FRACTIONAL HOMEOWNERSHIP AND ITS IMPACT ON LIFE CYCLE PORTFOLIO CHOICE

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Motivation

The prevalent housing affordability crisis renders it increasingly challenging for individuals to enter the housing market.

Yet, becoming homeowners one day is still among individuals' primary economic objectives.

Thus, novel financial products to facilitate individuals' housing market entry are developed. One of them is fractional homeownership (FHOS).

In this project, I study the impact of access to fractional homeownership on individuals' financial decision-making over the life cycle.

Fractional Homeownership (FHOS)

FHOS is a novel form of financing real estate that is also known as partial or shared homeownership.

The FHOS market is constantly growing in various countries such as China, Norway, the UK, and the US (see, e.g., Brandsaas and Kvaerner, 2023; Milcheva et al., 2023).

FHOS means that two parties share full ownership of a property: (i) a private investor who lives in the property full-time and (ii) an institutional investor who sees the property solely as an investment vehicle.

As compensation for the right to live in the property full-time, the private investor pays a rent rate to the institutional investor that depends on the time-varying FHOS structure and the property's value.

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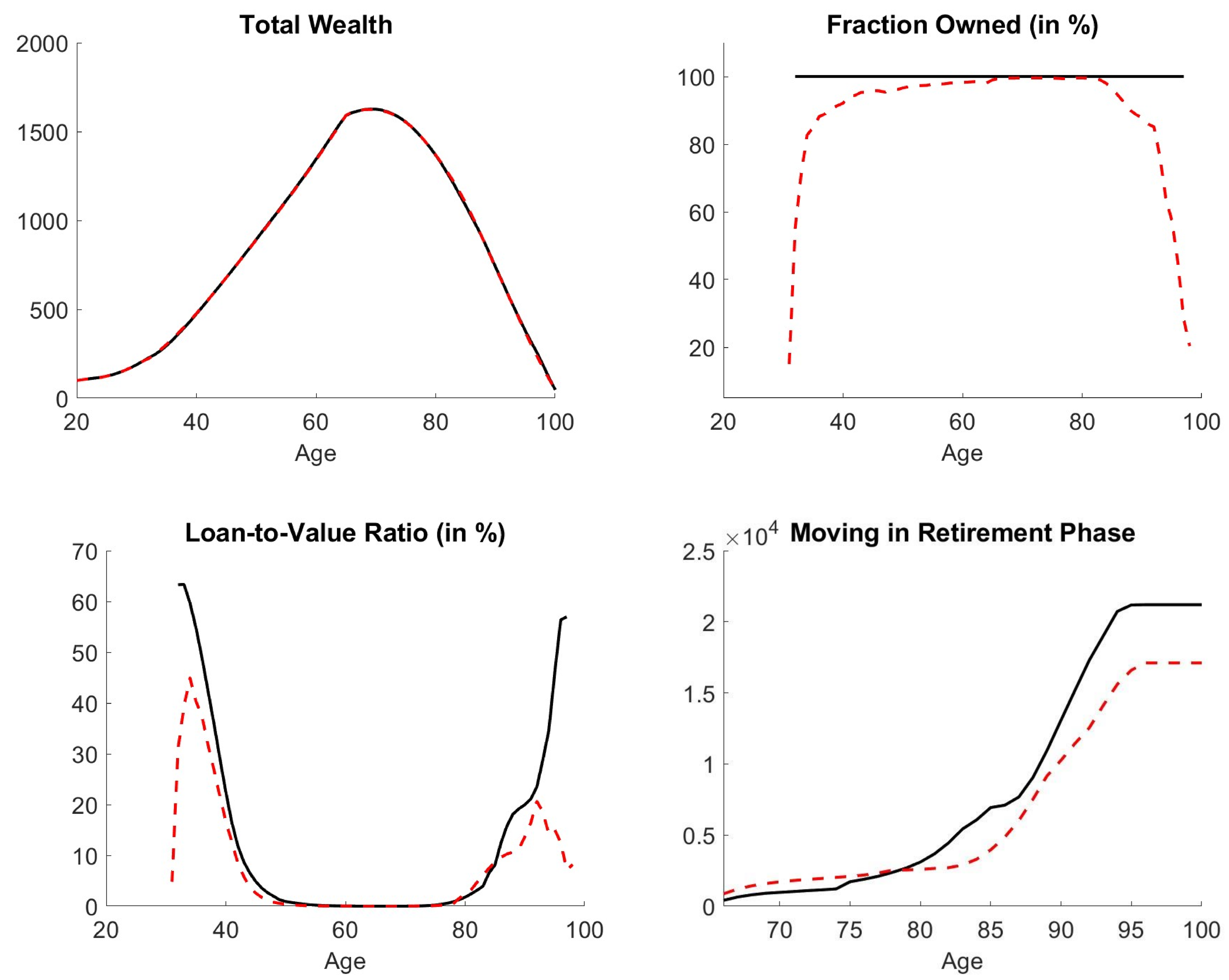
Results

The four panels below compare
- the evolution of total wealth,
- the evolution of the fraction of the property owned by the private investor,
- the evolution of loan-to-value ratios in %,
- the cumulative number of home acquisitions during retirement age.

The two lines represent individuals
- who do not have access to FHOS (black line) and
- who have access to FHOS (red line).



Discussion

Individuals with and without access to FHOS accumulate roughly the same level of total savings, i.e., individuals with access to FHOS are not undersaving.

Mainly, the youngest individuals and the elderly use FHOS to finance real estate. The young, typically severely liquidity-constrained individuals can thus avoid having to accumulate very high savings for a down payment, and the elderly can sell fractions of the property to get cash to finance consumption.

Access to FHOS also leads to lower loan-to-value ratios, indicating that individuals are less affected by the interest rate margin on mortgage debt.

FHOS also leads to reduced moving activity at old age, i.e., the elderly have to move less frequently to still make optimal financial decisions in their retirement phase.

Methodology

Set up a quantitative life cycle model of optimal consumption, savings, and housing decisions (see, e.g., Cocco, 2005; Schlafmann, 2021) to study the impact of access to FHOS on individuals' financial decision-making.

The common assumption of the rent-versus-own decision being binary is softened by allowing individuals to own fractions of the property they live in.

Model features:
- Epstein-Zin preferences
- Various risk factors: stochastic labor income prior to retirement age, investment risk, mortality risk
- Calibration using US data

Conclusion

FHOS is a novel form of financing real estate. It means that individuals can only own parts of a property they live in full-time while renting the other part from an institutional investor.

FHOS is mainly used by young individuals and the elderly to finance real estate.

It leads to individuals entering the housing market earlier, lower loan-to-value ratios, and reduced moving activity during retirement.

Further, it leads to individuals holding better-diversified portfolios. (These results are not depicted on this poster.)

References

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