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HOMEOWNERSHIP BY RACE

FACTORS THAT EXPLAIN THE

HOMEOWNERSHIP GAP BETWEEN

BLACKS AND WHITES

A Thesis Submitted

in Partial Fulfillment

of the Requirements for the Designation

University Honors

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University of Northern Iowa

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Date Jessica Moon, Director, University Honors Program

Abstract

A key source of wealth and a symbol of hard work, homeownership is at the heart of the American Dream. The disparity of homeownership between whites and blacks has existed for decades and has only increased. The homeownership rate gap is wider now than before the 1968 Fair Housing Act, with about a 30-percentage point gap. This paper investigates the reasons for the homeownership rate gap by discussing policies history, discriminatory practices, and other minority disadvantages.

Introduction

There is no mistaking the importance of homeownership in the United States. Many studies show that homeownership affects families' ability to gain wealth and financial security, childhood behavior and outcomes, and even one's attractiveness towards marriage (Goodman and Mayer, 2018; Haurin et al., 2003; Hu and Wang, 2019). An important indicator of a country's economic wealth, increasing the homeownership rate has been the goal of many politicians and approved policies over the last 40 years. President Clinton's 1995 National Homeownership Strategy, President George W. Bush's 2003 American Dream Downpayment Initiative (Goodman and Mayer, 2018), and President Biden's 2021 Build Back Better Agenda (Biden Harris Fact Sheet, 2021) all are initiatives with a common goal: to increase homeownership in the United States. These enacted policies concentrated on helping minority households through affordable housing and assistance to first time home buyers, recognizing the gap in homeownership between whites and minorities

Black homeownership rates and foreclosure rates are greater than white homeownership rates and foreclosure rates due to a variety of reasons, including steering and redlining (Besbris and Faber, 2017), racial disparity in mortgage financing (Kau et al., 2018), consumer financial literacy (Bialowolski et al., 2020), and effects of economic downturns. This paper explores the homeownership rate gap between the white and black American population and attempts to explain why the gap occurs and continues to grow.

The Importance of Homeownership

There are countless benefits to homeownership, the most obvious being building wealth and financial security. While security and wealth are important, these are not the only factors that motivate Americans. Psychological security, cultural identity, and financial rewards promote homeownership across all races and ethnicities. Having a sense of control in their own homes provides individuals with mental security. Homeowners are believed to have a greater control over living environments, greater self-esteem, higher levels of life satisfaction, increased social interaction and more (Rohe and Basolo, 1997). This is especially true in economically stable times when price volatility and foreclosure risks are at a minimum. While there are many benefits to homeownership, there are also risks. In times of economic instability, feelings of security may be replaced with anxiety of mortgage default and foreclosure. Maintenance and repair problems also cause anxiety, so the quality of homes plays a large factor in an individual's sense of security.

Similar to the psychological benefits, homeowners benefit from cultural identity. The pursuit of homeownership has been an American ideal for decades. The inalienable rights of land ownership can easily be rebranded as the inalienable right of homeownership, something that has been emphasized by political leaders since President Herbert Hoover (Ackert & Mazzotta, 2021). Homeownership provides individuals with a symbol of sacrifice and personal achievement. The belief in hard work is still fundamental in Americans today with the American Dream. Financial success, social mobility, and having a better life for one's child are all a part of this ideal goal (Parshina et al., 2021). In a study from the National Association of Realtors, nine in 10 current homeowners believe homeownership is a part of the American Dream, and 75 percent of non-homeowners believe the same (Simmons, 2019). Although homeownership is the goal of most Americans, many millennials questioned its attainability. In 2020, a study of

14,000 Americans showed only 54 percent of U.S. adults believed the American Dream was attainable. Compared to older Baby Boomers and Gen Z, Millennials were less likely to believe the American Dream was attainable (Ballard, 2020).

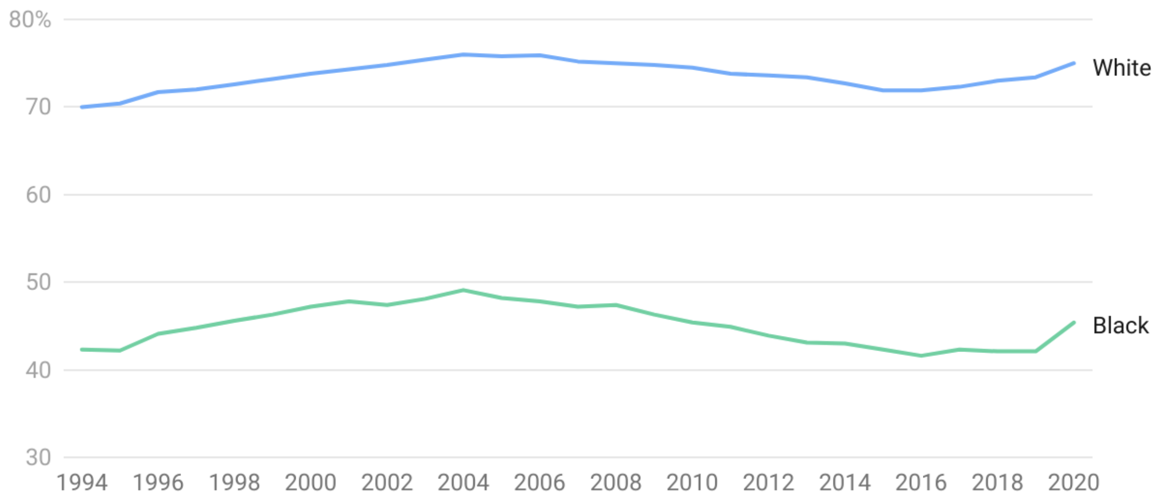
There are plenty of financial and economic benefits that come with owning a home, including economic mobility, diversified assets, and the ability to build wealth to pay for retirement and children's education, and to dampen economic shocks. Homeowners also benefit from lower taxation rates for capital gains and renting risks such as increased rent costs. Homeowners experience upward economic mobility from their ability to save and build wealth. Factors such as purchase timing, holding periods, and location all affect a homeowner's wealth gain (Goodman and Mayer, 2018). Homeownership wealth is dependent on the homeowner's time with the asset, market growth, and housing prices' growth. In times of economic downturn, homeowners run the risk of losing homeownership wealth due to an increased risk of foreclosure and inability to maintain homeownership. In the end, the overall success of homeownership is largely based on the ability to sustain homeownership.

There are many determinants in homeownership demand. These include quality, quantity, and location, along with personal preferences and needs. Individuals are continuously buying homes, selling homes, and changing their needs. Changes in culture such as birth rates, marriage rates, and the overall aging of the population affect demand. Another factor in demand is an individual's budget. Because a person's budget is based on their income, housing demand is therefore affected by wide economic changes such as changes in earnings, unemployment, and economic stability. The effects were very apparent during the Great Recession. Even with a stable economy, price volatility affects when an individual buys, causing housing market cycles. In housing market cycles, households buy homes when it is affordable. Because

individuals are constrained by a budget, their choice of renting or homeownership is influenced by costs. Cost factors include mortgage interest rates, home price appreciation, property taxes, maintenance costs, transaction costs, and income tax. The rate of price appreciation and future home values, along with rising rents and risk aversion all factor into households' decisions to buy. While homeownership may appear to be the obvious choice, many households do not have the funds to buy homes outright, so demand is also affected by mortgage financing availability and regulations. Tightening of credit standards and popularization of subprime mortgages rise with the increase of housing prices. These factors may affect the amount of demand from different races or income groups.

Many of the factors that affect the demand for housing are correlated with race and ethnicity. Quality, quantity, and location differ neighborhood to neighborhood, and access to upmarket neighborhoods are unattainable to certain minorities. High credit ratings and regulations, redlining, low income, and unemployment all play a role in homeownership and are also correlated with race. These challenges to homeownership for minorities have led to a decrease in the minority homeownership rate. Overall, the homeownership rate is declining across all races. In the second quarter of 2021, the rate had dropped by 2.5 percentage points in one year, going from 67.9 percent to 65.4 percent. While both blacks and whites experienced a decrease, the homeownership rate gap between the races persists. The white homeownership rate was 74.2 percent in the second quarter of 2021, dropping 1.8 percentage points from the previous year. The black homeownership rate was 44.6 percent in the second quarter of 2021, dropping 2.4 percentage points from the previous year. This reveals a 29.6 percentage point gap between black and white homeownership (US Census, 2021). This gap has varied over the years, but one thing remains constant, white homeownership is significantly higher than black

homeownership. The chart below shows the homeownership gap between blacks and whites over time with data provided by the U.S. Census Bureau (White, 2021).



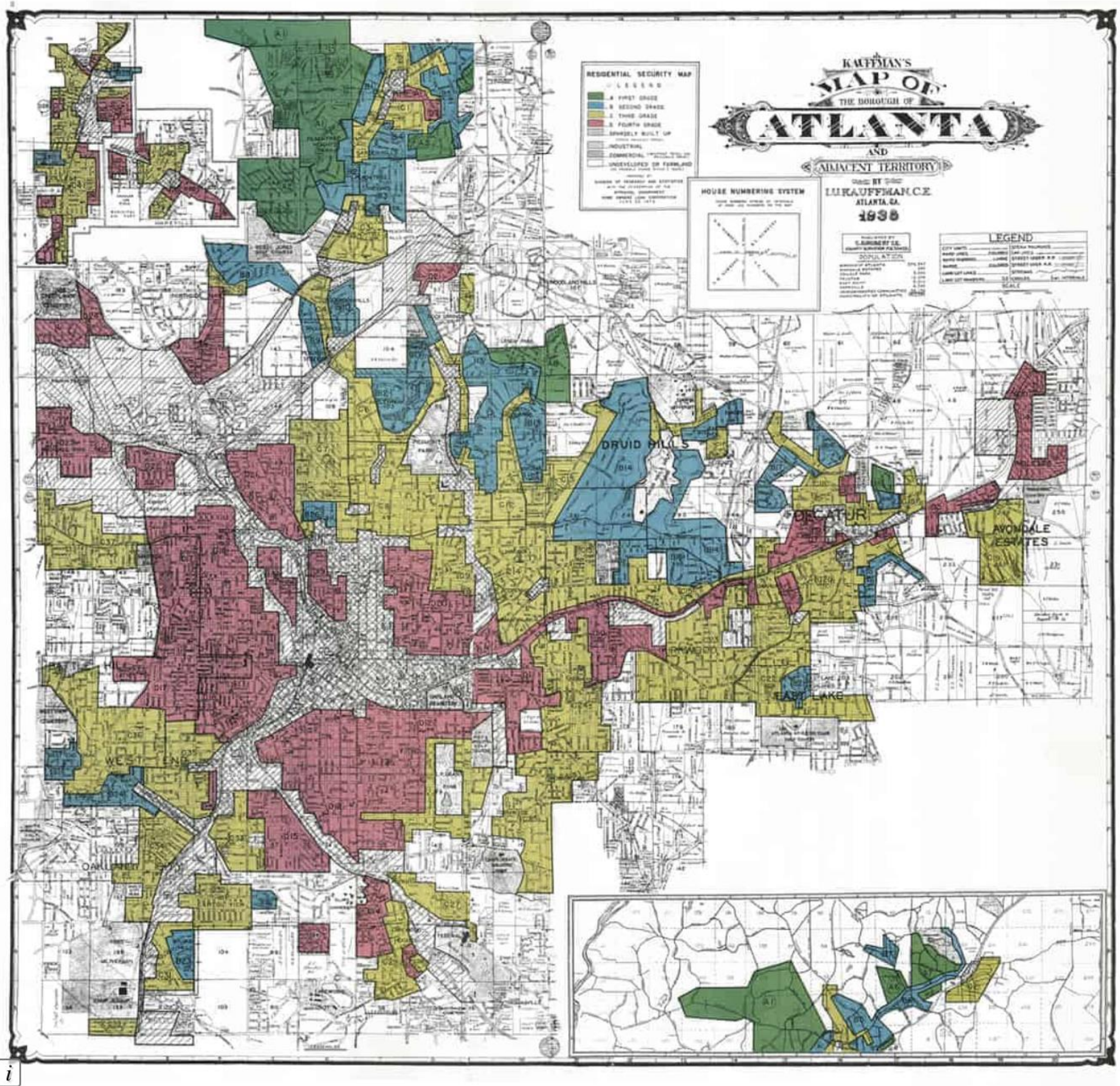
The gap does not appear to decrease, but rather the two races move together to keep the gap relatively the same. When the white line moves up, so does the black line and vice versa, but the gap never appears to minimize.

Reasons for the Gap

Redlining and Steering

The term "redlining" comes from the 1939 New Deal initiative and the Home Owner's Loan Corporation's (HOLC) neighborhood perceived credit risk map. Surveying 239 U.S. cities, the HOLC graded neighborhood credit risks on an A to D grading scale, color coded in order from green, blue, yellow, and red. Grade D neighborhoods were outlined on maps in red, creating the term "redlining." Local lending standards and mortgage insurance criteria were influenced by the HOLC map. Between 1933 and 1968, 98 percent of mortgages that received government

support were given to whites (Gano, 2017). The figure below shows an example of a "Residential Security" map (Mitchell, 2018).



This is an original 1938 HOLC map of Atlanta, Georgia with color-coded neighborhoods by risk. The green portions, which are A graded neighborhoods, are far fewer then the yellow and red, or C and D graded, neighborhoods.

"Redlining" was eventually outlawed with the Community Reinvestment Act (CRA) in 1977. The CRA's purpose was to increase the capital flow to the disenfranchised "red" neighborhoods. Although the act of redlining is illegal, the term has changed meanings to now represent any discriminatory lending based on race or location (Krimmel, 2020). While American neighborhoods are no longer legally segregated, 10 percent of neighborhoods in metropolitan areas are majority black, accounting for 41 percent of the black population living in metropolitan areas. These neighborhoods account for 37 percent of the U.S. black population. In metropolitan areas, neighborhoods with a 50 percent black population have homes valued at roughly half the price of homes in neighborhoods with no black residents (Perry et al., 2018). Although racial discrimination is illegal, inclusion of the black population into all or majority white populated neighborhoods has been minimal and actually reduces the overall value of these neighborhoods.

The devaluation of black neighborhoods cannot fully be explained by quality of home and neighborhood. Homes in majority black neighborhoods are valued 23 percent less than homes in majority white neighborhoods. Across all majority black neighborhoods, homes on average are undervalued by $48,000 per home. This devaluation of homes has a negative correlation with the upward mobility of black children. In other words, areas with a greater devaluation of homes in black neighborhoods lead to less upward mobility for black children who grow up in those neighborhoods (Perry et al., 2018). Other problems associated with undervaluation are lower wealth accumulation, which leads to a greater inability of business investments and educational investments. This penalty to black homeowners makes the integration of the black population into majority white populated neighborhoods very

difficult. Not only do black homeowners experience lower wealth gain from homes, but they are also steered into minority neighborhoods where these issues persist.

Under steering, consumer preference is not responsible for where individuals buy their homes. Steering is a discrimination tool used by real estate professionals that influences an individual housing decision based on race. Based on audit studies, real estate professionals are less likely to share information on home units with nonwhite clients, are less likely to show nonwhite clients home units in diverse neighborhoods, and are less likely to provide sufficient financial information to non-whites (Besbris and Faber, 2017).

Steering overall inflates demand in specific neighborhoods, such as majority white neighborhoods, while also solidifying nonwhite housing demand in majority nonwhite neighborhoods. Overall, nonwhites over whites are less likely to obtain first choice in home preference. In a study based in the state of New York, researchers found that real estate professionals are more likely to be found in areas of low poverty rates and white and Asian neighborhoods. Counties in New York state with a higher number of real estate professionals are significantly more segregated (Besbris and Faber, 2017). Steering has an effect on blacks' neighborhood preferences. Unlike whites, blacks are less likely to list convenient neighborhoods as a reason for homeownership. This is possibly due to the recognition of limited opportunities when homebuying. Perhaps blacks are already residing in neighborhoods with their social network, requiring them to leave family and friends in pursuit of homeownership or better valued neighborhoods (McCabe, 2018). Redlining and steering are discriminatory tools that have affected the quality of neighborhoods that are accessible to black homeowners, as well as access to mortgage loans for black households.

Mortgage Discrimination

Mortgage lending is a very important part of homeownership. In the third quarter of 2021, total household debt increased by $286 billion to $15.24 trillion. Mortgage balances, which account for the majority of household debt, increased by a total of $230 billion (Federal Reserve Bank, 2021). In 2016, nearly 50 million homes were secured by an incredibly large mortgage market. The first step to closing the racial wealth gap in the U.S. is to close the homeownership gap through mortgage lending (Gano, 2017). In 2019, primary residence accounted for over a quarter of all assets held by the average household. For black Americans, the primary residence was the largest asset owned, accounting for over 30% of all assets. This means that black homeowners' wealth is heavily reliant on their primary residence (Kuo, 2021). Racial discrimination in the mortgage market greatly effects minorities' ability to attain this major asset.

Discrimination in the mortgage market is identified in two different forms: differential treatment and disparate-impact discrimination. Differential treatment discrimination is when individuals with the same credit characteristics are treated differently based on factors such as race or ethnicity. This is intentional discrimination. Differential treatment discrimination includes denying loan applications to minority lenders at a higher rate or pricing loans differently to minority borrowers (Kau et al., 2018).

In a 2016 matched-pair correspondence experiment on Mortgage Loan Originators (MLOs), researchers found that MLOs were less likely to respond to email queries from individuals with black names than to individuals with white names. When responding to either black or white clients, researchers found that MLOs were more likely to write a preferential email to white clients. Although this discrimination is found during the inquiry stage of mortgages, it likely influences the mortgage outcomes for minority borrowers (Hanson et al.,

2016). Borrowers will be unable to attain a mortgage if mortgage lenders will not communicate with them. While racial discrimination is illegal, it is still very present in the mortgage market.

Disparate-impact discrimination is when racially neutral policy is applied to all borrowers, but the policy itself is excluding borrowers of certain groups. This is unintentional discrimination. In 1968, the Fair Housing Act was passed to provide "fair housing" to all Americans. The policy was enforced through several laws such as the Equal Credit Opportunity Act (ECOA), the Home Mortgage Disclosure Act (HMDA), and the Community Reinvestment Act (CRA) discussed earlier. The ECOA, enacted in 1974, made it unlawful to discriminate against applicants based on race with respect to credit transaction. The HMDA, enacted in 1975, required public disclosures of mortgage lending data. Discretionary pricing or risk-based pricing is a system that banks developed in the 1990s. Fulfilling policy requirements, risk-based pricing, banks price mortgages based on objective factors such as product type, loan term, down payment amount, loan to value ratio, and, most importantly, credit rating. In 2016, 85 percent of mortgage lenders used risk-based pricing, and the method is still very popular among lenders today. Although risk-based price is a completely legal practice, it is often criticized for promoting disparate-impact discrimination. The US Supreme Court includes disparate-impact discrimination within the Title VII of the Civil Rights Act as a prohibited practice. Disparate-impact discrimination and risk-based pricing became a big topic of conversation in 2012 with allegations against Wells Fargo Bank. After receiving criticism for their discretionary policies regarding minorities, the Department of Justice found that black and Hispanic borrowers with similar creditworthiness to white borrowers paid hundreds more in subjective fees. Black borrowers paid 50 to 100 percent more in fees than white borrowers (Gano, 2017). Neither the bank nor the workers were accused of discrimination based on animosity. Workers would raise

interest rates to increase their compensation. These actions disadvantaged minority buyers disproportionately.

Credit ratings are important to accessing credit worthiness for homeownership because they determine the underwriting of mortgage loans. Despite how a mortgage lender may use credit rates, those who do not have a credit rating or have relatively low ratings will find it difficult to secure a mortgage loan and therefore buy a home. In a 2021 Freddie Mac study, blacks were more likely than whites to have low to no credit scores, insufficient credit history, and high debt, all of which reduce chances of obtaining new mortgage. The study found that blacks were only 50 percent as likely as whites to attain mortgage ownership (Dey, 2021). In another study in 2016, data showed that black people were less likely to have a FICO credit score than white people. Of those with FICO credit scores, more than half of white individuals had scores over 700, while only 20.6 percent of black individuals had scores over 700. 30.8 percent of white individuals had mortgages, while only 14.8 percent of black individuals had mortgages. If blacks had the same distribution of credit scores as whites, the percentage of black individuals with mortgages would increase by 10.6 percent, resulting in a much smaller 5.4 percent homeownership gap between blacks and whites (Choi et al., 2019). The studies show how seriously credit ratings, and therefore mortgage lending policies, affect the homeownership gap.

Financial Literacy

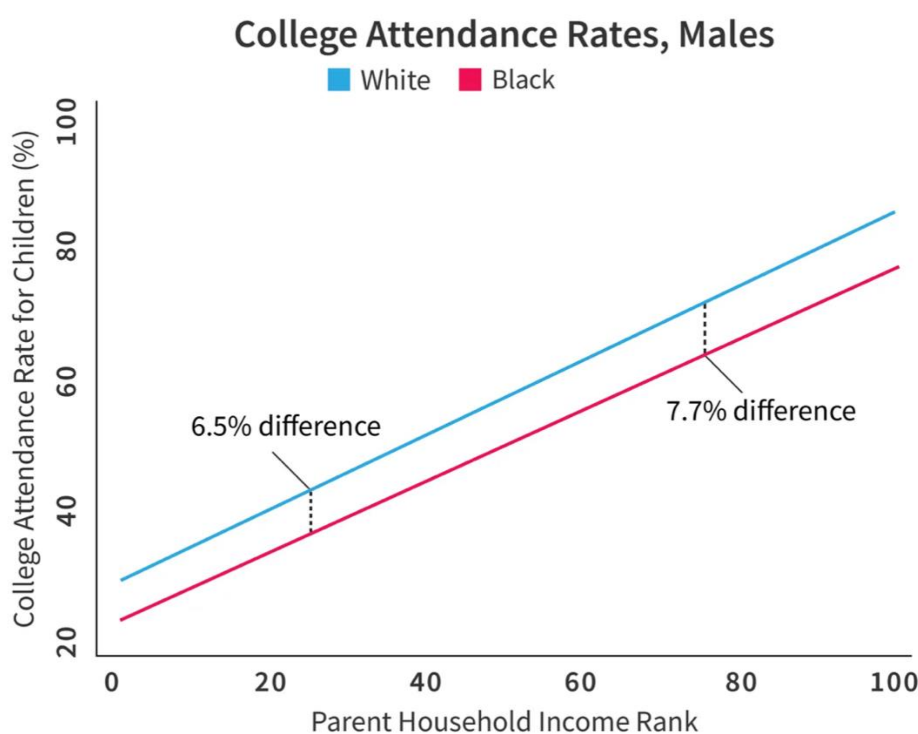
Financial literacy is important for any homeowner, particularly when securing a mortgage. While a home is a homeowner’s biggest asset, a mortgage is a homeowner’s biggest liability. The value of the mortgage is dependent on the borrower's determined interest rate. For

example, in a 30-year mortgage of $200,000, one percentage point in the annual interest rate can make the difference of $1,200 in monthly payments. Because mortgages are typically 30 years, interest rates are not the only factor that borrowers must consider. Changes in the real estate market, the financial market, the general economy, or the individual's income will affect their ability to pay future mortgages. For many homeowners, obtaining a mortgage is a rare opportunity, meaning there is a high learning curve and that the homeowner may have little experience (Bialowolski et al., 2020). Any potential homeowners' knowledge about mortgages is already limited. Financial literacy is important to understand an individual's mortgage and to find a mortgage right for the homeowner.

Financial literacy is difficult to measure, but there are different indices that try to quantify literacy. The Personal Finance (P-Fin) Index is an annual survey, starting in 2017, that measures financial literacy with 28 questions. These questions cover areas such as earning, consuming, saving, investing, borrowing/managing debt, and comprehending risk. In 2020, American respondents answered an average of 52 percent questions correctly, slightly higher than the 49 percent in 2017, but still "failing." On average, respondents had a score of 64 percent regarding borrowing, 47 percent regarding insurance, and 37 percent regarding risk. Low-income individuals and the less educated, along with other groups such as females and young people, tended to show lower levels of financial literacy. In the 2020 P-Fin Index, only 21 percent of white respondents were considered financially fragile while half of black respondents were considered financially fragile (Lusardi, et al., 2020).

Blacks are likely to have low financial literacy because of income and educational attainment, factors that affected the lowest scoring groups. In 2017, the median income for black households was $38,183, while for white households it was $61,363. Six percent of black

households earn more than $150,000, compared to over 15 percent by white households. Because black individuals are more likely to need college loans and have higher default debt, accumulation of debt is higher for black graduates. In 2017, 38.2 percent of white households had a bachelor's degree or more while only 23.5 percent of black households had a bachelor's degree or more. The following figure plots the fraction of male children, at the age of 20 or above, who have obtained at least some college credit by parental income percentile between 2005 – 2015 (Chetty et al., 2020).



As the parental income percentile increases, the percentage gap between black and white male children increases.

Lack of financial literacy correlates with riskier mortgages. In a study of homeownership between the years 2004 to 2009, researchers found that low financial literacy increased the probability of the borrower selecting a risky mortgage. Riskier mortgages tend to lead to higher

delinquency rates, meaning financial literacy contributes to an individual's sustainment of their home, which ultimately affects the individual's wealth, as discussed earlier. 2004 to 2009 was the height of the U.S. housing boom, right before the decline with the Great Recession. This means financial illiteracy is also indirectly tied to the housing market crash (Zahirovic-Herbert et al., 2015). Homebuyer education and counseling (HEC) is a possible solution to mortgage problems associated with financial literacy. HEC helps first time homebuyers with home purchases and mortgage decisions, becoming a standard among government nonprofits and industry programs. HEC focuses on low to moderate income first time homebuyers. In a study of homebuyers between 2013 to 2016, borrowers who received HEC showed evidence of increased familiarity and confidence with terminology and the mortgage process. Borrowers were also shown to have a higher level of satisfaction with their mortgage. The study found that out of the 24,847 individuals, only 17 percent, reported receiving HEC (Argento et al., 2019). While beneficial, HEC is not a widespread opportunity.

Economic Downturns

Economic downturns worsen the disparities in homeownership rates between blacks and whites. In the Great Recession, delinquency and foreclosure rates were far higher for blacks than whites. Between 2007 and 2013, the average value of owner-occupied homes among college educated white families fell by 25 percent for white families and 51 percent for black families (Garriga et al., 2017). Mortgage lending was also greatly reduced for black families. In 2012, purchase lending for blacks was down 55 percent, while for whites it was only down 41 percent (Goodman et al., 2014). In St. Paul, Minneapolis, researchers found that the homeownership rate

for blacks was 39.4 percent before the financial crisis (2005 to 2006), 39 percent during the crisis (2007 to 2008), and 29.4 percent after the crisis (2009 to 2015). For whites, homeownership rates were 83.5 percent before the crisis, 83.1 percent during the crisis, and 78.1 percent after the crisis. The homeownership rate dropped more for black individuals, widening the gap. The ratio of black to white loan denial rates also increased from 1.88 before the crisis to 2.14 after the crisis in St. Paul (Myers and Lee, 2018).

The Great Recession is not the only economic downturn that has had an adverse impact on black homeownership. Hurricane Katrina and COVID-19 are both disasters that resulted in large economic shocks. The 2005 Hurricane Katrina displaced 80 percent of New Orleans 450,000 citizens and destroyed the majority of the city's housing. After Hurricane Katrina, black residents were more likely to lose their jobs than low-income white residents, adding to the already reduced mobility of black homeowners. Black homeowners were also less likely to have adequate insurance, making recovery a slower process.

Unlike Hurricane Katrina, COVID-19 does not involve a loss of housing stock. With COVID-19 came an influx of unemployment in service industries. 20 percent of black homeowners are in the service industry as opposed to 13.1 percent of white homeowners (Neal and McCargo, 2020). Unemployment reduces a homeowner's ability to sustain homeownership because of a lack of income. A lack of income results in a default on mortgages.

Solutions

There have been many policies enacted in response to the homeownership gap. The most recent is the Build Back Better bill framed by the Biden-Harris Administration. The bill includes several steps to increase the affordable housing supply (Biden Harris Fact Sheet, 2021). While this is a big picture solution, there are other changes that can be made based on current supply.

Race blind mortgage applications are a possible solution to mortgage discrimination. With race blind applications, signals, such as names, are removed from the application, so the mortgage lender is unable to identify the individual's race. This lowers the probability of differential treatment racism. Although I could not find any article references regarding this method, I believe that this is an important tool for reducing mortgage discrimination.

Another solution includes the education of real estate agents and the accountability of appraisers. Educating includes informing real estate agents of programs and benefit options for low-income individuals such as down payment assistance programs and tax credits. These agents can help low-income homebuyers, including black households, by exposing them to these various programs and therefore building more trust into real estate interactions. Appraisers are also real estate professionals who have a history of racism in the housing market. Appraisal discrimination is when a home is devalued because it has been occupied by a black individual. Assembly Women Angela McKnight of New Jersey has proposed a bill that would allow the State Real Estate Appraiser Board to "revoke, suspend, or fine appraisers of appraisal management companies who knowingly engage in discriminatory appraisals of residential property on basis of race or national origin" (Torabi, 2021). Bills and other solutions like these directly target differential treatment in the real estate profession.

Individual homebuyers should also receive education and training in financial literacy. The state of Iowa is combating this issue with the 2019 change in high school graduation requirements. Now, high school students are required to complete one-half unit of financial literacy in order to graduate (Heitz, 2021). While the state is trying to beat financial illiteracy for the younger population, money managers and financial planners can help current and potential homeowners. AdvisersGiveBack and the Foundation for Financial Planning provide pro bono

work for low-income individuals. Those with questions can receive goal-based action plans from experts at no costs. This is an example of financial advisors not only seeing a problem but also creating a solution (Maurer, 2021). Changes like the ones described not only help with the current housing market but will also positively affect the growing affordable housing market set by the current administration.

Conclusion

The black and white homeownership gap in the United States is a growing problem. The purpose of this paper was to explore the reasons for the gap and why it has continued to grow. The paper looks at four key topics, historical issues such as redlining and steering, discrimination in the mortgage market, problems with financial literacy, and economic downturns. While outlawed practices, redlining and steering still influence black homeownership through home appraisals and segregation of black and white neighborhoods. The mortgage market discriminates through its use of risk-based pricing and its heavy reliance on credit scores. Financial literacy issues are found more among black homeowners than white homeowners leading to riskier mortgages for black households. Economic downturns such as the Great Recession, Hurricane Katrina, and the recent Covid-19 pandemic, disproportionally affects black households over white households. This paper proposes solutions that can quell some of the outlined issues. These include race-blind mortgage applications, accountability for racism in the real estate market, and education for real estate professionals and investors.

While this paper takes a deep dive into the reasons for the homeownership gap, it does not do an in-depth analysis of specific policy solutions. Many policies such as the Fair Housing

Act, the CRA, and, more recently, the Build Back Better bill have been enacted or suggested to remedy this historic problem. While these solutions look at the bigger picture, the gap is a complicated issue that requires intervention from more than just government influence. It will take leadership from not only the government, but financial institutions and communities to move forward and turn the tide on the homeownership gap.

This paper is important because it shines light on the reasons for the homeownership gap. To take the first step towards a solution, an in-depth understanding of the issue is needed. This paper provides that in-depth understanding and spreads awareness about this increasing problem. Future research should be focused on solutions to this issue not only on a government level, but on a community basis as well.

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