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Policy Brief

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WHAT HAVE WE LEARNED ABOUT HOMEOWNERSHIP?

LESSONS FROM CURRENT RESEARCH

Homeownership has been part of the American Dream in the United States for decades, perhaps even centuries. However, recent events in the nation's economy have elevated a fundamental questioning of homeownership, particularly as an affordable housing strategy for potentially vulnerable low and moderate income populations. While we take pause to reconsider the virtues and vices of homeownership, it is helpful to review current research on the topic, to help make sense of the past and to inform our strategies moving forward. This policy brief provides a condensed overview of some of the key findings in homeownership research, particularly as it pertains to low income and minority borrowers.

THE BENEFITS OF HOMEOWNERSHIP

The Benefits of Homeownership

Before considering the current status and consequences of homeownership, it is helpful to briefly review what we know about homeownership's benefits. First, some have found that homeownership promotes economic well being through providing housing security (no risk of eviction from a landlord), an opportunity for wealth accumulation (through equity in the home), and stabilizing housing costs (mortgage payments do not increase with inflation).[1] Second, others note the neighborhood benefits of homeownership, including less turnover and fewer vacant or abandoned properties. Third, homeownership has even been associated with positive behavioral outcomes for families and children, such as improved reading and math scores and increased graduation rates.[2] These benefits have often been cited to justify strategies that increase homeownership.

[1]McCarthy, George, Shannon Van Zandt and William Rohe.(2001). The Economic Benefits and Costs of Homeownership.: A Critical Assessment of the Research. Research Institute for Housing America. Available online at: http://www.housingamerica.org/Publications/TheEconomicBenefitsandCostsofHomeownership:ACriticalAssessmentoftheResearch.htm

[2]Galster, George, Dave E. Marcotte, Marvin B. Mandell, Hal Wolman, and Nancy Augustine.(2007). The Impact of Parental Homeownership on Children's Outcomes during Early Adulthood.*Housing Policy*

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While these findings are promising, it is important to offer two notes of caution. First, some of the observed benefits, particularly on child well-being, may be the result of housing stability rather than ownership. If this is the case, then alternatives to homeownership that also promote residential stability may result in similar benefits. Second, the benefits of homeownership are not realized if homeownership is not affordable and sustainable. As demonstrated by the current mortgage crisis, many homeowners do not build wealth (due to declining home values or high mortgage principal), and in fact acquire a debt rather than an asset. And, the likelihood of foreclosure offsets any potential benefits, and brings with it negative financial, neighborhood and potentially even behavioral outcomes.

THE STATE OF HOMEOWNERSHIP

There are two important considerations regarding the state of homeownership. First, after holding stable for several decades, homeownership rates increased significantly during the 1990s and early 2000s, rising from an overall rate of 65 percent in 1996, to 69 percent in 2004 (U.S. Census Data). This "homeownership boom" has been attributed in large part to changes in mortgage lending, including the growth in subprime lending. Second, there have been- and continue to be- substantial gaps in the homeownership rates between white and non-white individuals, and between low income and higher income households. In particular, there has consistently been a 25-30 percent gap in homeownership rates between white and minority households (black or Hispanic), where in 2007 the homeownership rate for white households was 75 percent, compared with less than 50 percent for black and Hispanic households (U.S. Census Data).

There are both "demand" and "supply" side factors that contribute to the gaps in homeownership. On the demand side, disparities in income, wealth and credit between minority and non-minority households (where minority households have lower incomes, less wealth and more credit barriers than white households) reduce the likelihood that a minority household will qualify for a mortgage. Further, research suggests that there are "information gaps" between white and minority households; in a study of black and white renters in Ohio, Don Haurin and Hazel Morrow-Jones (2006) found that up to 40 percent of black households identified lack of information about how to buy a home, get an agent or get a mortgage as a significant barrier to homeownership, compared with 10-20 percent of white households.[3]

Supply side factors consider both the availability of (affordable) housing for purchase, and access to (affordable) mortgage loans.[4] In areas where housing is expensive and/or where the availability of decent housing for sale is low, households may not have the

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Debate, Vol. 18, No. 4, pp. 785-827; Haurin, Donald R., Toby L. Parcel and R. Jean Haurin (2002). Does Homeownership Affect Child Outcomes? *Real Estate Economics, Vol. 30, No. 4, pp. 635-666.*

[3]Haurin, Don and Hazel Morrow-Jones.(2006). The Impact of Real Estate Market Knowledge on Tenure Choice: A Comparison of Black and White Households. *Housing Policy Debate.* 17(4): 625-654.
[4]Herbert et al. (2005). Homeownership Gaps Among Low Income and Minority Borrowers, Available online at: http://www.huduser.org/Publications/pdf/HomeownershipGapsAmongLow-IncomeAndMinority.pdf

opportunity to purchase housing. This may be more problematic in urban areas or depressed rural areas, where minority and/or low income households are more prevalent. Further, access to lending institutions- and in particular brick and mortgage banks- in a particular geographic area may influence whether or not individuals have access to mortgages, and the types (and cost) of mortgages that individuals receive. Research has consistently found that subprime lending (particularly by non-bank institutions) was heavily targeted in high minority areas, where there are fewer “brick and mortar” banks.[5]

Homeownership Sustainability

Perhaps one of the most pressing concerns resulting from the mortgage crisis has been the sustainability of mortgages to lower income borrowers. In the U.S., the mortgage delinquency rate for all types of loans more than tripled from 1998 to 2011 (first quarter), from 2.5 percent to more than 8 percent. For subprime mortgages, the delinquency rate increased from just over 10 percent in 1998, to more than 22 percent of 2011 (Mortgage Bankers Association). As we move forward, it is critical to identify the factors that contribute to mortgage delinquency and foreclosure. These risk factors can be categorized as economic, triggering events or institutional.

Economic factors are the most heavily researched, including housing values (equity in the home) and interest rates (and the general cost of the mortgage). Research has consistently found that declining housing values and higher costs lead to increases in foreclosure, and rising housing values and/or reductions in interest rates lead to increased prepayment (refinancing or home sales), though low income and minority borrowers are less likely to “prepay” even when it would be cost advantageous to do so.[6] While economic factors are associated with foreclosure and prepayment, triggering events-such as job loss, changes in household status, and medical crisis- are strongly associated with mortgage delinquency (which may or may not result in eventual foreclosure). Further, research has consistently found that borrower risk characteristics, including credit score, income and affordability ratios (debt to income) are strongly associated with both mortgage delinquency and home foreclosure.

While economic factors and triggering events (in addition to borrower risk) are substantial predictors of mortgage sustainability, new research suggests that institutional characteristics associated with home purchase also matter- in particular, characteristics of the lending institutions originating and servicing mortgages. A recent study found significant variations in the time it took a borrower to recover (if at all) from a spell of mortgage delinquency, depending on the mortgage servicer.[7] Further, research has found that borrowers who receive mortgages from third party originators

[5]Ashton, Phillip. (2008). Advantage or disadvantage?The changing institutional landscape of underserved mortgage markets.*Urban Affairs Review* 43(2): 352-402.
[6]Firestone, Simon, Robert Van Order and Peter Zorn.(2007). The Performance of Low-Income and Minority Mortgages. *Real Estate Economics* 35(4): 479-504.

[7]Stegman, Michael, Roberto G. Quercia, JannekeRatcliffe, Lei Ding and Walter Davis. 2007. Preventive Servicing Is Good for Business *and* Affordable Homeownership Policy. *Housing Policy Debate* 18(2): 243-78.

(such as brokers), are more likely to become delinquent or foreclose than borrowers who receive mortgages from banks, even after controlling for borrower risk characteristics such as credit score and income.[8] And, particularly for higher risk borrowers (with low credit score), the localness of a lending institution may be associated with mortgage sustainability. A recent study on the Mortgage Revenue Bond program found that higher risk borrowers with mortgages from local lending institutions are less likely to become delinquent or foreclose on their homes than borrowers with mortgages from non-local lending institutions.[9]

Homeownership Affordability

It is important to consider direct efforts to promote affordable homeownership separately from high cost strategies (subprime lending). For example, the 1977 Community Reinvestment Act (CRA), and subsequent revisions, requires certain lending institutions (depository banks) to demonstrate their reinvestment in the communities where they have branch offices (and collect deposits). Part of the reinvestment is evaluated based on a "lending test", which considers the proportion of loans made by the lender to low and moderate income homebuyers (with incomes below 80 percent of the area median income). Research demonstrates that the majority of CRA eligible loans have affordable interest rates and fees; only 6 percent of high cost loans were eligible for CRA credit. Further, research suggests that CRA eligible loans are 70 percent less likely to default than similar subprime loans.[10]

In addition to the CRA, specific affordable mortgage programs play an increasingly important role in extending homeownership to low and moderate income borrowers. The Mortgage Revenue Bond (MRB) program is an affordable mortgage program administered by state and local Housing Finance Agencies that provides reduced interest rate mortgages to low and moderate income homebuyers. A recent study of the MRB program in three states found that while the proportion of high cost home purchase loans to low income borrowers decreased from 28 percent in 2005 to 12 percent in 2008, the proportion of affordable MRB loans increased from 2 percent in 2005 to 8 percent in 2008.[11]

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[8] Alexander, William P., Scott D. Grimshaw, Grant R. McQueen and Barrett A. Slade.(2002). Some Loans are More Equal than Others: Third Party Originators and Defaults in the Subprime Mortgage Industry. *Real Estate Economics* 30(4): 667-97; Ding, Lei, Roberto Quercia, JannekeRatcliffe and Wei Li. (2008). Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Propensity Score Models. *Center for Community Capital*, Working Paper October.

[9] Moulton, Stephanie. 2010. Originating Lender Localness and Mortgage Sustainability: An Evaluation of Delinquency and Foreclosure in Indiana's Mortgage Revenue Bond Program. *Housing Policy Debate* 20(4): 547-583.

[10] Laderman, Elizabeth and Carolina Reid.(2009). CRA Lending During the Subprime Melltdown.Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act. San Francisco Federal Reserve Bank. Available online at: http://www.areaa.org/cms/cra_lending_during_subprime_meltdown.pdf.

[11] Moulton, Stephanie. (2009). The Substitutability of Mortgages to Underserved Borrowers: The Mortgage Revenue Bond Program as an Alternative to High Cost Lending. Presented at the *Association for Public Policy Analysis and Management*. Washington, DC: November 5-7, 2009.

SUMMARY

If we have learned anything from the past few years, we have learned that homeownership is not a one size fits all strategy that should be promoted carelessly. There are substantial costs-- for borrowers, neighborhoods, and the economy-- when homeownership is not sustainable. Indeed, while there are potential benefits to homeownership, such benefits are only realized if homeownership is sustained. This caution, however, should not lead us to throw out the strategy altogether. There have been, and continue to be, substantial gaps in homeownership rates based on race and income that are simply unacceptable. In particular, information gaps that prevent renters from becoming homeowners and supply side institutional barriers that reduce the accessibility of affordable mortgages, can (and should) be addressed. Further, institutional factors (such as servicing and origination approaches) that reduce the likelihood of a borrower becoming delinquent on their mortgage or foreclosing on their home, should be an integral part of mortgages to low and moderate income population moving forward. Finally, direct affordable homeownership strategies have provided and continue to provide a sustainable route to homeownership, and should be a dominant strategy for lending to vulnerable populations moving forward.

Note: This policy brief is a summary of a presentation at 2009 Ohio Housing Conference.