

Renting the Dream

Housing in America After the Great Reset

Richard Florida



We've been bingeing for a long time. For twenty-five years or more, the U.S. economy has grown and grown, feasting on the unchecked consumption of a never-ending cascade of real estate, goods, and gadgetry. The United States used to be revered for its innovative capacity, its so-called American ingenuity, but all that somehow got refocused on overly risky financial innovation. The economy became a giant bazaar, fueled by easy credit. At the same time, the financial markets, once a haven for investors, mutated into rolling casinos, where many of our most brilliant minds gambled recklessly, making bets of dizzying complexity.

Inevitably, it all came crashing down, but this isn't news to anyone. Nor is it anything new. We've been here before. Not just now, but at two other critical times in the last 150 years—in the 1870s and the 1930s—the economy caved in and depressions ensued. Both times, however, we emerged from those dark times healthier and wealthier than before. And it can happen again.

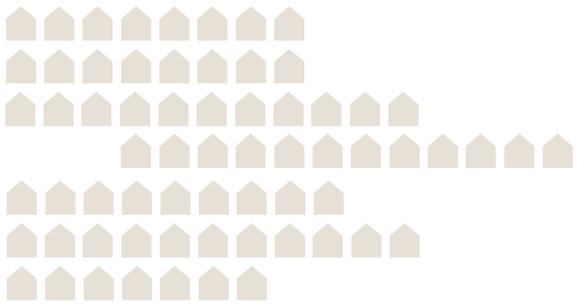
I can't help wondering what my parents would be thinking right now. Born in the 1920s, my mother and father lived through many of the greatest upheavals of the twentieth century, from the Great Depression of the 1930s to the roaring recovery of the decades that followed the Second World War. Both grew up in Newark, New Jersey's Italian district, my father's home absent a refrigerator or indoor plumbing.

They recounted stories of the bread lines and tent cities and government-issued clothing that marked the urban misery of the Depression years. My dad left school at age thirteen and took up work in an eyeglasses factory, combining his wages with those of his father, mother, and six siblings to make a family wage. At Christmas, his parents, unable to afford new toys, wrapped the same toy steam shovel, year after year, and placed it for him under the tree. But thirty years later, they were able to follow countless contemporaries to the greener pastures of the suburbs, buying first a house all their own, then a shiny new Chevy Impala, a washing machine, and a television, and raising their children

in relative security. My father saw his low-wage job—in the very same factory—turn into good, high-paying work that could support our entire family.

The economic peaks and valleys that my parents experienced are part of the life cycle of any society. They can be difficult, sometimes horribly painful, but just as trees shed their leaves in the fall to make room for the new growth of spring, economies reset themselves.

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The Great Reset

Great Resets are broad and fundamental transformations of the economic and social order and involve much more than strictly economic or financial events. A true Reset transforms not simply the way we innovate and produce but also ushers in a whole a new economic landscape. As it takes shape around new infrastructure and systems of transportation, it shapes the rise of new housing patterns, realigning where and how we live and work. Eventually, it gives rise to a whole new way of life—defined by new wants and needs and massive new models of consumption that spur the economy, enabling industry to expand and productivity to improve, while creating new and better jobs for workers.

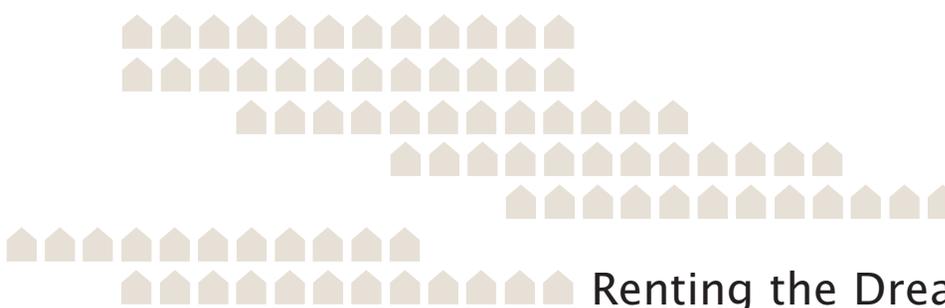
We're still very early on in the current economic Reset, so it's difficult to fully grasp how it will ultimately play out. But we can all sense that our way of life is changing and our economic landscape

is too. These changes are emerging—and have been emerging—organically, in fits and starts, for some time now. They don't result from top-down policy or programs, though government can encourage or discourage them by what it does or does not do. One thing is certain: this emerging new way of life, which some already refer to as an impending “new normal,” will be less oriented around cars, houses, and suburbs.

We've reached the limits of what George W. Bush used to call the “ownership society.” Owning your own home made sense when people could hope to hold a job for most or all of their lives. But in an economy that revolves around mobility and flexibility, a house that can't be sold becomes an economic trap, preventing people from moving freely to economic opportunity.

Not only has that piece of the American Dream grown dark, but it's also clear that financial excess in the housing sector was one of the central causes of the economic crisis. Housing sucked up far too much of the nation's and the world's capital, and too many people—already overextended by the purchase of outsized houses—used those homes like virtual ATMs to finance carefree consumption. Every Great Reset has seen our system of housing change, and this one is no different. The rate of home ownership has been on the decline for some time now. Many of those who still choose to buy homes will choose smaller ones, while many more will opt for rental housing.

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Renting the Dream

In 1931, in the depths of the Great Depression, the historian James Truslow Adams introduced the expression “the American Dream,” defining it as the “dream of a land in which life should be better and richer and fuller for everyone, with opportunity for each according to ability or achievement.” For the past half century, ownership of a single-family home has been one of the cornerstones of that dream. A home of one’s own, a yard, a picket fence, a car or two in the driveway: an important step on the road to happiness and security and part of the gospel for generations. But a whole slew of recent research indicates that it ain’t necessarily so. One detailed study by Grace Wong Bucchianeri, an economist at the University of Pennsylvania’s Wharton School of Business, found that after controlling for income and demographics, home owners are no happier than renters. Less surprisingly, home owners report considerably higher levels of stress than renters. That makes perfect sense: their financial burden is higher, and upkeep of a home is a chore. There’s a reason people refer to their houses as “money pits.” They are time pits as well.

Historically, one of the greatest allures of home ownership was that it represented wealth. A house was like a savings account that just kept growing over time. It was an investment. If you bought a house and hung on to it for twenty or thirty years, you could sell it at a big enough profit to fund your retirement. The tax code even allowed for this eventuality by granting a onetime exemption from capital gains taxes on home sales if the seller is over age fifty-nine and a half.

Of course, that era ended when the housing bubble burst. Now, instead of making money on their homes, millions of people have lost money. And millions more are stuck with homes whose mortgages exceed their value. According to one study, 30 percent of people age forty-five to fifty-four and 18 percent of those between fifty-five and sixty-four were underwater in their homes in 2009. Except for some exceptional boom periods, housing has never been a good financial investment.

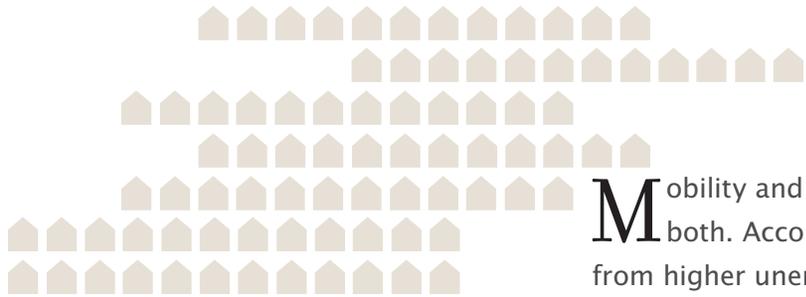
Yale University's Robert Shiller, the world's leading student of bubbles housing and otherwise, found that from "1890 to 1990, the rate of return on residential real estate was just about zero after inflation."

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Even if, by some miracle, a house isn't underwater, chances are good that its owners are "house poor" in the traditional sense: too much of their income is being sucked up by house payments and house-related expenses. The rule of thumb—at least this is what our parents told us—used to be that you should spend 25 to 30 percent of your household income on housing. But as average house prices climbed so much faster and so much higher than average wages, that percentage ballooned. In some places, people were spending—and many continue to spend—50 percent or more of their income on housing, never mind shelling out for cars and life's other necessities. For these reasons, you might start to think that renters may actually be financially better off than comparable home owners, especially those who bought near the height of the market during the boom. Indeed, that's what one study has found: among people of similar financial status, those who chose to rent in 2004 had more wealth in 2009 than those who bought their homes.

Home ownership does bring with it important social benefits. It generally instills in people a deeper emotional commitment to their community. Still, it can be very costly to the economy as a whole. A 1998 study by the Federal Reserve Bank of Dallas, undertaken well before the boom, provided detailed empirical evidence that the United States has overinvested in housing relative to other forms of capital since 1929. “The general pattern has been that we have invested more in housing relative to other kinds of capital goods than we would in an economy in which the tax system and credit institutions did not tilt the playing field at all,” wrote the MIT economist James Poterba. In other words, the housing sector drained off precious capital that could otherwise be spent on productivity improvement, innovation, medical technology, software, or alternative energy—the sectors and products that could drive U.S. growth and exports in the coming years. The demand for bigger houses also skewed residential patterns, leading to excessive low-density suburban growth, which in turn proved expensive in terms of energy consumption and infrastructure building for the economy as a whole. Or, as the economist Edmund Phelps succinctly puts it, “It used to be the business of America was business. Now the business of America is homeownership.” “To recover and grow again,” he adds, “America needs to get over its ‘house passion.’”

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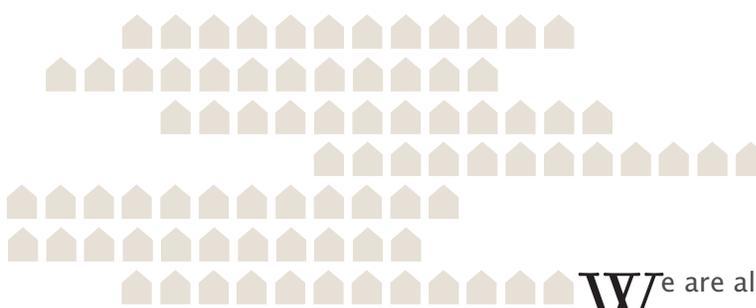


Mobility and flexibility are key principles of the modern economy. Home ownership limits both. According to one important study, cities with higher home ownership rates also suffer from higher unemployment rates. The study, by the economist Andrew Oswald, found that across European cities, a 10 percent increase in home ownership correlated with a 2 percent increase in unemployment. Home ownership, the study found, is a more important predictor of unemployment than rates of unionization or the generosity of welfare benefits. If you've invested in a house, you're less likely to pack up and move when times get tough, either because of the investment you've made in the community and the social roots you've established there or, more simply, because you're unable to sell your house at a price you consider reasonable.

Americans' mobility hit record lows during the crisis. In 2008, fewer people moved, as a percentage of the population, than in any year since the Census Bureau started tracking address changes, in the late 1940s: less than 12 percent in 2008, compared to more than 20 percent during suburbia's golden years. "[T]he U.S. population, often thought of as the most mobile in the developed world," the Brookings Institution demographer William H. Frey told *The New York Times*, "seems to have been stopped dead in its tracks due to a confluence of constraints posed by a tough economic spell." It is bitterly ironic that housing, for so many Americans, has gone from being their shelter to being their burden. A Reset like the current one is the absolute worst time to lose the ability for people to move around. The economy is going through a broad structural shift; this is no typical, predictable business or economic cycle. It is not, for instance, just a period of temporary layoffs of manufacturing workers, who will be picked up again as the economy recovers. This is a moment of significant creative destruction; older manufacturing firms, jobs, and industries are being destroyed, and new industries, occupations, and firms are being created. In this kind of situation, it's much harder for workers, particularly low-skilled ones, to find jobs where they live. In today's economy and the economy of the future, workers, firms, and the economy as a whole need geographic mobility to match workers and their skills to appropriate jobs.

We cannot escape the reality of the conflict of two great dreams: the dream of unlimited economic opportunity and the dream of owning a single-family home. We've seen the ways in which the importance of home ownership became overblown and began to undermine the economy; how it consumed an ever-larger share of income for far too many, constraining their lifestyle and sometimes even bankrupting them; and how it encouraged massive, unsustainable growth in places where land was cheap and the real estate economy dominant. We could well look back on this moment in history as a time when People lived like indentured servants, with their own homes as lord and master. For many of us, the dream of home ownership turned into an economic trap, one of our own making. The most staggering damage caused by the housing crisis may not be the impact on the financial markets; it may be the long-run competitive disadvantage caused by the inability to relocate the labor force to where the jobs of the future lie. It's not that home ownership per se is bad, it's that home ownership on the scale it has grown to is plainly ill suited to a creative postindustrial economy. Letting go of it as the centerpiece of our collective aspirations might be the healthiest, most liberating step we can take.

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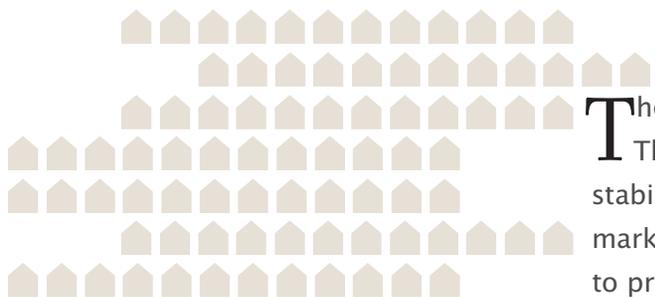
We are already beginning to see some signs of the shift toward renting. With all the turmoil in the housing markets, many people have put off buying. And with tightened credit standards (a modest down payment and a reasonable credit rating), it's become much harder for those who don't have their financial house in order to buy. A December 2009 *Wall Street Journal* story chronicled the many Americans who were giving up, or being forced out of, their homes and moving into rentals, summing up the situation with the headline "American Dream 2: Default, then Rent." The rate of home ownership has charted its biggest decline in two decades, falling from its peak of 69.2 percent in 2004 to 67.6 percent in September 2009. It has dropped the most for younger Americans. The home ownership rate for Americans under age thirty-five dropped by 2 percent between 2008 and 2009. It dropped by about 1 percent for those between thirty-five and sixty-five and actually grew by .2 percent for those over sixty-five. Across the United States, some 36 million people are renters. About a third of all occupied homes are rentals. The ongoing movement of higher-paid and higher-skilled talented people to megaregions and talent magnets is accelerating the demand for rental housing. Even though prices have declined somewhat, it's still very expensive to buy a home in many of these places. More people have no choice but to rent in those cities. Renting is much more prevalent in metro areas such as New York, where 66 percent of residents are renters, as well as D.C. and Chicago, where more than half (56 and 51 percent, respectively) rent their homes.

The housing crisis creates additional opportunities for rental housing. Across the country, there is an accumulation of foreclosed homes and failing condo projects that could be turned into rentals. With prices down 30 or 40 percent or more in some places, this kind of conversion increasingly makes economic sense. It becomes possible to assemble large numbers of units and capitalize on economies of scale. New building technologies and materials, as well as new energy-saving technology, offer long-run cost savings, while new strategies for delivering and managing rental housing hold even greater promise.

Tata, the huge Indian conglomerate that led the way in low-priced automobiles with its \$2,000 Nano car, is moving in the same direction in the housing sector. At a time when most developers in big Indian cities such as Mumbai are putting up luxury high-rises and suburban mansions to attract the newly wealthy of India's blossoming economy, Tata is building Nano housing. It's putting up whole communities of small, highly energy-efficient, inexpensive apartments in the industrial areas where decent lower-income housing is scarce. You may not think this concept has a much of a future in the land of McMansions, but I'm old enough to remember when Americans scoffed at Japan's tiny "shoe-box" cars. I'm not saying that typical American families will go for 250-square-foot Nano houses, but certainly these principles could be applied to the development of larger, but still affordable, rentals more in line with their tastes.

At the other end of the spectrum, upscale hotel chains such as the Four Seasons, the Ritz-Carlton, and the St. Regis are already in the condo business in a big way, offering complete amenities and soup-to-nuts service for their residents.

This kind of approach can be extended to more affordable rental housing. In fact, it already has been. Korman Communities, for example, is building new kinds of flexible rental communities in New Jersey, Pennsylvania, and suburban Virginia. The AVE complexes offer furnished and unfurnished rental units that come with condostyle amenities and hotel-style service. Furnished units are leased on a monthly basis, but unfurnished units are leased for a minimum of six months and, more ordinarily, a year. AVE communities also have movie theaters, pools and other entertainment facilities, organized social events, meeting rooms, and business facilities. Originally designed for people and families in transition—perhaps recently unemployed or divorced—this kind of approach also has the potential to serve mobile people. The kind of future I'm imagining is one where you sign up with a large-scale provider of rental housing. You select the place you like and specify the paint colors and fixtures you like. If you get a new job or simply want to move, no problem: you send in your notice and go through the list of properties in the new city. It's plug-and-play housing, if you will, that will facilitate the flexibility and mobility today's economy needs.



There are several things government can do to encourage the shift from owning to renting. Though well intentioned, the Obama administration has gone way overboard with its plan to stabilize housing, stem the tide of foreclosures, and breathe life back into the paralyzed mortgage market. It's makes absolutely no sense—in fact, it's just plain reckless—for the administration to propose foreclosure relief that will extend mortgage terms to forty years and reduce monthly payments to 38 percent—or even 31 percent—of income. That will simply continue the enslavement of people to houses they couldn't afford in the first place. And estimates are that more than half of those who have their mortgages refinanced under such programs ultimately end up defaulting on their mortgages. The administration's quest to reinvigorate home ownership actually works against the flexibility and affordability needed for economic recovery. Why not take the houses off the owners' hands and rent them back to them at a much more affordable rate? Fannie Mae has taken a step in this direction by enabling home owners who have defaulted on loans that it holds to transfer their deeds to the agency and then rent their homes back. Some 1,200 former home owners became renters under the program in the first half of 2009, though this was just 2 percent of the 57,000 foreclosures Fannie Mae made during that time.

The government could extend this kind of approach, working with banks and real estate companies to offer to rent each home to the owner at a market rate, which would typically be lower than the mortgage payments, for a certain number of years. At the end of that period, the former home owner could be given the option to repurchase the home at the prevailing market price. And what about the home owners already forced into foreclosure? Again, the government could help banks and large real estate companies turn these homes into rental properties, helping to clean up neighborhoods while providing affordable rental housing.

American housing policy massively subsidizes owners over renters. The federal government provided some \$230 billion in home ownership subsidies in 2009, nearly four times the \$60 billion that went to renters, according to the Congressional Budget Office. But guess who needs it more?

The report notes that renters bear a higher burden of housing costs. In 2007, 45 percent of renters devoted more than 30 percent of their income to housing—a percentage that typically indicates that housing is unaffordable when other household needs are taken into account—compared to 30 percent of home owners. Housing policy must become more balanced in light of the greater affordability burdens faced by renters and to meet the needs for more flexible alternatives to home ownership to encourage a shift toward rental housing.

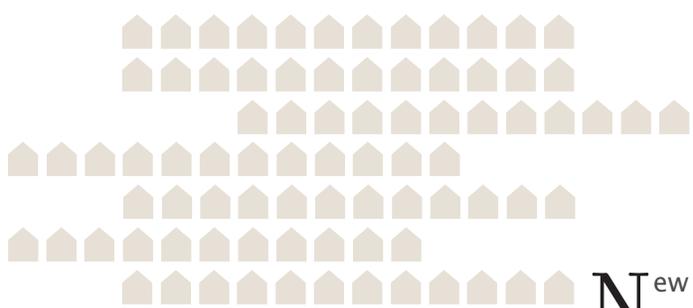
This kind of housing policy has to change. It no longer makes economic sense to provide massive subsidies, tax advantages, and incentives for owning a home. Edward Glaeser is among a growing number of economists who says it's time to kill, or at least somehow limit, the tax deduction for interest paid on mortgages. "The Great Depression provided an opportunity to rethink old policies in a major way," he writes. "In the current morass, everything should, once again, be open for debate. One sacred cow that has long been in need of a good stockyard is the home mortgage interest deduction." The deduction promotes inefficient use of scarce economic resources. On top of that, the bulk of the benefits go to fairly rich households, "people who are overwhelmingly in single-family detached houses," notes Glaeser, who "would be likely to own that house with or without the home mortgage interest rate deduction." He's describing me, for instance; I own a single-family home in Canada, where no such deduction exists. He suggests "gradually reducing the upper limit" on the deduction to loans of up to \$300,000.

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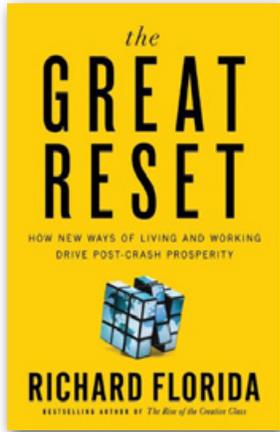
But it should not stop there; the current Reset provides the opportunity to rethink and restructure the housing system more broadly. We need to envision an overhaul as sweeping in scope as the one that brought us the modern system of housing finance of the Second Great Reset—the one after the Great Depression. That means bringing mortgage-lending practices into line with those of other advanced countries, such as Canada, Sweden, or most of the rest of Europe. It means larger down payments and stricter lending standards. The American tolerance of allowing borrowers to essentially mail in the keys and walk away from their loans is disastrous and needs to end. I can't do it in Canada, and neither can borrowers in most other parts of the world, where if you decide to stop paying your mortgage the bank comes after your earnings and savings. What kind of financial sense does it make to encourage people to buy homes, let them do so with virtually nothing down, and, if the home loses value, well, they can simply send the keys back?

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Just as government incentives, with the cooperation of private lending institutions, spurred a massive increase in home ownership after the Second World War, it can facilitate the expansion of new, more flexible forms of rental housing today, allowing people the freedom to move as their job, career, and lifestyle prospects change. Such a shift would stabilize the lives of countless individuals and the economy as a whole.



New forms of housing have always been crucial to Great Resets. The modern mortgage and the single-family house powered the spatial fix of the past era. They were the right developments for their time and absolutely contributed to the long-term dynamic of recovery. In hindsight, however, we can see how those same factors contributed to a massive misallocation of resources away from growing industries and productive assets. Our overwhelming reliance on suburban-style single-family home ownership is an experiment that has outlived its usefulness and is well past its sell-by date. It is now readily apparent not only that not everyone should own a home and that the mortgage system is a big part of what got us into the current financial mess but also that home ownership ties people to locations, making it harder for them to move to areas of economic prosperity. Now, as we move into the second decade of the twenty-first century, the bursting of the bubble has created an opportunity to remake the housing system into one that is more in tune with the knowledge-driven economy's need for flexibility and labor mobility. 🏠



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ABOUT THE AUTHOR

Richard Florida is author of *The Great Reset: How New Ways of Living and Working Drive Post-Crash Prosperity* (Harper; 2010). He is the Director of the Martin Prosperity Institute, Professor of Business and Creativity at the Rotman School of Management at the University of Toronto, and the founder of the [Creative Class Group](#), a AN advisory services firm charting new trends in business, communities, and lifestyles. His national bestseller *The Rise of the Creative Class* was awarded the Washington Monthly's Political Book Award and *Harvard Business Review's* Breakthrough Idea Award. He was named *Esquire* magazine's Best and Brightest in 2005. To learn more and find out how you can keep up with Richard, visit greatreset.com.

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