



# Preface

Today, Americans are more likely than ever to own their own homes. The annual homeownership rate stands at an all-time high with 69 percent of American families sharing this experience. Homeownership not only provides families with the single largest investment of their lifetimes, but also strengthens communities, fosters civic pride and provides children with a stable living environment.

At the same time, many families do not share the same opportunities and too many face barriers to homeownership. Indeed the rate of homeownership for minority families continues to lag behind the national average.

To address this problem head on, in June 2002 President Bush issued a bold challenge to the nation: to create an additional 5.5 million new minority homeowners by 2010. Already, significant progress has been made toward achieving this goal. Clearly, more must be done to overcome obstacles to expand homeownership opportunities for all Americans.

This study conducted by HUD's Office of Policy Development and Research is an important part of the effort to achieve the President's challenge. By identifying specific obstacles to homeownership – particularly for minority families – we will be better able to craft policies to overcome them.

This study, through careful research, identifies several key barriers accounting for the homeownership gap. Importantly, it finds that these barriers are often shared across ethnic and racial lines and include differences in income, wealth, marital status, and age of household.

The report highlights in particular the problem confronting many families - a lack of savings for downpayment and closing costs. Indeed, President Bush has already acted to address this obstacle, by signing into law the American Dream Downpayment Initiative in December 2003. This program has already distributed \$162 million in downpayment funds to over 400 State and local governments. The FY 2006 Budget requests \$200 million to fully fund the Initiative.

In addition, the President has proposed two additional tools in the FY 2006 Budget to remove the barriers to homeownership:

- The Zero Downpayment Mortgage to provide considerable help to first-time buyers with limited savings to purchase their own homes; and
- A new Single Family Homeownership Tax Credit that will increase the supply of homes affordable to low-income families

Finally, the report makes clear that racial discrimination continues to play a role in the homeownership gap. The Administration is committed to enforcing the nation's fair housing laws to stamp out this unfair and illegal practice.





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# Executive Summary

## Introduction

Homeownership rates currently stand at historically high levels for all segments of the U.S. population. Nevertheless, dramatic gaps in homeownership rates have been stubbornly present over the last several decades, and even increased somewhat during the decade of the 1990s. As of 2004, the white homeownership rate was 76 percent while African-American and Hispanic homeownership rates remained below 50 percent, and the Asian rate was 60 percent. At the same time households with very-low income had a homeownership rate that was 37 percentage points below the rate for high-income households.

Understanding the determinants of homeownership rates and gaps is important because homeownership is widely believed to provide a variety of benefits for both individuals and communities. Homeownership expands individual opportunities to accumulate wealth, enables a family to exert greater control over its living environment, creates incentives for households to better maintain their homes, and may benefit children of homeowners. Homeownership also benefits local neighborhoods because owner-occupiers have a financial stake in the quality of the local community.

In light of the many potential benefits of homeownership, the fact that homeownership rates first declined and then stagnated during the 1980s and into the early 1990s became a cause for concern for the federal government. First, Secretary Jack Kemp set a goal and initiated efforts to create one million new homeowners. Then in 1994, at the President's request, the U.S. Department of Housing and Urban Development (HUD) began work to develop a National Homeownership Strategy with the goal of lifting the overall homeownership rate to 67.5 percent by the end of the year 2000. While the most tangible goal of the National Homeownership Strategy was to raise the overall homeownership rate, in presenting the strategy HUD pointed explicitly to declines in homeownership rates among low-income, young, and minority households as motivation for these efforts. And in June of 2002, President Bush announced a joint public/private initiative to increase minority homeownership by 5.5 million households by the year 2010.

## Purpose and Approach of the Study

With these issues as a backdrop, this study has three main goals: to synthesize what is known about the determinants of gaps in homeownership rates by income, racial, and ethnic status; to identify the types of policies that are most likely to be effective in narrowing these gaps; and to identify promising areas for further research about the causes of gaps in homeownership rates.

The first chapter presents a detailed summary of the report's findings. Chapter 2 presents a conceptual framework for analyzing the determinants of homeownership. This framework is used to identify which factors contribute to observed homeownership differentials by income and race. Chapter 3 presents detailed information on trends in homeownership rates by race, ethnicity and income, including trends in key demographic characteristics of the population over time and variations in homeownership rates by geographic areas. Chapter 4 then reviews the existing literature employing statistical modeling to identify the relative importance of various contributing factors to overall observed homeownership gaps. Homeownership gaps are separated into two components: one

being the share of the gap that is explained by observed differences in socio-economic variables among income, racial, and ethnic groups, and the other being an unexplained residual that represents unmeasured factors that include discrimination, lack of information about the home buying and mortgage financing process, and omitted socio-economic variables. Chapter 5 explores policy options for addressing homeownership gaps, including an analysis of the nature of barriers to homeownership, a cataloging of existing efforts to address these barriers, and a review of the literature analyzing the relative importance of the various barriers in producing the observed homeownership gaps.

### **Conceptual Framework of the Determinants of Homeownership Gaps**

From a policy perspective, it would be natural to attempt to eliminate homeownership gaps, ultimately making homeownership equally likely regardless of income, race, and ethnicity. However, homeownership may not be the best financial option for some households. Instead, high transaction costs make ownership very costly for households with a high likelihood of moving, investment risk makes homeownership inappropriate for those with little wealth to risk, and the level of effort necessary to maintain a home may not be feasible for households who either cannot do these tasks themselves or cannot afford to pay for home maintenance. Together, these factors all contribute to differences in the *demand* for homeownership.

On the other hand, *supply* constraints also restrict access to homeownership for some families. These constraints may arise in both the housing and mortgage markets. With regard to housing markets, one factor that may contribute to homeownership gaps is that low-income and minority households tend to be concentrated in central cities due to a combination of economic pressures as well as racial discrimination and segregation. Concentration of these households in cities may contribute to homeownership gaps, as single-family housing, which is more conducive to homeownership, is less common in these areas. One reason for homebuyers' preference for single-family housing may be that multifamily housing is more subject to problems associated with noise, crime, shared access to common space, and additional administrative costs when organizing multifamily units into condominiums suitable for homeownership. Such problems in the housing market are further compounded by evidence of discrimination in mortgage markets. Together, reduced access to single-family housing neighborhoods and reduced access to mortgage credit serve to depress minority and low-income homeownership rates.

### **Homeownership Gaps by Income, Race and Ethnicity: Size, Trends and Contributing Factors**

A review of long-run trends in homeownership reveals substantial similarities in these trends by race and ethnicity, indicating that broad demographic, economic, and public policy factors are important in influencing the homeownership trends among all groups. During the two decades following 1940, the nation saw an unprecedented rise in homeownership rates by 18 percentage points. While all racial groups contributed to this rise, the gain in white homeownership rates outpaced the gains among blacks. Homeownership rates generally continued to rise between 1960 and 1980, but at a much more modest pace, gaining only 2.5 percentage points over this period. During this period gains among minorities generally outpaced gains among whites, helping to narrow homeownership gaps. Then during the 1980s, the overall homeownership rate actually declined by a few tenths of a percent, with slight divergences in trends between whites and minorities contributing to widening gaps. Finally, all racial and ethnic groups experienced rising homeownership rates during the 1990s. But

despite these gains, the decennial census of 2000 revealed that differences in homeownership rates between whites and minorities were near their highest levels of the past 60 years.

There are also large differences in homeownership rates by household income. As of 2004, 50.9 percent of very low-income households (those with income below 50 percent of the relevant area median income or AMI) owned their homes, compared to 87.7 percent of high-income households (those with income at or above 120 percent of AMI). Differences in homeownership rates by income are an important factor in understanding homeownership differences by race and ethnicity. Compared to whites, both blacks and Hispanics have much lower incomes, while Asian households have higher incomes. However, after accounting for differences in income levels, homeownership gaps remain for all racial and ethnic minorities, suggesting other factors are at work.

Other factors that contribute to the overall differences in homeownership rates include differences in households' demographic characteristics and geographic location. Key demographic characteristics are age, household type, and education level. Relatively low homeownership rates among blacks and Hispanics are in part attributable to the fact that compared to whites they are generally younger and have lower education levels. Blacks also have fewer married couple households and both blacks and Hispanics have more single-parent families than whites, which also contribute to the observed homeownership gaps. Asians, on the other hand, have household characteristics that are associated with higher homeownership rates. In addition to having income levels that are higher than whites, Asians also have a greater preponderance of married couple households and have higher education levels. The one aspect that serves to depress Asian homeownership rates relative to whites is age, as Asians in the U.S. are much younger on average than whites.

The geographic distribution of the minority population may also contribute to creating gaps in homeownership rates. Compared to whites, minorities are much more concentrated in central cities, which have homeownership rates that are more than 20 percentage points lower than suburban areas. Hispanics and Asians are also disproportionately located in market areas with relatively high housing costs.

Another important factor that contributes to racial and ethnic differences in homeownership rates is the high share of immigrants among the Hispanic and Asian population. Studies of homeownership among immigrants find that factors such as the length of time living in the U.S., English-language ability, and citizenship status affect the likelihood that immigrants will be homeowners. On first entry to the U.S., immigrants are less likely to become homeowners than are native-born individuals with similar characteristics, but they quickly close homeownership gaps. In fact, much of the white-Asian and some of the white-Hispanic homeownership gaps can be attributed to the relatively large numbers of Asian and Hispanic immigrants.

Projections for homeownership rates by race and ethnicity over the next two decades provide some indication of the likely stubborn nature of these homeownership gaps. Estimates that assume that there will continue to be moderate gains in homeownership rates similar to those that existed over the course of the 1990s indicate that the current gaps in homeownership are likely to persist. Despite the fact that these projections estimate that homeownership rates could rise 9.0 percentage points for blacks and 7.6 percentage points for Hispanics from 2000 to 2020, homeownership gaps with whites would only decline by 2.5 percentage points for blacks and 1.1 percentage points for Hispanics. The reason for the persistence in homeownership gaps despite significant increases in minority

homeownership is that factors that favor minority homeownership also favor white homeownership. For this reason, it is appropriate for policy makers to establish goals for increasing the number of minority homebuyers rather than setting goals for the size of racial and ethnic homeownership gaps.

### **Empirical Evidence on the Determinants of Homeownership Gaps**

What then drives the gaps in homeownership rates by race and ethnicity? An important conclusion from the literature reviewed is that most of the homeownership gap can be explained by differences across race and ethnicity in other household attributes that affect demand for homeownership. For example, differences in income, wealth, marital status, and age of the household are found to account for between 15 and 20 percentage points out of the total racial gap of roughly 25 percentage points. From a policy perspective, an important conclusion from this research is that a lack of savings needed to fund downpayments, closing costs, and to pay down other outstanding debt is a particularly important barrier to homeownership. The lack of savings is particularly evident among minority renters, as half of black and Hispanic renters have close to zero net wealth.

The remaining, unexplained difference in homeownership rates of between 5 and 10 percentage points is attributable to a variety of factors, including discrimination in housing markets, differences in understanding of how to successfully navigate housing and mortgage markets, as well as factors not adequately accounted for in the statistical models, including job security, anticipated mobility, and the like. In that regard, it is important to note that although there is some evidence in the literature that unexplained race-related gaps have diminished over time, that trend may simply reflect improved data and methods used by more recent studies. On the other hand, evidence from fair housing studies, accept-reject studies of mortgage applications, and the well-known concentration of minority households in central-city, high-density housing suggest that discrimination and segregation likely contribute to the unexplained portion of the gaps as well. Surveys of consumer attitudes also suggest that information gaps may also contribute to differences in homeownership rates by race and ethnicity. One implication from these findings is that additional policy initiatives that target information gaps or discrimination in housing and mortgage markets – though potentially important from a social and ethical standpoint – are likely to have a smaller impact on reducing present day racial (and income) gaps in homeownership rates than efforts to address differences in wealth.

### **Policy Options for Reducing Homeownership Gaps**

The first step in thinking about policy options for closing homeownership gaps is to identify the principal constraints on greater homeownership by low-income and minority households. For policy purposes, the most important constraints are on the supply side, as these barriers limit the ability of households who might otherwise choose to be owners from purchasing a home. Homeownership deterrents on the demand side largely relate to factors that make the investment risk of owning too great for some households. While some efforts to address these risks may be helpful and appropriate, in many cases it will simply be the case that the risk of homeownership is inappropriate for some low-income and low-wealth households.

There are two broad categories of supply-side barriers to homeownership: limitations on access to mortgage financing needed to purchase homes, and, in some markets, a lack of supply of housing units that are affordable and attractive options for low-income households. Much of the research on the importance of these barriers to homeownership has focused on access to mortgage finance. An

important feature that restricts low-income household access to mortgage finance is the set of underwriting guidelines used by lenders to limit the risk of mortgage default. Lenders require, for instance, that borrowers not exceed maximum debt-to-income ratios and loan-to-value ratios, and that they have a history of having met their credit obligations. The tendency of low-income families to have low levels of income and wealth, and also poor credit histories, all serve to limit low-income households' access to mortgage finance. In addition, lack of understanding about the mortgage process and racial discrimination further impair the ability of low-income and minority households to obtain mortgage financing.

The most informative studies about the likely impact of changes in the mortgage market on homeownership rates are those that use statistical models to estimate the impact on the probability of homeownership of removing these constraints. These studies have consistently found that a lack of wealth to meet downpayment requirements and, to a lesser extent, poor credit are more important barriers to homeownership than a lack of income to meet limits on monthly payments. The conclusion about the significant role played by wealth constraints in limiting homeownership opportunities is also supported by research using a synthetic underwriting approach, which examines the share of households that could qualify to purchase a modestly priced home under alternative mortgage underwriting and subsidy programs.

Few studies have attempted to estimate the impact of other supply side barriers that limit access to homeownership, such as racial discrimination, lack of information about housing and mortgage markets, or access to suitable housing for ownership. The little research that has been done suggests that while these barriers do restrict homeownership, these constraints are not as important as the lack of wealth.

Given the consistent finding that a lack of savings is the single most important barrier to homeownership, downpayment assistance in the form of loans or grants are an obvious policy response to the challenge faced by families with limited savings. But it is important to note that for many households it is not just the downpayment requirement that is binding. In fact, given the introduction of low or zero downpayment loans in the last decade, the downpayment itself may be becoming less of a constraint over time. The importance of savings is due in part to the fact that it is related to a range of financing requirements, including the downpayment, closings costs, reserve requirements, and the level of outstanding debts. The influence of savings on the willingness and ability of families to take on financial risk is also important. Thus, policies that address a lack of savings by low-income and minority families could have an important impact on homeownership rates. Examples of such policies include individual development accounts that give financial incentives for households to save for specified goals, and financial management training that help households develop the skills and habits needed for savings accumulation.

Aside from homeownership-specific policies, research findings described in this report imply that policy initiatives that address the broader problem of racial and ethnic differences in socioeconomic standing are also needed to close homeownership gaps. Such factors include enhanced job opportunities, job security, and household stability (i.e. marital status) for minority households, which are especially important determinants of the demand for homeownership.

In thinking about policy options for closing homeownership gaps it is also helpful to keep in mind the magnitude of the issue. According to the 2003 CPS, there were 13.3 million black households, 11.3

million Hispanic households, and 4.0 million Asian households. In order to raise the homeownership rate of each of these groups by 1 percentage point, there would have to be an increase of 133,000 black homeowners, 113,000 Hispanic homeowners, and 40,000 Asian homeowners, for a total of 286,000 minority households. In terms of income, there were 37.1 million households with income less than 50 percent of AMI (area median income) and 21.5 million households with income between 50 and 80 percent of AMI. In order to raise homeownership rates of these groups by 1 percent there would have to be an increase of 371,000 and 215,000 homeowners in these income classes. Thus, in order to close homeownership gaps by race and income by a single percentage point, public policy needs to assist several hundred thousand households. The implication is that making substantial progress in closing homeownership gaps by income and race-ethnicity will require moving literally millions of households into homeownership.

Perhaps more importantly, even if increases in minority homeownership of this magnitude are achieved, the homeownership gaps between whites and minorities may not narrow if whites also experience increases in their homeownership rates. Indeed, between 1993 and 2004 homeownership rates increased among blacks and Hispanics by 7.7 and 8.7 percentage points, respectively. Yet, because white homeownership rates increased by 5.8 percentage points, the homeownership gaps with whites only narrowed by 1.9 and 2.9 percentage points, respectively. For this reason, it is probably more relevant to establish policy goals for increasing minority homeownership rates rather for reducing gaps between minority and white rates.

#### **Further Efforts Needed to Enhance Our Understanding of Homeownership Gaps**

Our final conclusion is that much remains to be learned. At many points in the chapters to follow, the study notes the need for further research. While the tenure choice literature is quite rich, there is a lack of studies examining the impact of investment risk for low-income households and how this affects their demand for homeownership. Information on the tendency and ability of households to sustain homeownership is also scant. On the supply side, studies on the degree to which racial and income segregation limit access to neighborhoods and housing stock conducive to homeownership also are very limited. In contrast to these deficiencies, the existing literature has answered many of the questions most pressing with regard to the impact of mortgage financing constraints on homeownership. Finally, more research is needed examining the effectiveness of specific policies designed to support homeownership. In particular, studies on the effectiveness of counseling and education programs in spurring homeownership and on the effectiveness of specific efforts to remedy a lack of wealth are almost non-existent.

# Chapter One

## Introduction and Report Summary

### 1.1 Introduction

This study has three goals. One goal is to synthesize what is known about the determinants of homeownership rates by income, racial, and ethnic status. We focus on the differences in homeownership rates among these groups, that is, the “gaps” in homeownership rates. A second goal is to identify the types of policies that are most likely to be effective in closing these homeownership gaps. A third goal is to identify promising areas for further research about the causes of gaps in homeownership rates.

Understanding the determinants of homeownership rates and gaps is important because homeownership is widely believed to provide a variety of benefits for both individuals and communities. The benefits of homeownership for individuals include the ability to accumulate wealth through principal payments and asset appreciation and the ability to have greater control over their living environment. Owning a home results in greater investment by owners in their neighborhood and home because they are the recipients of changes in the value of the property. The incentive to invest in a home results in better maintenance and an improved home environment. A better home environment also may benefit resident children. The incentive to invest in a neighborhood may lead to greater participation in neighborhood and community organizations, thus contributing to improving local schools or reducing local crime. Homeownership also increases the stability of households and communities and this stability is thought to increase household investment in neighborhoods.

Given the many potential benefits of homeownership, the fact that homeownership rates first declined and then stagnated during the 1980s and into the early 1990s became a cause for concern. In 1994, at the President’s request, the U.S. Department of Housing and Urban Development (HUD) began work to develop a National Homeownership Strategy with the goal of lifting the overall homeownership rate to 67.5 percent by the end of the year 2000. While the most tangible goal of the National Homeownership Strategy was to raise the overall homeownership rate, in presenting the strategy HUD pointed explicitly to declines in homeownership rates among low-income, young, and minority households as motivation for these efforts.

Also of concern is the gap in ownership rates comparing high with low-income households and white and minority households. Over the period beginning in 1993, the national homeownership rate rose fairly sharply, achieving the goal of 67.5 percent by the third quarter of 2000 and reaching an all time high of 69.0 percent in 2004. The gains in homeownership since 1993 have been widely shared, with homeownership rates rising 5.8 percentage points for whites, 7.7 percentage points for blacks, 8.7 percentage points for Hispanics, and 7.0 percentage points for Asians. The somewhat greater gains in homeownership among minorities helped to close the gap between whites and minorities. But despite these gains, the gaps remained large. In 2004 the gap between white and black homeownership rates was 26.3 percentage points, which is only one-tenth of a percentage point lower than in 1960. Meanwhile, the homeownership gap between whites and Hispanics was 27.9 percentage points.

Similarly, while homeownership rates rose somewhat faster for households with incomes below the median for their area compared to households with incomes above the area median, the homeownership gap between these two groups remained high.

Our study presents a conceptual framework for analyzing the determinants of homeownership. This framework is then used to identify which factors contribute to observed homeownership differentials by income and race. We review the existing literature on homeownership gaps and identify what is known about the relative importance of the contributing factors. We separate gaps in homeownership rates into two components, one being the share of the gap that is explained by observed differences in socio-economic variables among income, racial, and ethnic groups and an unexplained residual that represents unmeasured factors that include discrimination, lack of information about the home buying and mortgage financing processes, and omitted socio-economic variables. The size of and trends in homeownership differences by income and minority status as well as likely future trends in homeownership rates and the homeownership gap are reported.

Finally, we identify the principal policy options that have been employed to promote homeownership and the types of barriers that these policies are designed to overcome. The existing literature on the actual or potential effectiveness of these policies for promoting homeownership is evaluated. Throughout the study, we suggest the most promising directions for further research to clarify our understanding of the causes of the disparities in homeownership by income and race, changes in homeownership rates over time, and the effectiveness of alternative policy approaches for promoting homeownership.

### **1.1.1 Methodology**

The primary methodology of this study is the identification, review, and synthesis of the relevant literature from academic, public policy, government, and housing industry sources. We also provide supporting descriptive analysis to document levels and changes in homeownership rates for key segments of the population.

#### ***Identification of the Relevant Literature***

The literature search identified theoretical, analytical, and descriptive studies of the factors impacting a household's tendency to become and remain a homeowner. Also identified were a substantial number of empirical studies of homeownership gaps among particular income, racial, and ethnic groups. Published research was identified through searches of bibliographic databases and unpublished research was identified through a search of the Internet and through contact with active researchers in the field.

#### ***Supporting Descriptive Analysis***

The existing literature provides snapshots of homeownership rates and gaps for particular years and population groups. A few studies depict trends in homeownership rates for particular time periods and population groups. However, differences in data sources and idiosyncratic aspects of the studies make global comparisons difficult. To overcome these inconsistencies, we provide a comprehensive overview of homeownership rates and gaps for white, black, Hispanic, and Asian households from 1940 through 2000. Our primary data sources include the Decennial Census and the Current Population Survey (CPS). The Annual Demographic Survey is conducted each year as part of the

March CPS. This supplement includes an additional sample and more detailed questions about income and employment status.

## **1.2 Outline and Summary of the Report**

The report is structured to address each of the goals of the study as outlined above. Chapter Two presents a conceptualization of the tenure choice decision with the goal of identifying the factors that contribute to observed differences in homeownership rates by income and race. This conceptualization provides a framework for presenting and interpreting the information discussed in the report. Chapter Three presents descriptive data and analysis of trends in homeownership rates by income and race and across geographic areas. Chapter Four provides a review of the empirical literature related to each of the factors identified in the conceptual framework as factors contributing to the observed differences in homeownership rates. Finally, Chapter Five discusses the principal policy approaches that have been used to promote homeownership, identifies the factors that these approaches are designed to address, and reviews existing literature that analyzes the actual or potential efficacy of these policies in increasing homeownership. The remainder of this section will summarize the report findings from each of these chapters.

### **1.2.1 Conceptual Framework of the Determinants of Differences in Homeownership Propensities**

The conceptual framework is derived primarily from an economic perspective. In keeping with this perspective, the determinants of homeownership are separated into demand and supply factors. The demand for homeownership is clearly an important organizing principle in the literature review, because families choose whether or not to seek out homeownership opportunities. In contrast, the supply of homeownership opportunities is less well defined because owner-occupied housing is not directly produced – any housing unit can be either owned or rented. But supply side effects influence access to homeownership and homeownership rates. Mortgage underwriting criteria, for example, affect the supply of mortgage credit available to individual households and hence the supply of homeownership opportunities. In addition, many lower income and minority inner city neighborhoods are filled with older multifamily buildings. The forces governing the supply of such buildings in these neighborhoods – including filtering mechanisms in the housing market and differences or constraints on minority neighborhood choice – affect the supply of different types of housing stocks over which minority and low-income families can choose. This feature of housing markets affects homeownership rates given that single-family stocks are usually more conducive to homeownership relative to older multifamily units. The demand-supply conceptual structure is general in its overall design and it provides an effective way to organize the discussion of the determinants of homeownership gaps and the potential to narrow these gaps.

#### ***Household Formation***

We begin by reviewing literature on household formation and the possibility that the decision to form a household is simultaneously determined along with the decision to own or rent a home. Homeownership rates are by definition equal to the number of owner-occupying households in the population divided by the total number of households present. Differences in the propensity to form a household could contribute to income, racial and ethnic gaps in homeownership rates. Factors contributing to differences in household headship rates include differences in marriage, divorce, and

widowhood rates, differences in the typical age that a youth leaves the parental home, and differences in tendencies to reside in group quarters such as college dormitories and prisons. Our review of the literature finds that substantial changes in these factors have occurred during the last thirty years and substantial differences in rates are present comparing income, racial, and ethnic groups. We conclude that household formation is potentially very important to the explanation of why gaps in homeownership are present and how these gaps have changed, but the existing literature that measures the impact is sparse.

### ***Demand Side Determinants of Homeownership***

Given that the decision to form a household has been made, the next question is what drives the decision to own versus rent a home. Consider first the demand side. Because housing is a durable asset, demand for homeownership is sensitive to investment considerations and, therefore, is subject to all of the considerations and factors that influence a family's preferred portfolio. The expected rate of return from investing in housing is important. Also, families sensitive to financial risk such as low-income households are less likely to want to own a home, all else equal. The return on homeownership is especially sensitive to household mobility given the very high transactions costs of selling an owner-occupied home relative to moving from a rental unit. Evidence reported in Chapter Two suggests that among renters, lower-income families are more mobile. This implies that low-income families will be less likely to want to own their homes. The Federal tax code provides generous subsidies to homeowners by not taxing imputed rent and allowing deductions for mortgage interest and property tax payments. But the benefits from such favorable tax treatment accrue disproportionately to higher-income households with higher marginal income tax rates and a greater propensity to itemize. Because minorities typically have lower income relative to white households, these considerations contribute to racial and ethnic gaps in homeownership rates as well.

The examples just mentioned highlight the investment return on housing. However, households also receive benefits from residing in a dwelling; that is, they have a consumption demand for shelter. Consumption demand is sensitive to family size, income, and other traditional determinants of consumer demand. A comprehensive approach to understanding households' demand for home ownership must account for the interplay of both consumption and investment demand.

We adopt a theoretical framework developed by Henderson and Ioannides that focuses on the interplay of investment and consumption demand for housing. If investment demand for housing for a given family is large relative to consumption demand, the family could choose to own a home that satisfies its portfolio motives and rent out any remaining unwanted space (e.g. a basement suite, second house, etc.): in this case the family is financially better off if it owns. Alternatively, if a family's consumption demand is large relative to investment demand, for example when family size is large but the family believes house prices will decline, purchasing a home sufficient to satisfy the consumption needs of the family would constitute a bad investment. In this case the family is financially better off if it satisfies its consumption demand by choosing to rent its principal residence.

The Henderson-Ioannides model, while stylized, offers guidance in organizing the demand side of the literature on the determinants of housing tenure choice and homeownership gaps. On the consumption side, all of the usual determinants of consumer demand are likely to apply (e.g. family size, income, control and security of the dwelling, etc.) and thus need little elaboration. On the investment side, we consider factors that affect the rate of return to housing investments and how

these factors create differences in the rate of return among income, racial, and ethnic groups. A discussion of each of the investment related factors follows.

Transactions costs are an important determinant of a household's tenure choice. The cost of selling a home is substantially greater than the cost of moving from rental housing because of the time and effort needed to prepare for and manage the sale, realtor fees, legal fees, and taxes. Further, there are differences in costs among homeowners because families who do not expect to move soon can spread out the high transactions costs of moving to and from owner-occupied housing over a longer period of time. This serves to increase the return on homeownership among relatively immobile families, increasing their demand for homeownership. Families that experience marital or financial instability are likely to have a greater frequency of moves, reducing the return on owner-occupied housing.

It is well established that various provisions of the tax code reduce the cost of housing for owner-occupiers relative to renters; these provisions include deductions for mortgage interest and property tax payments and no taxation of imputed rent and capital gains. Moreover, the benefits from such favorable tax treatment typically increase with the marginal income tax rate of the household and the resulting higher likelihood that the household itemizes instead of taking the standard deduction. Hence, because the financial returns from these tax benefits rise with income, those with relatively high incomes will be more likely to become owner-occupiers.

The characteristics of the housing stock may vary across geographic locations in a manner that affects the risk and return on homeownership and resulting homeownership rates. The risk of substantial maintenance and renovation costs is greater in older housing. This housing is typically located in inner city areas. Further, inner city areas tend to be populated by low income and minority households. Because low-income families are less able to absorb financial shocks such as catastrophic housing repair bills, they are less likely to prefer owner-occupation of housing located in inner city areas.

The investment return to housing also depends on expected house price appreciation (quality adjusted). We review the literature that measures spatial differences in observed house price appreciation and find evidence of substantial variation by location, at least in the short run. However, the correlation of the pattern of house price changes with household income, race, and ethnicity is unclear. There is evidence that the variance of house price changes is larger for houses with relatively low prices, suggesting the risk of investment is greater for these houses. Because low-priced houses are mostly purchased by low-income households, the Henderson-Ioannides model suggests that this high variance will deter the likelihood that these properties will be owner occupied.

It should be emphasized that all of the factors that affect the return on homeownership influence the flow cost of housing services for an owner-occupier. That flow cost – most often referred to as the user cost of owner-occupied housing – is analogous to the rent paid by a renter for the flow of housing services over a given period of time (such as a month or a year). In the case of an owner-occupier, such measures must necessarily take into account the cost of financing the home, maintenance costs, the anticipated length of stay in the home (which affects the annualized transactions cost of buying and selling the home), expected capital gains, as well as favorable tax provisions that reduce the cost of owner-occupied housing. As noted above, many of the components of the user cost of homeownership vary by income and by the location of the property. For these

reasons, the user cost of homeownership likely differs across families by race, ethnicity, and income and helps to explain observed differences in homeownership rates.

### ***Supply Side Determinants of Homeownership***

The conceptual framework is completed by considering supply side factors that affect the ability of families to attain homeownership. Most obvious, the supply of mortgage credit has a direct effect on the ability of most low-income and minority households to buy a home. We review studies that explain why competitive lenders impose binding credit constraints instead of rationing mortgage credit through interest rates. The nature of the loan contract exposes lenders to default and late-payment risk. Under certain market conditions, lenders may respond by offering credit at below market clearing rates and then using credit scores to ration out loanable funds to the lowest risk borrowers. Many studies have provided empirical evidence on the extent and manner in which credit barriers restrict access to homeownership. An important finding from these studies is that borrowing constraints continue to impede homeownership for underserved groups in the population, including younger families, minorities, and low-income households.

A related set of studies provides evidence of racial discrimination in mortgage markets. Such discrimination provides a different but clearly important explanation for differential access to mortgage credit. Because minorities often are of lower income and wealth, and have less secure employment, they may be subject to statistical discrimination in loan markets to the extent that lenders use race and ethnicity as predictors of hard-to-observe risk attributes. Such behavior is illegal in the mortgage market. Nevertheless, a number of studies have provided evidence of discrimination in mortgage markets, most prominently, a study of the Boston mortgage market in the 1980s conducted by members of the Boston Federal Reserve Bank. Regardless of whether the underlying discriminatory behavior is based on statistical discrimination or outright bigotry, it reduces minority homeownership rates.

Partly in response to concerns about minority access to mortgage credit, beginning in the early 1990s a variety of very low-downpayment mortgage products became available through conventional lenders. Given that research has consistently found that a lack of wealth is a significant constraint to accessing mortgage financing, these loan products offer the possibility of raising homeownership rates. Despite these mortgage product innovations, the very low level of wealth among minority renters is still a cause of concern. Half of black and Hispanic renters in 1998 had close to zero net wealth. For these families, even very low-downpayment mortgages will likely not be sufficient to make homeownership financially feasible. Moreover, these very low wealth families may rationally prefer to rent rather than subject themselves to the financial risks that go along with homeownership. Another supply side factor is the type of housing stock available in different neighborhoods. Single-family homes tend to be more conducive to owner-occupation relative to older, multifamily buildings. This could arise because of preferences for such housing among prospective homebuyers; that is, single-family housing and homeownership could be viewed by households as complementary goods. In addition, single-family housing does not typically entail common property issues. In contrast, in a multifamily building management and maintenance of common space and controls for noise and safety create administrative costs when organizing the units into condominiums suitable for homeownership. For these reasons, access to single-family housing may foster homeownership. We find evidence that among middle- and higher-income households, racial and ethnic gaps in homeownership largely disappear after controlling for central city location and the type of structure in which the family resides (e.g. single family versus multifamily). We also find that minorities of all

income levels are more likely to live in high-density central city housing relative to comparable white households.

The literature suggests several reasons why low-income and minority families are found more often in high-density inner city areas with older multifamily housing. Long-standing arguments in urban economics suggest that low-income families are more likely to live in the inner cities and higher income families in the suburbs. This argument hinges on the idea that the demand for land increases more quickly with income than do commuting costs. Access to public transit has also been noted as a reason for why low-income families without cars may seek out central city locations. Alternatively, the spatial mismatch literature has found evidence that suburban housing market discrimination has restricted minority access to suburban markets. Recent studies continue to find evidence of differences in access to suburban neighborhoods. For example, evidence suggests that minority households face discrimination in the housing search process. In addition, there is some evidence that white and minority home-seekers differ in their likelihood of using realtor services.

### **1.2.2 Homeownership Differences by Income, Race, and Ethnicity: Size, Trends, and Contributing Factors**

This chapter of the report presents data that describe homeownership gaps and inter-temporal trends in these gaps. There are substantial similarities in long-run trends in homeownership rates by race and ethnicity indicating that broad demographic, economic, and public policy factors are important in influencing the homeownership trends among all groups.

Decennial census data report that during the two decades following 1940, the nation saw an unprecedented rise in homeownership rates. The overall homeownership rate rose by more than 18 percentage points, from 43.6 percent to 61.9 percent. All racial groups contributed to this rise as the white homeownership rate rose by 17.7 points from 45.6 percent to 64.3 percent, the black rate rose by 15.3 points from 22.8 percent to 38.1 percent, and the Asian rate rose by 27.8 points from 16.3 percent to 44.1 percent.

Homeownership rates generally continued to rise between 1960 and 1980, but at a more modest pace. During this period gains among minorities generally outpaced gains among whites. The white rate increased by 4.2 points, while the black rate rose by 7.2 points and the Asian rate rose by 7.9 points.

During the 1980s, the overall homeownership rate declined by 0.2 points. This decline was comprised of a small rise in the white homeownership rate of 0.5 points coupled with declines among all minority groups: 1.4 points among blacks, 1.0 points among Hispanics, and 0.1 points among Asians.

All racial and ethnic groups experienced rising homeownership rates during the 1990s. Census data indicate that between 1990 and 2000, homeownership increased by 3.3 percentage points among whites, 2.4 percentage points among blacks, 3.0 percentage points among Hispanics, and 2.2 percentage points among Asians. However, because white households experienced the largest increase in homeownership, all of the white-minority homeownership gaps increased over the decade.

In 2000, we find that the white-black homeownership gap was near the highest levels of the past 60 years, as measured by decennial census data. The white-Hispanic homeownership gap has also

generally increased over the last few decades, rising from 23.0 percentage points in 1970 to 27.0 points in 2000. A significant factor in this widening gap is the rapid rise in Hispanic immigration, which has served to depress overall Hispanic homeownership rates. The greatest decrease in the homeownership gap has occurred among Asians when it dropped from 29.3 percentage points in 1940 to 16.5 percentage points in 1980, rising slightly to 18.3 in 2000. As with Hispanics, the increase in the gap between 1980 and 2000 is in part attributable to the growth in the Asian immigrant population.

An alternative data source is the Current Population Survey (CPS). Our study discusses why Census and CPS data differ in relatively small but important ways. Even though both data sets agree that the overall trend in homeownership rates is very similar, they differ in their conclusions about changes in the white-minority gap in homeownership rates. According to CPS data, black and Hispanic homeownership rates increased more sharply than white rates beginning in about 1993 when the size of the gap peaked. At that point the white-black gap reached 30.8 percentage points while for Hispanics the gap was 28.2 percentage points. The CPS finds that between 1993 through 2003 the white-black homeownership gap fell by 1.6 percentage points, while the white-Hispanic gap fell by 2.1 percentage points. The white-Asian homeownership gap, however, increased over this period, as increases in the Asian homeownership rate did not keep pace with gains among whites. According to both data sets, the sizes of white-minority homeownership gaps remain high by historical standards. As of 2003, the homeownership rate among whites was 26.6 percentage points higher than the black rate (CPS data), 28.7 percentage points higher than the Hispanic rate, and 19.1 percentage points higher than the Asian rate. In comparison, in 1980 these gaps were 23.2, 25.1, and 16.5 percentage points, respectively.

We find there are large differences in homeownership rates by household income. As of 2003, 51.2 percent of very low-income households (those with income below 50 percent of the relevant area median income or AMI) owned their homes, compared to 86.6 percent of high-income households (those with income at or above 120 percent of AMI). As described in Chapter Two, there are a number of reasons why homeownership is lower among low-income households including the financial risks of homeownership, few tax advantages, and the high transaction costs of buying and selling homes. We find that over the period from 1970 to 1986, the homeownership rate for very low-income households declined while that for high-income households increased. The result was the gap grew from 30.1 to 38.5 percentage points. This trend modestly reversed in the 1990s and the gap fell to 36.1 percentage points.

Differences in homeownership rates by income are an important factor in understanding homeownership differences by race and ethnicity. Compared to whites, both blacks and Hispanics have much lower incomes, while Asian households have higher incomes. However, after accounting for differences in income levels, homeownership gaps remain for all racial and ethnic minorities, suggesting other factors are at work. White-minority homeownership gaps are largest for very low-income households, ranging from 20 to 25 percentage points. Among high-income households the white-minority gap is 10 to 15 percentage points.

Other factors that contribute to the overall differences in homeownership rates include differences in households' demographic characteristics and geographic location. Key demographic characteristics are age, household type, and education level. Homeownership is higher for older households, married couples, and those with higher levels of education, and lower for other families with children (largely

single-parent families) and single persons, and those with low levels of education. Income is strongly associated with all of these demographic characteristics, as income rises with age, is higher for married couple families, and increases with education level.

Relatively low homeownership rates among blacks and Hispanics are in part attributable to the fact that, compared to whites, they are generally younger and have lower education levels. Blacks also have fewer married couple households and both blacks and Hispanics have more single-parent families than whites, which also contributes to the observed homeownership gaps. Asians, on the other hand, have household characteristics that are associated with higher homeownership rates. In addition to having income levels that are higher than whites, Asians also have a greater preponderance of married couple households and have higher education levels. The one aspect that serves to depress Asian homeownership rates relative to whites is age, as Asians in the U.S. are much younger on average than whites.

A lower percentage of married blacks than whites accounts for about 8 percentage points of the homeownership gap. Black-white age differences account for about a 5 percentage-point difference, and differences in education levels account for about a 2 percentage points of the homeownership gap. Among Hispanics, differences in age and education levels account for 5 to 7 percentage points of the difference from the white homeownership rate. Among Asians, differences in age contributes about 4 percentage points to observed differences from white homeownership rates, while the shares of married couples and education levels lead to higher homeownership rates compared with whites.

The geographic distribution of the minority population may contribute to creating gaps in homeownership rates. Central cities have homeownership rates that were 23.0 percentage points lower than suburban areas in 2001. Minorities are much more concentrated in central cities than whites. For example, 53.5 percent of black households live in central cities compared to only 22.9 percent of white households. The difference between suburban and central city homeownership rates is largest for the very low-income households at 24.5 percent, but even among the highest income households homeownership rates are 12.6 percentage points lower in central city areas. Thus, even for these relatively unconstrained households, homeownership is less likely in central cities, reflecting supply constraints or location-specific factors such as high risks on investments in residential property. These observations suggest that some aspect of central city location other than income affects homeownership rates. If minority households were distributed across regions and metropolitan areas in the same way as white households, the black homeownership rate in 2001 would be 2.4 percentage points higher, the Hispanic rate would be 5.0 percentage points higher, and the Asian rate would be 4.0 percentage points higher. These effects are relatively small compared with the total size of the white-minority gap.

Chapter Three of the study also reviews three other topics: the impact of immigration, trends among first-time homeowners, and projections of homeownership rates. Studies of homeownership among immigrants find that factors such as the length of time living in the U.S., English-language ability, and citizenship status affect the likelihood that immigrants will be homeowners. On first entry to the U.S., immigrants are less likely to become homeowners than are native-born individuals with similar characteristics, but they quickly close homeownership gaps. Much of the white-Asian and some of the white-Hispanic homeownership gaps can be attributed to the relatively large numbers of Asian and Hispanic immigrants.

An analysis of data on first-time homebuyers from the American Housing Survey (AHS) shows that during the 1990s the number of first-time homebuyers increased significantly. In the two-year period of 1989-1990 there were 3.1 million first-time homebuyers. By 1999-2000 this number had increased by 34 percent to 4.2 million. In comparison, repeat homebuyers only increased by 11 percent over this same period. Importantly, minorities made an important contribution to the increase in first-time homebuyers, with their share of this group rising from 22.9 percent to 31.5 percent over the same period. An analysis of changes in characteristics of minority first-time buyers over the 1990s finds that there was a rising share of moderate- and high-income households and younger households.

Projections for homeownership rates over the next two decades depend on the underlying assumptions. A low growth rate assumption mimics the homeownership trends of the early 1990s, a high series mimics homeownership trends from the late 1990s, and the average of these two rates forms the middle growth rate. In all cases, the current gaps in homeownership are likely to persist. Using the middle series, homeownership gaps with whites will decline by 2.5 percentage points for blacks and 1.1 percentage points for Hispanics—despite the fact that the homeownership rates are projected to rise 9.0 percentage points for blacks and 7.6 percentage points for Hispanics. The white-Asian gap is projected to increase by 2.2 percentage points as immigration continues to dampen homeownership among Asians. The reason for the persistence in homeownership gaps despite significant increases in minority homeownership is that factors that favor minority homeownership also favor white homeownership.

### **1.2.3 Causes of Racial Gaps in Homeownership Rates**

Despite the gains made by minorities since the 1960s in both economic affluence and in legal protection from housing market discrimination, there has been little improvement in minority homeownership rates over the last thirty years relative to white homeownership rates. Studies of racial and ethnic differences in homeownership rates have consistently found that two broad factors contribute to minority households having a lower probability of homeownership. One factor relates to differences between whites and minorities in a range of demographic and economic factors that are associated with homeownership. The other factor relates to unobserved variables that include discrimination and a lack of understanding about the home buying and mortgage finance processes.

Early studies of homeownership gaps assumed that the factors influencing households to become homeowners were the same for minorities and whites and that both groups' behavioral responses to these factors were the same. The studies separated the gap into two components: that due to differences in endowments and an unexplained residual amount. In these early studies, the magnitude of the residual shortfall in the probability of homeownership attributed to race rather than endowments has ranged up to 20 percentage points depending on the time period and the sample. Subsequent studies dropped these restrictive assumptions and followed a more general technique to decompose the homeownership gap into effects due to differences in socio-economic variables and the residual amount.

Over time there has been a downward trend in the estimated size of the residual component of the white-minority homeownership gaps. Also, studies of new households and recent movers found single digit gaps in homeownership once differences in endowment were taken into account. The decreasing size of the residual could occur because recent studies have used a more comprehensive set of socio-economic explanatory variables as the quality of data sets improved. Or, it could be due

to a smaller impact of discrimination in the mortgage and housing market. The latter conclusion is consistent with the establishment and enforcement of a number of policies that monitor mortgage markets and brokerage services and that enforce fair housing laws. To date, most studies that have noted a decline in the residual component of the homeownership gap have attributed this change to reduced discrimination. However, it is also clear that researchers are now including more and better explanatory variables in their analyses, thus reducing the size of the unexplained residual.

Current estimates of the residual gap appear to be in the range of five to ten percentage points. This remaining unexplained gap may well be accounted for by potentially important explanatory variables that have not generally been captured by these studies, such as a household's expected mobility, credit history, income variability, willingness to take financial risks, and understanding of the home buying and mortgage finance processes. Thus, it is possible that a future study using a complete set of all relevant explanatory variables will "explain" the entire racial gap in homeownership. However, this finding should not be construed as providing evidence that existing anti-discrimination laws are obsolete. Rather, it is possible that the inter-temporal decline in and current modest-sized race-related residuals from homeownership gap studies result, at least in part, from government policies and oversight regarding discriminatory treatment in housing and mortgage markets. However, the degree to which current government legislation has helped to reduce the size of race-related disparities in homeownership is unknown.

A major limitation of existing studies is the lack of linkage between the theory of homeownership and the set of explanatory variables included in empirical studies of ownership gaps. This failure results in the omission of important concepts (e.g. income stability) and it complicates the interpretation of included variables. For example, age and marital status become proxies for expected mobility and income becomes a proxy for the tax benefits of homeownership. Further, theory suggests that the effects of variables such as income and its interaction with the tax code should have nonlinear effects. Few studies of gaps in homeownership allow for such nonlinearities.

Another general problem with the literature on homeownership gaps is that it trails advances that have been made in the study of the propensity of a given household to become a homeowner. Most current studies of when and whether households become homeowners adopt an inter-temporal approach, using information on changes in household circumstances over time to predict future choices. In contrast, apart from the occasional use of permanent rather than current income, studies of homeownership gaps are typically silent regarding inter-temporal aspects of homeownership and instead rely exclusively on current household attributes to predict tenure choice. In many cases, studies of gaps in homeownership appear to have not advanced very much beyond methods used in the 1970s to estimate the probability of homeownership. In contrast, studies of the likelihood that individual households become homeowners have been using panel data and related econometric methods for two decades. While the homeownership literature recognizes that a household's current tenure status will affect its future housing tenure choices, there is little recognition of this inter-temporal dependence in the homeownership gaps literature. The literature on the propensity for homeownership also recognizes that expectations of future events affect current tenure choice decisions, but again the gaps literature, in general, fails to take this point into account.

Two broad but compelling conclusions emerge from our review of the literature in this chapter. First, additional efforts targeting discrimination in housing and mortgage markets and a lack of information about the homebuying process are unlikely to narrow racial gaps in homeownership by more than

perhaps five percentage points. That in turn implies that future efforts to narrow aggregate white-minority gaps in homeownership should primarily focus on addressing the differences in household circumstances by race – including wealth, income, education levels, and marital status – that account for a large majority of the observed differences. Some of these factors can be addressed by efforts to reduce barriers to homeownership associated with wealth and income. But the fact that so much of the homeownership gap is attributable to the generally lower socioeconomic standing of minorities suggests that policies that address broader societal factors will also be needed to close these gaps over time. The factors that are important to supporting homeownership but may fall outside the range of homeownership policies include enhanced job opportunities, job security, marital status, and household stability. Creating an environment conducive to financial and family security for minorities is a challenging task, but one that policy makers must grapple with if they are to substantially reduce current racial gaps in homeownership. A second conclusion from this review is that there are considerable opportunities for further research to expand our knowledge of the determinants of race-related and income-related gaps in homeownership.

#### **1.2.4 Policy Options for Reducing Homeownership Gaps**

In thinking about policy options for closing homeownership gaps it is also helpful to keep in mind the magnitude of the issue. According to the 2003 CPS, there were 13.3 million black households, 11.3 million Hispanic households, and 4.0 million Asian households. In order to raise the homeownership rate of each of these groups by 1 percentage point, there would have to be an increase of 133,000 black homeowners, 113,000 Hispanic homeowners, and 40,000 Asian homeowners, for a total of 286,000 minority households. In terms of income, there were 37.1 million households with income less than 50 percent of AMI (adjusted median income) and 21.5 million with income between 50 and 80 percent of AMI. In order to raise homeownership rates of these groups by 1 percent there would have to be an increase of 371,000 and 215,000 homeowners in these income classes. Thus, in order to close homeownership gaps by race and income by a single percentage point, public policy needs to assist several hundred thousand households. The implication is that making substantial progress in closing homeownership gaps by income and race-ethnicity will require moving literally millions of households into homeownership, requiring a sustained policy effort over many years. In the short run, it seems appropriate for policy makers to focus on incremental gains. We provide evidence in this report that a more modest goal of raising homeownership rates by a few percentage points is certainly within the reach of variety of policy options and would help hundreds of thousands of households.

A further challenge facing policy makers in attempting to narrow homeownership gaps by race and ethnicity is that policies cannot be targeted to minorities. Policies can, however, be targeted by income and, because minorities (at least blacks and Hispanics) disproportionately have lower incomes, efforts to assist low-income households may help close homeownership gaps by race and ethnicity. But there are many low-income white households who will, rightly, also benefit from these efforts. As a result, efforts to aid low-income households may only have a marginal impact on closing homeownership gaps. This suggests that as a policy goal it may be more appropriate to focus on raising minority and low-income homeownership *rates* rather than specifically on narrowing *gaps*. This is consistent with the Bush administration's policy goal of increasing the number of minority homeowners by 5.5 million over the first decade of the century.

The first step in thinking about policy options for closing homeownership gaps is to identify the constraints on greater homeownership by low-income and minority households. For policy purposes, the most important constraints are on the supply side, as these barriers limit the ability of households who might otherwise choose to be owners from purchasing a home. Homeownership deterrents on the demand side largely relate to factors that make the investment risk of owning too great for some households. While some efforts to address these risks may be helpful and appropriate, such as home equity insurance, in some cases it will simply be the case that the risk of homeownership is inappropriate for some low-income and low-wealth households. The high transaction costs of buying and selling homes also deters households with high-expected mobility from pursuing homeownership. But, again, these households are probably simply best off renting. But while it is true that homeownership may not be the best choice for some low-income households, a challenge for policy makers is that there is no bright line distinguishing which low-income households would be better served by delaying a move to homeownership.

There are two broad categories of supply-side limits on homeownership: limitations on access to mortgage financing needed to purchase homes, and, in some markets, a lack of supply of housing units that are affordable and attractive options for low-income households. Much of the research on the importance of these barriers in limiting homeownership has focused on limits on access to mortgage finance. The most informative studies about the likely impact of changes in the mortgage market on homeownership rates are those that estimate the impact on the probability of homeownership of removing these constraints. In general, these studies have found that a lack of wealth is a much more important limitation on homeownership than is a lack of income to meet limits on monthly payments. Wealth is needed to meet downpayment and reserve requirements, to pay closing costs, and to reduce outstanding debt levels. In terms of the magnitude of the potential for increasing homeownership, research has shown that reduction in wealth and credit constraints could increase overall homeownership rates by between 4 to 8 percentage points, with larger gains generally for lower-income and minority households. Given the importance of the wealth constraint, the most effective policies for increasing homeownership are likely to be efforts to provide downpayment assistance, provide mortgage products with lower downpayment requirements, or efforts to support wealth accumulation by low-income households such as individual development accounts.

Few studies have attempted to estimate the impact of other supply side barriers that limit access to homeownership, such as racial discrimination, lack of information about housing and mortgage markets, or access to suitable housing for ownership. More research is needed to better understand the importance of housing supply restrictions on homeownership rates.

Another strand of the literature that examines the potential for increasing homeownership uses a synthetic underwriting approach. These studies rely on very detailed information on current household financial circumstances and apply varying assumptions about underwriting requirements, home prices, and transaction costs to estimate how changes in these parameters affect the number of households who could qualify for a mortgage. Estimates from these studies of the influence of various underwriting requirements on homeownership rates are fairly small, possibly because these studies do not allow for households to change their financial circumstances in order to qualify for homeownership. Nonetheless, the findings from these studies are instructive about the relative importance of different options for increasing access to homeownership.









































































































































































































































































































































































































































































































