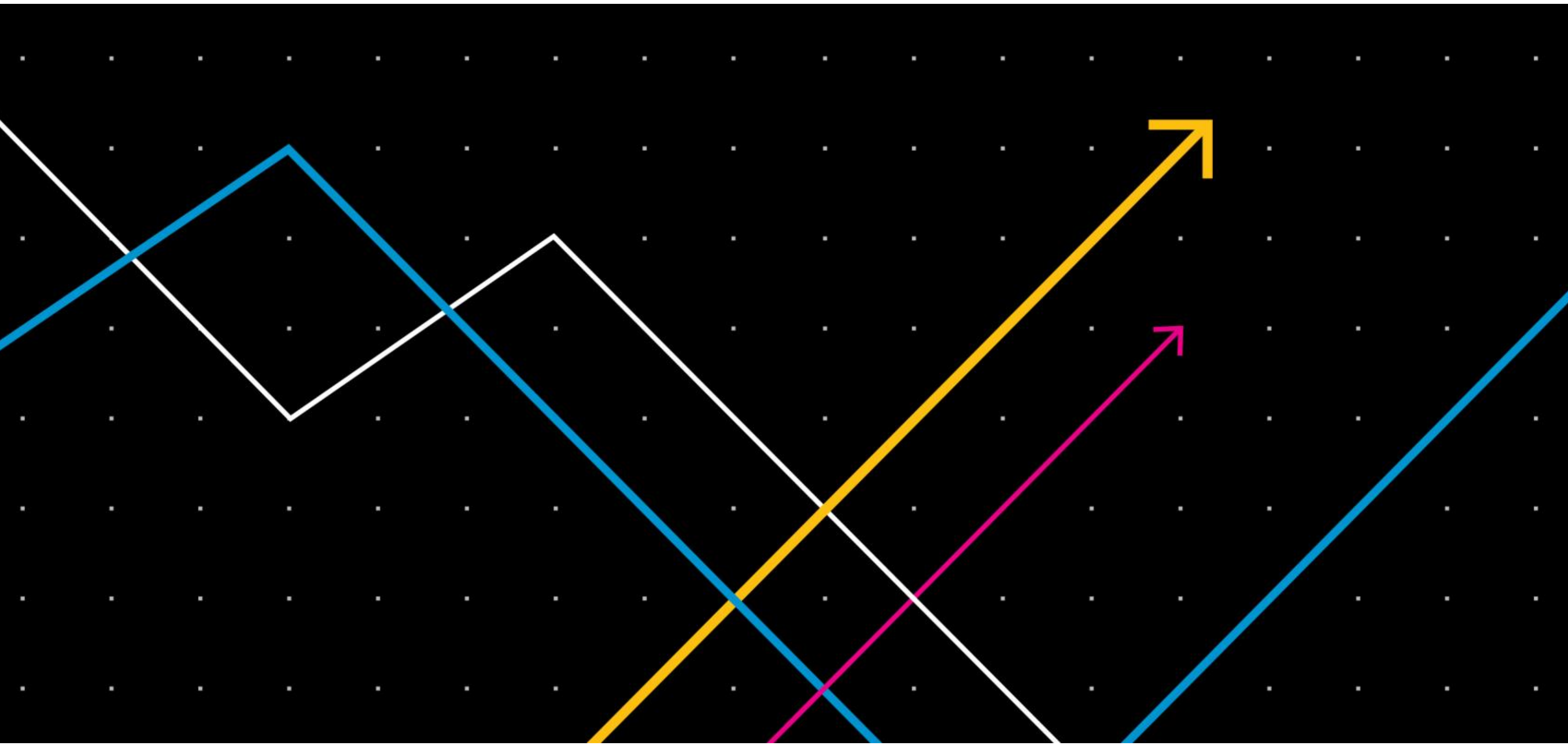

RESEARCH REPORT

How Higher Mortgage Interest Rates Can Widen Racial Gaps in Housing Wealth

The Case of Newark, New Jersey

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High Mortgage Interest Rates and Housing Wealth

The Causes and Consequences of Higher Mortgage Rates for Homebuying In Newark: Reduced Affordability and Limited Housing Wealth Accumulation

Homeownership represents a key path to wealth accumulation. But the homeownership rate in Newark, New Jersey, is 24 percent. In the wake of the Great Recession, efforts to boost the homeownership rate have been undermined by strong home price appreciation, which has reduced homebuying affordability. In recent months, mortgage interest rates have risen dramatically and further eroded mortgage affordability. In addition, higher mortgage rates also slow the pace of principal reduction, partially limiting housing equity increases.

These results are further exacerbated by racial and ethnic differences. Black and Hispanic homebuyers typically pay modestly higher mortgage rates than white homebuyers, contributing to racial wealth inequities. And when combined with having higher loan-to-value (LTV) ratios, Black and Hispanic homebuyers face relatively greater affordability challenges. These challenges are further magnified for Black renters living in Newark because their incomes are comparatively low. But to maintain affordability, Black and Hispanic borrowers typically purchase less expensive homes.

The city has already taken several steps to address challenges related to homebuying affordability. But examples from other cities could provide ways to expand their toolkit. For example, indexing down payment assistance to home price changes could help absorb the impact of higher home prices. And coupling this assistance with an opportunity to buy down mortgage rates could boost both affordability and the early pace of wealth accumulation. These steps could ensure that all Newark renters, but especially Black and Hispanic households, can better achieve homeownership over the course of an economic cycle.

The Urban Institute has produced numerous reports describing key steps to boost homeownership in Newark. In a previous report, we highlighted policy risks that could increase the city's foreclosure rate, which could lead to housing wealth losses. In this report, we explore how higher interest rates reduce homebuying affordability and limit housing wealth accumulation. By assessing the impact of differential mortgage rates paid by Black, Hispanic, and white households; the increase in interest rates market-wide; and other key housing trends, we show how evolving homebuying conditions make it more difficult to afford homeownership and curtails the early pace of mortgage principal reduction.

This report focuses on affordability and housing wealth accumulation at time of home purchase. But Black and Hispanic households face additional obstacles if they achieve homeownership, such as higher user costs. And the higher costs of maintaining and benefiting from homeownership, relative to renting, are partly rooted in Black and Hispanic homeowners' lower likelihood of refinancing.

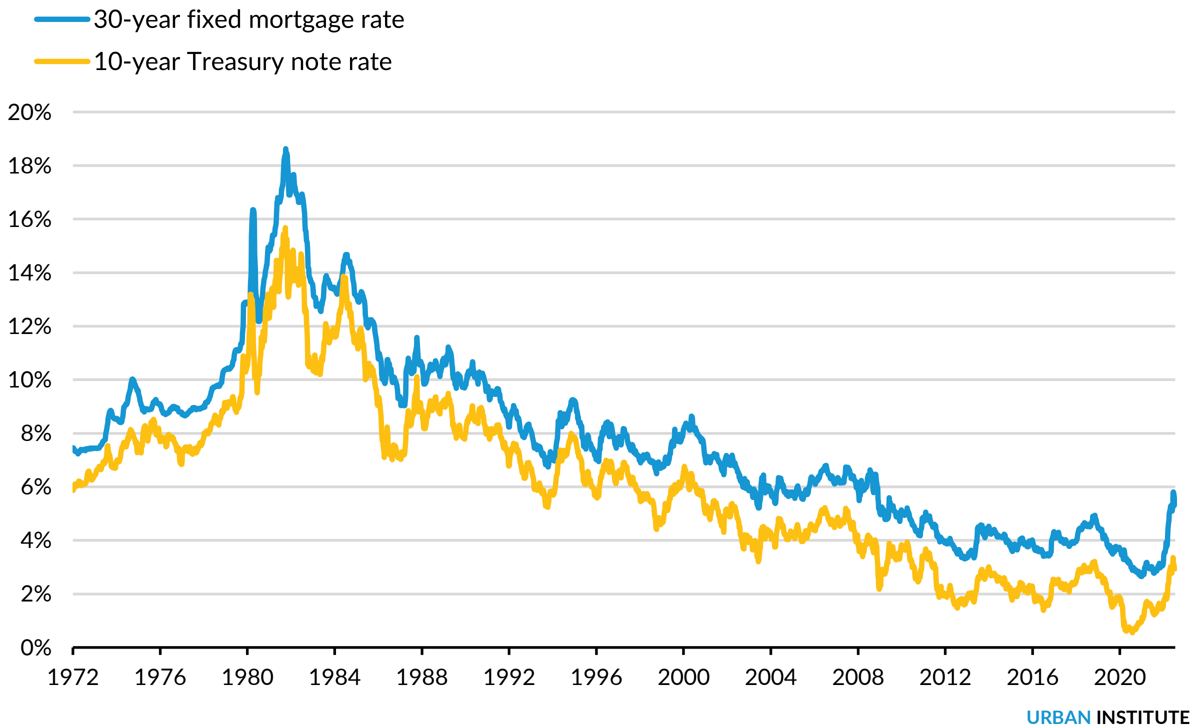
Why Are Mortgage Interest Rates Rising?

Mortgage rates rise and fall through time. But despite cyclical volatility, mortgage rates have been in a secular decline since the early 1980s. Relative to the past 40 years, mortgage rates today are still low. But they have increased dramatically in recent months. Despite some pullback recently, mortgage rates remain elevated relative to 2021. Figure 1 illustrates that after reaching 2.84 percent in August 2021, the 30-year fixed mortgage rate has risen rapidly, increasing by 270 basis points to 5.54 percent by July 2022.[1]

Although mortgage rates have returned to levels last seen in 2008, this does not mean the housing market is in a similar condition. First, lending standards have remained tight in the aftermath of the financial crisis. Second, the lack of affordable housing supports home values and should limit the possibility of a home price collapse. Amid higher home prices, the average homeowner has significant equity in their home today. And third, government action, including forbearance and the foreclosure moratorium, have helped many homeowners get through the worst of the financial crisis and maintain their home. But a future recession could raise foreclosure risk.

FIGURE 1

Interest Rates, 1972 through 2022



Sources: Freddie Mac and US Department of the Treasury.
Note: The mortgage rate data are as of the week of July 21, 2022, and the US Treasury rate data are as of the week of July 22, 2022.

Trends in mortgage rates closely track the rate on the US Treasury Department's 10-year note rates. Over the same August-to-July period, the 10-year Treasury note rate has increased by 172 basis points, from 1.22 percent to 2.94 percent. In practice, lenders use this long-term bond to determine the rate it lends to prospective mortgage borrowers. In theory, the Treasury note reflects the risk-free return, or what mortgage lenders and other financial market participants could earn if they lend to the federal government, which promises to repay all its debt. The higher rate on 30-year fixed mortgages reflects the additional risks and costs associated with mortgage lending.

Mortgage Rates Are Key Determinants of Homeownership Affordability and the Pace of Wealth Accumulation, but Other Factors Play a Role

Strong economic fundamentals, global supply-side challenges, and tight monetary policy, including open market operations, balance sheet runoff, and forward guidance, are contributing to higher mortgage rates. On their own, higher mortgage rates make homeownership more expensive largely because homebuyers will now make higher mortgage payments, all else equal. Higher monthly payments mean homeowners will spend more over the life of a mortgage. On average, first-time homebuyers, who typically have fewer financial resources, will be affected more by higher interest rates than repeat homebuyers who can use their housing equity as a down payment on another home purchase. As a result, higher mortgage rates can weigh on the homeownership rate.

In the following sections, we use Home Mortgage Disclosure Act (HMDA) data to determine the financial characteristics of mortgage loans used to purchase a one-to-four-family primary residences in Newark. To determine the impact of key loan features, we compare this information with estimates of mortgage specifications today. This will provide a clear assessment of the impact from higher mortgage rates by themselves and in tandem with other key differences.

For example, table 1 isolates the impact of higher mortgage rates using data covering 2020 and collected under HMDA.[2] Across Newark, the median value of a primary residence purchased using a one-to-four-family mortgage was $355,000.[3] The typical borrower had an LTV ratio of 91.5 percent, and the median loan amount was $325,000. At a median mortgage rate of 3.25 percent, the typical monthly mortgage payment was estimated as $1,414.42 per month. We further estimate that in the first payment, $534.21 went to pay down the principal while $880.21 went to pay interest.

TABLE 1

Impact of Higher Mortgage Interest Rates on Payments

	2020 interest rates	2022 interest rate	Percentage change
Median property value	$355,000.00	$355,000.00	0%
Loan-to-value ratio	91.50%	91.50%	0%
Principal loan amount	$325,000.00	$325,000.00	0%
Loan term in months	360	360	0%
Median mortgage rate	3.25%	5.50%	69%
Monthly mortgage payment	$1,414.42	$1,845.31	30%
First payment (principal)	$534.21	$355.73	-33%
First payment (interest)	$880.21	$1,489.58	69%
Total principal paid	$325,000.00	$325,000.00	0%
Total interest paid	$184,191.39	$339,313.13	84%

Source: Authors' calculations using Home Mortgage Disclosure Act data.

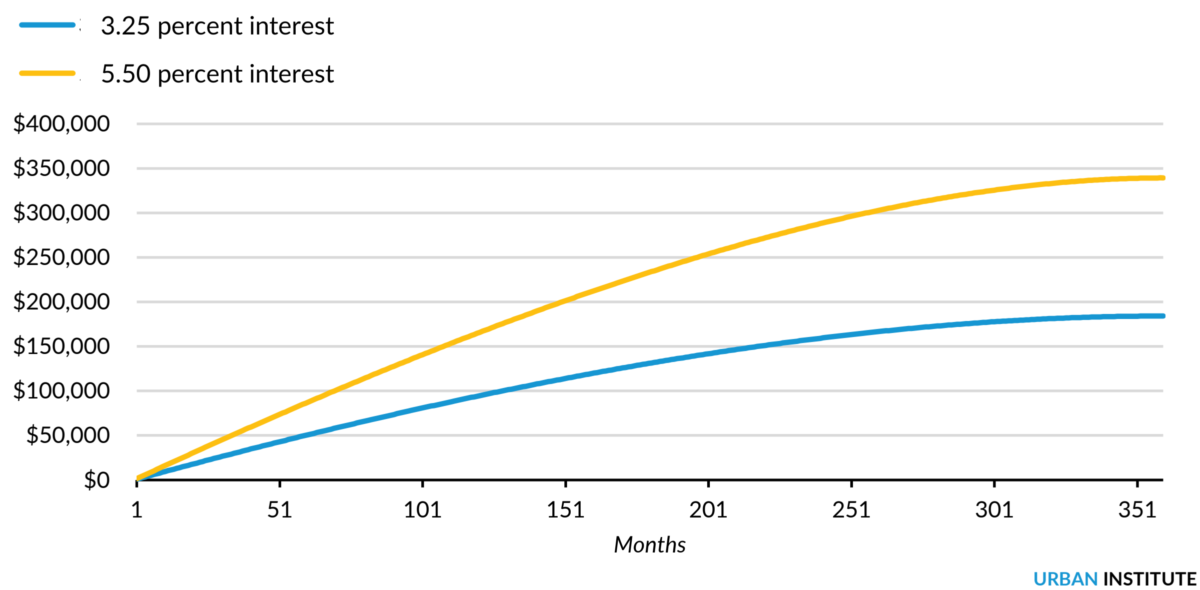
Assuming that property values, LTV ratios, and mortgage loan amounts remain the same, an increase in mortgage rates from 3.25 percent to 5.50 percent would have boosted the typical monthly mortgage payment by $430.89 per month to $1,845.31, while reducing the amount of principal paydown with each payment.[4] In the first payment, the amount going to principal falls by $178.48 to $355.73, while the amount of interest paid in the first month increases by $609.38 to $1,489.58.

In addition, assuming a homeowner held the mortgage for the entire 30-year period, an extreme but illustrative example, the percentage change in the interest paid in the first month's payment equals the percentage increase in the mortgage rate. The increase in the monthly mortgage payment, however, is smaller because less is paid to principal. But because less is paid to principal in the first month's payment, the borrower is left with a higher loan amount in the second month. And when combined with a higher mortgage rate, the amount that would be paid in interest over the life of the loan is greater than the increase in the mortgage rate.

This exercise indicates that higher mortgage rates have two implications. First, they increase mortgage payment amounts by raising the amount of interest paid. But rising mortgage rates affect the principal-interest composition of the mortgage payment as well. Early in the life of a mortgage, higher mortgage rates reduce the mortgage payment amount used to pay down the principal while increasing the amount used to pay interest. Although the original principal balance is the same in both examples, in the short term, the contribution of monthly mortgage payments to housing equity is greater for borrowers with lower mortgage rates.[5]

FIGURE 2

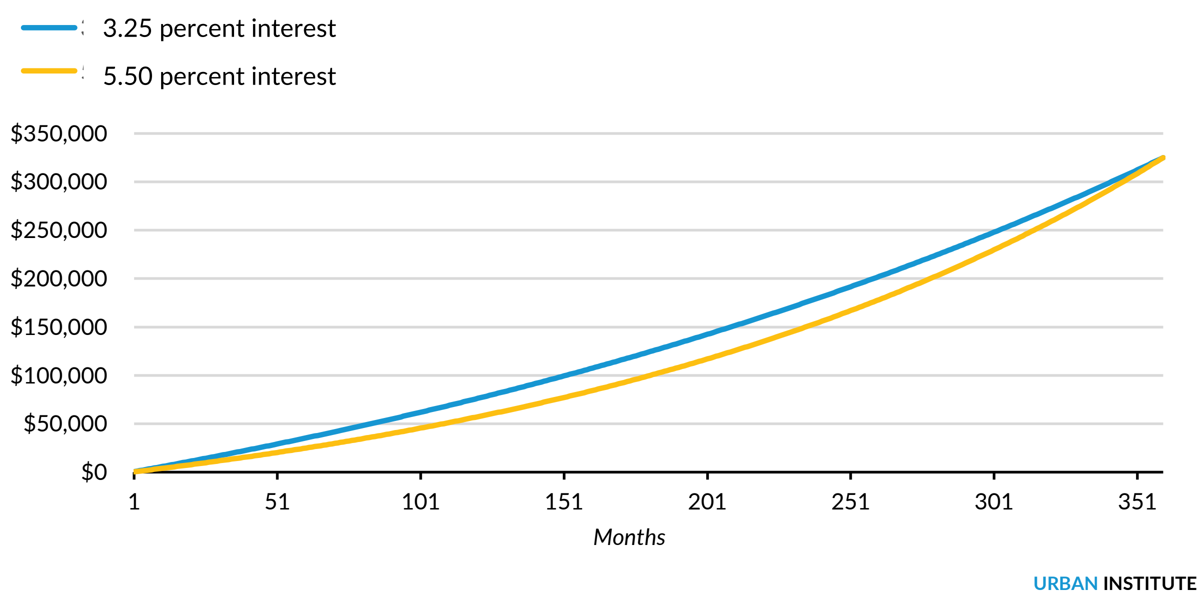
Cumulative Interest Payments over a 30-Year Fixed-Rate Mortgage



Source: Authors' calculations.

FIGURE 3

Cumulative Principal Paid over 30 Years



Source: Authors' calculations.

Figures 2 and 3 illustrate these two effects. Figure 2 illustrates how borrowers with higher mortgage rates pay more in cumulative interest, thereby increasing mortgage payment amounts, and the difference increases over time. Figure 3 shows how borrowers with higher mortgage rates pay less toward principal compared with borrowers with lower mortgage rates. In this scenario, the gap starts at the first payment and widens until the 218th payment (more than 18 years into the mortgage) before converging to zero by the end of the 30-year period.

Over time, borrowers with higher rates pay $155,122 in total payments more than those with lower rates, or 48 percent of the original amount borrowed. And, until the last payment, they build less equity through principal reduction, with the largest gap in accumulated principal paid down occurring in month 218, when the borrowers with lower rates will owe $25,742 less on their loan while having made lower payments throughout.

But not all homebuyers in Newark obtained the same mortgage rate in 2020. HMDA data indicate that white mortgaged homebuyers paid a slightly lower rate in 2020 than Black and Hispanic homebuyers. This was also the case in 2019.

Several factors produce these racial and ethnic mortgage rate differentials. White borrowers may be more affluent and hence less likely to default, which lowers the mortgage interest rate. In addition, originators build higher default servicing costs in for more risky borrowers, who are often Black and Hispanic.[6] As a result, white borrowers may pay lower loan-level pricing adjustments on conventional mortgages, reflecting higher credit scores and lower LTV ratios.

In addition, research suggests that white borrowers are more likely to pay points and fees to reduce their mortgage rates (Bhutta and Hizmo 2021). Mortgage points are the fees a borrower pays a mortgage lender to trim the interest rate on the loan. Each point the borrower buys costs 1 percent of the mortgage amount. For example, one point on a $300,000 mortgage would cost $3,000. Research suggests that Black and white borrowers face identical point-rate schedules, but differences in whether to pay points or fees may reflect preferences or a lack of financial savings.

But at the same time, higher mortgage rates may reflect financial disparities and racial prejudice that result in lower credit scores for Black and Hispanic homebuyers. Laws such as the Fair Housing Act of 1968 and the Equal Credit Opportunity Act of 1974 forbid housing and mortgage lending discrimination, but evidence suggests discrimination continues today (Quilian, Lee, and Honoré 2020). And the channels of discrimination, including capital, credit, and collateral, can affect whether Black and Hispanic applicants can obtain mortgages and the interest charged if they do qualify for one.[7]

TABLE 2

Mortgage Interest Rates, by Race or Ethnicity

	Overall	White	Black	Hispanic
2019	4.25%	4.13%	4.25%	4.25%
2020	3.25%	3.13%	3.25%	3.25%

Source: Authors' calculations from data collected under the Home Mortgage Disclosure Act.

In 2020, the median white homebuyer obtained a mortgage rate of 3.13 percent. The median Black and Hispanic homebuyer secured a 3.25 percent rate. All else equal, the higher mortgage rate secured by the median Black or Hispanic mortgaged homebuyer in 2020 means that, relative to white buyers, they would have paid a higher mortgage payment and paid less toward principal in the short term.

We do not know what the racial and ethnic dimension to the recent rate increases will be, but we can produce some estimates. Assuming Black and Hispanic homebuyers continue to pay a mortgage rate that is 12.5 basis points higher than what their white counterparts pay, and assuming the rate increase affects all borrowers equally, table 3 shows the impact. When interest rates increase, all borrowers make higher monthly payments and see slower principal reduction, but the impact on Black and Hispanic homebuyers is greater.

TABLE 3A

Mortgage Characteristics Based on 2020 Mortgage Interest Rates

	Newark, NJ	White homebuyers	Black homebuyers	Hispanic homebuyers
Median property value	$355,000.00	$355,000.00	$355,000.00	$355,000.00
Loan-to-value ratio	91.50%	91.50%	91.50%	91.50%
Principal loan amount	$325,000.00	$325,000.00	$325,000.00	$325,000.00
Loan term in months	360	360	360	360
Median mortgage rate	3.25%	3.13%	3.25%	3.25%
Monthly mortgage payment	$1,414.42	$1,392.22	$1,414.42	$1,414.42
First payment (principal)	$534.21	$545.87	$534.21	$534.21
First payment (interest)	$880.21	$846.35	$880.21	$880.21
Total principal paid	$325,000.00	$325,000.00	$325,000.00	$325,000.00
Total interest paid	$184,191.00	$176,518.00	$184,191.00	$184,191.00

Source: Authors' calculations.

TABLE 3B

Mortgage Characteristics Based on 2022 Mortgage Interest Rates

	Newark, NJ	White homebuyers	Black homebuyers	Hispanic homebuyers
Median property value	$355,000.00	$355,000.00	$355,000.00	$355,000.00
Loan-to-value ratio	91.50%	91.50%	91.50%	91.50%
Principal loan amount	$325,000.00	$325,000.00	$325,000.00	$325,000.00
Loan term in months	360	360	360	360
Median mortgage rate	5.50%	5.38%	5.50%	5.50%
Monthly mortgage payment	$1,845.31	$1,819.91	$1,845.31	$1,845.31
First payment (principal)	$355.73	$364.18	$355.73	$355.73
First payment (interest)	$1,489.58	$1,455.73	$1,489.58	$1,489.58
Total principal paid	$325,000.00	$325,000.00	$325,000.00	$325,000.00
Total interest paid	$322,528.00	$313,850.00	$322,528.00	$322,528.00

Source: Authors' calculations.

Low Incomes Make First-Time Homeownership Even More Difficult

Renter households in Newark have significantly lower incomes relative to homeowner households. In 2019, the median income of Newark renter households was $32,757 compared with the median homeowner household income of $65,856 (Neal and Pang 2021). The impact of lower household incomes in Newark suggests that homeowning affordability for first-time homebuyers is very low for the city's renters.

At $28,800, the median Black renter household had the lowest renter household income in the city, making homebuying affordability even more challenging. White and Hispanic renter households both have median incomes of around $34,000 (table 4).

To calculate the differential impact of higher mortgage rates on renter households by race and ethnicity, we compare the mortgage payment with median renter household income. But because renter household incomes were calculated in 2019, we first update them to 2021 by using a growth rate equal to the annualized change in worker earnings nationwide over 2020 and 2021. We use earnings because renter households are more dependent on income from their job than homeowner households.[8]

According to the Bureau of Labor Statistics, annual average hourly earnings nationwide increased by 4.9 percent in 2020 and by an additional 4.1 percent in 2021. Compounded over two years, average hourly earnings increased by 9.2 percent. Table 4 updates 2019 household income by race and ethnicity for renter households.

TABLE 4

Renter Household Income, by Race or Ethnicity

	Overall	White	Black	Hispanic
2019 income	$34,000	$34,000	$28,800	$34,300
Income after 4.9 percent increase in 2020	$35,670	$35,670	$30,215	$35,985
Income after 9.2 percent increase over 2020 and 2021	$37,140	$37,140	$31,460	$37,468

Source: Authors' calculations using data collected under the Home Mortgage Disclosure Act and the Bureau of Labor Statistics.

Table 5 illustrates that even amid lower mortgage rates, renter households would have struggled to afford mortgage payments. At mortgage rates obtained by Newark homebuyers in 2020 and inflating 2019 renter household incomes by 4.9 percent, the typical citywide annual mortgage payments would have amounted to 48 percent of renter household income. This suggests that the typical renter household would be cost burdened with only principal and interest payments. The mortgage payment burden would have been lowest for the typical white renter household, while the typical Black renter household would be severely cost burdened.

TABLE 5

2020 Mortgage Characteristics, by Race or Ethnicity

Includes annual mortgage payments and cost burdens for renter households

	Newark, NJ	White homebuyers	Black homebuyers	Hispanic homebuyers
Median property value	$355,000.00	$355,000.00	$355,000.00	$355,000.00
Loan-to-value ratio	91.50%	91.50%	91.50%	91.50%
Principal loan amount	$325,000.00	$325,000.00	$325,000.00	$325,000.00
Loan term in months	360	360	360	360
Median mortgage rate	3.25%	3.13%	3.25%	3.25%
Monthly mortgage payment	$1,414.42	$1,392.22	$1,414.42	$1,414.42
First payment (principal)	$534.21	$545.87	$534.21	$534.21
First payment (interest)	$880.21	$846.35	$880.21	$880.21
Total principal paid	$325,000.00	$325,000.00	$325,000.00	$325,000.00
Total interest paid	$184,191.00	$176,518.00	$184,191.00	$184,191.00
Annual mortgage payment	$16,973.05	$16,706.64	$16,973.05	$16,973.05
Annual est. renter HH income	$35,670.00	$35,670.00	$30,215.00	$35,985.00
Cost burden	48.00%	47.00%	56.00%	47.00%

Source: Authors' calculations.

Note: HH = household.

A 200 basis-point increase in mortgage rates combined with a slower increase in already low renter household incomes would further strain homeownership affordability and suggests that the typical renter household would be severely cost burdened. Citywide, these two dynamics would increase the mortgage cost burden by an estimated 12 percentage points to 60 percent (table 6). The typical white or Hispanic renter household might experience a "smaller" increase (12 percentage points, respectively). And although the typical Hispanic homebuyer pays a modestly higher mortgage rate than the median white homebuyer, the median Hispanic renter household income is slightly higher than the median white renter household income. But the typical Black renter household, who also pays a marginally higher mortgage rate than white homebuyers in addition to having relatively lower household incomes, may see an estimated 14 percentage-point increase in mortgage cost burden to 70 percent.[9]

TABLE 6

2022 Mortgage Characteristics, by Race or Ethnicity

Includes annual mortgage payments and cost burdens for renter households

	Newark, NJ	White homebuyers	Black homebuyers	Hispanic homebuyers
Median property value	$355,000.00	$355,000.00	$355,000.00	$355,000.00
Loan-to-value ratio	91.50%	91.50%	91.50%	91.50%
Principal loan amount	$325,000.00	$325,000.00	$325,000.00	$325,000.00
Loan term in months	360	360	360	360
Median mortgage rate	5.50%	5.38%	5.50%	5.50%
Monthly mortgage payment	$1,845.31	$1,819.91	$1,845.31	$1,845.31
First payment (principal)	$355.73	$364.18	$355.73	$355.73
First payment (interest)	$1,489.58	$1,455.73	$1,489.58	$1,489.58
Total principal paid	$325,000.00	$325,000.00	$325,000.00	$325,000.00
Total interest paid	$322,528.00	$313,850.00	$322,528.00	$322,528.00
Annual mortgage payment	$22,143.77	$21,838.88	$22,143.77	$22,143.77
Annual est. renter HH income	$37,140.00	$37,140.00	$31,460.00	$37,468.00
Cost burden	60.00%	59.00%	70.00%	59.00%

Source: Authors' calculations.

Note: HH = household.

Low Down Payments Limit Homeowner Affordability

Nationwide, the median homebuyer using a one-to-four-family primary residence mortgage had a 94 percent LTV ratio. This means the total loan amount when the mortgage was originated equaled 94 percent of the property value. Conversely, it could also be interpreted as the median homebuyer had housing equity equal to 6 percent of the property's value.[10] And it suggests the homebuyer paid 6 percent of the home's value as a down payment for the purchase.

Across Newark, the median homebuyer had a 96.5 percent LTV ratio in 2020,[11] higher than the national median (table 7). This means the typical Newark mortgaged homebuyer had less equity as a share of the property value when they purchased the home, and it suggests that the median Newark homebuyer had a smaller down payment percentage.

The impact of a higher LTV ratio is illustrated in table 7. Using the citywide data, a higher LTV ratio increases the monthly mortgage payment by increasing the loan amount.[12] This increase reflects proportionate growth in both the amount paid in principal and the amount paid in interest. The mortgage cost burden increases as well.

TABLE 7

2020 Mortgage Characteristics, by LTV Ratio

Includes annual mortgage payments and cost burdens for renter households

	United States LTV ratio	Newark, NJ, LTV ratio	Percentage change
Median property value	$355,000.00	$355,000.00	0%
Loan-to-value ratio	94.00%	96.50%	3%
Principal loan amount	$333,700.00	$342,575.00	3%
Loan term in months	360	360	0%
Median mortgage rate	3.25%	3.25%	0%
Monthly mortgage payment	$1,452.28	$1,490.91	3%
First payment (principal)	$548.51	$563.10	3%
First payment (interest)	$903.77	$927.81	3%
Total principal paid	$333,700.00	$342,575.00	3%
Total interest paid	$189,122.06	$194,151.90	3%
Annual mortgage payment	$17,427.40	$17,890.90	3%
Annual est. renter HH income	$35,670.00	$35,670.00	0%
Cost burden	49.00%	50.00%	3%

Source: Authors' calculations.

Note: HH = household; LTV = loan-to-value.

Table 8 illustrates that in 2020, Black and Hispanic mortgaged homebuyers had higher LTV ratios relative to white borrowers. It also means they had less equity at origination and potentially a smaller down payment percentage.

Combined with relatively higher mortgage rates, Black and Hispanic borrowers with higher LTV ratios would pay higher monthly mortgage payment amounts, and the composition of the mortgage payments in the short term would shift away from principal and toward interest. The next table illustrates how higher mortgage rates worsen affordability and the degree of short-term equity accumulation through principal payments[13] for borrowers buying the median-price home in Newark. But property prices play a key role in determining mortgage outcomes as well.

TABLE 8A

2020 Mortgage Characteristics, by Race or Ethnicity, Based on Higher LTV Ratios

Lower mortgage interest rates

	Newark, NJ	White homebuyers	Black homebuyers	Hispanic homebuyers
Median property value	$352,000.00	$352,000.00	$352,000.00	$352,000.00
Loan-to-value ratio	96.50%	95.00%	96.50%	96.50%
Principal loan amount	$339,680.00	$334,400.00	$339,680.00	$339,680.00
Loan term in months	360	360	360	360
Median mortgage rate	3.25%	3.13%	3.25%	3.25%
Monthly mortgage payment	$1,478.31	$1,432.49	$1,478.31	$1,478.31
First payment (principal)	$558.34	$561.65	$558.34	$558.34
First payment (interest)	$919.97	$870.83	$919.97	$919.97
Total principal paid	$339,680.00	$334,400.00	$339,680.00	$339,680.00
Total interest paid	$190,500.00	$181,623.00	$192,511.00	$192,511.00
Annual mortgage payment	$17,739.71	$17,189.85	$17,739.71	$17,739.71
Annual est. renter HH income	$35,670.00	$35,670.00	$30,215.00	$35,985.00
Cost burden	50.00%	48.00%	59.00%	49.00%

Source: Authors' calculations.

Note: HH = household; LTV = loan-to-value.

TABLE 8B

2020 Mortgage Characteristics, by Race or Ethnicity, Based on Higher LTV Ratios

Higher mortgage interest rates

	Newark, NJ	White homebuyers	Black homebuyers	Hispanic homebuyers
Median property value	$352,000.00	$352,000.00	$352,000.00	$352,000.00
Loan-to-value ratio	96.50%	95.00%	96.50%	96.50%
Principal loan amount	$339,680.00	$334,400.00	$339,680.00	$339,680.00
Loan term in months	360	360	360	360
Median mortgage rate	5.50%	5.38%	5.50%	5.50%
Monthly mortgage payment	$1,928.67	$1,872.54	$1,928.67	$1,928.67
First payment (principal)	$371.80	$374.71	$371.80	$371.80
First payment (interest)	$1,556.87	$1,497.83	$1,556.87	$1,556.87
Total principal paid	$339,680.00	$334,400.00	$339,680.00	$339,680.00
Total interest paid	$337,096.00	$322,928.00	$337,096.00	$337,096.00
Annual mortgage payment	$23,143.99	$22,470.53	$23,143.99	$23,143.99
Annual est. renter HH income	$37,140.00	$37,140.00	$31,460.00	$37,468.00
Cost burden	62.00%	61.00%	74.00%	62.00%

Source: Authors' calculations.

Note: HH = household; LTV = loan-to-value.

High Property Values Weigh on Affordability

Not all borrowers buy the median-price home, however. The property's purchase price is another key determinant of a homebuyer's mortgage payment, if it corresponds to a larger loan. At the same LTV ratio, higher prices raise monthly mortgage payments, and less expensive homes correspond with smaller monthly payments (table 9). In the first month of payment, both the principal and interest amounts are higher. And the mortgage cost burden increases as well.

TABLE 9

Mortgage Characteristics Based on Sales Price Increases

	Newark, NJ, 2020 sales price	Newark, NJ, estimated sales price increase	Percentage change
Median property value	$355,000.00	$413,950.00	17%
Loan-to-value ratio	91.50%	91.50%	0%
Principal loan amount	$325,000.00	$378,968.00	17%
Loan term in months	360	360	0%
Median mortgage rate	3.25%	3.25%	0%
Monthly mortgage payment	$1,414.42	$1,649.29	17%
First payment (principal)	$534.21	$622.92	17%
First payment (interest)	$880.21	$1,026.37	17%
Total principal paid	$325,000.00	$378,968.48	17%
Total interest paid	$184,191.39	$214,777.37	17%
Annual mortgage payment	$16,973.05	$19,791.54	17%
Annual est. renter HH income	$35,670.00	$35,670.00	0%
Cost burden	48.00%	55.00%	17%

Source: Authors' calculations.
Note: HH = household.

To determine home price increases, we use Black Knight data to estimate the annual average home price index in Newark in 2020 and 2021. Applying this 17 percent increase to the median property value for originated mortgages for the purchase of a one-to-four-family primary residence yields a property value of $413,950. The impact of higher property values disproportionately increased the monthly mortgage amount, principal and interest paid, and the cost burden.

Given that Black and Hispanic homebuyers have higher LTV ratios and secure higher mortgage rates relative to white homebuyers, with Black renters also having lower incomes, how do Black and Hispanic homebuyers afford homes? The data suggest that Black and Hispanic homebuyers purchase less expensive homes relative to white borrowers (Haygood et al. 2022; Neal, Choi, and Walsh 2020; Neal et al. 2021).[14]

In 2020, the median property value of homes purchased was $345,000 for Black homebuyers and was $360,000 for Hispanic homebuyers. Meanwhile, the median white homebuyer purchased a $385,000 property in 2020. Compared with white borrowers, the lower property values for Black and Hispanic mortgaged homebuyers shrinks the gap between the mortgage payment and the mortgage cost burden (table 10).

TABLE 10

Mortgage Characteristics, Based on Varied Home Prices and LTV Ratios, by Race or Ethnicity

	Newark, NJ	White homebuyers	Black homebuyers	Hispanic homebuyers
Median property value	$355,000.00	$385,000.00	$345,000.00	$360,000.00
Loan-to-value ratio	96.50%	95.00%	96.50%	96.50%
Principal loan amount	$325,000.00	$365,000.00	$325,000.00	$335,000.00
Loan term in months	360	360	360	360
Median mortgage rate	3.25%	3.13%	3.25%	3.25%
Monthly mortgage payment	$1,414.42	$1,563.57	$1,414.42	$1,457.94
First payment (principal)	$534.21	$613.05	$534.21	$550.65
First payment (interest)	$880.21	$950.52	$880.21	$907.29
Total principal paid	$325,000.00	$365,000.00	$325,000.00	$335,000.00
Total interest paid	$182,267.00	$198,243.00	$184,191.00	$189,859.00
Annual mortgage payment	$16,973.05	$18,762.84	$16,973.05	$17,495.29
Annual est. renter HH income	$35,670.00	$35,670.00	$30,215.00	$35,985.00
Cost burden	48.00%	53.00%	56.00%	49.00%

Source: Authors' calculations.
Note: HH = household.

But home prices have risen in Newark. Applying the same rate of home price appreciation to the median value of properties purchased by white, Black, and Hispanic borrowers and incorporating higher mortgage rates as well as racial and ethnic differences in mortgage rates, LTV ratios, and renter household incomes indicate that higher prices further reduce homebuying affordability and the mortgage cost burden.[15] Black renter households would experience the greatest cost burden (table 11).

But the impact of higher home prices is similar to higher LTV ratios or lower household incomes in that they affect the monthly mortgage payment burden generally. Higher mortgage rates, however, also shift the short-term composition of the mortgage payment away from principal reduction and toward interest payments. As a result, Black households pay a greater share of their income to purchase a smaller home, and they pay down less of their loan balance in the early years of homeownership.

TABLE 11

Mortgage Characteristics, Based on Varied Home Prices (after Price Increases) and LTV Ratios, by Race or Ethnicity

	Newark, NJ	White Homebuyers	Black Homebuyers	Hispanic Homebuyers
Median property value	$413,950.00	$452,116.00	$405,143.00	$422,758.00
Loan-to-value ratio	96.50%	95.00%	96.50%	96.50%
Principal loan amount	$399,462.00	$429,510.00	$390,963.00	$407,961.00
Loan term in months	360	360	360	360
Median mortgage rate	5.50%	5.38%	5.50%	5.50%
Monthly mortgage payment	$2,268.10	$2,405.13	$2,219.84	$2,316.36
First payment (principal)	$437.23	$481.29	$427.93	$446.54
First payment (interest)	$1,830.87	$1,923.85	$1,791.91	$1,869.82
Total principal paid	$399,462.00	$429,510.00	$390,963.00	$407,961.00
Total interest paid	$396,424.00	$414,775.00	$387,990.00	$404,859.00
Annual mortgage payment	$27,217.21	$28,861.59	$26,638.12	$27,796.30
Annual est. renter HH income	$37,140.00	$37,140.00	$31,460.00	$37,468.00
Cost burden	73.00%	78.00%	85.00%	74.00%

Source: Authors' calculations.
Note: HH = household.

What Steps Can Local Policymakers Take to Offset Worsening Affordability and Slower Up-Front Equity Accumulation?

Amid sharply reduced affordability, principally caused by increases in interest rates and in home prices, some households are not buying homes, reducing home sales.[16] Other households are taking actions to partially offset these sharp increases to purchase homes. To mitigate the shock to affordability, more borrowers are paying up-front fees that cut their mortgage rates.[17] And some borrowers are making higher down payments to reduce the amount financed. Still other borrowers are choosing adjustable-rate mortgages, which come with lower up-front mortgage rates.[18]

Local policy can help low-income homebuyers of color achieve homeownership. The analysis above suggests three areas where policy action may need to be expanded: down payment assistance, income enhancement, and housing supply. To a large degree, jurisdictions like Newark have already taken steps in these areas to improve affordability, but the shock from higher mortgage rates, when combined elevated home prices, suggests additional steps may be needed.

Down Payment Assistance along with Interest Rate Paydowns Can Reduce the LTV Ratio

As indicated by LTV ratios, the analysis suggests that homebuyers in Newark have smaller down payments than the nationwide average. A smaller down payment results in a larger loan balance, which, on its own, increases the monthly mortgage payment. This outcome is exaggerated by higher home prices. And when combined with higher mortgage rates, it slows the up-front pace of equity building by shifting the composition of initial payments toward interest and away from principal.

Down payment programs are available to Newark residents seeking to purchase their first home. Under the Live Newark Program, the Home Closing Cost and Downpayment Program allows homebuyers in Newark to use forgivable loans for down payment or closing costs for the purchase of an owner-occupied residential property. The loans under these programs will be forgiven if the resident continues to occupy the residence for five years after the loan has closed. The loan will carry a 0 percent interest rate.

According to the program,[19] the average annual income of new homeowners benefiting from the program has been $54,000, and the average price of the homes they bought has been $235,386. In addition, the city offers a municipal employee housing assistance program that provides $10,000 no-interest forgivable loans to purchase homes in Newark.[20] Financial support for closing costs may help homebuyers amass larger down payments.[21]

In addition, through its Section 8 Homeownership Conversion Program, qualified Section 8 recipients may use their vouchers and down payment assistance to purchase single-family homes. The Newark Housing Authority operates and administers the city's Section 8 Program. It selects and coaches families in preparation for homeownership opportunities by helping tenants qualify for mortgages and works with them through the homebuying process. And purchasers receive pre- and postsale certified US Department of Housing and Urban Development homeownership counseling from local nonprofit partners.[22]

In addition, the program uses properties transferred to the Newark Land Bank from the city's Department of Economic and Housing Development. And where needed, the properties are rehabilitated for sale by local contractors certified as minority- or women-owned business enterprises.

The severe reduction in housing affordability from higher mortgage rates and higher home prices can be reduced by expanding down payment assistance. One step is to index down payment assistance to home prices. For example, Atlantic City, New Jersey, provides down payment assistance up to 10 percent of a home's purchase price.[23] And all down payment and closing cost assistance is offered to the homebuyer as a deferred 0 percent interest loan, secured by a mortgage, to be repaid to the program based on the proceeds from resale, refinance, or any changes in title and a portion of the appreciation as detailed in the recapture provision.

Washington, DC, provides a program that addresses both the potential lack of a down payment and higher mortgage rates. Its DC Open Doors program provides eligible borrowers with below-market interest rates for first-trust mortgages for the purchase of a home in the District of Columbia. These loans can be combined with a down payment assistance loan through the same program and for the purchase of a primary residence.[24]

Broader Income Support Can Lower the Mortgage Cost Burden

Nationwide, the median renter households' income is low. But the median renter household living in Newark has even lower income than the national average, while Newark's home prices and rents are higher than the national average. A renter household's income is a key source of savings for a down payment and other closing costs. In addition, higher and more stable income is critical to maintaining homeownership, particularly through the early years.

The city has already taken steps toward addressing the income challenges its vulnerable inhabitants face. For example, Hire Newark is a local hiring initiative set to empower residents through economic inclusion and access to resources and employment opportunities. Leveraging the commitment of the city's large corporations, this local hiring initiative harnesses the strength of Newark's renowned educational excellence and aligns it with the city's economic boom to create sustainable employment opportunities for its residents.[25]

In addition, the city initiated a guaranteed income pilot program in response to the Newark Movement for Economic Equity, a two-year research study that will give a guaranteed income, or unconditional cash payments, to Newark residents, with a focus on households experiencing housing insecurity. Although these beneficiaries may not achieve homeownership immediately, providing them income that improves their housing stability puts them on a path toward future homeownership.

One way to increase a household's income is through additional educational attainment. But additional schooling could cause borrowers to incur significant student loan debt. Maryland's SmartBuy 3.0 program provides up to 15 percent of the home purchase price for the borrower to pay off their outstanding student debt, with a maximum payoff amount of $30,000.[26] This program helps low-income households make investments to increase their earnings and allows them to use any accumulated wealth toward a down payment instead of student loan debt; the program is partially indexed to home price appreciation.

But the full student loan debt must be paid off at the time of the home purchase. The program cannot be used for a partial student loan payment. In addition to the first mortgage used to purchase the home, the lender will also extend a second interest-free loan for closing the homebuyer's student loan debt account. This loan is not secured by the property and is forgivable over five years at a 20 percent rate per year (MDHCD 2022).

New projects seek to shift the hiring paradigm away from new degrees and new degree programs as the principal means of workforce growth. For example, Equity Cities connects regional coalitions of employers, educators, and community leaders building sustainable and inclusive talent marketplaces. They work with stakeholders across the region to help reskill and upskill employees of color to improve their marketability and employability.[27]

More Affordable Housing Supply Can Help Limit Property Valuations

Down payment assistance and income support will help the demand side of the homebuying equation, but lack of inventory is another barrier. More affordable housing would provide homebuyers lower-cost options. These less expensive homes could maintain affordability for low-income renter households when mortgage rates are elevated.

The city has already taken steps to provide additional supply through its land bank. The Newark Land Bank strategically acquires, maintains, and repurposes vacant, abandoned, and foreclosed properties and efficiently returns them to productive use. The Newark Land Bank acquires and repurposes properties with an aim toward boosting homeownership.[28]

In addition, the city announced bold affordable housing goals to guide the city's housing and development efforts over the next five years. These goals include funding the creation or preservation of 6,600 affordable homes, prioritizing units affordable to renters making less than 30 percent of the area median income, supporting 1,500 new and 200 existing low- and moderate-income homeowners, supporting 10,000 vulnerable or unsheltered households annually, and adding 3,000 new housing units (market rate and affordable) across all five wards, ready for residents to move in. Most of these homes are expected to target renters, but a portion of the new housing will be for sale. And in response to recent research (Troutt and Nelson 2022), the city has begun limiting corporate purchases of homes.[29]

The mayor has outlined several steps, including submitting legislation to bring more transparency to limited liability companies that are purchasing private properties to keep them accountable and legislation covering properties not under rent control to impose fees on renting and landlord registrations for property owners and landlords who increase rents more than 5 percent year over year. In addition, the mayor plans to add a deed restriction to all city-owned and land bank properties that will require the properties to be affordable.[30]

The city has also introduced amendments to its inclusionary zoning ordinance to increase the supply of housing that residents can afford and ensure that Newark is an equitable city.[31]

And more recently, for people seeking affordable housing, the city launched a housing locator site, NewarkHousingSearch.com, which enables prospective tenants to find affordable housing.[32] The site offers users the ability to search listings along various potential details, including photographs, size, and type of bedrooms. Property listings are shown on a map and by address.[33]

There are additional policies that the city could implement to boost the for-sale housing supply. For example, strengthening rules discouraging the conversion of condominiums to apartments could support a key affordable for-sale product, particularly amid evidence that condominium construction remains depressed.[34]

In addition, Alexandria, Virginia, helps market resale-restricted units purchased with city assistance.[35] The units are priced at levels affordable to low- and moderate-income first-time homebuyers and have long-term affordability requirements. The homes are available to first-time homebuyers who live or work in Alexandria and have a gross annual income below 100 percent of the area median income. Buyers may be eligible for a city shared equity loan of up to $50,000 in down payment and closing cost assistance through the Flexible Homeownership Assistance Program, and they may be eligible for a 1 percent mortgage interest rate reduction through the Virginia Housing Sponsoring Partnerships and Revitalizing Communities Program.[36]

Property Taxes and Insurance, as Well as the Propensity to Refinance, Also Play a Critical Role in Determining Monthly Payment Amounts

In addition to principal and interest payments that are determined by mortgage rates, homebuyers also pay for homeowners' insurance and property taxes. The typical homeowners' insurance in New

Jersey is estimated at $775 for a $250,000 home.[37] For homebuyers in Newark, insurance costs are higher, in part because recent values of purchased properties have been higher. Homeowners' insurance is also determined by other factors, including property condition and location, which may lead to higher or lower annual premiums.

Across Newark, property tax rates are higher than the national average. Recent data suggest that real estate taxes paid amounts to 2.4 percent of the median home value. But as a share of homeowner household incomes, the amount of real estate taxes paid annually in 2019, $6,390, accounted for 9.7 percent of homeowner household incomes,[38] more than three times the national average, 3.1 percent. And median real estate taxes paid are 19.5 percent of the median renter household income. Moreover, research suggests that Black homeowners may pay relatively more in property taxes relative to white homeowners, suggesting this is a key area of racial disparity that could further limit first-time homeownership.

First-time homebuyers face additional costs and benefits when they become homeowners. In addition to mortgage payments, property taxes, and insurance costs, many also face maintenance costs and depreciation costs related to the home's structure. These costs can be partially offset by appreciation, but taking each of these into account, nationwide research suggests that Black and Hispanic homeowners face higher user costs relative to white homeowners.[39]

Finally, higher mortgage rates could be amerliorated by refinancing in the future when rates inevitably fall. But research suggests that Black and Hispanic homebuyers are less likely to refinance relative to white homeowners (Gerardi, Willen, and Zhang 2020). This could significantly reduce homeownership's benefits and the growth of wealth through homeownership or other investments, potentially contributing to the broader racial and ethnic wealth gap.

Conclusion

Boosting homeownership can help Newark renter households build wealth. But higher mortgage rates, like rising home prices, reduce homebuyer affordability. Higher mortgage rates also slow the pace of principal reduction, limiting housing equity accumulation.

The increase in mortgage rates reflects broader economic conditions and the response of the Federal Reserve to these economy-wide fundamentals. But there is a racial and ethnic angle as well. Typical Black and Hispanic homebuyers in Newark pay a modestly higher mortgage rate relative to white homebuyers. Not only does this result in a slower pace of principal reduction for Black and

Hispanic homeowners, but for Black renters, who have the lowest incomes across the city, the impact on homebuying affordability is even more significant.

The city has already taken bold steps toward helping Newark households achieve homeownership, but there is a further opportunity to expand its arsenal and build homebuyer resilience in the face of changing market conditions. Doing so will better support homebuyer affordability, particularly for households of color, and could reduce racial wealth disparities that may prevail across the city.

Notes

[1] The mortgage rate data are as of the week of July 21, 2022, and the US Treasury rate data are as of the week of July 22, 2022.

[2] In this report, we assess only 30-year fixed-rate mortgages.

[3] This value is significantly above the average amount found in the Newark Housing Pulse and reflects the inclusion of two-to-four-unit homes, which are more expensive than one-unit homes.

[4] For illustrative purposes, we use 5.50 percent instead of the mortgage rate as of this writing, 5.54 percent.

[5] Slower principal repayment limits housing equity growth, but this could be offset by home price appreciation rates.

[6] Black and Hispanic borrowers are more likely to use mortgages endorsed by the Federal Housing Administration (FHA), which have higher rates because mortgage insurance is often built in.

[7] Liam Reynolds, Vanessa G. Perry, and Jung Hyun Choi, "Closing the Homeownership Gap Will Require Rooting Systemic Racism Out of Mortgage Underwriting," *Urban Wire* (blog), Urban Institute, October 13, 2021, https://www.urban.org/urban-wire/closing-homeownership-gap-will-require-rooting-systemic-racism-out-mortgage-underwriting.

[8] This strategy does not incorporate any racial or ethnic differences in income changes over 2020 and 2021. We use average hourly earnings instead of average weekly earnings. The latter accounts for the number of hours worked per week. We exclude hours worked because it is largely stable.

[9] A cost-burdened household pays shelter costs equal to or greater than 30 percent of household income. A severely cost–burdened household pays costs equal to or greater than 50 percent of household income.

[10] The LTV ratio is not always equivalent to the down payment percentage. Consider a mortgage endorsed by the FHA. An FHA mortgage requires a 3.5 percent down payment, but if the borrower finances the up-front mortgage insurance, the LTV ratio will be greater than 96.5 percent.

[11] This likely reflects the greater share of FHA mortgages originated to homebuyers in Newark. FHA loans require a down payment of only 3.5 percent, but homebuyers will have to pay mortgage insurance over the life of the mortgage.

[12] The difference between the original loan amount and the sales price, measured as the LTV ratio, reflects any down payment made, as well as mortgage insurance and loan-level pricing adjustments capitalized into the loan.

[13] Up to now, we have estimated the LTV ratio from the ratio of the median loan amount and the median sales price. In this table, we use the median sales price and median LTV ratio to impute the loan amount.

[14] The estimated LTV ratio is shown but is not used in any calculations in this table.

[15] The difference between the two tables is overestimated because in the first table, the implied LTV ratios from the median sales price and median loan amount calculated from the 2020 HMDA data are less than 95 percent citywide and for all racial and ethnic groups. In the second table, the LTV ratios of 95 and 96.5 percent are used to estimate the loan amount.

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