U.S. Department Of Housing and Urban Development

New Trends In American Homeownership

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Executive Summary

Overview

Survey research confirms that Americans continue to aspire to homeownership. Approximately 86 percent of Americans believe they are better off owning their homes, and no more than one fourth of renters prefer renting to homeownership. Homeownership reinforces responsibility and self-reliance, engendering both private and public benefits. Furthermore, homeownership promotes stability by increasing the number of society's stakeholders and reducing disparity in the distribution of wealth and income.

This report examines trends and recent changes in U.S. homeownership, focussing on the turnaround in homeownership rates created by more conducive economic conditions and industry efforts to develop underwriting and marketing techniques targeted toward underserved families and their neighborhoods. The main findings follow.

Trends in Homeownership Before 1990

In the 50 years prior to World War II, the homeownership rate fluctuated between 43 and 48 percent. Aided by Federal Housing Administration and Veterans Administration innovations in mortgage financing and by significant growth in incomes, household formations, and intraurban infrastructure, the homeownership rate increased by about 18 points in the 1940s and 1950s, and reached 61.9 percent in 1960.

During the 20-year period from 1970 to 1990, homeownership experienced modest but steady growth but then retrenched. Over this period, families experienced varying environments for homeownership. In the 1970s, low and stable interest rates, high levels of inflation in house prices, a growing number of families earning higher real incomes, and the maturing of the baby-boom generation pushed the homeownership rate to a record high of 65.6 percent by 1980.

Conversely, the 1980s were characterized by negative real income growth at the beginning of the decade, weaker appreciation in house prices, lower rates of household formation, and extremely high interest rates. As a result, the homeownership rate had dropped to 63.9 percent by the end of the decade.

The 1990s Homebuying Market

Improved homebuying environment in the 1990s. The 1990s has seen a return to economic conditions more conducive to a sustained increase in homeownership. Relatively low and stable inflation rates have reduced mortgage interest rates to the relatively low levels of the early 1970s. Moreover, low inflation has facilitated a climate for modest but stable appreciation in house prices. Together these two factors—low interest rates and stable home price appreciation—have substantially lowered the monthly cost of homeownership compared with that of the 1980s. While median family income was 20 to 30 percent below that necessary to qualify for purchase of the median-priced home throughout the early 1980s, it is now 20 to 30 percent greater than what is necessary. By the fourth quarter of 1995, the homeownership rate had risen to 65.1 percent.

Characteristics of 1990s homebuying market. Annual surveys of homebuyers conducted by the Chicago Title and Trust Family of Title Insurers have identified important trends in the housing market for the first half of the 1990s.

- **First-time homebuyers.** After being priced out of the homeownership market during the 1980s by high interest rates and the high house prices of the early 1980s, first-time buyers became more important in the homebuying market in the 1990s. While they accounted for about 40 percent of all home sales in the 1980s, their share has been more than 47 percent since 1992.

- **Single and nontraditional households.** Although overall household formations have declined, postponed marriages, divorce, and other nontraditional life styles have led a record number of never-married singles to become homebuyers as well as an increasing share of single parents and divorced persons. Never-married singles comprised about 30 percent of the first-time buyers between 1992 and 1994.

- **Affluent buyers.** The growing importance of first-time buyers reflects not only the fact that more households of moderate means can afford homeownership in a period of relatively low interest rates, but also a decline in home purchasing by the affluent move-up buyer. A sluggish economy in 1990 and 1992-93, and perhaps greater caution with the uncertainty of many white-collar jobs, may have contributed to the decline in the number of repeat buyers.

- **Low-income households.** Growing access to homeownership by households with more modest means is evident from the fact that the proportion of first-time buyers with incomes less than $30,000 has increased steadily, from 11 percent in 1991 to 17 percent in 1995.

- **High loan-to-value ratios (LTVs).** The average down payment for first-time buyers has fallen from 15 percent in 1991 to 13 percent in 1995. The proportion of home purchase loans with LTVs greater than 90 percent rose from 19 percent in 1993 to 28 percent in 1994.

- **Immigration.** Immigrants seem to be an important portion of the strong presence of first-time buyers in the market. The continued increase in immigration during the

1990s will help offset a decline in the demand for housing by the aging baby-boom generation.

- **Regional trends.** High-cost housing markets on the East and West Coasts have been sluggish. Moderate cost markets, such as those in the Midwest and the Rocky Mountain States, have been robust.

Unmet Needs in the Housing and Credit Markets

The U.S. system of housing finance is the most efficient in the world. However, there is evidence that our highly efficient system does not work equally well everywhere or for everyone.

Social groups facing homeownership challenges. Homeownership is more difficult for certain groups to attain, and a gap has always existed between the homeownership rates for these groups and those of majority families. These challenged groups include racial and ethnic minorities, and young households, particularly those households with children. Minority households have persistently reported homeownership rates 20 percentage points below those of whites. The share of families with children that reside in owner-occupied homes fell by 7 percentage points between 1980 and 1991. These challenged groups were closed out of the housing market during the 1980s when the combination of slow income growth and higher prices made saving for home purchase more difficult and increasing interest rates pushed monthly mortgage payments out of reach for more households.

Unmet needs in the mortgage market. Numerous studies have documented the substantial credit problems faced by lower income and minority families. Discrimination on the part of lenders, overly restrictive underwriting standards, and limited financial experience have contributed to the problems these families face when trying to obtain credit.

Affordability problems. Studies have shown how difficult it is for lower income families to accumulate enough cash to cover the down payment and closing costs and to make monthly mortgage payments. Low incomes and high debt are the primary reasons why such households cannot afford to purchase a home. Furthermore, some potential low-income homebuyers do not understand the importance of establishing and maintaining a good credit history.

Lending disparities. Research based on Home Mortgage Disclosure Act (HMDA) data suggests that there are pervasive and widespread disparities in mortgage lending across the Nation. A major study by researchers at the Federal Reserve Bank of Boston shows that mortgage denial rates are substantially higher for minorities, even after controlling for indicators of credit risk. Black and Hispanic applicants in Boston with the same borrower and property characteristics as white applicants have a 17-percent denial rate, rather than the 11-percent denial rate experienced by whites. A recent study at the Federal Reserve Bank of Chicago reports similar findings.

Mortgage credit also appears to be less accessible in low-income and high-minority neighborhoods. The U.S. Department of Housing and Urban Development's (HUD's) analysis of HMDA data shows mortgage denial rates to be nearly twice as high in low-income and high-minority neighborhoods as in other neighborhoods. Other studies have found that mortgage denial rates are higher in low-income neighborhoods, even after accounting for other loan and borrower characteristics.

Affordable Lending Programs

Recent industry initiatives. In the past few years, conventional lenders, private mortgage insurers, and Fannie Mae and Freddie Mac have begun implementing changes aimed at extending homeownership opportunities to lower income and historically underserved households. The industry has begun to offer specialized mortgage products, such as 3-percent down payment mortgages. It has entered into partnerships with local governments and nonprofit organizations to increase mortgage access to underserved borrowers. Even more significant is the industry modification of underwriting standards to address the needs of families that have difficulty qualifying under traditional guidelines. For instance, Fannie Mae and Freddie Mac now allow loan approval based on income stability, which helps less-skilled workers who manage to earn a steady income despite frequent job changes.

Prudent changes. The new affordable lending programs are designed to attract creditworthy homeowners in a prudent fashion. Homebuyer education is a key component. The industry is also relying on intensive default monitoring and loss mitigation programs to manage the credit risk of the affordable lending programs. To date, there is little information about the credit quality of these new programs that combine low downpayments with prepurchase counseling and intensive servicing. The loans need more seasoning before a serious evaluation of their credit risk can be made.

Industry initiatives matter. HMDA and Government-Sponsored Enterprise (GSE) data suggest that the new industry initiatives may be increasing the flow of funds to underserved borrowers. Between 1991 and 1994, HMDA data show conventional loans to low-income and minority families growing at a much faster rate than loans to higher income and white families. The number of conventional purchase loans to families with less than median income increased by 27 percent between 1991 and 1992, compared with a 10 percent growth for loans to higher income families. The following percentage changes in the origination volumes of conventional home purchase loans show that these trends continued into 1993 and 1994.

Borrower Characteristics	Percentage Change in Origination Volume From Previous Year 1993	1994
All borrowers	17%	18%
Income less than 80% AMI[1]	38%	27%
Income greater than 120% AMI	8%	13%
Black	36%	52%
Hispanic	25%	42%

Since the housing goals were established for Fannie Mae and Freddie Mac in 1993, the GSEs have introduced flexibility into their underwriting standards and have markedly increased their outreach efforts and new products targeted to lower income families and underserved neighborhoods. GSE financing of housing for low- and moderate-income families has increased from about 25 percent of their combined business in 1992 to more than 40 percent in 1995.

Large Number of Potential Beneficiaries

Available data suggest large potential benefits from encouraging the industry to continue improving its homeownership efforts. Studies show that an overwhelming majority of renters would prefer to be homeowners. Harvard's Joint Center for Housing Studies show a large homebuying potential among immigrant and minority households. Immigrants have a stronger than average desire to be homeowners, and this population group is a growing share of the population.

In a HUD-funded study, The Urban Institute finds a significant low-income population of potential homeowners with low credit risk that could be served by continuing outreach efforts. In other words, not only do many renters want to become homeowners, but research shows that a large number of them are qualified to do so.

Home Ownership and the Future

Demographic trends are expected to somewhat increase the homeownership rate into the future. In addition, special housing initiatives can be expected to improve homeownership rates for groups such as minorities and low-income households.

[1]AMI is the metropolitan area median income.

I. Introduction

Homeownership has long been a key aspiration of Americans and, as such, a basic concern of Government. According to a recent Fannie Mae survey, 86 percent of Americans believe they are "better off owning" their homes. The survey reveals that only one-fourth of renters prefer renting to homeownership.[1] Homeownership spawns both private and public benefits, which justifies Government's encouragement and support.

Homeownership provides private benefits by expanding the range of individual choice, permitting households—particularly families with children in search of larger homes and better neighborhoods—to more carefully tailor or customize living arrangements to their specific situation. Renters are more constrained in their choices because landlords concerned about marketing their units normally invest in a narrower mid-range housing stock appealing to the norm or average situation. Moreover, renters must get permission from landlords to customize exterior or interior features of the home or to use it for certain purposes, such as having a pet.

Planning for and meeting the demands of homeownership may reinforce the qualities of responsibility and self-reliance. White and Green (1994) provide some empirical support for the association of homeownership with a more responsible, self-reliant citizenry. They report that homeowners' children are more likely to graduate from high school, less likely to commit crime, and less likely to bear children as teenagers than renters' children.[2] Both private and public benefits are increased to the extent that developing and reinforcing these qualities improve prospects for individual economic opportunities.

Furthermore, homeownership is one of the most common forms of property ownership and one of the most common sources of savings. As such, it promotes social or community stability by increasing the number of stakeholders and reducing disparity in the distribution of wealth and income. Home equity is the largest source of wealth for most Americans. Median net wealth for renters is only about 3 percent of the median net wealth

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[1] Fannie Mae National Housing Survey (1994), pp. 4 and 7.

[2] These tendencies are especially strong for lower income households. Children of low-income homeowners are 15 percent more likely to stay in school than children of nonhomeowners. See White and Green (1994). It is well known that causation cannot be inferred from the measured association. Nevertheless, the association exists, leaving the questions of whether greater self-reliance and responsibility lead to homeownership, the reverse, or both.

for homeowners. Among homeowners, about 60 percent of their wealth consists of home equity. Even among low income homeowners, home equity comprises over half their wealth.[3]

This report examines the pattern of homeownership and factors affecting it through the 1970s and 1980s. It also focusses on the recent turnaround in homeownership rates with the advent of more conducive economic conditions and with industry efforts to develop more discerning underwriting and marketing techniques for underserved families and their neighborhoods. Finally, the report examines the as yet unrealized potential for increased homeownership.

II. Background

A. The Past

The decennial census of 1890 was the first in which basic housing questions were asked. In particular, those polled were asked whether the householder owned or rented. The census data shown in Table 1 depict three distinct eras of homeownership since 1890.

In the period from 1890 to 1940, the homeownership rate fluctuated between 43 and 48 percent. From 1890 to 1920, the homeownership rate fell as immigration and urbanization offset a rise in income. Income growth increased the homeownership rate during the 1920s, but the Depression more than wiped out this gain so that by 1940, the rate had fallen to a low of 43.6 percent.

Table 1
Trends in Homeownership

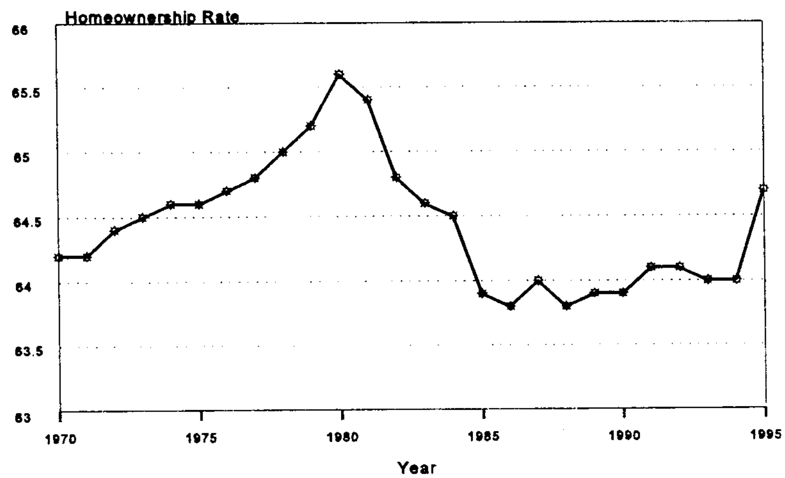
Census	Homeownership Rate
1890	47.8%
1900	46.7%
1910	45.9%
1920	45.6%
1930	47.8%
1940	43.6%
1950	55.0%
1960	61.9%
1970	62.9%
1980	64.4%
1990	63.9%

During the period from 1940 to 1960, the homeownership rate rose dramatically by more than 18 percentage points, from 43.6 to 61.9 percent. This remarkable transformation was facilitated by higher incomes, a larger number of households in prime homebuying age groups, a revolution led by the Federal Housing Administration (FHA) in mortgage financing, the GI bill of, improved intraurban transportation, and the development of affordable large-scale housing subdivisions. Following this unparalleled increase, fluctuations in the homeownership rate returned to

[3]"Homeownership and Its Benefits." (1995).

a more normal range of 2 to 3 percentage points, and the rate rose only a modest 1 percentage point through the 1960s.

Figure 1
Homeownership Rate: 1970–1995



Source: Bureau of the Census

B. Patterns from 1970 to 1990

During the subsequent 20-year period from 1970 to 1990, the rate of homeownership experienced modest, steady growth and then retrenched, as demonstrated in Figure 1.[4] During the 1970s, homeownership continued to increase, extending to about 1.5 million more families. The annual rate rose every year in the 1970s, going from slightly more than 64 percent to 65.6 percent in 1980, an all-time high.[5] The homeownership rate declined throughout the early 1980s until it reached 63.8 percent in 1986. Between 1986 and 1990 it remained fairly flat, finishing the decade at 63.9 percent.

Much of the movement in homeownership between 1970 and 1990 can be attributed to four factors: household growth resulting from the post-war baby-boom generation reaching its prime homebuying age, changes in real family incomes, variations in housing

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[4]Homeownership rates in table 1 come from the decennial census, while the rates in figure 1 come from the Current Population Survey/Housing Vacancy Survey. The two sources produced slightly different rates. The CPS/HVS is a sample survey with sampling error, while the decennial census estimate has no sampling error. Trained and experienced interviewers are used to collect CPS/HVS data. The decennial census use self-administered questionnaires. Also, there are some definitional differences.

[5] On a quarterly basis, the all-time high was 65.8 percent, a level reached in the third quarter of 1979.

prices with respect to the general price level, and the level of mortgage interest rates.[6] In the two decades preceding the 1990s, families experienced quite different environments for homeownership. In the 1970s, low and stable interest rates, high levels of inflation, growing numbers of families earning higher real incomes, and the baby-boom generation coming of home-buying age led to record high levels of homeownership. Conversely, the 1980s were characterized by negative real income growth in the early years of the decade, weak appreciation in house prices, lower rates of household formation, and extremely high interest rates.

Household growth and the baby boom. Homeownership is a goal of most young families. With the passage of time, earnings increase and families can accumulate the savings needed for a downpayment on their first home. Fewer than 40 percent of households with a head younger than 30 years old have become homeowners. When the heads of these households reach the 30-to-34-year-old category, 50 to 55 percent are homeowners. Finally, when they reach 35 years and beyond, the rates for homeownership are always greater than 65 percent until nearly 80 percent are homeowners in households where the head is older than 55 years.

The aging of population generally leads to higher homeownership rates, with the largest shift coming as the population moves from under 30 to the 30-to-34-year-old age bracket. The baby boomers moved into this prime homebuying age range during the 1970s and early 1980s. In 1970 the number of householders aged 30 to 34 was 5.6 million; in 1980 this group had increased by 66 percent to 9.3 million. Although the maturation of the baby boomers led to higher homeownership rates in the 1970s, the number of householders moving into the prime homeownership phase of their lives in the 1980s was much less. In 1980 the net change in the number of households in the 30-to-34-year-old age bracket was nearly 1 million. However, no more than 400,000 householders per year came into that age category during the remaining years in the decade. In 1983 a negative change occurred, with the population in the 30-to-34-year-old age group falling by nearly 200,000 householders.

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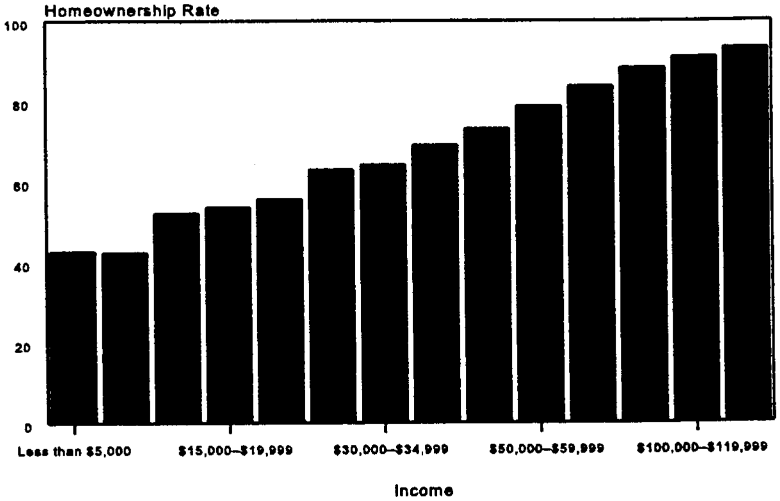
[6]Household preferences, income, wealth and the relative cost of owning and renting impact the ownership decision. This section focuses on changes in important factors affecting the overall homeownership rate. A more comprehensive review of the tenure-choice literature can be found in Megbolube and Linneman (1993).

Changes in real incomes. Higher income families are much more likely to own their homes. They have discretionary funds to allow saving for a downpayment, and they can carry higher monthly housing costs. The tax advantages of homeownership are also more valuable to higher income households, due to their higher marginal tax rates. Figure 2 shows the positive relationship between income and homeownership. Although overall nearly 65 percent of American families owned their own homes in 1993, only about 40 percent of low-income families were homeowners, according to the American Housing Survey. Approximately 70 percent of near-median-income families owned their homes, and more than 93 percent of the wealthiest householders were homeowners. Thus, as observers would expect, the homeownership rate rose in the 1970s as incomes rose.

Figure 2
Income and Homeownership

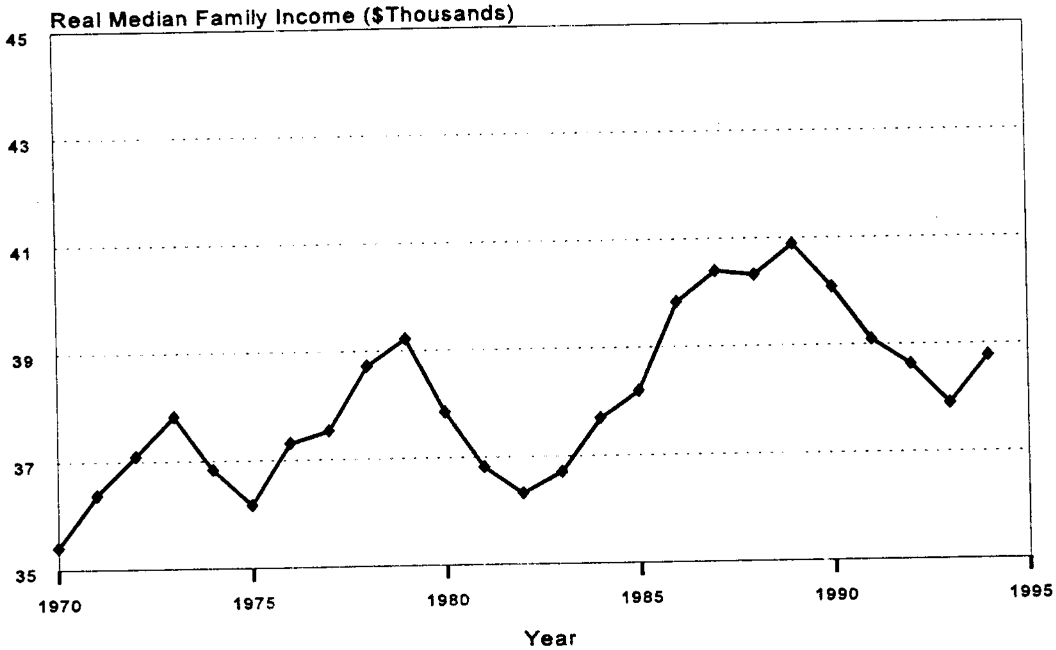


Source: American Housing Survey 1993

Figure 3 shows that real family income went through three cycles during the period from 1970 to 1990. Real incomes increased by 7 percent between 1970 and 1980, with most of that growth (5 percent) coming in the second half of the decade. Real family incomes declined annually from 1979 to 1982, falling by nearly 8 percent. Although real incomes started to increase after 1982, they did not return to their 1980 level until 1986.

Figure 3

Real Family Income: 1970–1994

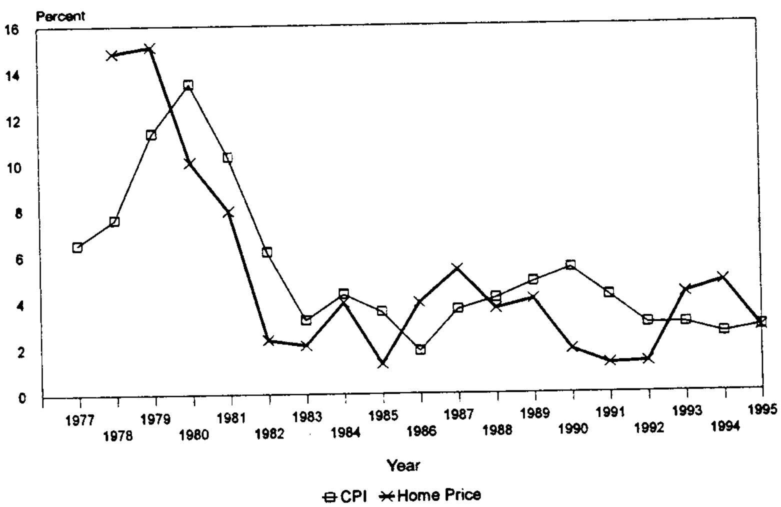


Source: Bureau of the Census

Rising prices and inflation. In times of inflation, homeownership is both a disadvantage and a benefit. As consumers homeowners suffer because their purchasing power erodes with increasing costs of living. However, homeowners have a hedge against inflation because houses increase in value as inflation forces price-level increases. Homeowners treat these capital gains as offsets against their housing costs. Some of the rush to homeownership in the late 1970s may have been the result of householders attempting to protect themselves from inflation. As shown in Figure 4, the price of a constant quality house out paced general inflation from 1977 to 1980, rising by approximately 46 percent. Once the cost of homeownership is adjusted for capital gains, housing costs become negative because of such high inflation in house prices.[7] Although house prices increased during the 1980s, the price of a constant-quality house rose only 43 percent. Unlike the 1970s when home prices

Figure 4

Home Price and CPI Inflation, 1977-1995

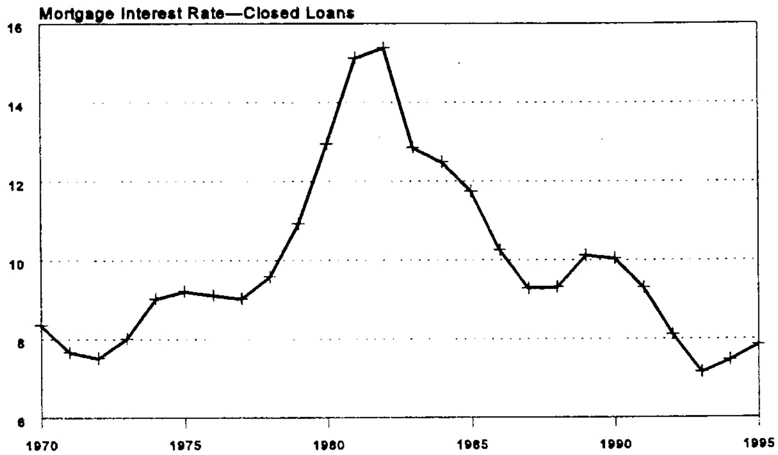


[7] See Dougherty and Van Order (1982).

appreciated significantly, lowering the net cost of homeownership, the 1980s brought general inflation of 59 percent, making homeownership a poorer hedge.

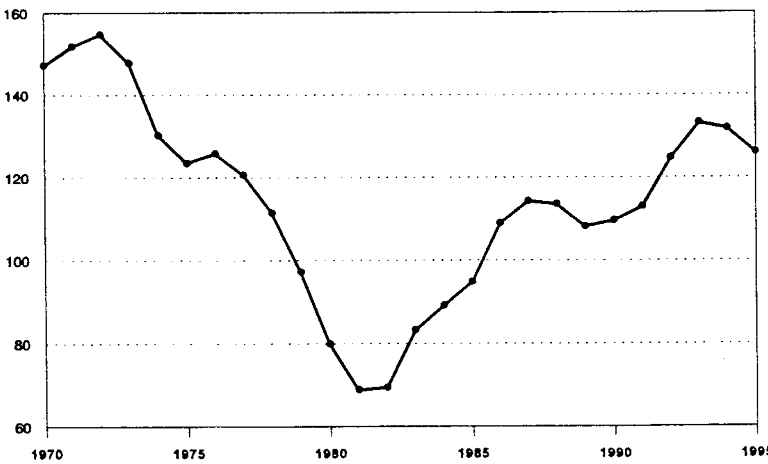
Interest Rates. Homeownership costs are predominantly carrying charges on interest, and large increases in interest rates make homeownership unaffordable to a larger number of families. During the 1970s interest rates, at 8 to 9 percent, were fairly low, as indicated in Figure 5. However, interest rates increased dramatically from 1979 until their peak at more than 15 percent during 1981 and 1982. They remained above 10 percent until 1987. These high interest rates, combined with declining real incomes, contributed to a serious affordability crisis, as shown in Figure 6. According to the National Association of Realtors, a family earning the median income in 1981 and 1982 had less than 70 percent of the income needed to purchase the median-priced resale home.[8] In other words, a family earning the median income would have needed an income increase of more than 40 percent to be able to afford the median-priced existing house. In contrast, at the beginning of the 1970s, a family earning the median income had more than 150 percent of the needed income. Although affordability improved

Figure 5
Mortgage Interest Rate: 1970–1995



Source: Federal Housing Finance Board

Figure 6
Affordability Index: 1970–1995



Source: National Association of Realtors

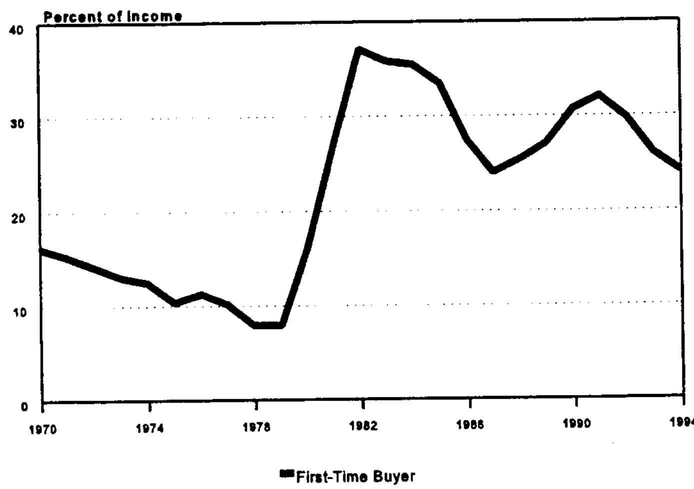
[8]The National Association of Realtors affordability index places the role of interest rates, house price changes and income changes into a unified measure. The affordability index can be faulted for several reasons including the lack of control for the quality of the median-priced home, the use of cash flow instead of net housing costs, and the failure to recognize the use of alternatives to a 30-year, fixed-rate mortgage with an eighty percent loan-to-value ratio.

for the prospective homebuyer after the early 1980s, the index remained below the values of the early and mid-1970s.

Ownership cost index. Figure 6 shows how income and the relationship between home price and interest rates, which determine monthly mortgage payments, affect simple cash-flow cost and affordability of homeownership. However, it does not reveal the true economic carrying cost of homeownership. Actual cash payments needed for homeownership can be lessened by tax deductions for mortgage interest. Moreover, when the annualized value of the expected appreciation[9] of the home price is factored in, the actual real cost of homeownership can be significantly less than the explicit operating outlays. The Joint Center has estimated this more refined measure of the yearly operating cost of homeownership by comparing it with "young renter" income to form a percent-of-income cost index for first-time homebuyers. Figure 7 reveals that, with high expected appreciation, the economic cost of homeownership fell to below 8 percent of first-time buyer income in the late 1970s before rising with interest rates and slowing appreciation to roughly 37 percent of income in 1982. Excluding 1986, when expected appreciation rebounded somewhat, the reduction in cost has been largely the result of declining interest rates.

Figure 7

Homeownership Cost for First-Time Buyers



Source: Joint Center for Housing Studies of Harvard University.

III. Recent Economic Turnaround

The preceding section shows how relatively low interest rates, rising real incomes, and significant appreciation in home price as a hedge against rising inflation contributed to the rise in homeownership through the 1970s and how the reversal of those conditions has brought about a decline in homeownership throughout the 1980s. Figure 1 reveals that, in the 1990s, homeownership is again on an upward path across the board for virtually all social groups. This turnaround is in large part the result of changes in economic

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[9]The Joint Center (1995) measures expected appreciation as a weighted average of the increases in house prices in the previous three years.

conditions and efforts to improve the mortgage delivery process, which are discussed in the section titled "Underserved Populations: Current Conditions and Industry Response."

A. Economic Conditions in the 1990s

The 1990s has thus far witnessed a return to economic conditions much more conducive to a sustained increase in homeownership. Relatively low and stable inflation rates have returned mortgage interest rates to the relatively low levels of the early 1970s. Moreover, low inflation has facilitated a climate for a stable but modest appreciation in house price. Together these two factors—low interest rates and stable appreciation in home price—have substantially lowered the monthly cash cost of homeownership compared with that required throughout the 1980s. This fact is reflected in Figure 6, which shows the rebound in the National Association of Realtors Affordability Index, the percentage by which the median family income exceeds that necessary to qualify to purchase the median-priced home. In 1995 median family income was 126 percent of (or approximately one-fourth more than) that necessary to finance a median-priced home. By the fourth quarter of 1995, the homeownership rate had risen to 65.1 percent.

The return to relatively low interest rates makes homeownership not only much more accessible to potential homebuyers but also less costly to those who purchased homes in the 1980s. Homeowners who purchased their homes at higher rates in the 1980s could refinance at the lower interest rates, thereby increasing their discretionary income and strengthening their hold on homeownership.

B. Homebuyer Characteristics in the 1990s

Demographic changes, such as the decline in household formation and the aging of the baby-boom generation, can be expected to reduce housing demand in the 1990s.[10] However, many factors, when combined with the decline in household formation, have resulted in a changing profile of homebuyers. Annual surveys of homebuyers conducted by the Chicago Title and Trust Family of Title Insurers[11] identify a number of changing trends among homebuyers in the early 1990s.

First-time homebuyers. After being priced out of the homeownership market during the 1980s by high interest rates and high house prices, first-time buyers have become a more important force in the homebuying market in the 1990s. Although they accounted for

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[10]Although the demand for additional housing units would fall, the homeownership rate would tend to increase as the population ages. Homeownership rates increase for every age cohort until age 65.

[11] Chicago Title and Trust Family of Title Insurers (1992, 1993, 1994, 1995, 1996).

about 40 percent of all home sales in the 1980s, their share has risen to more than 47 percent since 1992.

Single and nontraditional households. While overall growth in new households has slowed, nontraditional households have become more important in the homebuyer market. With later marriages, divorces, and other nontraditional living arrangements, household growth has been increasing fastest among single-parent and single-person households. First-time buyers include a record number of never-married single households, constituting about 30 percent of first-time buyers from 1992 to 1994. The importance of singles peaked in 1993 but has declined to 27 percent in 1995. However, divorced and separated homebuyers are continuing to increase their share of both first-time and repeat purchases. Through the overall homeownership rate of these groups is much lower than that of married-couple households, their rates have been increasing since 1993.

Single-person households, which require less living space than do families, are more apt to purchase townhomes and condominiums. Indeed, sales of condominiums and cooperatives reached a record 363,000 units in 1992. The prominence of single first-time buyers, who tend to purchase less expensive starter homes, has contributed to strong below-median-price housing markets across the country.

Affluent buyers. The growing importance of first-time buyers reflects both the ability of more householders of moderate means to afford homeownership in a period of relatively low interest rates and a decline in home purchasing by the more affluent move-up buyer. A sluggish economy in 1990 and from 1992 to 1993 and, perhaps, the uncertainty of many white-collar jobs because of corporate downsizing may have made middle and affluent households more cautious. The number of repeat buyers has been declining. As a result, appreciation of house prices for more expensive homes has lagged behind that of lower-priced homes.

Following a period when the income gap between homebuyers and renters widened, the income gap between those who do and do not buy homes has been narrowing in recent years. In 1991, 66 percent of home buyers had family incomes of $50,000 or more compared with 57 percent in 1993 and 54 percent in 1995. These trends reflect senior citizens moving to smaller homes in less expensive markets, an increase in home purchase among other lower income households, and the decline in activity among more affluent buyers.

Lower income buyers. Growing access to homeownership by households with more moderate means is evident. The proportion of first-time buyers with incomes less than $30,000 has increased steadily, from 11 percent in 1991 to 17 percent in 1995. More borrowers typically choose adjustable rate mortgages (ARMs) over fixed-rate mortgages when interest rates rise, as they did in 1994. However, the ARM proportion of loans increased sharply among first-time buyers from 1991 to 1992, as fixed rates returned to levels of the early 1970s and the spread between fixed and ARM rates widened to about 2.75 percentage points. This fact is further evidence of the importance of affordability in driving the homebuying market in the 1990s. Evidently, the lower interest rates of ARMs allowed some households to achieve homeownership, which had been out of their reach before.

High loan-to-value (LTV) ratios. Average downpayments for first-time buyers fell from 15 percent in 1991 to 13 percent in 1995. The proportion of home purchase loans with LTVs greater than 90 percent rose from 19 percent in 1993 to 28 percent in 1994.[12] High LTV loans are popular among first-time buyers and among repeat buyers in areas with slow appreciation of house price.

Immigration. The continued increase in immigration during the 1990s will help offset declines in the demand for housing caused by the aging of the baby-boom generation. During the 1980s, 6 million legal immigrants entered the United States, compared with 4.2 million during the 1970s and 3.2 million during the 1960s. Immigration is projected to add even more new Americans in the 1990s. According to the Chicago Title survey, immigrants seem to be an important part of the strong presence of first-time buyers in the market.[13] The homeownership rate of recent immigrants rose from 24 percent in 1980 to 55 percent in 1990.[14]

Regional trends. Following two recessions, the East and West Coasts have maintained flat housing markets in the 1990s. In general, housing markets with more moderate price levels have been more active than the high-cost coastal markets. Rocky Mountain areas have shown very strong housing markets due to strong emigration from California. Markets in the South have also been robust, while the Midwest market has been fairly strong.

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[12] Perry and Gates (1995).

[13] Chicago Title and Trust Family of Title Insurers (1995).

[14] The Joint Center for Housing Studies of Harvard University (1995), p. 16.

IV. Underserved Populations: Current Conditions and Industry Response

This section discusses social groups facing difficulty achieving homeownership. Then it turns to the mortgage finance system, providing evidence that significant unmet demand and disparities in credit availability continue to exist in the mortgage market. The section outlines industry efforts to address these needs and the role of the Community Reinvestment Act (CRA) and Government-Sponsored Enterprise (GSE) housing goals in fostering these efforts. Finally, the section estimates the substantial potential market that could benefit from these initiatives.

A. Social Groups Facing Homeownership Challenges

Homeownership is more difficult for certain social groups to attain. These challenged groups include racial and ethnic minorities, young households, and households with children. A gap has always existed between homeownership rates for those groups and the rates of majority families.

Minorities. Historically, homeownership rates among African-American and Hispanic American-households have been below that for white households, as shown in Figure 8. Many lower income and minority families were closed out of the housing market during the 1980s. Slow income growth[15] and increasing rents made saving for home purchase more difficult, and increasing interest rates pushed monthly mortgage payments out of reach for more households. In 1983 only 45.6 percent of African-American householders were owners, but by 1990 the rate had fallen to 42.6 percent. Although homeownership rates for Hispanic-American families improved slightly during the 1980s, they decreased in 1990 and 1991. Moreover, the gap in their homeownership rate compared with that of whites continues into the last decade of the century, as does the gap for African Americans.

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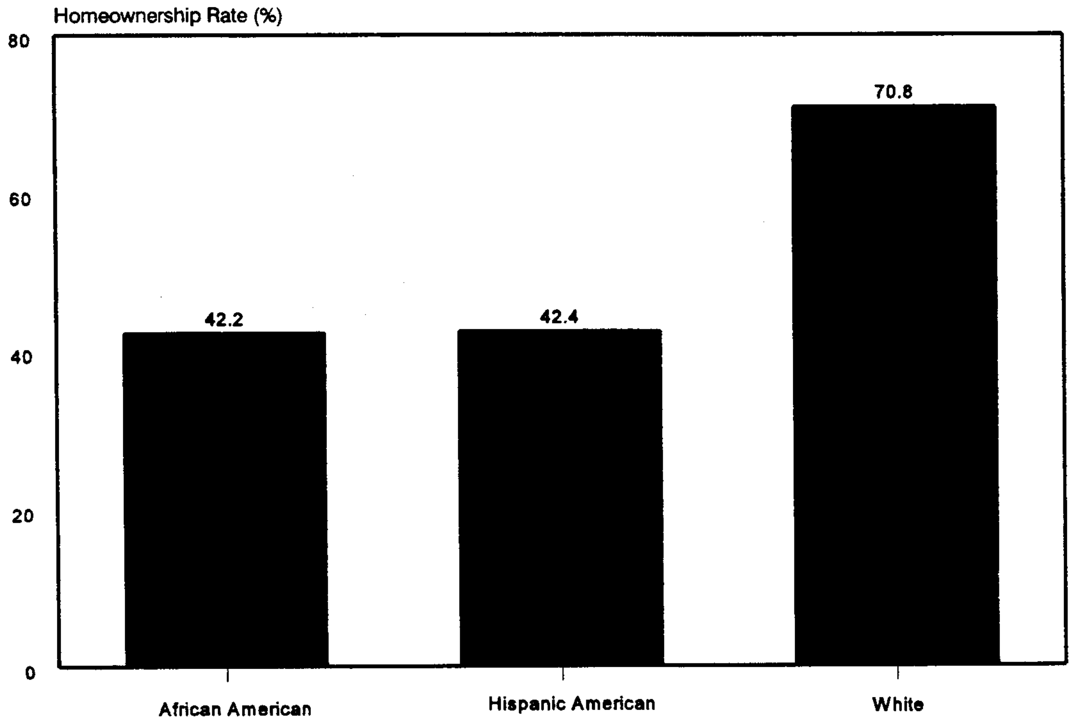
[15] Minorities are more concentrated in unskilled, entry-level, and blue collar jobs. The wages of these groups have fallen compared with the wages of professional and technical workers.

Figure 8
Homeownership by Race and Ethnicity: 1995



Source: Bureau of the Census

Minority households persistently exhibit ownership rates 20 percentage points lower than that of white households. About 80 percent of this difference can be attributed to the lower incomes and wealth of minority households, their greater likelihood to have family structures, such as single-headed families, that have more difficulty affording homeownership, and other factors such as age.[16] However, as shown in Table 2, even when controlling for age, family status, and income, minority families consisting of a married couple with children with a household head between 35 and 44 years of age still experience significantly lower homeownership rates than whites. The probability of ownership among minority households occurs much more in response to an increase in income than does the probability for white households. Thus, the gap in homeownership rates across races is much greater for lower income families than for higher income families. This difference may reflect discrimination faced by lower income minorities that restricts their choice of housing. Conversely, it may reflect the fact that at any given income level, minorities have fewer assets than white households. Studies have found wealth to be a major determinant of home purchase, especially for first-time buyers.[17]

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[16] See Wachter and Megbolugbe (1992).

[17]Megbolugbe and Linneman (1993).

Table 2

Homeownership Rates of White and Minority Married Couples With Children With a Household Head Between 35 and 44 Years Old

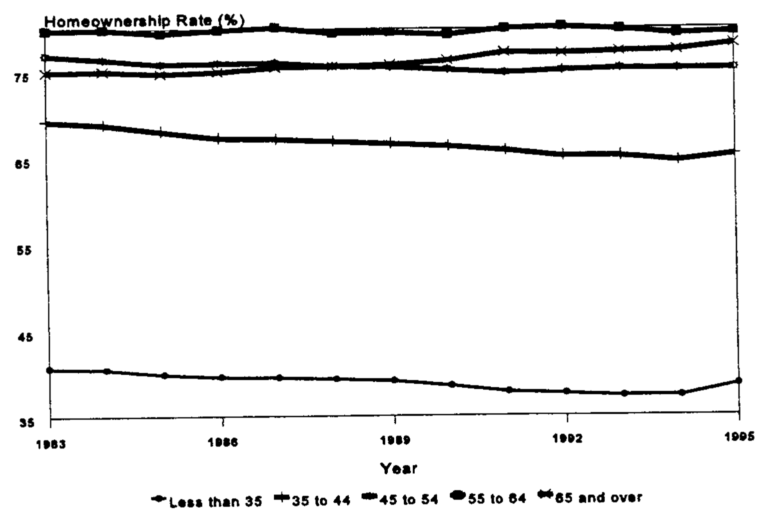
Income	Whites	Minorities
Less than $20,000	62%	36%
$20,000–$39,999	79%	57%
$40,000–$59,999	88%	72%
$60,000–$79,999	93%	80%
Greater than $80,000	96%	83%

Source: U.S. Housing Market Conditions, August 1994

Younger households. The lowest percent of homeownership is among households in the under-35-years-of-age group. This group exhibited homeownership rates of 40 percent or less through the 1980s, as indicated in Figure 9. Typically, younger households have lower incomes and less wealth than older households. In the 1980s as their real incomes declined and house prices rose, younger householders found saving for a downpayment and affording monthly mortgage costs more difficult. Declines in homeownership rates in the 1980s were most pronounced for younger, lower income households, particularly those with children.

Families with children. Single-parent families with children have shown very low rates of homeownership, below 40 percent since 1983. Furthermore, low-income families with children, who could most benefit from the advantages of homeownership, experienced the greatest rate of decline in homeownership during the 1980s. The proportion of the Nation's families with children living in owner-occupied homes decreased by almost 7 percentage points between 1980 and 1991.

Figure 9
Homeownership by Age of Family: 1983 to 1995



Source: Bureau of the Census

B. Unmet Needs in the Housing Finance System

The Nation's housing finance market is a highly efficient system in which most homebuyers can put down relatively small amounts of cash and obtain long-term funding at relatively small spreads above the lender's borrowing cost. However, evidence shows that our system for funding mortgages does not work everywhere or for everyone. The substantial housing and credit problems faced by lower income and minority families are well documented. Lender discrimination, overly restrictive underwriting standards, and limited financial experience have contributed to the barriers these families have experienced in obtaining access to credit markets.

B.1 Affordability Problems

Census Bureau studies have shown the difficulty for lower income families to accumulate cash for downpayments and closing costs and to make monthly mortgage payments.[18] The upfront cash requirements for home purchase remain relatively high. Assuming a 20 percent downpayment, an estimated $14,200 or 58 percent of the average first-time buyer income was required upfront to purchase the average starter home in 1994.[19] This cost, which is substantially above that required in the early 1970s, has been fairly steady since 1989. Although the cash required for a 10-percent downpayment was $7,600, this amount was substantially higher than the less than $2,500 median net wealth of renters.[20]

In addition to low incomes, high debt is another reason that these households cannot afford to purchase a home. Nearly 53 percent of renter families have both insufficient income and excessive debt problems that may cause difficulty in financing a home purchase.[21] High debt-to-income ratios frequently make potential borrowers ineligible for mortgages based on the underwriting criteria established in the conventional mortgage market.

Furthermore, some potential low-income homebuyers do not understand the importance of establishing and maintaining a good credit history. Poor credit ratings are the result of unexpected and uninsured events like hospital bills, which often times are unpaid because of a lack of medical insurance. Other causes of poor ratings are the lack

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[18] Savage and Fronczek (1993), p. ix.

[19] See Joint Center for Housing Studies of Harvard University (1995), p. 15.

[20] Halving the downpayment does not halve the upfront costs because there are fixed closing costs in addition to the downpayment.

[21] Savage and Fronczek (1993), p. ix.

of budgeting skills. Prepurchase counseling and homebuyer education programs are central features in many of the industry's efforts to reach these potential homeowners. The goal is to teach borrowers how to manage debt better and to maintain a home.

B.2 Lending Disparities

Research based on Home Mortgage Disclosure Act (HMDA) data suggests pervasive and widespread disparities in mortgage lending across the Nation. A major study by researchers at the Federal Reserve Bank of Boston shows that mortgage denial rates are substantially higher for minorities, even after controlling for indicators of credit risk.[22] African-American and Hispanic-American applicants in Boston with the same borrower and property characteristics as white applicants have a 17-percent denial rate compared with the 11-percent denial rate experienced by whites. A recent study at the Federal Reserve Bank of Chicago reports similar findings.[23]

Mortgage credit also appears to be less accessible in low-income and high-minority neighborhoods. The U.S. Department of Housing and Urban Development (HUD) analysis of HMDA data shows mortgage denial rates to be nearly twice as high in census tracts with low-income and/or high-minority composition, as in other tracts (21 percent versus 11 percent). Yet another study[24] finds that mortgage denial rates are higher in low-income census tracts, even accounting for other loan and borrower characteristics. The effect of tract racial composition is more complicated. While whites face higher denial rates in minority neighborhoods, minorities do not. That is, minorities face higher denial rates no matter where they attempt to borrow, although whites face the disparity only in minority neighborhoods. In addition, home improvement loans have had significantly higher denial rates in minority neighborhoods.[25]

B.3 Reasons for Lending Disparities

Discrimination. Several possible explanations for these disparities have been suggested. For example, studies such as that by the Boston and Chicago Federal Reserves have found evidence of lender bias. These studies found that racial disparities

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[22] Munnell et al. (1992). See Rachlis and Yezer (1993) for a methodological and econometric critique of this study.

[23] Hunter (1995). In addition, a study undertaken for HUD also found higher denial rates among FHA borrowers for minorities after controlling for credit risk. See Schnare and Gabriel (1994).

[24] Avery et al. (1994).

[25] Two other studies failed to find a relationship between tract racial composition and origination rates. See Holmes and Horvitz (1994) and Schill and Wachter (1993).

could not be explained by differences in creditworthiness. In other words, minorities were more likely to be denied than whites with similar credit characteristics. In addition, if race is correlated with credit risk, loan officers may use race as a screening device to save time, rather than devote effort to distinguishing the creditworthiness of the individual applicant.[26] While the intent may not be discriminatory.

Cost factors. Geographic disparities, or apparent redlining, can be the result of cost factors, such as the difficulty of appraising houses in such areas because of the paucity of previous sales of comparable homes. Sales of comparable homes may be difficult to find also due to the diversity of central city neighborhoods. The small loans prevalent in low-income areas are less profitable to lenders because upfront fees are frequently based on a percentage of the loan amount although the costs incurred are relatively fixed.

Inflexible underwriting. Underwriting rigidities may fail to accommodate creditworthy minority or low-income applicants. For example, under traditional underwriting procedures, applicants who have conscientiously paid bills on time but have never used credit would be penalized for having no credit record. Applicants who remain steadily employed, but change jobs frequently would also be penalized. Many of the changes recently undertaken by the industry to expand homeownership have focused on finding prudent alternatives to establish creditworthiness that do not disadvantage creditworthy minority or low-income applicants.

Another underwriting issue involves successful communication of underwriting standards to lenders. Evidence shows that underwriting guidelines of private mortgage insurers and secondary markets have been viewed by the lenders as strict requirements, rather than guidelines allowing for compensating factors. A study commissioned by Freddie Mac discovered that lenders tend to have more rigid perceptions of Freddie Mac underwriting standards than Freddie Mac had intended.[27] The result is that lenders use criteria to deny loans that Freddie Mac would find acceptable.

Attitudes of potential homebuyers. An additional barrier to homeownership is fear and uncertainty about the buying process and the risks of ownership. A study using focus groups with renters found that even among those whose financial status would make them capable of homeownership, many felt that the buying process was insurmountable for them because they feared rejection by the lender or being taken advantage of.[28] Also, many

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[26]See Calomeris, Kahn, and Longhofer (1994) for more discussion of this phenomenon, which is called "statistical discrimination."

[27] ICF, Incorporated (1991).

[28] Bradley and Zorn (1996).

feared the obligations of ownership, because of concerns about the risk of future deterioration of the house or the neighborhood.

Although the lending community has not reached consensus about why the observed disparities exist, it has recently begun to search for responsible ways to reduce them. The initiatives undertaken are linked to the factors described here, which contribute, in varying degrees, to lending disparities. For example, recent counseling and outreach efforts by the industry are aimed at alleviating the concerns about the buying process.

C. Affordable Lending

This section reviews recent initiatives of the mortgage industry to extend homeownership opportunities to lower income and underserved borrowers and their communities. Activities of the major players at the affordable end of the mortgage market are summarized. After that, examples of how the industry has begun to reach out to underserved households are given. Finally, it is shown that the pool of potential homeowners who could benefit from the industry's affordable lending programs is quite large.

C.1 Overall Market for Affordable Loans

Table 3 reports borrower and census-tract characteristics of mortgages originated in metropolitan areas in 1994 based on HMDA data. The table compares the distributions of mortgages insured or guaranteed by the FHA and the Veterans Administration; purchased by the two GSEs, Fannie Mae and Freddie Mac; conventional mortgages originated and retained by depositories (banks and thrifts); and the overall conventional conforming market.[29] To highlight the affordable sector of the non-government housing market, only FHA-eligible loans are included in this analysis.[30]

FHA stands out as the entity that has facilitated the financing of the greatest share of its loans for affordable lending. Certain groups accounted for particularly high shares of FHA-insured loans: very-low-income borrowers (18.3 percent), African-American and Hispanic borrowers (24.8 percent), and borrowers living in underserved areas (38.6

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[29] Data for manufactured housing loans are also included. Conventional loans that are above the conforming loan limit (so-called "jumbo loans") are not included in this analysis.

[30] FHA-eligible loans are defined as conventional loans whose loan size does not exceed the FHA loan limit for the metropolitan area in which the loan is made. Typically, the FHA loan limit is 95 percent of the area median house price, subject to a current minimum of $78,660 and a maximum of $155,250.

Table 3

FHA-Eligible Mortgage Funding by Borrowers and Census Tract Characteristics 1994 HMDA

			FHA-Eligible Conforming Conventional			
Borrower Income	FHA	VA	GSEs	Depositories	Conforming Market	Mobile Home
Below 60% AMI [1]	18.3%	9.8%	11.4%	15.9%	13.6%	28.5%
Below 80% AMI	42.2%	28.3%	28.5%	33.4%	31.0%	51.9%
Below Median	64.7%	49.4%	48.2%	50.9%	49.8%	70.7%
Borrower Race						
African American	13.3%	14.6%	4.5%	5.4%	5.4%	4.9%
Hispanic	11.5%	5.4%	6.1%	5.7%	6.0%	6.8%
Both	24.8%	20.0%	10.6%	11.1%	11.4%	11.7%
Census Tracts						
Low-Income [2]	17.2%	12.1%	10.7%	13.8%	12.5%	18.5%
High-Minority [3]	25.1%	23.1%	16.8%	15.7%	16.7%	20.0%
Underserved Areas [4]	38.6%	33.2%	26.6%	30.5%	28.8%	43.2%
In Central Cities	45.7%	45.8%	37.2%	36.1%	37.0%	36.9%

Note: FHA-eligible home purchase and refinanced mortgages in metropolitan areas. Mortgages with loan amounts less than $15,000 (except for mobile homes) or loan-to-income ratios greater than six are excluded. Loans originated by primarily B&C or manufactured home lenders have been excluded. Bank and Savings and Loan mortgages (including originations of mortgage company subsidiaries) are only those originations that have not been sold during the calendar year.

[1] AMI refers to the median income of the metropolitan area.

[2] Census tract median income is less than or equal to 80 percent of AMI.

[3] Minority composition of the census tract is equal to or greater than 30 percent.

[4] Metropolitan census tracts with (1) median income less than or equal to 90 percent of AMI or (2) minority concentration of equal to or more than 30 percent and the tract median income less than or equal to 120 percent of AMI.

percent).[31] These high shares for underserved groups are not surprising, given FHA's historical focus on first-time homebuyers and borrowers with greater credit risk.[32]

The data for the conventional market highlight the important role played by banks and thrifts in affordable lending. Very-low-income borrowers accounted for about 16 percent of their 1994 business, a proportion only slightly below that for FHA. Canner and Passmore (1995) recently showed that portfolio lenders assume more of the total credit risk from affordable loans than either FHA or the GSEs. Canner and Passmore point out that portfolio lenders have extensive knowledge of their communities, which they use to manage credit risk. In addition, portfolio lenders have direct interactions with their borrowers, enabling them to assess credit risk more flexibly. These factors allow portfolio lenders to exercise more flexibility than the GSEs, which must set underwriting standards to compensate for the fact that they cannot evaluate risk in such a detailed way.

Another important factor influencing the types of loans held by portfolio lenders is CRA, which requires depository institutions to help meet the credit needs of their communities. CRA provides an incentive for portfolio lenders to initiate affordable lending programs with underwriting flexibility; the loans are often held in portfolio because they may not conform to secondary market standards.

In the 1990s Federal regulators have had a renewed interest in providing mortgage credit to underserved areas and borrowers. CRA compliance is now determined by examining lending outcomes, rather than just institutional procedures. This change in regulatory focus, and the introduction of housing goals for the GSEs are two factors explaining recent industry efforts to reach out to underserved borrowers.

C.2 Recent Affordable Lending Initiatives

In the past few years, conventional lenders, private mortgage insurers, and the GSEs have begun implementing changes to extend homeownership opportunities to lower income and historically underserved households. The industry has started offering more customized products, underwriting, and outreach so that the benefits of the mortgage

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[31]Underserved areas are metropolitan census tracts with median income less than or equal to 90 percent AMI or minority concentration of more than 30 percent with the tract median income less than or equal to 120 percent of AMI.

[32] The Department's Office of Policy Development and Research recently completed a study of FHA's role relative to that of conventional lenders with affordable lending programs. It found that FHA underwriting and programs remained substantially more flexible when compared with the new conventional affordable lending initiatives and that FHA and conventional loans were made to significantly different types of borrowers. See Bunce et al. (1995).

market can be extended to those who have not been well served through traditional products, underwriting, and marketing.

These initiatives started with GE Capital's 1989 Community Homebuyer Program, which allowed homebuyers who completed a program of homeownership counseling to have higher than normal cost-to-income qualifying ratios while providing less than the full 5-percent downpayment from their own funds. Thus, the program allowed borrowers to qualify for larger loans than would be permitted under standard underwriting rules. Fannie Mae made the Community Homebuyer Program a part of its program offerings in 1990. Affordable Gold is a similar program introduced by Freddie Mac in 1992. Many of these programs allowed 2 percentage points of the 5-percent down payment to come from gifts from relatives or grants and unsecured loans from local governments or nonprofit organizations.

More recently, in 1994, the industry (including lenders, private mortgage insurers, and the GSEs) began offering mortgage products that required only 3 percent downpayments plus points and closing costs.Other industry efforts to reduce borrowers' upfront costs have included zero-point-interest-rate mortgages and monthly insurance premiums with no upfront component. These new plans eliminated large upfront points and premiums normally required at closing.

In addition to developing new affordable products, lenders and GSEs have been entering into partnerships with local governments and nonprofit organizations to increase mortgage access to underserved borrowers. Fannie Mae's partnership offices in 21 central cities, serving to coordinate Fannie Mae's programs with local lenders and affordable housing groups, are examples of this initiative. However, even more importantly, lenders, mortgage insurers, and GSEs have been modifying their underwriting standards to address the needs of families who find qualifying under traditional guidelines difficult.

Underwriting flexibility. The goal of these underwriting changes is not to loosen underwriting standards but rather to identify creditworthiness by alternative means that more appropriately measure the circumstances of lower income households. The changes to underwriting standards include, for example:

- Using a stable income standard rather than a stable job standard. This particularly benefits low-skilled applicants who have successfully remained employed, even with frequent job changes.

- Using an applicant's history of rent and utility payments as a measure of creditworthiness. This measure benefits lower income applicants who have not established a credit history.

- Allowing pooling of funds for qualification purposes. This change benefits applicants with extended family members.

- Making exceptions to the "declining market" rule and clarifying the treatment of mixed-use properties.[33] These changes benefit applicants from inner-city underserved neighborhoods.

Numerous economic studies have shown that low downpayment and low income are associated with higher mortgage defaults (see Neal (1989) and Querica and Stegman (1992) for a review of the mortgage default literature). Thus, there has been some concern about the credit quality of mortgages originated under the industry's special programs and more flexible underwriting guidelines. The industry, however, has been using several risk control techniques. Generally, underwriting standards are not relaxed on more than one dimension unless compensating factors, such as a strong credit history, offset the higher risk of the relaxed standard. Potential homebuyers are often required to complete a prepurchase education course designed to instill good budgeting habits. Another way in which the industry has controlled credit risk to permit more flexible underwriting is the use of monitoring and loss mitigation programs that seek to avoid or reduce the cost of foreclosure. To date, there is little information about the credit quality of these new programs that combine low downpayments with prepurchase counseling and intensive servicing. The loans need more seasoning before a serious evaluation of their credit risk can be made.

C.3 Impact of Affordability Initiatives *on Underserved Borrowers*

HMDA data. Data suggest that the new industry initiatives may be increasing the flow of credit to underserved borrowers. Between 1991 and 1994, conventional loans to low-income and minority families increased at much faster rates than loans to higher income and non-minority families. The number of conventional purchase loans going to families with less than median income increased by 27 percent between 1991 and 1992, compared with 10 percent growth for loans to higher income families. As shown in Table 4, these trends continued into 1993 and 1994. These HMDA data suggest that recent affordable homeownership initiatives may be increasing the flow of funds to underserved borrowers.

Of course, these years reflect a period of historically low interest rates. Given that many lower income and minority renters were closed out of the housing market during the 1980s, the gains mentioned above are attributable to lower interest rates giving these

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[33] Standard underwriting procedures characterize a property in a declining neighborhood as one at high risk of losing value. Implicitly, these underwriting standards presume that the real estate market is inefficient in economic terms, that is, prices do not reflect all available information.

households the opportunity to enter the homeownership market as well as to the new affordable home loan programs.

Table 4

Changes in Origination Volumes of Conventional Home Purchase Loans

Borrower Characteristics	Percentage Change in Origination Volume from Previous Year	
	1993	1994
All borrowers	17%	18%
Income less than 80% of AMI	38%	27%
Income greater than 120% of AMI	8%	13%
African American	36%	52%
Hispanic	25%	42%
Non-Hispanic white	18%	16%

GSE data. Fannie Mae and Freddie Mac have certain public responsibilities, including providing stability in the secondary mortgage market and increasing access to mortgage credit for lower income borrowers and in underserved areas. In particular, under the Federal Housing Enterprises Financial Safety and Soundness Act (FHEFSSA) of 1992, Congress called for the Secretary of Housing and Urban Development to establish three housing goals to focus GSEs on these borrowers and areas:

- A low- and moderate-income goal that targets mortgages on housing for families with less than median income.
- A geographic goal that targets mortgages on housing in areas underserved by mortgage credit institutions.
- A special affordable goal that targets mortgages on housing for very-low-income families and low-income families in low-income areas.

These housing goals began to be implemented only recently—in 1993—based on the provisions of FHEFSSA. The approach to affordable lending envisioned by the housing goals appears to be producing results. The GSEs' performance has improved significantly since the goals were first established in 1993. The GSEs' financing of housing for low- and moderate-income families has increased from about 25 percent of the GSEs' combined business in 1992 to more than 40 percent in 1995. Both GSEs have been increasing their mortgage purchases in low-income and high-minority neighborhoods where credit access has historically been limited. Fannie Mae, which has put the most emphasis on lending in inner-city neighborhoods, increased its performance in underserved areas from 22.9 percent in 1993 to 31.2 percent in 1995, while Freddie Mac's performance rose from 21.3 percent to 25.1 percent over the same period. While record low interest rates were certainly a factor, the GSEs' affordable lending initiatives are also a major reason for their increases in such lending.

C.4 Large Number of Potential Beneficiaries from Affordability Initiatives

Evidence exists that the pool of potential homeowners that could benefit from the industry's affordability initiatives is quite large. A 1991 survey by the National Association of Realtors indicates that only one-third of renters prefer to remain renters for the foreseeable future.[34] Fannie Mae's 1995 national housing survey indicates that only one-fourth of renters prefer renting to homeownership. Thus, there are many potential homebuyers among the 34 million householders currently renting.

Immigration is expected to be a major source of future homebuyers. Fannie Mae's 1995 national housing survey reveals that immigrant renter households are almost 3 times as likely as all renter households to list home purchase as their "number-one priority." At the same time, immigrants as a group are currently nearly twice as likely to be renters despite the fact that they appear as financially capable of becoming homeowners as the population at large.[35] The Joint Center for Housing Studies estimates that if the homebuying potential of immigrant households were realized—that is, if immigrants purchase with the same propensity as nonimmigrants with similar characteristics— the number of homeowners in the largest 40 metropolitan areas would increase by about 900,000. In addition, the Joint Center estimates that another 950,000 native-born minority households in the same metropolitan areas would be added as homeowners if their rate of homeownership matched that of their native-born white counterparts with similar income and demographic characteristics.[36] Thus, a need for homeownership programs to assist previously underserved families exists.

Urban Institute study. The most substantial evidence of the potential size of the pool of lower risk potential homebuyers derives from a recent study by The Urban Institute, which found that a large number of current renters are more qualified to become owners

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[34] National Association of Realtors (1991).

[35] Fannie Mae (1995), pp. 3 and 5.

[36] Joint Center for Housing Studies of Harvard University (1995), Table 20.

than many former renter households that have achieved ownership.[37] Of 20.3 million renter households having low or moderate incomes, roughly 16 percent are better qualified for homeownership than one-half of the renter households that actually have become homeowners over the sample period. Looking also at the likelihood of default relative to the average expected for those renters who became homeowners, 10.6 percent or 2.15 million low- and moderate-income renters were better qualified for homeownership, assuming the purchase of a home priced at or below median area home price. These results indicate the existence of a significant lower income population of low-risk potential homebuyer households that might become homeowners with continuing outreach efforts.

V. Homeownership and the Future

As in the past, the demand for housing and homeownership in the future will depend heavily on demographic trends already in motion. The demand for housing will be influenced by household formations. During the 1970s, as the leading edge of the baby boom generation (born between 1946 and 1964) entered adulthood, household formation surged to an annual average of 1.7 million. Aided by rising incomes and low real interest rates, household heads aged 25-34 purchased homes in record numbers. During the 1980s, annual household growth fell slightly to an average of 1.5 million. Many in the "housing upgrade" group (age 35-44) had benefited from substantial increases in the prices of their first homes, and were able to afford bigger and higher quality homes during the 1980s. Census Bureau projects that the older baby boomers (aged 45 to 54) will be the fastest growing population group during the 1990s. This age group had a homeownership rate of 75.2 percent in 1995.

The effects of these demographic trends on housing demand have been debated in the economics literature for several years. In 1989, Mankiw and Weil (1989) predicted that the aging of the baby boomers and the small size of the following "baby bust" generation would substantially reduce housing demand (due to a decline in the number of first-time homebuyers) and cause housing prices to collapse during the 1990s. Several researchers disagreed with Mankiw and weil's predictions. Reductions in housing demand due to aging of the baby boom generation might be offset by many factors, including rising incomes, pent-up demand for homeownership by those priced out of the housing market during the 1980s, and high levels of immigration.[38]

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[37] Galster et al. (1995).

[38] See, for example, Joint Center for Housing Studies of Harvard University (1994). Some analysts note that immigration will not offset the decline in housing demand due to the aging of the baby boom generation. Duncan (1996) points out that recent immigrants are more likely to receive public assistance than the native population. He cites simulations by the Dallas Federal Reserve Bank as showing that even if immigrants had the same characteristics as the native population, net single-family investment would decline slightly through the year 2010 due to the decline in domestic

As recently as 1995, two studies projected the homeownership rate to rise to about 65 percent by the year 2000. These projections are based on income growth and factors such as the aging of the population, changes in household composition, and changes in minority population. They do not incorporate changes in the underlying cohort homeownership rates resulting, for example, from affordable housing initiatives. However, homeownership rates have already reached the 65 percent level, indicating the influence of other factors.[39]

The homeownership rate should rise in response to a continuation of income and demographic trends alone. However, as the cited studies and other experts note, special initiatives, such as those reviewed earlier in the section entitled "Underserved Populations: Current Conditions and Industry Response", can be expected to improve the underlying homeownership rates for various demographic groups and may help raise the rate above 65 percent. These efforts are particularly important for groups such as minorities, first-time buyers, and female-headed families.

households.

[39] See Eggers and Burke (1995) and Berkovec (1995). Berkovic projects a 65.3 percent homeownership rate by the year 2000. The aging of the population and growth in income are expected to have the greatest positive contributions to the homeownership rate, adding a respective 1.4 and 1.5 percentage points to the overall homeownership rate. Shifts in household composition from married couples with children to a greater proportion of single-headed households are expected to move the overall homeownership rate down by 1.3 percentage points. Moreover, the growing proportion of minorities and immigrants, who have lower homeownership rates, are expected to lead to a decrease in the overall rate of 0.3 of a percentage point.

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