Homeownership: A Housing Success Story

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Owning one's own home is one of the defining elements of the American dream. But, only a few years ago, this part of the dream seemed to be fading away. After 40 years of continuous progress, homeownership became less achievable, and the Nation's homeownership rate actually declined in the early 1980s. Between 1985 and 1994, the homeownership rate remained virtually unchanged.

Making homeownership more attainable became a goal early in the Clinton-Gore administration. In late 1994 the President set a national goal of raising the homeownership rate to 67.5 percent by the end of the year 2000. Beginning in 1995, the homeownership rate has risen almost steadily until, by the second quarter of 2000, it was 67.2 percent—within range of the President's ambitious goal.

This remarkable turnaround in the homeownership rate is attributable both to broad economic factors and to specific policy initiatives. Balancing the Federal budget allowed the Federal Reserve to lower interest rates, creating the most favorable climate for financing a home since the 1960s. Strong economic growth and low unemployment boosted consumer confidence to record levels and encouraged many families to consider homeownership for the first time. A surging stock market created wealth that allowed parents and grandparents to help young Americans afford their first home.

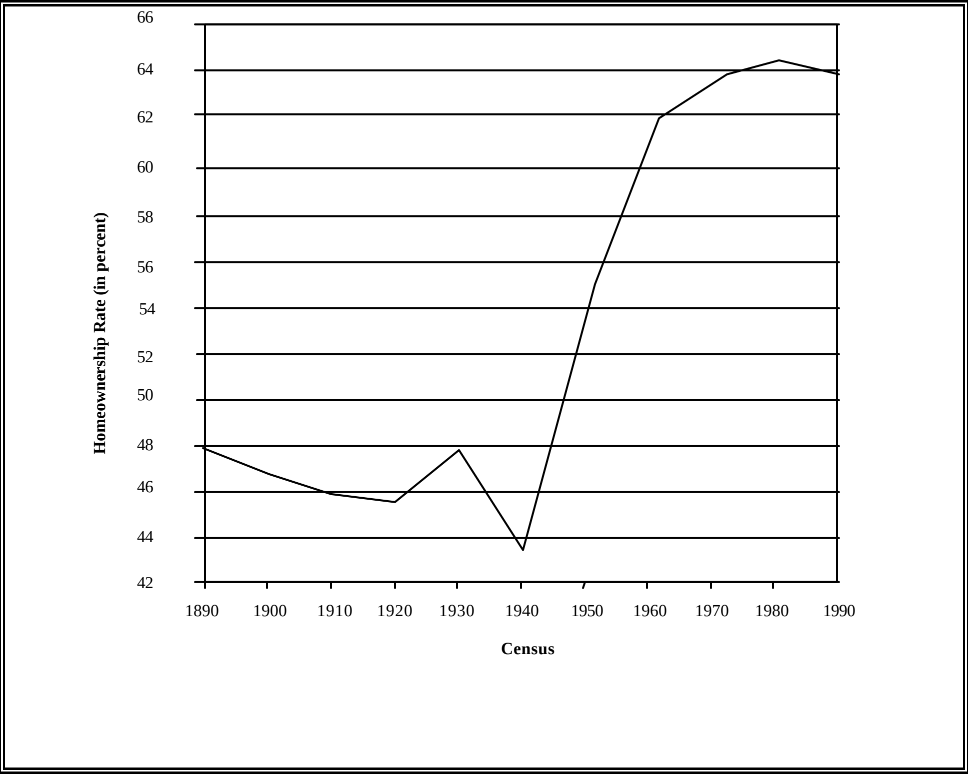
The administration reinforced these economic incentives with policy initiatives focused on broadening homeownership. Enforcement of the Community Reinvestment Act (CRA) and the Home Mortgage Disclosure Act (HMDA) was strengthened. The U.S. Department of Housing and Urban Development (HUD) used its oversight of Fannie Mae and Freddie Mac to encourage those entities to reach out to low-income borrowers and areas underserved by the private market. Finally, a revitalized Federal Housing Administration (FHA) has substantially increased lending to African-Americans, Hispanics, and other traditionally underserved groups and, in doing so, has worked to increase homeownership opportunities of these segments.

The sections in this article document the progress in homeownership, examine how recent improvement in the homeownership rates has affected different segments of the population, analyze whether the booming economy and other policy changes were more important factors in the recent improvements than demographic shifts, provide a reminder that important gaps still remain in the ability of families to own their own home, and discuss the role of specific policy initiatives.

Trends in the National Homeownership Rate

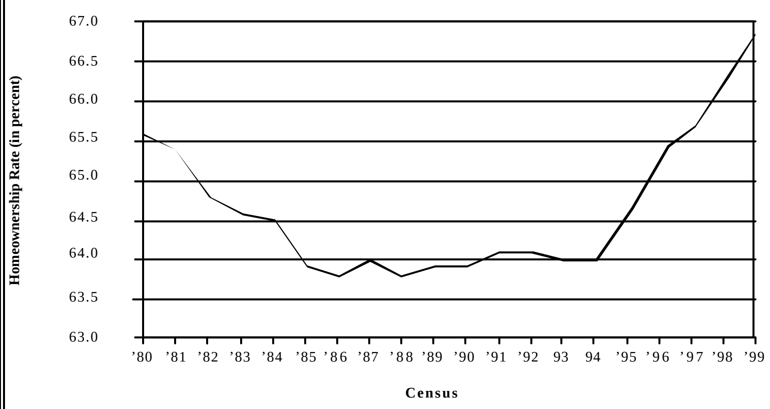
As shown in figure 1, according to decennial census data, the homeownership rate fluctuated around the 45-percent level from 1890 to 1940, rose rapidly from 1940 to 1960, and then increased slowly until 1980. The 1890-to-1940 period saw a decline between 1890 and 1920 attributable to rapid immigration and urbanization, with a rise and subsequent fall matching the income fluctuations around the Great Depression.

Figure 1. Homeownership Rate Fluctuations: 1890–1990



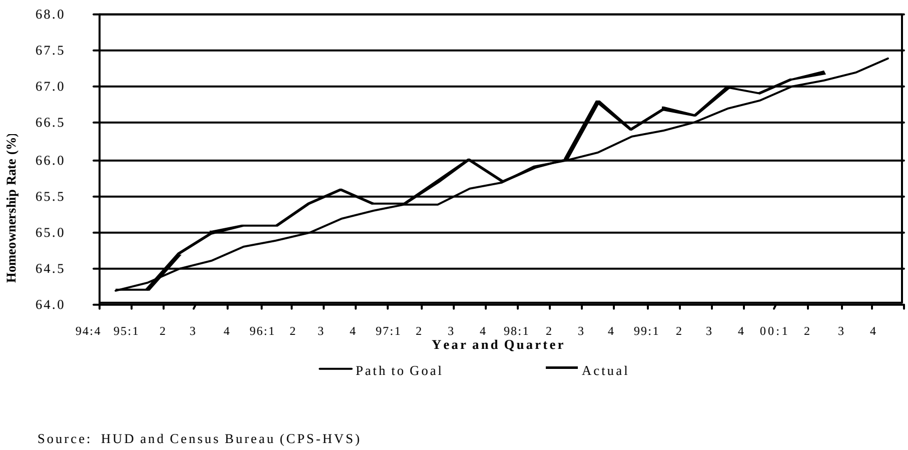
Beginning in 1965, the U.S. Census Bureau has reported homeownership rates on quarterly and annual bases. These data more sharply demonstrate the decline in the early 1980s and subsequent trends. As figure 2 shows, the national homeownership rate declined from 1980 to 1986, remained virtually unchanged from 1985 through 1994, and then rose steadily from 1995 through 1999.[1]

Figure 2. Homeownership Rate Fluctuations: 1980–1999



Beginning in 1995, the homeownership rate has risen nearly every quarter so that in 1999 the Nation experienced the highest annual homeownership rate in its history, 66.8 percent. By the second quarter of 2000, the homeownership rate was 67.2 percent—a record quarterly rate and within range of the President’s ambitious goal–67.5 percent by the end of the year 2000 (see figure 3). As a result of the rising homeownership rate and the Nation’s growing population, a total of 70.1 million families owned homes in 1999. There were 8.7 million more homeowners at the end of 1999 than when President Clinton took office in 1993.

Figure 3. Path to Year 2000 Goal



Source: HUD and Census Bureau (CPS-HVS)

Homeownership for Different Segments of the Population

Table 1 shows how the increase in homeownership rates from 1993 to 1999 affected major racial and ethnic groups and was distributed among central cities and suburbs. The category of "Other" includes Asian Americans, Native Americans, and Pacific Islanders. The 1999 rates reported in table 1 are record highs for every group reported.

Table 1. Homeownership Distribution, by Location and Among Major Racial and Ethnic Groups

	1993 (%)	**1999 (%)**
Nation overall	64.0	66.8
White (non-Hispanic)	70.2	73.2
African-American (non-Hispanic)	42.0	46.7
Hispanic	39.4	45.5
Other (non-Hispanic)	50.6	54.1
Central cities	48.6	50.4
Suburbs	70.3	73.6

There were 57.7 million White; 6 million African-American; 4.2 million Hispanic; and 2.2 million Asian American, Native American, and Pacific Islander homeowners in 1999—all record-high annual numbers and annual percentage rates. A total of 40 percent of the net new homeowners since 1994 are minorities—even though minorities account for just 24 percent of the population. In addition to hitting annual record highs in 1999, the African-American and Hispanic homeownership rates continued growing twice as fast as the White homeownership rate.

Relative Importance of Demographic Shifts

Using data from the American Housing Survey (AHS), this section examines how changes in homeownership rates for different groups have added up to the large increase in the national homeownership rate between 1991 and 1997.

Calculating homeownership rates to the hundredths place, AHS shows that the national homeownership rate increased by 1.62 percentage points between 1991 and 1997. This change in the homeownership rate can be decomposed into the change caused by the rate changes experienced by demographic subgroups—the *rate effect*—and the change caused by shifts in the sizes of the demographic subgroups—the *composition effect*.[2] The rate effect accounted for 1.37 percentage points or 85 percent of the increase. The composition effect accounted for 0.26 percentage point or 16 percent of the increase. Although the population changed in ways that enhanced homeownership during the 1990s, this composition effect was minor compared to the general improvement in rates for all groups.

AHS also shows that homeownership rates for minorities increased by 2.25 percentage points between 1991 and 1997. This increase was larger than the overall change. The rate effect for minorities was 1.52 percentage points or 68 percent of the increase. The composition effect was 0.73 percentage point or 32 percent of the increase.

For non-Hispanic Whites, the homeownership rate increased by 2.60 percentage points between 1991 and 1997. The rate effect was 1.32 percentage points or 51 percent of the increase, and the composition effect was 1.28 percentage points or 49 percent of the increase.[3]

Between 1991 and 1997, the homeownership rate in central cities increased by 0.34 percentage point, according to AHS. However, the composition effect was negative as population shifts alone should have reduced the central-city homeownership rate by 1.43 percentage points. Instead, a rate effect of 1.78 percentage points offset the demographic trends and produced an increase in homeownership rates in central cities.

AHS evidence shows that the demographic changes made a relatively small contribution to the improvement of the national homeownership rate. Demographic effects were more important factors in the increase in the minority and White homeownership rates, contributing roughly one-third of the increase in the minority rate and one-half of the increase in the White rate. For central cities, demographic shifts worked against homeownership; the observed increase in the central-city homeownership rate is the net effect of positive changes in the underlying rate structure that more than offset the negative demographic effects.

Gaps

Despite this progress, serious gaps remain. In 1999 the minority homeownership rate (47.4 percent) was 25.8 percentage points lower than the homeownership rate for non-Hispanic Whites (73.2 percent). The gap in 1994 was 26.8 percentage points. Table 2 shows the change in the gaps for the various subgroups of the minority population over this period (see also figure 4).

Table 2. Gaps in Minority Homeownership Rate

	Gap in 1994 (%)	Gap in 1999 (%)
All minorities	26.8	25.8
Non-Hispanic African-Americans	27.5	26.5
Hispanics	28.8	27.7
Other non-Hispanic	19.2	19.1

Figure 4. Homeownership Rate by Ethnicity

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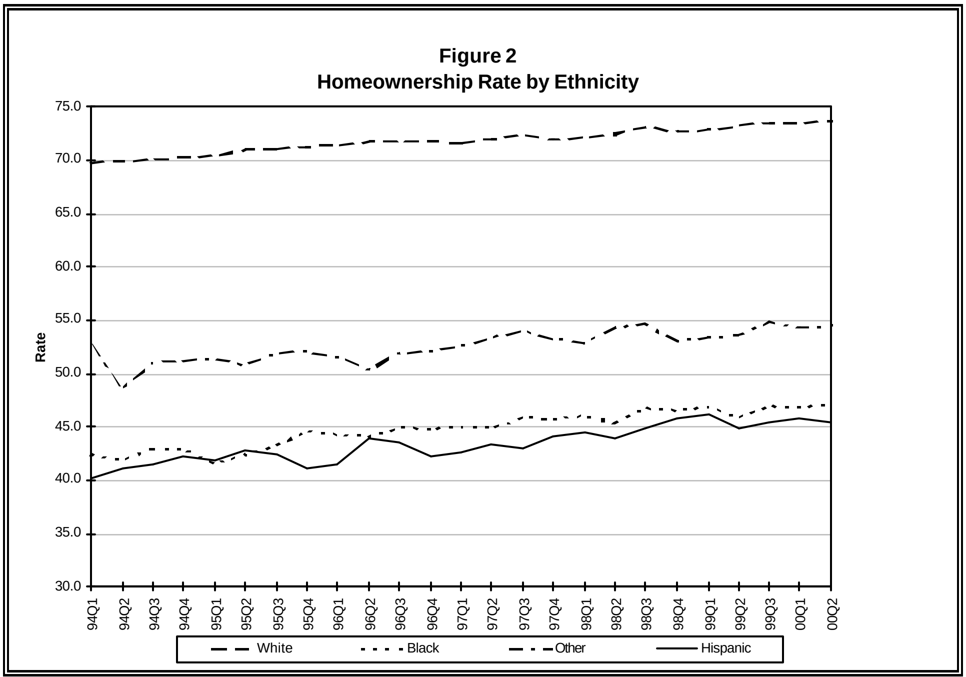


In 1999 households with incomes less than the median income had a homeownership rate (51.2 percent) that was 27.4 percentage points lower than the homeownership rate for households with above-median income (78.6 percent). The gap in 1994 was 28.7 percentage points.

In 1999 the central-city homeownership rate (50.4 percent) was 23.2 percentage points lower than the suburban homeownership rate (73.6 percent). The gap in 1994 was 21.8 percentage points.

Strengthening the Federal Housing Administration (FHA)

FHA has traditionally been the mechanism used by borrowers who have difficulty obtaining mortgage financing in the private conventional market. It has long been recognized as the major source of funding for first-time, low-income, and minority homebuyers. The combination of a strong economy and significant program and policy changes has allowed FHA to expand on its traditional role. Since 1993, the share of FHA-insured home-purchase loans going to first-time buyers has increased from 67 to 81 percent (see figure 5). In total, during this period, FHA has helped 4.2 million first-time homebuyers realize their dream of homeownership.

Figure 5. First-Time Homebuyer Share of FHA Home Loans

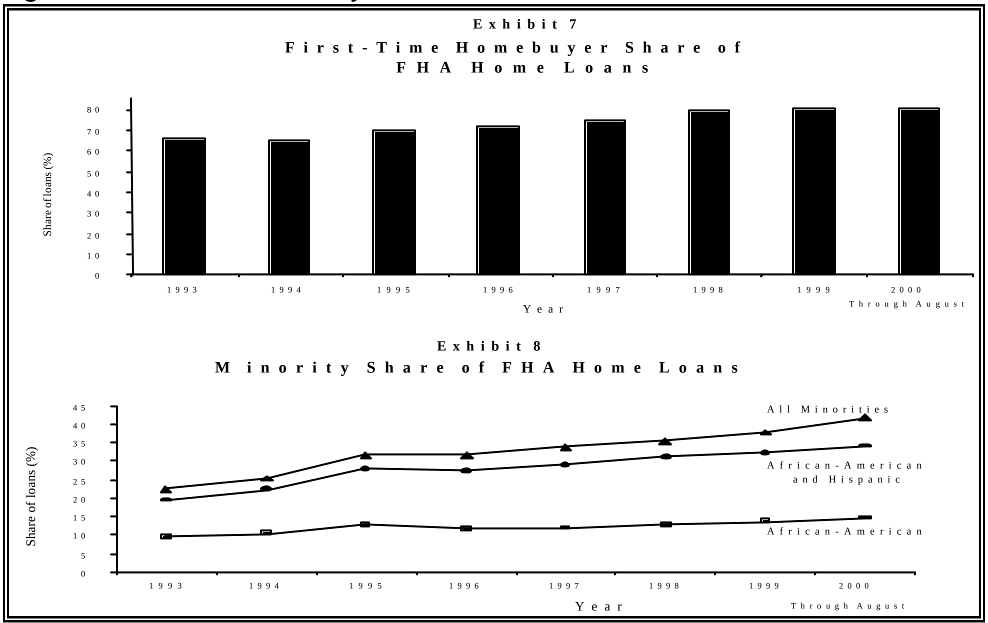
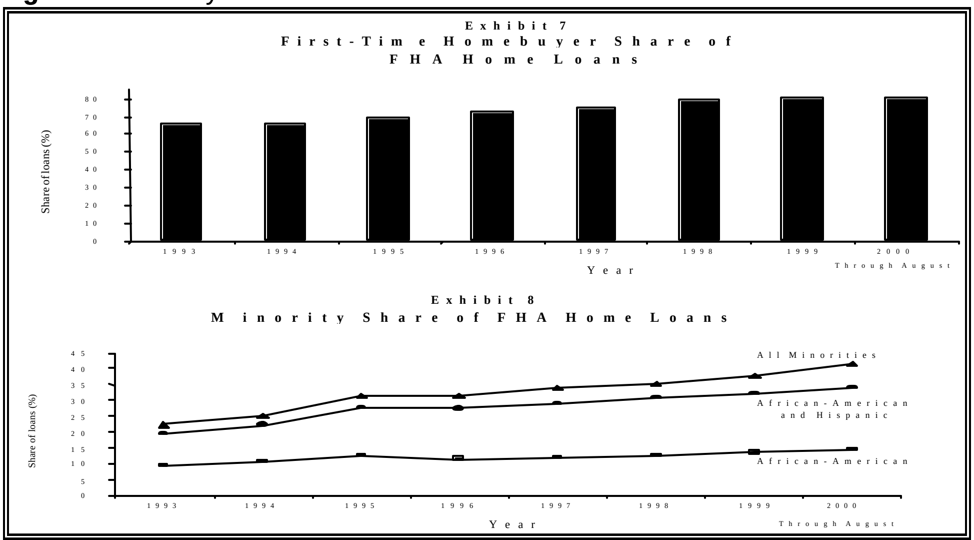


Figure 6. Minority Share of FHA Home Loans



The increasing reach of FHA is particularly important for African-American and Hispanic homeowners. As shown in figure 6, the share of FHA home loans accounted for by these two groups of borrowers increased from 19.5 percent in 1993 to 34.0 percent during the current year (through August 2000). Similarly, the share for all minorities increased from 22.5 percent in 1993 to 41.8 percent during 2000.

The conventional conforming market funds low-income and minority borrowers and their neighborhoods at much lower rates than FHA. According to the Home Mortgage Disclosure Act (HMDA) data for 1999, African-American (minority) borrowers accounted for 14.6 (37.7) percent of all FHA home loans in metropolitan areas, compared with only 5.4 (19.0) percent for the conventional conforming market. More than 40 percent of FHA loans financed properties in underserved neighborhoods, compared with only 26 percent of conventional conforming loans.

The importance of FHA in financing homeownership for traditionally underserved families can best be seen by examining the market share data presented in table 3. Although FHA insured 21 percent of all home-purchase loans originated in metropolitan areas during 1999, it insured 42 percent of loans for African-American and Hispanic borrowers. FHA also insured approximately 3 out of 10 home loans originated in low-income and high-minority census tracts.

Table 3. FHA's Share of Home-Purchase Market in Metropolitan Areas, 1999

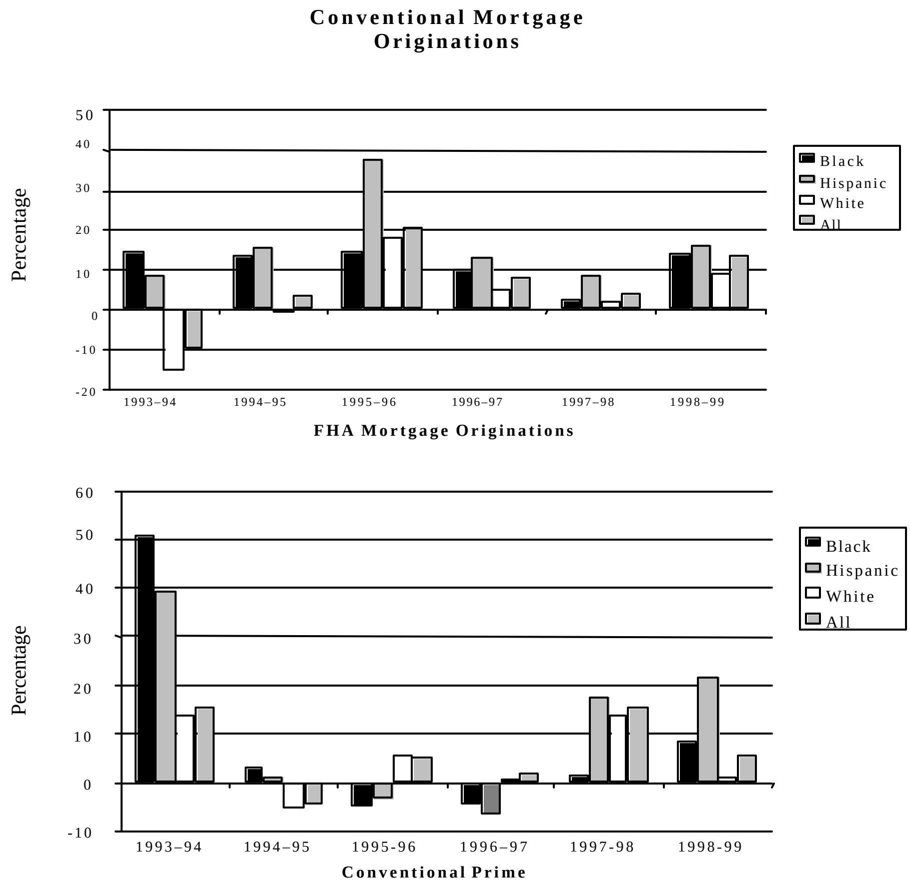
Borrowers/Areas	FHA Share of Market (%)
Low-income borrowers	31
African-American and Hispanic borrowers	42
All minority borrowers	35
Low-income tracts*	30
High-minority tracts	31
Underserved areas	29
All home-purchase loans	21

**Low-income tracts are metropolitan census tracts with median income less than or equal to 90 percent of area median income (AMI). High-minority tracts are those with minority concentration greater than or equal to 120 percent of AMI.*

Source: 1999 HMDA data for metropolitan areas.

Figure 7 compares the growth rate in conventional and FHA mortgage originations by race for various years from 1993 through 1999. Minority originations rose sharply for conventional loans between 1993 and 1994, but year-to-year changes were flat or slightly negative from 1995 through 1997. Conventional lending to Hispanics increased sharply again in 1998 and 1999. FHA lending to minorities increased every year, with particularly strong increases between 1995 and 1996.

Figure 7. Home Purchase Origination Growth Rates by Borrower Race



Source: HMDA data. Conventional prime loans exclude conventional loans originated by lenders that specialize in manufactured housing and subprime loans.

Because of the importance of FHA insurance for those groups with large housing gaps, the U.S. Department of Housing and Urban Development (HUD) has taken a number of steps to enhance the usefulness of FHA insurance. These steps include:

- **Higher loan limits.** Prior to late 1998, dollar loan limits on FHA mortgages were set at 95 percent of area median home sales price within a county and ranged between a statutory minimum of 38 percent of the conforming loan limit for conventional loans purchased by Freddie Mac or Fannie Mae and a statutory maximum of 75 percent of the conforming limit, which could change annually with the general level of home prices. At HUD's request, Congress raised the statutory minimum and maximum limits to 48 and 87 percent, respectively, of the conforming limit.[4] This increase in loan limits made the benefits of FHA mortgage lending accessible to many more families throughout the country, particularly those in high-cost areas who had been unable to use conventional mortgage products. Currently, FHA loan limits for one-unit properties vary by the price of housing across the country and range from a nationwide minimum of $121,296 up to the statutory maximum of $219,849.[5]

- **Faster processing through FHA service centers.** FHA used to disperse its processing of loans across 81 separate field offices throughout the country. However, over the past several years FHA has consolidated and streamlined its mortgage insurance operations and endorsement processing into four regional Homeownership Centers, located in Atlanta; Denver; Philadelphia; and Santa Ana, California. The new consolidated structure has provided numerous opportunities to take advantage of economies of scale and to improve the consistency of FHA's operations.

- **Greater flexibility in using gifts for downpayments.** FHA has long been more flexible in its policy on using gifts for downpayments. FHA policy with respect to gifts allows a borrower to pay the entire downpayment from gift funds. This policy is substantially more lenient than what is allowed in the conventional mortgage market.

- **Simplified calculation of downpayments.** In late 1998, FHA persuaded Congress to authorize a simpler method for calculating the minimum downpayment required for an FHA mortgage. Under the new process, FHA borrowers are required to put a minimum cash investment of 3 percent of the purchase price toward the acquisition cost of the home (price plus closing costs) and whatever additional cash is required to achieve a maximum loan-to-value percentage that varies with loan size and whether the property is located in a State with high closing costs.

- **Strengthening of the appraisal process.** FHA has made substantial reforms to strengthen the appraisal process and to help FHA borrowers. Recent reforms have included measures to ensure that appraisals are performed more diligently as well as a requirement that appraisers notify homebuyers about any observable defects in the house. The new process also requires a notice advising the homebuyer to obtain a professional inspection.

- **Automated underwriting through Freddie Mac and Fannie Mae.** FHA worked with both Freddie Mac and Fannie Mae to make automated underwriting of borrower credit available to speed the process for many borrowers and to allow for more efficient targeting of lender resources to help in qualifying more FHA borrowers. Automated underwriting of FHA loans has been available through Freddie Mac since March 1998 and through Fannie Mae since August 1999.
- **FHA scorecard (under development).** FHA has been involved in developing and testing its own FHA mortgage scorecard to be used in the Freddie Mac and Fannie Mae systems as well as any other system offering automated underwriting of borrower credit for FHA loans. FHA is on the verge of bringing its new universal mortgage scorecard to the market. The new scorecard will offer a uniform evaluation to identify applicants who can be credit approved without a traditional underwriter review. The scorecard is designed to accept applicants for expedited processing and documentation waivers; other applicants will be afforded a full traditional credit underwriting.

Housing Goals for Fannie Mae and Freddie Mac

The October 1992 Federal Housing Enterprises Financial Safety and Soundness Act (FHEFSSA) affirmed and strengthened HUD's role as mission regulator of these government-sponsored enterprises (GSEs). FHEFSSA also established the Office of Federal Housing Enterprise Oversight, an independent office within HUD, as GSEs' safety and soundness regulator.

HUD's primary responsibility under FHEFSSA has been the establishment of goals for GSEs' purchase of mortgages for targeted groups of borrowers. These include low- and moderate-income (low-mod) families, families living in geographically targeted areas, and special affordable families (very low-income families and low-income families in low-income areas). In December 1995 HUD increased the levels of the goals substantially relative to previous levels—for example, the low-mod goal was raised from 30 percent in 1995 to 40 percent in 1996 and to 42 percent in 1997–99. HUD also revised the geographically targeted goal to better focus on underserved neighborhoods.

The 1999 goals are also in effect for 2000. The goals for 2000 are: the 42-percent low-mod goal; at least 24 percent of GSEs' mortgage purchases are required to finance

mortgages for properties in underserved areas; and at least 14 percent are required to finance special affordable mortgages.[6]
Both GSEs have surpassed all of their housing goals in the 1996–99 period—for example, in 1999 GSEs averaged 46 percent on the low-mod goal, 27 percent on the underserved areas goal, and 17 percent on the special affordable goal. Fannie Mae's performance has generally exceeded Freddie Mac's performance, but this pattern was reversed on two of the three goals in 1999.

Analyses by HUD and independent researchers have indicated that GSEs have generally lagged behind the primary market and depositories in their shares of purchases of targeted mortgages. This finding is one reason why HUD proposed higher goals for GSEs in March 2000. Specifically for 2001–03, the proposed low-mod goal would rise to 50 percent, the proposed underserved areas goal would rise to 31 percent, and the proposed special affordable goal would rise to 20 percent. In addition HUD has established incentives for GSEs to step up their purchases of mortgages on small (5- to 50-unit) multifamily properties and owner-occupied 2–4-unit rental properties. Both of these types of properties are underserved by mortgage markets. This policy—announced by the Secretary of Housing and Urban Development in July 1999—would require the Nation's two largest housing finance companies to buy $2.4 trillion in mortgages during the next 10 years to provide affordable housing for approximately 28.1 million low- and moderate-income families.

In addition to the housing goals, FHEFSSA directed the Secretary to periodically review and comment on the underwriting and appraisal guidelines of GSEs to ensure that they are consistent with the Fair Housing Act and FHEFSSA. As part of this responsibility, HUD contracted with the Urban Institute to undertake a study of GSEs' single-family underwriting guidelines; this report was published in April 1999.[7] HUD has also initiated a fair lending review of GSEs' underwriting practices. The initial phase of this review is focusing on GSEs' automated underwriting systems.

Acting independently and in response to the housing goals, Fannie Mae and Freddie Mac have undertaken a number of initiatives to help families who might otherwise be forced to delay purchasing a home to afford homeownership. As seen in table 4, the effectiveness of these and other industry efforts, as well as the increased role of FHA, can be seen in the general decline in the downpayment rate for first-time homeowners.

Table 4. Average Downpayment as Percent of Sales Price

Year	All Buyers	First-Time Buyers	Repeat Buyers	Percent With Downpayments of 10% or Less
1993	20.2	14.0	25.4	44.3
1994	20.2	13.7	26.1	44.4
1995	20.4	13.3	26.8	46.4
1996	19.5	12.4	25.3	50.4
1997	20.3	13.7	26.1	48.5
1998	19.3	12.8	24.9	54.5
1999	19.5	12.6	25.5	50.7

Source: Who's Buying Homes, Chicago Title Corporation—Various Years

Increased Enforcement of Community Reinvestment Act (CRA)

CRA, a Federal law that requires lenders to make loans to all segments of the communities they serve, has resulted in some $1 trillion in loans to people in low- and moderate-income neighborhoods since it was enacted in 1977. A significant portion of these funds has been used for mortgage lending that has boosted homeownership.[8]

The Clinton administration has both tightened the criteria used to measure CRA compliance and expanded the range of business opportunities allowable only to lenders with a satisfactory CRA rating. In 1995 Federal banking regulators revised CRA regulations to explicitly focus compliance measures on actual performance. Although prior regulations established in 1989 required that CRA compliance be assessed on 12 factors, which included the geographic distribution of loans, the perception was that CRA evaluations still relied too heavily on process issues related to the ways in which the institution tried to comply with the law. The new regulations also provided expanded opportunities for public comment on an institution's CRA performance by requiring that the banking regulators publish a list of banks that will have CRA examinations in the coming quarter. The incentive of institutions to meet their CRA obligations was enhanced by the Financial

Modernization Act of 1999, which granted expanded business opportunities to depository institutions only if they have satisfactory CRA ratings.

Other Initiatives

HUD's crackdown on housing discrimination, which was ordered by President Clinton, is opening up new housing opportunities to minorities. HUD is also conducting a major study of housing discrimination around the country as part of its continuing efforts to eliminate discrimination that stands as a barrier to minority homeownership.

The Building Homes in America's Cities initiative is a partnership among HUD, the National Association of Home Builders, and the U.S. Conference of Mayors. Its goal is to produce an additional 1 million homes in America's cities during the next decade—an additional 100,000 new housing units per year. The three partners have signed a memorandum of understanding and have selected an array of pilot cities. HUD is providing Community Builders in the pilot cities to help mayors and builders identify new Federal resources, such as the HOME program, Homeownership Zones, and technical assistance grants, as well as to ensure coordination of existing resources and programs.

The National Partners in Homeownership—a coalition of 66 national groups representing the housing industry, lenders, nonprofit groups, and all sectors of government—was created in 1995 as part of President Clinton's National Homeownership Strategy. The partners have successfully implemented initiatives to make buying a home more affordable, faster, and easier. Activities to increase homeownership are also being carried out by 153 local homeownership partnerships established to support the national strategy. Among the activities developed by the partners are homeownership counseling, homebuying fairs, and help with locating homes.

Endnotes

[1] The annual data come from the Current Population Survey and do not match exactly the rates obtained from a decennial census.

[2] The AHS sample is disaggregated into 1,050 groups defined along 5 dimensions: age (7 classes), household type (5 classes), race (White and minority), real income (5 classes), and location (central city, suburb, and nonmetropolitan). HUD then computed homeownership rates for each of these groups in 1991 and 1997. The rate effect involves changes in these 1,050 rates; the composition effect involves shifts in the distribution of the population across the 1,050 classes.

[3] It should be noted that the homeownership rates for both non-Hispanic Whites and minorities increased by more than the national rate. This situation resulted from a shift in the population, resulting in a higher weight for the minority rate and a lower weight for the non-Hispanic White rate.

[4] Congress also switched from county-specific limits within a metropolitan statistical area (MSA) to a single MSA-wide limit equal to the limit for the county within the MSA having the highest median home sales price.

[5] FHA figures refer to FHA’s percentage share of all home-purchase loans (except jumbo loans higher than the conforming loan limit) that were originated in metropolitan areas during 1999. Thus the “total market” in these calculations includes all (government and conventional) home-purchase mortgages originated in metropolitan areas during 1999 that were below the conforming loan limit of $240,000. The analysis assumes that HMDA’s coverage is the same for both FHA and non-FHA loans. That is, it is estimated that FHA insured 31 percent of all home-purchase loans that were originated during 1999 and that were for low-income borrowers in metropolitan areas.

[6] Individual mortgages can, and often do, qualify for more than one goal—the goals are not additive.

[7] See Temkin et al., 1999. *A Study of the GSEs’ Underwriting Guidelines: Final Report*. Urban Institute report submitted to HUD.

[8] Under CRA, some lenders have made significant progress in reaching underserved communities. A recent report for the U.S. Department of the Treasury showed that banks and thrifts increased the share of their mortgage originations to low-income borrowers and borrowers in low-income communities from 25 percent in 1993 to 28 percent in 1998. See Litan et al., 2000.

Reference

Litan, Robert E., Nicolas P. Retsinas, Eric S. Belsky, and Susan White Haag. 2000. *The Community Reinvestment Act After Financial Modernization: A Baseline Report,* U.S. Department of the Treasury.