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Examining the Unexamined Goal

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Anthropologists point out that the notion of ownership is a cultural construct. In some societies, land and buildings constitute community wealth; those societies would find the notion that an individual might "own" a house—and even the notion of "ownership" itself—bizarre.[1]

This construct, though, is embedded in American culture; it is oft equated with the American Dream. From its agrarian roots in medieval England, the concept of landholding as a precondition of liberty has evolved into a yearning for ownership.[2] We have the attendant rituals: the wedding checks amassed toward a down payment, the housewarming parties, the burn-the-mortgage celebrations, the "starter" home, the intense spending to give it bigger bathrooms, gourmet kitchens, more square footage. A few communitarian societies, focused on a utopian ideal, have existed, but in the history of American housing, those enclaves are footnotes. For the most part, Americans have wanted to own their patch of space—whether it is a one-acre lot in exurbia or a one-bedroom condo on a yuppified city block. And homeowning Americans have lavished attention (and money) on those spaces, considering them anchors—psychologically, physically, and economically.

1. One nomadic tribe in Northern Africa describes homes as "graves for the living."
2. In commenting on the Homestead Act of 1860, Proudfit (1924) notes: "The primary conception of the home as the only basis of State and national permanence has been kept intact."

Government has helped, using its bully pulpit to spur homeownership.[3] In 1918 the Department of Labor launched the "Own Your Own Home" campaign. Herbert Hoover, as secretary of commerce, established "Better Homes of America," a program supported by Presidents Warren Harding and Calvin Coolidge.

The government also acted. Some actions were overt: the initial land grants gave people land for homesteading; the Veterans Administration subsidized mortgages for veterans (just as the GI bill subsidized their college educations); fair housing laws attacked race-based exclusionary practices; the 1977 Community Reinvestment Act required banks to look beyond their traditional borrowers, to inner-city residents.

Other actions indirectly bolstered housing, a side effect of programs initiated to spur economic recovery. For instance, the pre–New Deal Federal Home Loan Banks, the New Deal Federal Housing Administration, and its companion, the first National Mortgage Association, aimed to restore liquidity to a Depression-era banking system in collapse. These agencies bolstered the shaky underpinnings of banks, thereby guarding against insolvency but also bolstering their ability to make mortgage loans. Similarly, in 1918 the first income tax allowed a deduction for all loan interest, not just mortgage interest. Tax architects did not foresee its impact on housing. (But in 1986 when Congress expressly retained that deduction while dropping most other deductions, Congress recognized this deduction as a homeownership incentive.)

Today politicians stand firmly behind homeownership, cheering at every incremental boost in the number of homeowning households (now up to a record high 68 percent of households in 2001). Fannie Mae and Freddie Mac, the two secondary mortgage market behemoths that bought or securitized nearly three-fifths of prime conventional conforming mortgages written last year, have a special status as "government-sponsored enterprises" because they undergird the current flux of first-time home buyers. Every state but Arizona has a Housing Finance Agency, authorized to issue bonds using a federal tax exemption to subsidize mortgages for low- and moderate-income first-time buyers. Local communities use their federal block grant moneys to spur homeownership among inner-city residents.

Today supplying credit to home buyers and owners is an enormous industry, with debt outstanding on single-family properties alone at over $5 trillion in 2001, a level that exceeds either corporate or federal government debt. The mortgage finance system has become highly specialized and regulated. Though banks and thrifts still hold some loans they originate in their portfolios, they are more apt to sell their loans into the secondary market and retain only the servicing rights and take origination fees. Increasingly, they lend through mortgage

3. Retsinas (1999).

company affiliates that, together with independent mortgage companies, originate the lion's share of mortgages. Banks and thrifts are under regulatory pressure to lend to low-income borrowers and areas (in the form of the Community Reinvestment Act), and Fannie Mae and Freddie Mac are as well (in the form of goals established annually for them by the Department of Housing and Urban Development).

Homeownership, in short, is valued and promoted by government: it is considered good for the buyers, good for their communities, and good for the country. It is not far behind motherhood and apple pie as an American symbol. At least in the abstract, nobody questions this American icon.[4]

It is time, however, for some iconoclastic scrutiny—time to examine the unexamined goal. With the industry geared up to lend to low-income borrowers in ways the nation has never seen before, the government egging them on, and cultural norms drawing renters into the market, the time is ripe to pause and take stock of what we know and do not know about low-income homeownership. Rhetoric aside, is homeownership truly good for low-income buyers, their communities, and the country? Even if homeownership was a worthy goal two generations ago, have times changed to devalue the notion that individuals should own their homes?

Supported by the Ford Foundation, Freddie Mac, and the Research Institute for Housing America, Harvard's Joint Center for Housing Studies organized the symposium "Low-Income Homeownership as an Asset-Building Strategy." The symposium asked researchers to play the role of iconoclasts, statistically probing the impact of housing on these buyers and their communities. Their findings, published herein, deserve attention. On the one hand, the authors offer reassurance to policymakers: homeownership as a national goal does merit government support. For individuals struggling to save for a down payment, it is worth the effort; for the country struggling to bolster homeownership, it is a worthwhile goal. On the other hand, America at the dawn of this century is a markedly different place from the America of 1960: the "typical" home buyers of today bear only a passing resemblance to their earlier counterparts. The benefits, the constraints, the pitfalls—all have changed within the past few decades. To sustain the current high level of homeownership, and to increase that rate, policymakers will need to reexamine their strategies.

The Home Buyers of Today

The most startling fact about homeownership today lies in the title of the symposium: "Low-Income Homeownership." A generation ago, there were not

4. Interest in the value of homeownership has increased recently; see DiPasquale and Glaeser (1999); Green and White (1997); Rohe and Stewart (1996); Rossi and Weber (1996).

enough low-income home buyers to warrant a study. Consider the typical buyer of the 1920s. Banks required a 50 percent down payment and offered a loan of three to five years. Wealthy people owned their own homes; they could bypass banks. But the nonwealthy homeowners tended to be frugal older couples with moderate-but-not-modest incomes who had saved throughout their working lives. Households with low incomes could rarely save enough for a 50 percent down payment.

The New Deal's banking subsidies lowered banks' risk, letting them lend to more borrowers, for longer periods, with lower down payments. By the 1950s the typical borrower put 20 percent down and got a fixed-rate mortgage for twenty years. That buyer had a moderate income. Still, a 20 percent down payment shut most low-income households out of the market, even in neighborhoods of modest homes. (Race and foreign accents closed the door still tighter.)

Today a buyer can put as little as nothing down, get a variable-rate mortgage, and amortize a loan for as long as thirty years. The secondary mortgage market, buttressed by statistical techniques that assign a "credit score" that correlates well with loan repayment behavior, has let lenders (which now include mortgage companies as well as traditional banks) reach out to people whom the lenders of the 1960s would have shunned. Low-income households are no longer shut out; now families with incomes of $30,000 or less can buy a house. From 1993 to 2000 the number of home-purchase loans to low-income families surged by 79 percent. Mortgage lenders recognize low-income borrowers as a profitable market. Evidence presented in the following chapters shows that, properly insured against losses, low-income loans can be every bit as profitable to lenders as others, especially now that technology has cut mortgage origination costs.

Growing recognition of the capacity to lend profitably to borrowers and in areas once thought too risky has spawned a surging industry of "subprime" lenders. Pushing the envelope even further, these lenders have been marketing mortgages to borrowers with shaky credit histories, borrowers even aggressive "prime" mortgage lenders still turn away. But that too is changing, and conventional mainstream lenders are experimenting with products that grade into the subprime market.

Minorities also are no longer shut out. From 1994 to 2000 loans to black home buyers soared 89 percent, loans to Hispanic buyers rose by 138 percent, but loans to whites grew by only 25 percent. Admittedly, a racial and ethnic gap persists: holding income constant, a higher proportion of whites own homes than do blacks and Hispanics. But most studies attempting to control for both income and wealth differences find that most of the disparities are caused by these differences, which emanate not from housing markets but from education and labor markets.[5] And, as census data demonstrate, the buyer of today may well be a Latin American, Caribbean, or Asian immigrant or a person of color native to the United States.

As for the "traditional" Beaver Cleaver family-owner of the 1960s (two parents with a stay-at-home mother watching over a few children), it no longer predominates. Homeownership rates are up sharply among single-parent families, with female-headed households nearing the 50 percent mark for homeownership in 2001. The homeownership rates of people living alone have also surged: from 50 percent in 1994 to 54 percent in 2001. And among married couples youth is no impediment to homeownership, as 62 percent of those under age 35 now own their home, up from 56 percent in 1994. Whatever the mixture of people that can constitute a "household," chances are high and growing that they will own a home.

Their homes, though, may not be the "traditional" ones: high-rise condos, suburban capes and ranches, or to-be-gentrified townhouses. For many low-income households, an "affordable" house is a "manufactured" one. In the South, 40 percent of low-income buyers bought manufactured housing in the 1990s, often on the periphery of the urban core on tracts of leased land (in the noneuphemistic vernacular, in trailer parks).

Overcoming Borrowing Constraints

Today's good news is that low-income borrowers' access to credit has improved dramatically. A decade ago, lenders did not offer loan terms and underwriting standards that would help low-income borrowers overcome their income and wealth constraints. Mortgages with low down payments were scarce, and few lenders were willing to let borrowers—many already spending well over half their incomes on rent for years on end—qualify for a loan whose payments with taxes and insurance amounted to more than 28 percent of their income. The government through the Federal Housing Administration (FHA) was willing to let them devote more of their income to these payments but did not stretch in

5. Using data from the 1989 American Housing Survey, Wachter and Megbolugbe (1992) found that variation in household (income, age, education, family type, and gender) and market (price and location) "endowment" factors explained 80 percent of the racial and ethnic gap in homeownership rates, with income and marital status being most important. They suggest that the 20 percent of the homeownership gap unexplained by their regression model may be due to discrimination, but caution that other unobserved influences (such as employment and credit histories) might account for some or all of the residual. Many others cite wealth as the key unobserved influence, including Linneman and colleagues (1997), who assess the relative importance of the income and wealth constraints, finding that while each acts to lower the rate of homeownership, wealth has a more pronounced effect. Gyourko, Linneman, and Wachter (1999) find little difference in ownership rates among households that are not wealth-constrained but that minorities are far more likely to be wealth-constrained than whites.

the ways lenders now will under some circumstances. As for low-income borrowers with less-than-stellar credit histories, banks rarely let them even get past the front desk. A strike on their credit history or problems documenting a credit history disqualified them.

Today neither low income nor flawed credit is as insurmountable a barrier to homeownership. One in six borrowers puts down 5 percent or less, and if their credit history is solid and their down payment large enough, lenders are prepared to let them qualify for loans with housing payments closer to 40 percent of monthly income. Increasingly, borrowers with minor to serious past credit problems can qualify for a loan if they are willing to pay higher than a "prime" mortgage interest rate to cover the added risk they pose for lenders. As Stuart Rosenthal points out, credit constraints may delay homeownership for some households and overall may depress ownership rates by 4 percent, but progress in better understanding the risks posed by such borrowers may reduce their depressive effect on homeownership.

Low-income borrowers, though, do face two hurdles. First, the low-income borrower must keep up payments. Each borrower is only a crisis—a pink slip, an illness, a broken car—away from delinquency or default on a loan that will impair his or her credit history and add to the mortgage borrowing costs. After low-income borrowers purchase a home, because they are a population that historically has been at greater risk of job loss, they are more likely to face difficulties staving off default. (Low-income borrowers rarely have wealthy families who can tide them over in a crisis.) Not surprisingly, home buyers with low incomes and poor credit histories fall behind on their payments more often than higher-income borrowers with unblemished credit histories.

As Abdighani Hirad and Peter Zorn point out, though, credit counseling helps. By now credit counseling is standard for many low-income borrowers: a lender gives them a home-study kit, hooks them up to telephone instructions, enrolls them in a class, or gives them one-on-one counseling. Hirad and Zorn, reviewing 40,000 mortgages, conclude that borrowers who receive classroom instruction are 23 percent less likely to be delinquent after fifty days than their noncounseled counterparts. Individual counseling works even better: a remarkable 41 percent were less likely to be delinquent. (Neither telephone counseling nor home study reduced the risk of delinquency.) As awareness of the value of credit counseling spreads, some borrowers who failed to make payments in the past may seem like better risks in the future if they are counseled.

Michael Collins, David Crowe, and Michael Carliner point out that a second hurdle for the low-income borrower is finding an inexpensive house. A family that can borrow enough for a $70,000 home needs to be able to find that $70,000 starter. Some regions of the country—indeed, some neighborhoods—have a surfeit of low-priced homes (though the bargain fixer-uppers may require thousands of dollars of cash, not just sweat equity). In other regions, few houses sell for less than $70,000, a circumstance that explains the popularity of manufactured houses on leased land, which can sell for as little as $25,000.

Profitable Business Proposition

Back in the 1960s and 1970s, lending to low-income borrowers and their communities was shrouded in mystery. Few studies examined how credit was supplied to these people and areas. Suspicion in the 1970s that lenders were "redlining" low-income communities and withholding credit from them under the untested assumption that they represented unmanageable or impossible-to-price risks gave rise to the Community Reinvestment Act (CRA) of 1977 and the Home Mortgage Disclosure Act (HMDA) of 1975.[6] CRA affirmed the obligation of banks and thrifts to lend to low-income communities and authorized federal regulators to deny or condition an application for acquisition or merger if lenders failed to meet that obligation. HMDA began as a trickle of public disclosure of information on mortgage lending that became—especially from the lenders' perspective—a flood by the early 1990s.

Slowly at first, lenders under community pressure began to step up lending in low-income areas and to experiment with more lenient underwriting standards. By the 1990s the advent of powerful new risk assessment tools and technologies converged with stepped-up regulation and enforcement of community lending laws, as well as sometimes withering media attention on fair lending, to drive low-income mortgage lending to new heights. Aided by a strong economy and automated underwriting tools, mortgage lenders were emboldened to reach out to low-income, minority, and immigrant markets in new ways.

All the while, many lenders complained that reaching out to low-income borrowers resulted in higher origination costs and higher credit losses that eroded the profitability of loans to low-income borrowers. Thus many have assumed that low-income lending is less profitable than loaning money to higher-income buyers. But investors in mortgages incur more than just credit risk: the risk that borrowers will not make their payments and that some fraction of them will ultimately default on their loans. They also incur risk that borrowers will pay off their mortgages ahead of when originally scheduled or estimated by "prepayment" models and that investors will get stuck with their cash in a lower-interest-rate environment than when they first invested. These prepayments therefore have a cost to the investor: lower returns on their invested capital. For those who service loans, prepayments can mean a complete cessation of the income stream on the loan.

According to Wayne Archer, David Ling, and Gary McGill, because low-income borrowers are more likely to have greater income constraints and are

6. See Litan and others (2000).

more likely to take out loans with small initial down payments, they are less likely than others to refinance when interest rates fall enough to make it profitable for them to do so. And although low-income loans do indeed tend to carry greater credit costs, Robert Van Order and Peter Zorn find that they tend to carry far smaller prepayment-related costs. Moreover, though the evidence available is only suggestive and limited to a sample of loans purchased in the 1990s by Freddie Mac, it does indicate that the prepayment savings associated with low-income lending may more than offset the higher credit costs. Hence the presumption that low-income loans need be less profitable demands rethinking. Indeed, as long as fewer low-income borrowers prepay, and given the prospect for lowering credit losses through better home-buyer counseling and reducing the fixed costs of mortgage origination and servicing, many forms of low-income mortgage lending could prove to be as profitable as other loans, if not more so.

Families' Financial Capital

Behind the homeownership-is-good mantra is an unexamined premise: that homeownership is an asset-building strategy for low-income buyers.

Low-income buyers typically do not hold stock portfolios. They are not likely to hold bonds. Few have 401K nest eggs, Roth IRAs, or trust funds. Often they have no pensions. Instead, they plough whatever savings they have into buying a home and, postpurchase, plough much of the money they might have saved and invested back into their homes to keep them in good repair. And most do not benefit from the deduction of mortgage interest payments and real estate taxes that makes homeownership such an attractive financial choice for wealthier home buyers. The mortgages and property taxes of low-income owners are often too small to make it pay to itemize their deductions, so they forgo itemizing them in favor of taking the standard deduction.

So the question of the financial merits of homeownership is a salient one. Do low-income buyers build housing wealth? The answer is encouraging: yes, in most cases. Although housing prices do fluctuate—leaving some regions of the country at some periods of time with housing that has lost value (such as the Southwest in the late 1980s)—most lower-income owners have benefited from house price appreciation and fared *better* than those who purchased higher-cost homes. Looking at owners of low-cost homes in four metropolitan areas, for example, Eric Belsky and Mark Duda found that between 70 and 78 percent of those who sold within just two and a half years sold them for more than their purchase price (after adjusting for inflation and transaction costs). Still, though, relatively little is known about the financial performance of low-income homeowners, and much more needs to be done to assess the chances that they will come out ahead of renting, even over short holding periods.

Also, homeownership constitutes enforced savings and, if accompanied by a fixed-rate mortgage, fixes the largest component of housing costs: capital costs. Academicians' models may posit "alternative" investment scenarios for renters that make investing in other ways look better than renting. Indeed, William Goetzmann and Mark Spiegel find that housing has a lower historical return than stocks and bonds and an even poorer risk-adjusted return, making it a more sensible investment only if it is part of a diversified portfolio. But in the world beyond the models, given today's high rents, the low-income renter is hard-pressed to save and may see a host of financial benefits in owning. The promise of fixing housing costs so that they do not rise with inflation may alone be sufficient to justify the risks. Insulation from the corroding effects of housing inflation is a powerful incentive to buy, especially among low-income families who do not intend to move and have long successfully found ways to pay the rent even in the face of adversity. And low-income borrowers are able to risk relatively little money on a home now in pursuit of potentially high leveraged returns later because down payment requirements have been loosened, but this option is not available to low-income people investing in financial instruments. Furthermore, there is a potent sense that paying rent does nothing to build equity, while paying off a mortgage does.

Families' Social Capital

Aside from financial gains, the advocates of homeownership for low-income families firmly believe that homeownership will improve families' functioning and childhood outcomes, another largely unexamined premise. Does buying a home make a family more stable, the children more successful in school, the family happier? Advocates assume yes, but that answer is more a matter of faith than of demonstrable statistical proof.

For researchers, this is murkier terrain than calculating gains in assets. After all, a family that owns a home may be, by virtue of owning the home, less mobile and hence more "stable." But is that stability desirable? Would a renter-family, able to move quickly, be able to find better jobs or better schools? Assuming that stability is good, do owner-families stay rooted in their communities longer because their desire for stability prompted them to buy homes in the first place? That same self-selection conundrum haunts research on children's success: Donald R. Haurin, Toby L. Parcel, and R. Jean Haurin find that children in owner-occupied homes do better in school. But perhaps those children's parents were more concerned about their children's progress in school, a concern that prompted them to buy homes in places with better schools and safer neighborhoods. Though researchers have tried to control for neighborhood effects, these controls have mostly been weak and aimed at levels of geography much broader than a neighborhood or the service area of an elementary school.

As for families' overall well-being or happiness, researchers would have to define happiness, holding constant expectations, social mores, and individual definitions; the terrain grows murkier. And researchers would have to consider the threat of foreclosure that haunts many low-income families. William M. Rohe, Shannon van Zandt, and George McCarthy find that there is some evidence to suggest that homeownership affords people a greater sense of control over their lives, spurs them to greater civic participation, and helps their children do better in school, but also that delinquencies and defaults can have the opposite effect.

Nevertheless, the research offers a tentative yes to the question of whether families benefit from owning a home. Apart from statistical validation, moreover, the fact that children who grow up in owner-occupied homes tend to buy homes more often than their counterparts who grew up in renter-occupied homes argues that the psychic benefits of homeownership, however hard to define, do lead successive generations to aspire toward it.

Community Capital

Mayors and city councils see homeownership as a fulcrum. It is not too much of an exaggeration to say that many of them believe that as homeownership rates in low-income neighborhoods creep up, crime rates, juvenile delinquency, vandalism, vacant properties, truancy, and even litter will plummet. Indeed, they look to homeownership to increase property values, school attendance, reading scores, even voter participation. In short, they have faith that homeownership will resurrect neighborhoods in decline. So local politicos trust.

In fact, there are few studies that look at the positive externalities of homeownership and its potential role in neighborhood revitalization. One study in this volume provides limited support for their trust. In their seminal study on the impact of homeownership on property values in New York City, Ingrid Ellen, Scott Susin, Amy Schwartz, and Michael Schill show a demonstrable positive impact. But homeownership is no panacea for neighborhood decline. It does not automatically remove other impediments to regeneration such as poor schools, crime, and a deteriorated housing stock. As a cornerstone of redevelopment efforts, renovation and rehabilitation of housing, combined with promotion of homeownership, can be a potent force.

Once again, though, the self-selection of home buyers stymies ironclad conclusions about less-quantifiable variables. If neighborhoods of low-income owners show higher indices of "good" traits and lower indices of "bad" traits, is part of the explanation the differing motivations of renters and owners? Consider front yard gardens. Homeowners, particularly new ones, plant them more often than renters. Those of us who have gone from renting to owning can attest to a change in our perception of space: the "ownership" fosters a mix of care-taking, pride, and responsibility. Hence, in a rite of spring, many of us plunk straggly perennials into the dirt. Renters rarely do this, especially if they won't be there long enough to see them come back the next year. Yet does that desire to plant a garden spur some renters to contemplate buying? Or does ownership itself foster the desire?

Whichever comes first, local officials push for homeownership, not because a study has convinced them of its merits but because they have seen enough benefits up close to believe in a redemptive power to low-income homeownership.

The End of the Socratic Exercise

Americans want to own homes. The anthropologist who studies us in the future may wonder whether, like Robertson Davies's protagonist in *What's Bred in the Bone*, our yen to claim space and buildings is "bred in the bone," whether we have an almost genetic yearning, borne from centuries of ancestral serfdom, to claim and fence and demarcate our dwellings, physically and legally, from others.

Lower-income Americans share the same yearning as upper-income families. Their home may be a triple-decker tenement, a condo, or a "manufactured" side-by-side. Indeed, for some immigrant families, the promise of America is freedom, jobs, and the chance to own a house. Is this yearning rational? Is the lower-income household that scrimps for a house better off than a renting household? Is the family? Is the neighborhood? Researchers at the symposium that resulted in this volume, after the caveats and the codicils, concluded that the answer is yes.

So the confluence of actors behind the current surge of low-income homeowners—the mortgage industry, the government, the city and town councils—should persevere. At this writing in 2001, only 52 percent of low-income households own their own homes, while 82 percent of upper-income households do. We can, and should, aim higher.

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