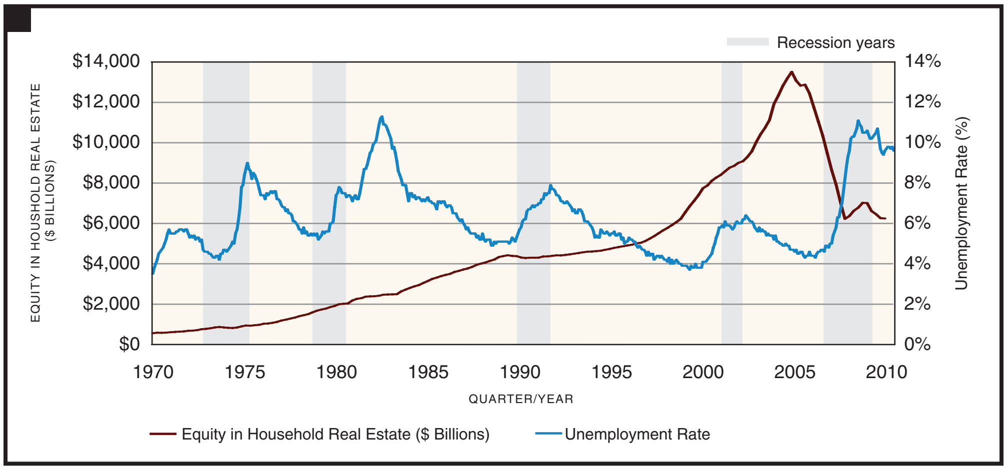
Who Has Been Hardest Hit?

We next ask whether certain groups and populations have borne the brunt of the housing crisis. The regional disparities are perhaps most obvious in this regard. While housing prices have fallen throughout the country, the housing crash has had a disproportionate impact in certain areas, just as the truism "all real estate is local" would have it. For example, according to the Case Shiller housing price indices, as of the middle of 2011, prices had fallen by 59 percent from their peak in Las Vegas, while they had fallen by less than 10 percent in Denver.

In general, the markets that saw the sharpest increase in prices in the first half of the 2000s experienced the greatest declines in the recession. Within any given market, the relatively less expensive properties typically experienced larger price increases during the boom and larger declines during the bust. Figure 3 illustrates this pattern in Boston and Miami.

Equity losses also appear to have been particularly severe for minority households. A recent study by the Pew Research Center found that median wealth fell by 66 percent from 2005 to 2009 among Hispanic households and 53 percent among

FIGURE 1. Unprecedented Home Equity Declines and Sharp Unemployment Increases in the Late 2000s



Source: Board of Governors of the Federal Reserve System; Bureau of Labor Statistics.

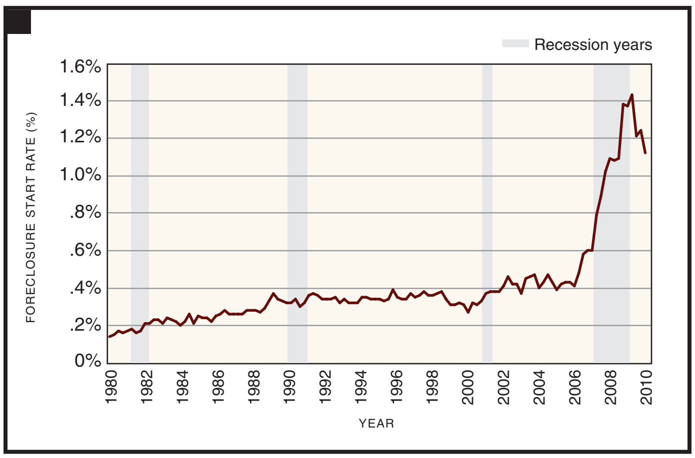
Black households, as compared with just 16 percent among White households. Multiple studies show that subprime lending during the housing price boom was more prevalent in minority neighborhoods, while other research suggests that neighborhoods with large shares of minority households also experienced the sharpest increases in default.

Reductions in homeownership rates following the housing crash have also been more extreme for minority groups. While all racial and ethnic groups have experienced a decline in homeownership in recent years, the fall has been sharpest for Blacks and Latinos. In figure 4, we see that just 44.2 percent of Black households and 47.1 percent of Latino households owned their homes in 2010, down from 46.3 and 49.3 percent respectively in 2006.

As shown in figure 5, homeownership rates have also fallen much more sharply for young adults as compared to older adults. This is both because transitions out of homeownership are less likely for older homeowners and because transitions into homeownership have slowed due to the weak labor market, uncertainty about prices, and tightened underwriting.

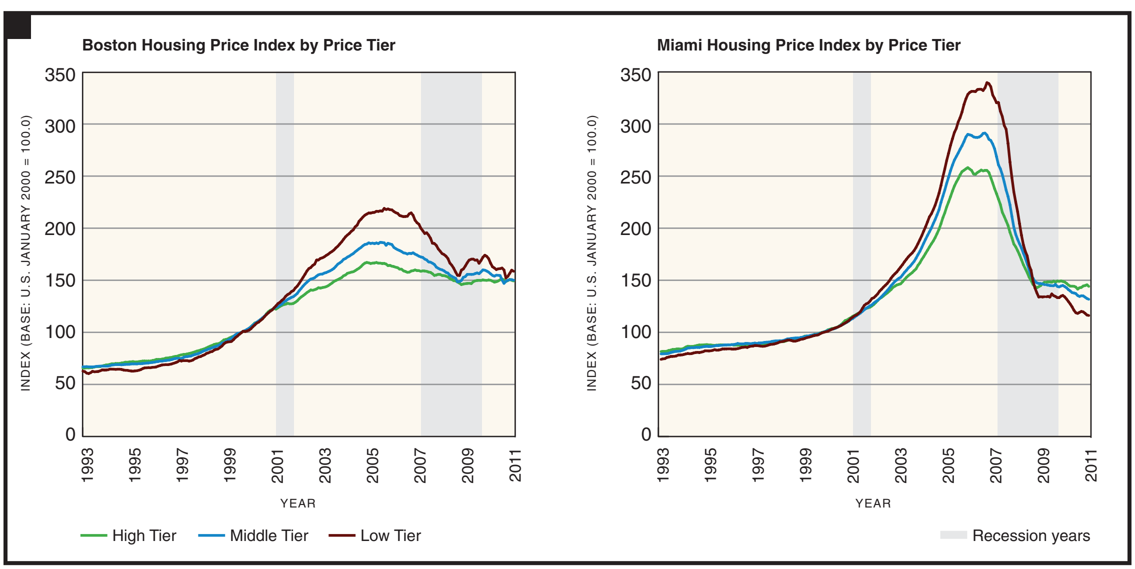
Far less attention has been paid to how renters have fared in the recession. Although housing prices have fallen and prices in general declined during the recession, figure 6 shows that

FIGURE 2. Foreclosure Starts Quadrupled During the Great Recession



Source: MBA National Delinquency Survey.

FIGURE 3. Lower Priced Homes Experienced Greater Price Swings



Source: MBA National Delinquency Survey.

rents held steady and continued to increase, as more households turned to renting. This trend, together with declining incomes, has increased the proportion of renters who are "severely rent burdened," or pay more than 50 percent of their incomes for rent, as shown in figure 7. This is particularly true among low-income renters, more than 60 percent of whom pay over half of their pre-tax income on housing. This leaves them little to spend on other critical goods and highly vulnerable to even modest swings in income. While the number of very low income renters who meet the eligibility criteria for government housing assistance programs grew by 1.2 million households between 2007 and 2009, housing assistance resources did not match this increase. As a result, the share of eligible households receiving federal housing assistance fell from 27.4 to 25.0 percent, according to a report on rental housing recently released by Harvard's Joint Center for Housing Studies.

The upshot: the upheaval in the housing market may be understood as operating in accord with the "Matthew Effect," a simple principle that in this context means that the recession hit the already disadvantaged especially hard. The effects on renters, many of whom are low-income, is troubling. Likewise, African Americans and Latinos have historically had very little in the way of housing wealth (as well as other types of wealth), yet what little they had proved vulnerable in the current crisis.

The Hidden Costs of the Housing Downturn

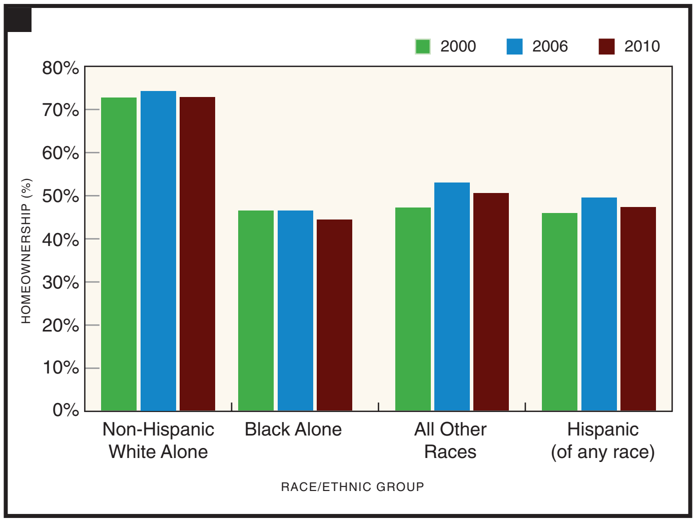
The foregoing results may be categorized as the direct and obvious costs of the housing crisis. There are, however, a range of more far-flung and indirect costs that arise because homes are not just sources of shelter but also repositories of wealth, determinants of access to credit, and the basis for accessing schools and other community services. We list below just some of the ways in which the housing crisis has affected these other domains.

Credit: A recent study by Kenneth Brevoort and Cheryl Cooper shows that defaulting homeowners are left with impaired credit scores that can take years to repair. This may constrain not only borrowing but employment and renting, as a growing number of employers and landlords are checking credit scores of potential hires and tenants.

Education: Our recent studies on educational outcomes find that children in homes entering foreclosure in New York City are more likely to change schools than their peers and to move to schools with lower test scores. There is also evidence that students experiencing mortgage default in San Diego suffered a decline in educational outcomes.

Health: Foreclosures may be bad for your health too. In a recent

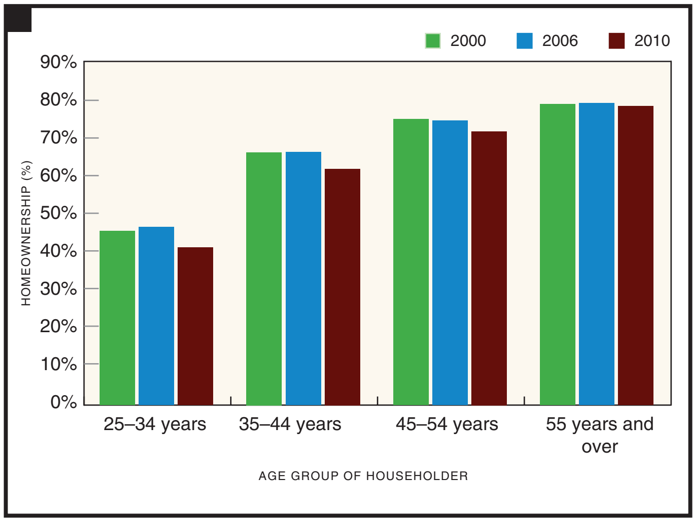
FIGURE 4. Black and Hispanic Households Experienced Greater Declines in Homeownership After the Housing Crash



Note: "All Other Races" includes people who reported Asian, Native Hawaiian or Other Pacific Islander, or American Indian or Alaska Native regardless of whether they reported other race, as well as all other combinations of two or more races.

Source: U.S. Census Bureau, American Community Survey.

FIGURE 5. Homeownership Rates Declined More Steeply for Younger Adults



Source: U.S. Census Bureau, American Community Survey.

study, Janet Currie and Erdal Tekin show that health outcomes are worse for families experiencing housing-related stress.

Neighborhoods: Our own research shows that neighbors of foreclosed properties suffer as well, as foreclosures reduce the value of surrounding properties and may even increase neighborhood crime.

Homelessness: Data from the U.S. Department of Housing and Urban Development show that the estimated number of homeless families in the United States rose by 30 percent to 170,000 from 2007 to 2009, with the average length of stays in shelters rising during the recession as well.

It's not by accident that measures of poverty take expenditures on housing so deeply into account. They do so because we know that housing is at the center of individual and household well-being. A recession that hits housing first and foremost will accordingly be a recession with all manner of troubling spinoff effects.

Is There a Way Out?

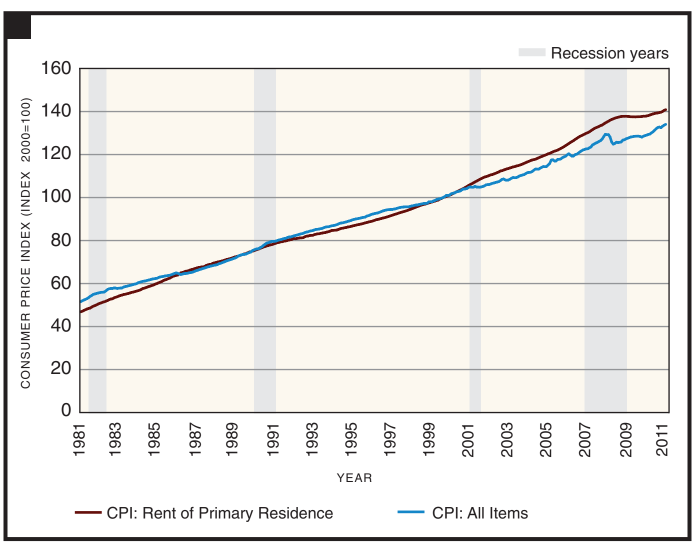
The housing crisis of the Great Recession underscores the devastating impacts that housing price declines can have on homeowners and the broader economy. Meanwhile, renters, especially low-income renters, are feeling serious strains too, as more households turn to renting, putting upward pressure on rents.

The figure with which we led off showed how the recession has affected two key markets in the U.S. economy: the housing market and the labor market. Although we argued that the Great Recession has been distinctive by virtue of its extreme effects on the housing market, no one would argue that the effects on the labor market have been anything but profound. These two markets are deeply interconnected in especially troubling ways.

The main dilemma with which all efforts to end this crisis must contend is that the housing sector is caught up in a larger cycle of self-reinforcing decline or stagnation. It's a truism that recessions are self-reinforcing cycles: For example, declines in employment lead to declines in consumption, which in turn feed further declines in employment. This is the stock stuff of recessions. But what makes this particular recession so troubling is that the housing market has entered into this self-reinforcing cycle in a more prominent way than is typically the case in recessions.

We've already noted the close relationship between the housing crisis, credit, and consumption. As homeowners are less able to draw on accumulated equity, they are hard-pressed to maintain consumption. The tight relationship between the housing and labor markets is equally troubling. On one hand, the tepid labor market has weakened demand for homes, putting downward pressure on prices. On the other hand, these foreclosures and broader equity losses have also likely magnified and extended unemployment rates by decimating the construction and real estate industries, reducing appe-

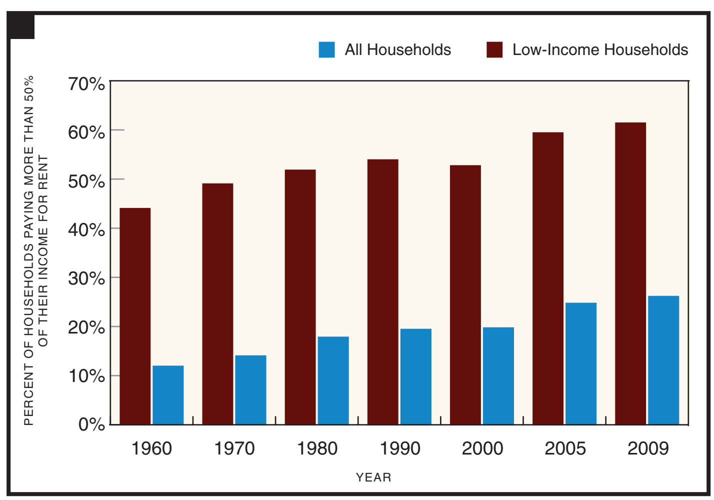
FIGURE 6. Rent Increased More Quickly Than Inflation Since 2000



Note: Showing seasonally adjusted Consumer Price Index for all urban households.

Source: U.S. Department of Labor, Bureau of Labor Statistics.

FIGURE 7. Low-Income Households are Increasingly Burdened by Rent



Notes: Rents include tenant-paid utilities. Severely cost-burdened renters pay more than 50% of pre-tax household income for housing. Renters with zero or negative income are assumed to be severely burdened, while renters not paying cash rent are assumed to be unburdened.

Source: Joint Center for Housing Studies of Harvard University (analysis of American Community Survey Data).

tites for spending on other goods as households see their home equity diminished, and limiting the ability of households with negative equity to sell their homes and move to new communities in response to job opportunities. Researchers at the Federal Reserve Bank of Cleveland have also shown that the creation and financing of small businesses is constrained when homeowners can no longer rely on home equity or personal lending to fuel business expansion.

The key question is whether our efforts to break this cycle have treated the housing sector, to the extent they should, as the natural point of entry. We think much could be gained by thinking more critically about how to dampen swings in house prices and how to safeguard low-income households against housing instability.

ADDITIONAL RESOURCES

Brevoort, Kenneth P. Cooper, & Cheryl R. (2010). *Foreclosure's Wake: The Credit Experiences of Individuals Following Foreclosure*. Finance and Economics Discussion Series 2010-59, Board of Governors of the Federal Reserve System.

Currie, Janet, & Tekin, Erdal. 2011. "Is the Foreclosure Crisis Making Us Sick?" NBER Working Paper No. w17310.

Furman Center for Real Estate and Urban Policy, 2011. Mortgage Lending to Vulnerable Communities: A Closer Look at HMDA 2009. http://furmancenter.org/files/publications/HMDA_2009_National_DataBrief.pdf

Joint Center for Housing Studies of Harvard University. (2011). *America's Rental Housing: Meeting Challenges, Building on Opportunities.* Cambridge, MA. Retrieved from: http://www.jchs.harvard.edu/publications/rental/rh11_americas_rental_housing/AmericasRentalHousing-2011.pdf

Mayer, C. J., & Pence, K. M. (2008 June). *Subprime Mortgages: What, Where, and to Whom?* (Working Paper No. 14083). Retrieved from the National Bureau of Economic Research: http://www.nber.org/papers/w14083.pdf

Nelson, Ashlyn Aiko, and Couch, Kenneth A., Editors. 2011. "Point Counterpoint: The Foreclosure Crisis: Causes and Consequences." *Journal of Policy Analysis and Management* 30(2): 381-400.

SUGGESTED CITATION

Gould Ellen, Ingrid, & Dastrup, Samuel. 2012. *Housing and the Great Recession.* Stanford, CA: Stanford Center on Poverty and Inequality.

This publication was supported by Grant Number AE00101 from the U.S. Department of Health and Human Services, Office of the Assistant Secretary for Planning and Evaluation (awarded by Substance Abuse Mental Health Service Administration).

To further explore the data presented here and to produce customized graphs on recession trends, go to www.recessiontrends.org