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Housing: An Investment □  
and a Piggybank for Spending □

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December 2003



NATIONAL ASSOCIATION  
OF REALTORS®

The Voice For Real Estate®

## **HOUSING: AN INVESTMENT AND A PIGGYBANK FOR SPENDING**

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We are grateful to the National Association of Realtors® for research support and to Assen Assenov, Paul Bishop, Don Jud and Peter Bearse for their helpful comments and suggestions.

# Executive Summary

## HOUSING: AN INVESTMENT AND A PIGGYBANK FOR SPENDING

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Households in America choose to hold their assets principally in a house and in a retirement account. For the typical household, two-thirds of all wealth is in housing and another one-quarter in retirement accounts. Only about seven percent of its wealth is in liquid, unrestricted financial assets such as checking and money market accounts, and stocks and bonds outside of retirement accounts. Households choose these two piggybanks to hold their assets for a number of reasons. Both homeownership and retirement savings provide tax benefits, including deferral or elimination of charges on income and capital gains. Homeowners receive other intangible benefits from community participation. However, both homeownership and holding funds in a retirement account involve illiquidity. Funds cannot easily be withdrawn from a house directly without a sale. Breaking open the housing piggybank requires a mortgage.

Households can borrow against the equity in their homes by increasing their mortgage balances and equity lines of credit. Household spending is determined by both the value of the house and the size of the mortgage. Withdrawal for consumption comes by using a mortgage to fund a college education, take a vacation or buy an appliance.

In this double-entry transaction, the household increases assets available to fund consumption by increasing liabilities, principally mortgage debt. This increase in mortgage debt is offset by an equal increase in the amount of unrestricted financial assets from which consumption occurs. The only two sources available for consumption are from unrestricted financial assets and from borrowing against the house through a mortgage.

In a double-entry context, the amount in unrestricted financial assets is likely to be offset by increasing the size of debt. The household borrows against its house, increasing the balance on its mortgage. These borrowed funds are deposited to increase the cash balance or to purchase liquid investments, thereby making the funds available for consumption.

This indirect method of consumption and spending views the house and the mortgage as the primary driver of consumer behavior. Housing is not only a source of shelter and an investment, but also a piggybank. Households keep their savings in their house because they can consume and enjoy the services, earn a return largely free of taxes on imputed rental income and capital gains, and have access to a debt market backed by explicit or implicit federal guarantees. Empirically, consumption should be increasing when household mortgage debt increases, and it should increase when the loan-to-value ratio increases.

A typical household, based on national survey data from the Federal Reserve Board and including renters, holds housing equity of \$43,700. The household has \$20,800 of financial assets, of which \$16,000 is in restricted retirement and insurance accounts. Conventional estimates are that the household spends 3 percent each year of the \$64,500 in total wealth, or \$1,935. A typical household has income from a job or interest and dividends of \$48,000 a year and spends 98 percent of that, or \$47,040. Total spending is \$47,040 plus \$1,935 or \$48,975.

An alternative view of the link between assets, liabilities and consumption is that the size of the mortgage is relevant for consumption. The median balance is \$22,500, and if the household consumes from that amount, there is an added stimulus to the economy. Based on this alternative view, it is the scale or size of the entire balance sheet that determines the amount that a household spends.

Empirical tests in this study discriminate between the conventional net wealth and the alternative total balance sheet definitions using data for the United States economy over the period from the first quarter of 1952 to the fourth quarter of 2002.

These empirical results show that households increase spending when their housing assets rise, when their mortgage liabilities rise, and when their financial wealth rises. Increased spending over one year is 15 cents per dollar of assets held in housing, six cents per dollar of mortgage liability, and two cents per dollar of financial assets. These results indicate that households are consuming based on their total balance sheet and not on net wealth.

Home ownership is important not only as shelter and as an investment, but also as a tax-protected savings vehicle. All three benefits contribute to consumer spending and provide additional economic stimulus. The mortgage loan-to-value ratio is also a driver of consumption, suggesting that there is risk that households could become excessively leveraged. The average loan-to-value ratio was 41 percent in 2002, an increase from 25 percent during the 1950s. Households concentrate their assets in housing and retirement accounts because of tax, preferences and locational considerations. Once having chosen this portfolio, consumption is financed by the mortgage market.

The NATIONAL ASSOCIATION OF REALTORS® National Center for Real Estate Research supports original, high quality research which contributes to a greater understanding of the real estate industry, the real estate business, housing and homeownership.

Topics of primary interest include, but are not limited to:

- Real estate brokerage
- Real estate brokerage business models
- Real estate markets
- Housing policy
- Housing markets
- Real estate wealth effect
- New economy / technology
- Cost and impact of regulation
- Land use controls
- Multifamily
- Retail
- Office
- Industrial
- Commercial property finance

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