

Dynastic Home Equity

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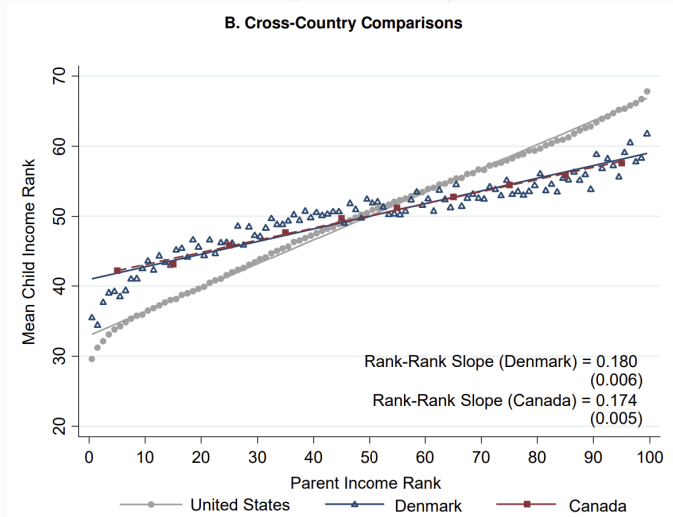
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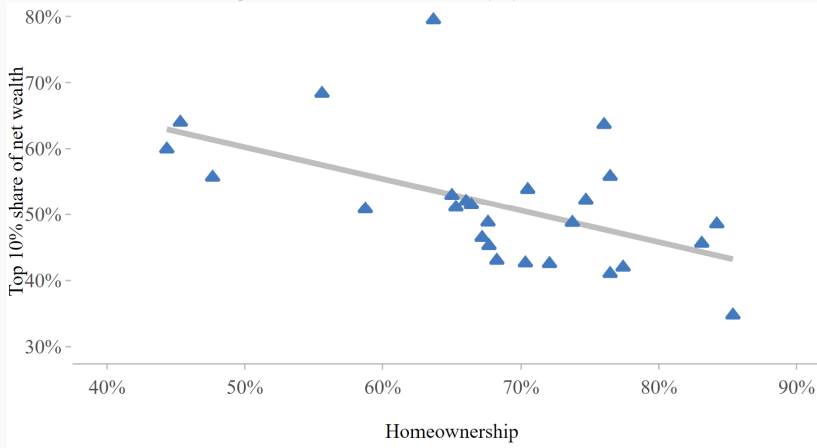
What Drives Intergenerational Economic Mobility?

Economic mobility is relatively low in the US



What Drives Intergenerational Economic Mobility?

Across OECD countries, higher homeownership predicts lower wealth inequality



Source: OECD (2015)

What Drives Intergenerational Economic Mobility?

- Why does parental wealth predict children's wealth?
- **Debate:** what is the importance of...
 - ▶ Facilitating human capital investment (education)?
 - ▶ Social networks?
 - ▶ Learning/knowledge transmission ?
 - ▶ Genetics?
 - ▶ This paper: [wealth transfers \(via home equity extraction\)](#)?

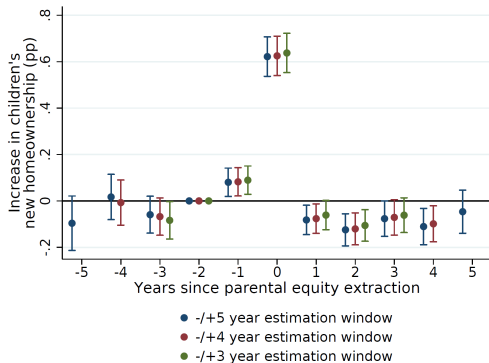
Paper Overview

- **Q:** is parental home equity an important source of intergenerational wealth transfers?
- **Approach:** leverage large, long credit bureau panel with linked family members
 - 1 OLS: Compare $\Pr(\text{buy home})$ vs $1[\text{parent extract equity}]$
 - 2 Event Study (ES): Compare $\Pr(\text{buy home})$ before, during, & after equity extraction
 - 3 IV: instrument for $1[\text{parent extracts}]$ with parent's LTV
- **Findings:** home equity extraction appears important!
 - ▶ OLS & ES: 0.6pp jump in $\Pr(\text{buy home})$, 60% increase relative to 1pp average!
 - ▶ IV: 5pp jump!!! 5x increase relative to 1pp average!
 - ▶ Back-of-the-envelope: differential home equity extraction can account for 20% of housing wealth inequality

Comment 1: Empirical Strategies

Strategy 2 (Event Study)

Figure 2: PARENTAL EQUITY EXTRACTION AND CHILDREN'S NEW HOMEOWNERSHIP



IMO, most convincing piece of evidence that parents use home equity to aid purchases!

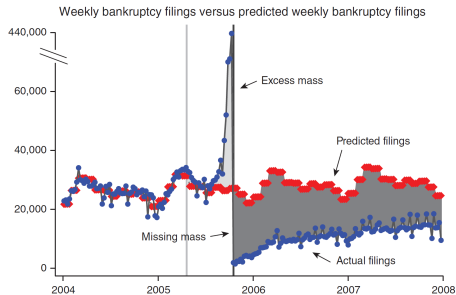
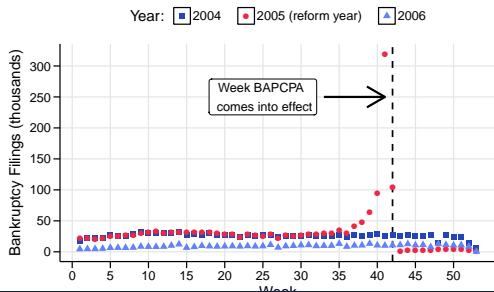
- Appears to show anticipation and decrease in post-extraction purchases

Alternative Implementation: Bunching Estimation

- We see excess mass at/before extraction and lower mass after
 - ▶ **Could estimate amount of purchases induced (not shifted forward) with bunching!**
- Could further refine by differencing against placebo groups:
 - ▶ Compare behavior close to extraction event vs. more distant years w/o extractions
 - ▶ Compare families where kids already own homes (may understate causal effect)

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- Examples (unreported results in Indarte, 2023 and Gross et al. 2021):



Strategies 3 (IV)

- **Identification Challenge:** unobserved factors affect parent and kid wealth
 - ▶ E.g., wealthy parents → education → high-earning kids → buy homes sooner
 - ▶ Expect **positive** OLS bias: overstate causal effect of parent wealth
- IV: instrument for equity extraction with parents' housing leverage
 - ▶ Are parents' financial constraints unrelated to other drivers of kids' homebuying?
 - ▶ E.g., what if constrained parents were less able to afford college education?
- Possible IV bias: overstates effect of parent equity extractions
 - ▶ If IV solves OLS bias problem, it's surprising that $\beta^{IV} > \beta^{OLS}$

IV Suggestions

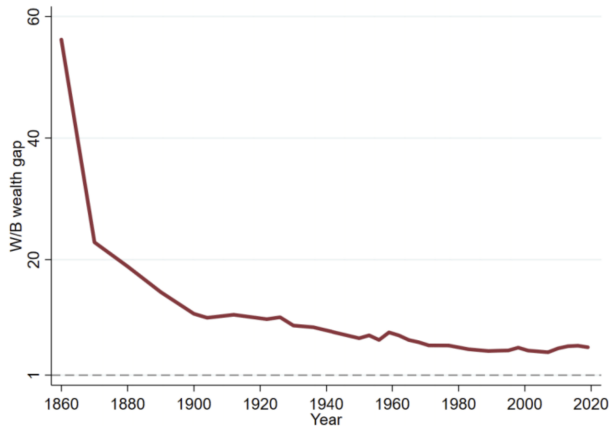
- Suggestions to alleviate concerns:
 - ▶ Balance tests showing parents' constraints don't predict kids' financial outcomes
 - ▶ Is there are different argument for OLS having negative bias?
 - ▶ Alternative instruments?
- Alt IV 1: differences in amortization speed
 - ▶ Faster amortization → faster accumulation of equity (Bernstein and Koudijs, 2021)
 - ▶ Compare parents with similar balances, home values, and interest rates 5 (?) years ago, but with different loan ages:
 - ▶ Idea: exploit faster amortization for older loans
- Alt IV 2: natural disasters and the destruction of home equity

Comment 2: Implications for Black-White Wealth Gap

Racial Wealth Inequality

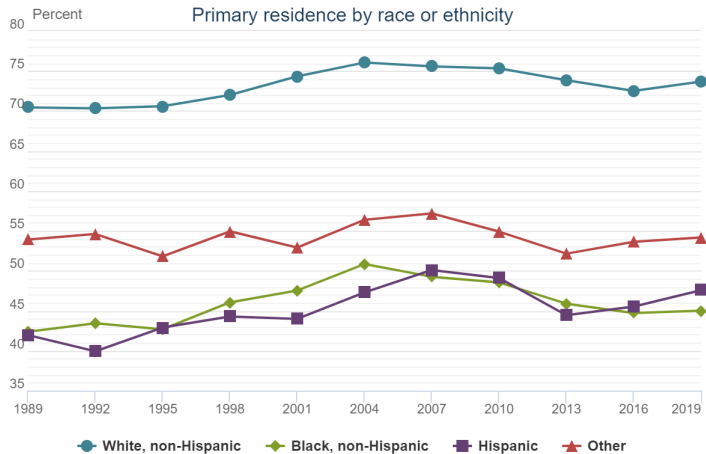
Black-white wealth gap has fallen but remains large (Derenoncourt et al, 2022)

Figure 1: White-Black per capita wealth ratio: 1860-2020



Racial Wealth Inequality

Black homeownership rate is around half that of whites

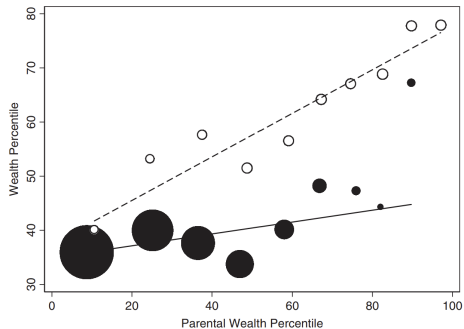


Source: Survey of Consumer Finances

Racial Wealth Inequality

Black wealth mobility appears lower than for whites (Pfeffer Killewald, 2018)

Figure 1. Race differences in intergenerational wealth correlations (Binned scatterplot (with bins defined as wealth deciles) and linear fit; age 45–64.)



Note:

(a) Hollow circles and dashed line = Whites ($N = 1,135$)

(b) Solid circles and solid line = African Americans ($N = 802$)

Aside: it was hard to find a parent-kid wealth rank graph! It would be **valuable** to make one for homeownership and housing wealth with data as large as yours!

Quantify Implications of Channel for Racial Housing Gap

- Differences in strength of Black-white equity extraction channel could vary with...
 - ① Differences in parent **homeownership** and **home values**
 - ② Differences in parent **home valuation errors**
 - ③ Differences in parent **credit access**
- Counterfactual in slides uses (first half of?) #1 \Rightarrow **understate importance** of channel

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- Black-owned homes are typically undervalued and have lower returns
(Perry et al, 2018; Kermani and Wong, 2022)

The New York Times

Home Appraised With a Black Owner: \$472,000. With a White Owner: \$750,000.

Nathan Connolly and his wife, Shani Mott, say an appraisal company undervalued their home based on their race. The couple has filed a lawsuit in Maryland.

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(Perry et al, 2018; Kermani and Wong, 2022)
- Black households have less access to mortgage credit as well (Bayer et al, 2018)
- How does propensity to extract equity differ in primarily Black ZIP codes? How does relationship with parents' extraction and kids' buying vary?

Comment 3: Intensive Margin Outcomes

More Expensive Homes?

- There is substantial inequality in the **amount** of housing wealth
- Does parental equity extraction help kids buy **more expensive** homes?
- Paper gives evidence that extraction → lower LTVs
- **Challenge:** parents likely extract when kids *need* help affording down payment
 - ▶ Event study might show those receiving help get smaller homes because of selection
 - ▶ Here, IV could have an advantage over event study

Better Neighborhoods?

- ZIP codes strongly predict intergenerational mobility (Chetty and Hendren, 2017)
- Does parental home equity help kids buy in better neighborhoods?
 - ▶ Higher mobility score? (à la Opportunity Insights' measures)
 - ▶ Higher income ZIP codes?
 - ▶ Higher school test scores?
 - ▶ Lower crime?
- Does equity extraction then help them jump relative to parents' ZIP?
- Wrt race, this may be informative about forces that perpetuate segregation

Conclusion



In conclusion...

- Important, big picture question
- Large, individual-level data linked to families: near-ideal opportunity to shed light on equity extraction channel
- Nailing causality would be a huge contribution in the debate on the importance of wealth transfers in propagating wealth inequality
- Home equity extraction is plausibly an important channel for wealth transmission

Thanks!
