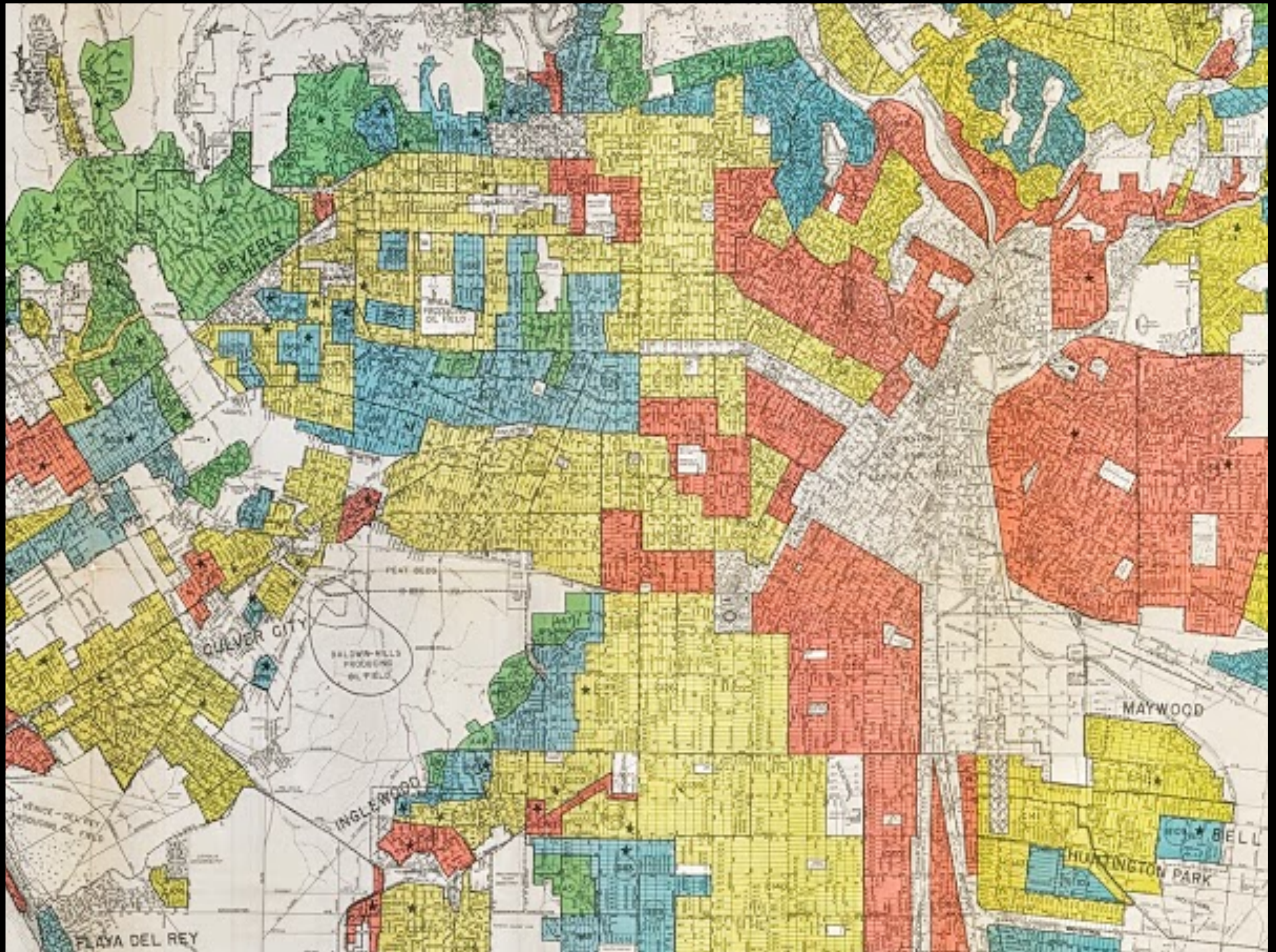

The History of the American Dream

Homeownership and its Impact on Diverse Communities

Introduction

Race is often left off of the table when housing policy is discussed—poverty and class are usually deemed to be enough for the discussion. Our brief report attempts to instead address race and its impact on housing and homeownership head on.

This report will look at both the past and present practice of federal subsidy for homeownership and the extent to which that subsidy has and has not flowed to communities of color. This report will also look at the more recent mortgage market innovations that led to the subprime loan crisis, as well as the impact that crisis has had on communities of color. Lastly, our report will look at how a lack of homeownership, and abundance of subprime lending and foreclosures, have created a historic gap in wealth between white and non-white communities.

Our research is not groundbreaking but our findings have rarely been presented through the lens of our country's persistent racial wealth gap. It is our hope that policy leaders will use this research to ensure that people of color are allowed the same opportunities to build wealth that other communities have.

Federal Subsidy of Homeownership and Subsequent Benefits to Society

The American housing finance system as we know it is less than 100 years old. Prior to 1930, the mortgage market was almost completely private and what we associate most with the American housing market—the 30-year, fixed rate mortgage—did not exist. The vast majority of home loans had five to ten years terms, a variable interest rate, and down payment requirements of approximately 50%.[i] Another feature of these early mortgages was that the borrower was expected to pay off any remaining principal at the end of the loan term, otherwise known as a "balloon payment," since refinancing was often very difficult to come by.

While this system worked well prior to the Great Depression, by 1930 almost 50% of homes were in default and housing starts had dropped 90% between 1925 and 1933.[ii] It was not just homeowners who were suffering either, housing-related businesses began to feel a significant impact. In fact, it was a coalition of housing industry business interests, the "Own Your Own Home Coalition," that initially lobbied for a federal response to the precipitous drop in housing starts and mortgage originations. Persistent lobbying efforts by the business community led to the creation of the Federal Home Loan Bank System by the Hoover Administration. This new system included federally charted thrift institutions (savings & loans and mutual savings banks) and provided liquidity to the struggling housing industry. Later, the Roosevelt Administration signed into law the Home Owners Loan Corporation (HOLC), which used government back bonds to purchase mortgages in danger of foreclosure. While HOLC was an important first step in stabilizing the housing market and creating a national system of capital for the housing market, it was only meant to be a temporary solution and as such, ceased making new loans in 1935.

In 1934 the Roosevelt Administration created the Federal Housing Administration (FHA). The FHA provided lenders a government guarantee of mortgages, an act which in hindsight is one of the most momentous steps in the creation of the US mortgage system. By insuring these mortgages the federal government was guaranteeing that private investors would always see payment of the principal balance and interest payments on mortgages they originated. This had the effect of greatly expanding the capital available to finance home loans for a longer period of time, at a lower interest rate, and with a higher loan-to-value ratio. A few years

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later, and at the end of WWII, the Veteran's Administration (VA) mortgage insurance program began offering similar loan guarantees to returning American servicemen with small or no down payment requirements.

In 1938, the Federal government went even further and created the Federal National Mortgage Association, or "Fannie Mae." Fannie Mae allowed for purchase and sale of FHA insured loans by investors and had the effect of increasing the liquidity of the mortgage market, but also eliminating regional differences in pricing as well as helping to shrink the cyclical effect of real estate value on the market. Between 1940 and 1960, homeownership rates rose from 40% to 60%, and an entire generation went from urban working class renters to suburban middle class homeowners.[iii]

Historic Exclusion of Communities of Color from Federally Subsidized Homeownership

The massive government intervention into the housing market did not benefit all Americans. While perhaps no more exclusionary than many other government programs at the time, these new government housing programs were all structured in a way that directly or indirectly disenfranchised most communities of color.

De jure categorization of mortgages by ethnic background began with the federal government's first housing program, HOLC, which marked different neighborhoods according to a code of A,B,C, or D.[iv] Neighborhoods assigned an "A" were designated for ethnically homogenous, white, native born citizens and businesses, while neighborhoods assigned a "D" were designated for African Americans.[v]

The FHA also categorized neighborhoods by race, adding greater emphasis on these categories in their underwriting and risk assessment. The term "redlining" comes from the HOLC and FHA practice of outlining Black, Latino, and Asian neighborhoods in red in order to designate them as too risky for mortgage guarantees. The FHA's own underwriting manual laid out their philosophy: *"if a neighborhood is to retain stability, it is necessary that properties shall continue to be occupied by the same social and racial classes."*[vi] This policy, aided by racially coded maps in cities and racially restrictive covenants in new suburban developments, resulted in the vast majority of communities of color unable to access FHA insured loans.

Unlike the FHA's homeownership program, the Veteran Administration's GI Bill was written in such a way that, at least in theory, all servicemen returning from WWII would have the ability to access low-cost, subsidized mortgages. In practice, the legislation that passed left the management of its mortgage loan program up to state and local communities. Since many of these local and state boards were also enforcing Jim Crowe laws at the time, they became notorious known for denying Black serviceman participation in the program.

Growth of Homeownership

Despite systemic barriers within the mortgage market, minority homeownership actually grew substantially between 1960 and the mid-2000s. Banks, spurred in part by legislation such as the Community Reinvestment Act (CRA) and the Home Mortgage Data Act (HMDA), began to make more and more home loans to minority communities because they saw an opportunity to profit from an emerging market.

Between 1970, the year HMDA began publishing mortgage data, and 2005, African American homeownership grew from 43% to 49% (although the largest gain came after 1990).[vii] In the same period, Hispanic homeownership grew from 42% to almost

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50%. White families, already with the highest homeownership rates, grew from 67% to 72% in the same time period.

The growth in homeownership benefitted not just individual homebuyers, but the nation as a whole. The Housing and Urban Development Department (HUD) found that homeownership contributed to increased jobs and business in sectors connected to housing and real estate; in particular, the construction sector and businesses catering to homeing and home improvement experienced a boom during this period. In 2001 alone, the housing sector represented 14% of the national GDP. [viii]

Growth of Subprime Lending

Once financial institutions discovered how lucrative lending to low-income and minority communities could be, they began widespread marketing of home loans to these communities. By the mid-2000s, "subprime" mortgages became one of the primary ways minority communities purchased homes.

Subprime lending is a broad term applied to any mortgage loan made to a borrower outside of traditional "prime" standards. Subprime loans generally carry a higher interest rate, a non-30 year term, and are almost always more expensive than prime rate mortgages. Subprime lending grew from approximately 2% of the market in 1998 to 14% at its height in 2007.[ix]

Due to a number of regulatory policies and other factors having to do with access to capital, subprime lending grew rapidly in the beginning of the 21st century. According to the Financial Crisis Inquiry Commission, which was tasked by the Federal Government with investigating the causes of the financial crisis, "one of the earliest enablers of the growth of subprime lending can be traced back to the 1980 Depository Institutions Deregulation and Monetary Control Act (DIDMCA), which eliminated previous caps on the interest lenders were able to charge on mortgage loans."[x] Another important deregulation by the government was the Graham Leech Bliley Act of 1999. The Act removed the last vestiges of the Glass-Steagel Act, which had previously kept the commercial, investment, and insurance components of financial institutions separate.[xi] To paraphrase the New York Times article by David Leonhardt, for the first time there was no separation between the parts of a financial institution that engaged in basic banking services and the other departments that engaged in more precarious and risky activities.[xii]

De-regulation also helped to provide capital for the new sub-prime industry. Following the financial crisis in Asia in the 1990s, Asian countries amassed huge amounts of savings and began searching for safe ways to invest all of their excess capital. After the dot-com bubble burst in the early 2000s and proved technology companies to be riskier than first imagined, Asian and other foreign investors began to plow money into what everyone at the time knew to be the gold standard for safe and stable investment: American home mortgages.[xiii]

The subprime market also gained an infusion of capital through the securitization of loans, or the slicing and repacking of loans into securities to be sold on the secondary market.[xiv] Theoretically, securitization should have lessened risk for investors because they could mix and match highly rated loans with lower investment yields, with riskier, but more profitable, subprime loans. The problem with this system was that rating agencies were found to rate risky subprime loans as highly as the safest prime loans, thus causing investors such as pension funds to invest billions of dollars in bonds backed by subprime loans they assumed were as safe as prime loans.[xv]

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Housing Market Crash and the Racial Wealth Gap

The crash of the subprime market not only had a devastating impact on the job market, it also dealt a crushing blow to wealth in minority communities. "Wealth," or the sum of all of a family's assets and debts, acts as a cushion for families against financial shocks, helps to finance small businesses, and sends kids to college. Wealth can be passed down across generations and help to finance the next generation's dreams. Following the housing crash, the disparity between white household wealth and minority household wealth grew even worse. As Annie Lowrey succinctly puts it in her New York Times article Wealth "Gap Among Races Has Widened Since Recession", "many experts consider the wealth gap to be more pernicious than the income gap, as it perpetuates from generation to generation and has a powerful effect on economic security and mobility."[xvi]

Since a home usually makes up the largest part of a family's assets, the housing crash severely impacted families across the country. U.S. family wealth overall decreased almost $27,000 to $70,000 between 2009 and 2007.[xvii] In 2005, 29% of African American families and 23% of Latino families either had no wealth or negative wealth (debt) compared to only 11% of white families. After the housing crash, these numbers grew to 35%, 31% and 15% for African American, Latino and White families, respectively.[xviii]

Currently, only 45% of Blacks and Latinos own their own homes compared to 73% of white families. Additionally, for every $1 held by a white family, African American Families have approximately $0.12 and Latino families have $0.14. In terms of family wealth, the average white family holds approximately $632,000 compared to $98,000 in African American families and $110,000 in Latino families.[xix]

Policy Recommendations and the Way Forward

It would be naïve to think that addressing any single issue, even one as important as homeownership, would be able to address all of the issues facing communities of color. It is the responsibility of America's new majority, people of color, to play a role in government, academia, business, and all other important sectors in this country to address these issues at both micro and macro levels. Our communities will not have the opportunity to play these roles, however, unless we are able to build wealth, insulate ourselves from economic shocks in the way white Americans have, and finance our children's educations without going deeply into debt.

With that in mind, we believe that there are important steps that can be taken towards addressing the lack of homeownership and opportunities for wealth building in low-income communities of color. First, there needs to be a forum connecting business, government, and non-profit community leaders where they can talk openly and earnestly about solutions for addressing one of the most pressing issues facing our society today. While in the past, homeownership for low-income communities and communities of color have been relegated to either purely governmental programs or purely private market, we believe that solving as monumental an issue as the racial wealth gap will require more deliberate and robust public-private partnerships.

Second, academic study needs to be leveraged not just to retrospectively assess what has happened, but also to proactively construct solutions that move us forward. To that end, we call on academic institutions and think tanks to provide us with the cutting edge information needed to move policies forward that will provide concrete solutions.

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Housing experts, understandably, often get caught up in the minutia of the their discipline and the constraints of today without thinking of the big issues at hand and how they can be solved with bold action. Yes, it will be hard to create the political will and capital to finance safe, affordable loans for low-income families, especially communities of color who have been locked out of the financial system for so long, but keep this in mind: at one point, the 30-year fixed rate loan did not exist. If that can be created and made the bedrock of our mortgage system, slight tweaks can be made to make that more fair.

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[ix] Federal Reserve Bank of San Francisco: Share of subprime mortgages to total mortgages
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[xiii] Revenge of the Glut. Paul Krugman.
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[xv] U.S. sues S&P over subprime ratings
[xvi] Wealth Gap Among Races Has Widened Since Recession
[xvii] Wealth Gaps Rise to Record Highs Between Whites, Blacks and Hispanics. Paul Taylor. P. 4
[xviii] Wealth Gaps Rise to Record Highs Between Whites, Blacks and Hispanics. Paul Taylor. P. 4
[xix] Wealth Gap Among Races Has Widened Since Recession

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