The Housing Act of 1949: Its Place in the Realization of the American Dream of Homeownership

Sylvia C. Martinez
Federal Housing Finance Board

Abstract

The Housing Act of 1949 pledged a decent home for every American family. This article examines how that promise has been met through homeownership. It traces the evolution of mortgage markets and federal homeownership policies from the post–World War II era to the end of the 20th century and it concludes by identifying the challenges now facing the nation.

Initially, the act displaced lower-income families and fostered segregation. In the aftermath of the civil rights movement, Congress invoked the act to extend homeownership opportunities to lower-income families and racial minorities. Despite early failures, federal initiatives, together with a maturing mortgage market and a favorable economic climate, have increased homeownership rates. These gains notwithstanding, affordability and lagging homeownership rates for minorities pose critical challenges that must be met in the new millennium.

Keywords: Federal; Government-sponsored enterprises; Policy

The legacy of the Housing Act of 1949

In the "Declaration of Housing Policy" of Title II of the Housing Act of 1949, Congress first articulated a national housing policy for "the realization as soon as feasible of the goal of a decent home and suitable living environment for every American family." Several Congresses have reaffirmed this goal, turning the 1949 act into a living document and a lodestar for housing policy.[1]

The 1949 act reflected paramount national concern over the quality of the housing stock, particularly in rural areas. According to the 1950 census, nearly 30 percent of occupied units lacked one or more

[1] The 1949 act's goal of a decent home in a suitable environment was later invoked in the Housing and Urban Development Act of 1968 (42 U.S.C. 1441a); in the Housing and Community Development Act of 1974 (42 U.S.C. 5301); in the Housing and Community Development Act of 1987 (42 U.S.C. 5301); and in the 1990 Cranston-Gonzalez National Affordable Housing Act (42 U.S.C. 12701).

basic plumbing facilities.[2] Accordingly, the 1949 act makes several references to the structural quality of housing and calls for "sound standards of design, construction, livability, and size adequate for family life." Today, the quality of the housing stock has dramatically improved.

Although the act did not specify the type of tenure through which the national goal of decent housing was to be achieved, the legislative record shows the value that the framers placed on homeownership in addressing the need. The Farmers Home Administration Section 502 program, the mainstay rural homeownership program, was authorized in the 1949 act.

In fact, perhaps one of the greatest national achievements of the 20th century has been the democratization of homeownership. Owning one's home is no longer a privilege reserved for the elite. For most Americans today, the opportunity to own a home is implicit in the promise of 1949. The overwhelming majority of Americans aspire to own a home, and only 28 percent of renters say they rent as a matter of choice (Fannie Mae 1997). Today, 67.1 percent of American households owned their homes. Such a high rate of homeownership is, however, a recent occurrence.[3] In fact, it was not until 1949 that a majority of the nation's households were homeowners. By 1950, the national homeownership rate was 55 percent, a significant increase from 43.6 percent in 1940 (Bunce et al. 1996).

The 1949 act called on local public bodies to encourage the development of "well planned, *integrated* residential neighborhoods" (emphasis added). If the reference to integrated residential neighborhoods reflected a congressional intent to address segregation in housing and expand housing opportunities for *all* Americans, it is clear that for at least 20 years this objective carried no greater legislative momentum than moral intent. In the two decades after the passage of the 1949 act, housing conditions for minority households did not improve as those of non-Hispanic whites did. Further, the slum clearance programs authorized in the 1949 and 1954 housing acts resulted in massive displacement of lower-income and minority families (Bell 1973; Hartman 1975; Massey and Denton 1993; Saunders and Shackleford 1998). The goal of a decent home and suitable living environment for *every* American family would not be legally protected until 20 years later, with passage of the Fair Housing Act.

[2] The 1950 census found that 28.6 percent of occupied units lacked a private toilet, 29.9 percent had no hot or running water, and 30.7 percent lacked a tub or shower. The assessment of housing quality was highly subjective and not consistent, but by standards used by the U.S. Department of Housing and Urban Development, 35.5 percent of units were substandard.

[3] Census records on housing do not go back past 1890. The term "homeownership" is used in the modern-day sense of the word, implying recorded, fee-simple ownership.

Reaffirming the goals of the 1949 act

By reaffirming its principles in subsequent legislation, several Congresses have turned the 1949 act into a living document. The seminal iteration of the act, however, occurred near the midpoint of its history, with passage of the 1968 Housing and Urban Development Act, which closely followed the assassination of Martin Luther King Jr. and the urban rioting that ensued.

Integration in housing and effective housing choice had been an important goal for the civil rights movement (Branch 1989). According to the 1970 census, the nation's homeownership rate at the time was 63 percent, a modest increase from the 1960 rate (61.9 percent). Throughout the 1960s, although housing in general was not considered a priority, federal policies emphasized new rental housing (Downs 1974). By the end of the decade, a substantial percentage (10 to 14 percent) of homes occupied by African Americans still did not have one or more basic plumbing conveniences. Further, there was evidence that African Americans were paying more for the same quality of housing than non-Hispanic whites because of discrimination (Aaron 1972).

The disparate housing conditions facing minorities came to the fore during deliberations on the racial crisis facing the nation. Between 1965 and 1968, there were civil disturbances in 150 cities across America. In 1968, the National Commission on Civil Disorders (the Kerner Commission), which was convened to investigate the causes of the unrest, warned that the nation was turning into two societies: one black and one white—separate and unequal. The commission called for open housing in single-family homes and recommended an expansive subsidized housing production program. In June 1967, another presidential commission, the Kaiser Commission, released its report titled *A Decent Home*—a direct reference to the 1949 act (U.S. National Advisory Commission on Civil Disorders 1988). The Kaiser Commission's report was the blueprint for what was to become the Housing Act of 1968.

The 1968 act legitimized the original goals of the 1949 act. In its policy declaration, the 1968 act started off by reaffirming the 1949 goal of a "decent home and suitable living environment for every American family." The act noted, "*This goal has not been fully realized for many of the Nation's lower-income families*" (emphasis added). The 1968 act authorized a new program, the Federal Housing Administration (FHA) Section 235 homeownership program, and required the president to report to Congress on the housing needs of lower-income families and on the progress made toward *"expanding homeownership and equal housing opportunities, and assuring reasonable shelter costs"* (emphasis added). The act thus clearly linked the concept of decent housing with homeownership that was both affordable *and* accessible for *every* American family—including minorities and the poor.

In many ways, 1968 was a benchmark year for legislative initiatives to expand housing opportunities for minorities and the poor. This was the year that the Fair Housing Act was finally enacted, after a difficult struggle in Congress (Mathias and Morris 1999). The framers also recognized that equal opportunity in housing would not be achieved solely by addressing housing discrimination. The 1968 act contained an ambitious goal of 26 million housing units over 10 years, with 6 million of them reserved for lower-income people. The new cabinet-level Department of Housing and Urban Development (HUD), created in 1965 through the merger of several agencies (including the FHA), was put in charge of alleviating the nation's urban problems. HUD was given the authority to enforce fair housing laws and to administer several new programs authorized in the 1968 act, including the FHA Section 235 program.

Measures fostering homeownership in the past 30 years

FHA and the Section 235 program

It would not be long before the FHA became the target of much deserved criticism for the way it ran the Section 235 program. However, at the time the 1968 act was passed, the FHA was the logical choice to run the program. In 1968, HUD was a startup agency and FHA (newly a part of HUD) was the only agency with the experience to run a major national housing program. Also, FHA insurance was essential to ensuring lender participation.

Moreover, FHA's past contribution to the nation's housing made the aspirations of the 1968 act possible in the first place. Established in 1934, FHA had been the foundation for the nation's system of housing finance. In the 1920s, mortgage loans originated by S&Ls carried an average loan-to-value ratio of 58 percent and matured in 11 years. The S&Ls, however, carried only half of the nation's mortgage debt. The remainder consisted of nonamortized loans held by life insurance companies and commercial banks at terms ranging from 2 to 4 years (Aaron 1972).

The FHA had a revolutionary impact on mortgage finance. This new insurance program extended the reach of mortgage capital to areas of the country where it was in short supply. FHA's guarantee of timely payment of interest and principal for 95 to 97 percent of the loan and a 20- to 30-year fully amortized term paved the way for the home financing available today.

FHA's market share of housing starts averaged around 31 percent from 1936 to 1940 and increased to 43 percent during World War II. Its contribution to housing finance, however, exceeded both its market share and its role as a mortgage insurer. During a time when much of the nation's housing stock was substandard, FHA "quality assurance" (a term still in use by the FHA) gave rise to lender and investor confidence. Equally significant, the FHA provided important loan performance information to conventional lenders and investors, encouraging them to originate loans under terms more favorable to borrowers. The FHA thus set the stage for the formation of a secondary market (Aaron 1972). However, FHA achievements in elevating the quality of the nation's housing stock came at a societal price. The very underwriting standards that increased the quality of housing steered FHA financing away from properties and neighborhoods that did not meet those standards. Moreover, given the influence of FHA standards on the conventional lending industry, the deleterious effects of these policies probably extended beyond their immediate reach. FHA policies and practices favored new home construction in the suburbs and bypassed the central cities. The net result was the outmigration of white families to the suburbs, thus contributing to the decline of the cities. Most egregiously, not only did FHA policies implicitly favor white homeowners, but FHA underwriting standards had also been explicitly discriminatory. Until 1950, the FHA recommended the use of racially restrictive covenants (Massey and Denton 1993).

These practices were reinforced by other federal policies. White families were able to afford new suburban homes through Veterans' Administration and FHA insurance and generous mortgage interest deductions. In the meantime, housing and urban renewal policies as they applied to lower-income households, many of which were minorities, promoted racially segregated public housing and inner-city rental housing (Downs 1974; Massey and Denton 1993; Roisman 1995).

The new Section 235 program might have reversed this trend. Unfortunately, it did not, although it had an ambitious start. The amount of funding authorized was $75 million in 1969, to be gradually increased to $200 million by 1971. In fact, by 1971 the Section 235 program had become the largest single subsidized housing program, responsible for almost 30 percent of all 480,000 federally subsidized units funded that year (Aaron 1972).

For many minority families, however, the Section 235 program failed to live up to its promise to provide equal housing opportunities. In 1972, hearings before the U.S. Senate Judiciary Committee documented in city after city flagrant abuses and egregious examples of racial discrimination involving the Section 235 program.[4] The U.S. Commission on Civil Rights found that FHA used the Section 235 program to perpetuate racially segregated residential patterns in metropolitan areas (Hartman 1975).

Even when there were no deliberate abuses, underwriting standards in many instances were lax. Borrowers were underwritten to carry debt service and housing costs that would not support family emergencies or repair costs.[5] The stories of low-income families losing hard-earned savings after their homes were foreclosed were legion. In the end, the Section 235 program did not fully meet its goal of serving the poor. Further, it had intrinsic programmatic flaws and was structurally designed for middle-income families.[6]

Yet for all its failings, the Section 235 program provided the one and only possibility for many families to become first-time home buyers. Between 1970 and 1973, it financed some 142,000 to 193,000 homeownership units a year. By 1973, it had insurance in force for more than 588,000 units. Had Section 235's programmatic deficiencies been

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[4] In Boston, the hearing record shows that a coalition of lenders, the Boston Banks Urban Renewal Group, established a loan pool for low- and moderate-income purchasers and delineated where the funds could be spent, thereby limiting the area where African-American families could live (a practice known as "redlining"). FHA was exclusively available in the suburbs, out of reach to African-American families, which were forced to live in neighborhoods with poor services. In some cities, FHA staff shared office space with lenders. Loan, appraisal, and income information was falsified. Property flipping was also cited as an abuse. In Boston, a home purchased from a white family for $14,000 was sold to an African-American family on the same day for $22,000. In Chicago, realtors would "block bust" by selling homes to minority families in white neighborhoods and then charge the remaining whites 18 points to sell their homes. In Baltimore, a speculator purchased a home for $6,500 and sold the home to an African-American family for $13,000. A low appraisal would support a loan of only $8,500. The speculator would then provide the seller a loan (known as the "black tax") for the remainder. These practices, tolerated or ignored by FHA field offices, led to racial strife in neighborhoods. Ethnic and religious minorities, (e.g., Irish, Catholics, or Jews) would be pitted against racial minorities. As one witness stated, "They do not see themselves as victims of the same set of real estate transactions. Rather, each sees the other as the culprit" (Statement of Walter Brooks before the Subcommittee on Antitrust and Monopoly of the Committee of the Judiciary, U.S. Senate, 92nd Congress 1972).

[5] Families were to pay 20 percent of their income for housing, and the FHA would insure the subsidized mortgage. The maximum mortgage amount was $40,000, with adjustments for large families or homes in high-cost areas.

[6] Cumbersome regulations and rigid property standards that could not be met by inner-city properties steered the program to the suburbs. Moreover, from the standpoint of program administration, there were embedded flaws in Section 235. The long-term interest rate subsidy commitment was tied to the recipient's income, which would change over time. This made it difficult to budget accurately for the program and costly when interest rates increased. Rising interest rates resulted in the program's not meeting its unit goals.

corrected and the program rescued from abuses, history might have been different. But the problems were not completely addressed, and the program was allowed to languish until it was eliminated in 1989. Tragically, since then the nation has not had as ambitious a program of homeownership as it did three decades ago with the Section 235 program.[7]

The 1970s: A decade of steady progress

The following decade saw steady progress in mortgage markets. In 1975, S&Ls held 55.8 percent of the market share. The secondary markets, however, were beginning to take off. In the Housing Act of 1968, Fannie Mae was authorized as a privately owned corporation. A portion of its portfolio was transferred to the newly created Government National Mortgage Association, which remained a government-owned corporation. Freddie Mac issued the first participation certificate in 1971.

The nation's homeownership rate increased steadily during the 1970s, reaching a record high of 65.6 percent by 1980. As a result of a more mature mortgage market, the emergence of a secondary market, and the growing presence of private mortgage insurers, the FHA's market share had already receded to about 12 percent at the start of the decade. By 1975, the FHA insured less than 8 percent of total construction starts.[8] Its role in minority lending, however, was more significant than popular perception might indicate. During the early 1970s, approximately one in three minority home buyers used FHA

[7] From 1992 through 1998, the HOME program committed funds to approximately 347,000 rental and homeownership units—an average of 58,000 units a year. Less than 40 percent of HOME funds have been used for homeownership units, however. And although HOME units are deeply targeted, this is only a fraction of the units endorsed under the Section 235 program. The Mortgage Revenue Bond (MRB) program has provided homes for 2 million families—approximately 125,000 families a year. Family income can go up to the median income, although in practice, the income of the average MRB home buyer is two-thirds of the median income. However, the MRB program provides a shallow subsidy. A typical MRB home buyer saves as much as $100 a month compared with a conventional mortgage. Deeper income targeting is achieved through other subsidies used in conjunction with MRB financing (HUD 1999a; National Council of State Housing Agencies 1998).

[8] The growing presence of private mortgage insurers resulted in direct competition for the FHA and eroded its market share (HUD 1977). Private mortgage insurance gave lenders the option of holding loans in portfolio. By the 1970s, the S&Ls, which were proffered rate and deposit protection, had the additional option of selling a loan to secondary market conduits such as Freddie Mac, which at the time was a part of the Federal Home Loan Bank System. This tension between private mortgage insurers and the FHA continues today, as market shares fluctuate. For example, in 1987, the private insurance share was 29 percent, but increased to 57 percent by 1992 (GAO 1997).

insurance. In 1977, HUD reported that some 22 percent of all home buyers under the FHA Single-Family 203(b) program were minorities (HUD 1977).

Two important homeownership milestones for low- and moderate-income borrowers also occurred in the 1970s. The Home Mortgage Disclosure Act of 1975 (HMDA) required lenders to report government-backed and conventional mortgage loans by census tract, and the Community Reinvestment Act of 1977 (CRA) required "regulated" financial institutions to "help meet the credit needs of [their] local communities." These two acts, strengthened by amendments in 1989, allowed the nation to monitor progress in expanding homeownership opportunities for minorities and lower-income families.

The 1980s: A troubled decade

The 1980s were characterized by high interest rates, a recession, and dramatic changes in the financial services industry. A sharp rise in interest rates shocked mortgage markets: Rates on three-month Treasury bills rose from a low of 6.31 percent in 1978 to 16.30 percent in 1981. Thrift institutions, which were subject to regulatory price controls on deposit taking, were caught in a cycle of borrowing under high interest rates while yields on previously originated mortgages were at much lower rates. The thrifts' deposit base, subject to rate ceiling regulation, eroded as depositors were lured away by money market funds. Declining real estate values resulted in portfolios of defaulted loans. Poor regulatory oversight and the absence of timely and corrective government intervention contributed to the insolvency of much of the thrift industry: By 1987, 1,106 thrifts were operating at a loss (White 1991).

Like other sectors of the financial services industry, FHA experienced a serious financial crisis. In fiscal year 1988, the FHA fund had lost $1.4 billion, mostly from losses in the southwestern and Rocky Mountain states. The U.S. Government Accounting Office (GAO) concluded that economic factors and poor program management were at the heart of FHA's difficulties (1995). By 1990, FHA's capital reserve ratio had fallen to negative 88 percent.[9] Congress, in the Omnibus Budget Reconciliation Act of 1990, required FHA to reach a positive capital reserve ratio of 2 percent, and its viability as a government corporation was questioned (Vandell 1995).

After years of steady increase, the nation's homeownership rate declined in the 1980s. By 1988, it had dropped to 63.7 percent, although

[9] The capital reserve ratio, defined as a percentage of insurance in force, provides a financial cushion against claims. A capital reserve ratio is commonly accepted by insurance companies as a measure of financial strength.

the 1980s were characterized by silent but steady improvements in secondary market instruments. The private sector and the government-sponsored enterprises, Fannie Mae and Freddie Mac, began to experiment with the first conduits: collateralized mortgage obligations and real estate mortgage investment conduits, which were to step in to fill the capital gap left in the wake of the nation's financial crisis (Bartlett 1989).

The 1990s: A decade of evolution in mortgage finance for lower-income households

At the beginning of the decade, with much of the banking and housing industry in fiscal disarray, it would have been difficult to predict that the 1990s would end on such a positive note. A balanced federal budget, increases in national productivity due to technological innovation, mortgage interest rates below 8 percent (and for several periods below 7 percent), low unemployment, unique household formation and demographic patterns, and supportive government policies came together in an unprecedented historical confluence.

As a result of these factors, the downward trend in the national homeownership rate was reversed and a record number of families purchased homes. Perhaps the best housing "story" at the end of the millennium was the growth in homeownership opportunities for lower-income and minority borrowers. The early part of the decade ushered in several significant public policies and regulatory measures encouraging lending to lower-income borrowers.[10] Although it is difficult to quantify the effect of any one initiative,[11] the CRA has, at a minimum, resulted in increased attention in lending to lower-income borrowers and minority communities. Initial concerns that regulating the financial services industry might lead to adverse credit allocation have not

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[10] The Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) required public disclosure of CRA ratings. FIRREA also added minorities as a new reporting category under HMDA and created the Federal Home Loan Bank System's community investment programs. In 1992, Congress enacted the Federal Housing Enterprise Financial Safety and Soundness Act, requiring Fannie Mae and Freddie Mac to meet housing performance goals targeted to low- and moderate-income households and underserved neighborhoods. In 1996, CRA regulations were amended to better assess lender performance.

[11] Evanoff and Segal (1997) found mixed results in their analysis of the effect of CRA on lending. They noted a significant increase in lending to groups targeted by the CRA, but raised doubts as to whether increased regulatory scrutiny resulted in lending increases to these groups, since nonregulated lenders also increased CRA lending. However, these researchers do not consider the effects of similar forces (such as voluntary efforts to forestall regulation) brought to bear on nonregulated lenders. Moreover, the period covered by their research is from 1990 to 1995, and the regulatory amendments to the CRA were not enacted until 1995.

been borne out, and a compelling argument can be made that the CRA leads to information efficiencies and creates new markets (Avery, Beeson, and Sniderman 1997; Beshouri and Glennon 1996; Schwartz 1998). A 40 percent decline in the number of banking institutions did not lead to a decline in lending to low-income and minority borrowers, as some had feared, but instead lending to minority borrowers increased substantially over lending to nonminority borrowers[12] (Avery et al. 1999).

Another significant development was the passage of the Federal Housing Enterprise Financial Safety and Soundness Act of 1992, which set affordable housing goals for Fannie Mae and Freddie Mac. By statute and regulation, Fannie Mae and Freddie Mac are now required to dedicate 42 percent of all loan purchases to mortgages and rental property affordable to families with incomes at or below the area median income. This goal has led to the development of "affordable" credit products (HUD/Rutgers 1998) that loosened loan-to-value ratios and debt-to-income ratios to enable more households to afford a home. From 1996 through 1997, approximately 70 percent of all loans purchased had loan-to-value ratios over 80 percent. In 1998, both Fannie Mae and Freddie Mac exceeded the 42 percent affordable housing purchase goal (HUD 1999b), which increased to 50 percent for 1999.

Lenders and the secondary market government-sponsored agencies have adopted a broad range of initiatives to increase lending to minorities, and these efforts are beginning to bear fruit. A recent survey identified 50 "exemplary"[13] lenders, and found that black and Hispanic mortgage applicants are approximately 13 percent more likely to be approved by exemplary lenders than by other lenders (HUD 1999a). The Federal Home Loan Bank System supports its 7,000 member financial institutions with a variety of community credit products and services, including subsidized financing through the Affordable Housing Program.[14]

This growing collaboration within the banking and housing industries to reach out to low- and moderate-income and minority first-time home buyers is evidenced in the Clinton administration's National Homeownership Strategy, whose objective is to increase the nation's home-

[12] From 1993 to 1997, despite a 40 percent decline in banking institutions, home purchase lending to nonminority borrowers increased by 13 percent, while lending to minority borrowers increased by 53 percent.

[13] In defining an exemplary lender, the survey identified a series of actions that comported with recommendations from several existing "best practices" guides.

[14] The Federal Home Loan Banks Affordable Housing Program (AHP), a subsidy program for low- and moderate-income households, has been primarily used for rental housing, although the funds can be used for either rental or homeownership units. In 1998, the AHP financed more than 8,000 homeownership units. The importance of

ownership rate from 64.2 percent at the end of 1994 to a record high of 67.5 percent by the end of 2000. The strategy is carried out by the National Partnership in Homeownership, a coalition of more than 60 national housing industry organizations and government agencies. Interest groups that were historically opposed to such initiatives have joined together in a common pursuit. An important hallmark of the effort is the agreed-upon strategy to expand homeownership opportunities for lower-income and minority households (HUD 1995).

By the first quarter of 2000, the national homeownership rate was 67.1 percent, an impressive 2.9 percentage points above the 1994 rate. Much of this increase was due to growth in the minority homeownership rate. Between 1994 and 1995, minorities contributed more than 40 percent of that homeownership growth, although they made up less than 20 percent of homeowners (U.S. Bureau of the Census 1999/2000). In 1998, minorities accounted for 30 percent of first-time home buyers, up from just 19 percent in 1985 (Joint Center for Housing Studies 1999a).

Recent (1998) HMDA data confirm this trend. From 1993 to 1998, conventional home purchase loans to Hispanics increased by 77.7 percent, and loans to African Americans increased by 94.6 percent, compared with an increase of 40 percent to non-Hispanic whites. Lending to lower-income households (below 80 percent of the area's median income) increased by 75.1 percent—the highest increase of any income category (Federal Financial Institutions Examination Council 1999).

FHA turnaround

FHA, which benefited from a salubrious housing climate and improved management, experienced a turnaround from previous years. By 1996, its capital ratio had exceeded the congressional target for 2000 (HUD 1996). From 1985 through 1995, FHA's share of all insured loans fluctuated between a low of 29 percent in 1992 and a high of 51 percent in 1987 (GAO 1997). A GAO study of the FHA found that in 1995, relative to its market share, the FHA was the leading insurer of loans to minorities and low-income borrowers[15] (GAO 1996). In 1997, the FHA

the AHP, however, transcends the number of units. Unlike most housing programs, the applicants for the funds are the lenders themselves. The presence of lender underwriting and private debt financing serves to leverage additional subsidies. In addition, AHP units often act as important demonstration projects for new types of projects or project financing that leads to replication by other lenders.

[15] By examining 1994 HMDA and Mortgage Insurance Companies of America data, the GAO found that in 1994, FHA insured 15 percent of all home purchase loans and an even larger portion of the loans made to low-income home buyers. The FHA served 20 percent of all the low-income home buyers and 24 percent of all the minority home buyers in 1994.

insured 43.8 percent of all home purchase loans to Hispanic borrowers and 35.9 percent of loans to African-American borrowers (Scheesele 1998).

The decade also witnessed unprecedented growth in the role of nonprofit organizations in housing delivery. The number of housing and community development nonprofit organizations is reported to have increased by over 80 percent since 1994. Of approximately 3,600 community development corporations across the country, 82 percent are involved in housing development as a primary activity[16] (National Congress for Community Economic Development 1999).

Nonprofits have an emerging role in the development of "best practices" in underwriting and counseling first-time home buyers. The Neighborhood Reinvestment Corporation's NeighborWorks program provides a full complement of lending services to lower-income borrowers and has achieved good loan performance while stabilizing housing costs.[17] Habitat for Humanity International, an ecumenical association that builds homes primarily for very low income families, has become one of the nation's top 20 home builders. Although Habitat homeowners have very low incomes, with Habitat training and support they are well able to assume the responsibilities of homeownership (HUD 1998a).

Community development financial institutions, which serve as financial intermediaries between traditional sources of financing and lower-income borrowers, also have a growing presence. These nonprofit organizations are finding nontraditional ways to serve lower-income borrowers and work well within the interstices of traditional mortgage markets. The National Council of La Raza reports that its program of training community-based organizations as housing counselors has several benefits. The organizations become better informed as to

[16] Over the past 25 years, this sector reports that it has produced more than 550,000 affordable units. Of these, 26 percent are homeownership units (National Congress for Community Economic Development 1999). In light of more favorable lender financing policies and recent subsidy programs, more nonprofits are venturing into ownership housing. A good number of these organizations are faith based. The National Catholic Housing Survey found that Catholic organizations had produced 51,400 units of housing (McAuley Institute 1999).

[17] The NeighborWorks "Full Cycle Lending" program provides pre- and postpurchase counseling support and loan packaging assistance to lower-income borrowers. Borrowers are predominantly minorities; almost half pay less than 25 percent of their annual income for housing, and for 31 percent, their housing costs are either less or marginally less costly than renting. Although NeighborWorks loans serve lower-income households, 90-day "past due" loans are 0.77 percent of loans, compared with 0.62 percent for loans (at all income levels) originated by other lenders. The secondary market packager for these loans, the Neighborhood Housing Services of America, recently sold $75 million in securities backed by these mortgages, garnering an AA rating on Wall Street (Neighborhood Reinvestment Corporation 1999).

lenders' needs and prepare borrowers in advance, thereby increasing loan qualification rates. These organizations also provide necessary underwriting information to lenders, bridging the barriers in cross-cultural lending and expanding markets. Prospective Hispanic home buyers not only receive homeowner counseling and support, but they also gain financial literacy in the process.[18]

A decent home and suitable living environment at the start of the millennium

As promising as these recent developments are, there are serious challenges ahead if the goal of a decent home and suitable living environment for every American family is to be met.

The affordability crisis

Affordability is the greatest challenge facing the nation. To the extent that housing competes with other basic needs, the objective of a "decent" home has not been met. More than 5.3 million households have "worst-case" housing needs, as classified by HUD. In 1995, almost 3.9 million unsubsidized households spent half their incomes for housing. Despite a favorable economic climate, rents outpaced incomes for the households with the lowest income and also outpaced inflation. Whereas the consumer price index grew by 3.9 percent from 1992 to 1996, residential rents grew 6.2 percent (HUD 1998b). Fifty-four percent of renters and 30 percent of very low income homeowners suffer from severe housing cost burdens (Dolbeare 1999). In eight states, it requires two full-time jobs to meet HUD's fair market rent, and in a few states it takes almost three jobs[19] (Joint Center for Housing Studies 1999a).

Expanding housing opportunities for lower-income home buyers

The debate between rental housing and homeownership for lower-income households, however, should not be posed as one form of tenure in opposition to another. The optimal objective is to provide people with an *effective choice of tenure that is affordable and appropriate to their needs*. Rental housing provides residents with fewer

[18] Author's interview with Lot Diaz and Mark Van Brundt of the National Council of La Raza, July 1999.

[19] The assumption is that it takes one full-time job with a take-home wage of $7 per hour to afford a two-bedroom apartment at the HUD-established fair market rent, with no more than 30 percent of income going toward housing.

responsibilities and greater mobility, which can optimize transitions to employment or enhance educational opportunities. To those for whom rental housing is the preferred form of tenure, affordable rental housing is critical.

However, affordable rental housing is equally critical to those who rent but would prefer to own. Homeownership is the preferred form of tenure for many families, including lower-income families. The high cost of rental housing can tax a budget, preventing savings and rendering homeownership an ever-elusive goal.

Homeowners reveal high satisfaction with their circumstances. Research points to many personal and societal benefits resulting from homeownership, including the stabilization of housing costs (HUD/Rutgers 1998). For most Americans, their home is their greatest source of wealth. Racial disparities in homeownership rates perpetuate wealth inequality from one generation to another.[20] Homeownership provides a means for households that have historically been disenfranchised to accumulate wealth and enables new Americans to become economically assimilated.

Nancy Denton (1999) notes that spatial/racial segregation patterns evidenced in the 1960s persist today. Homeownership, particularly when exercised voluntarily by households, can be a tool to reverse patterns of spatial concentration along racial or economic characteristics. There is some evidence that lower-income, first-time home buyers exercise their housing choice in ways that maximize other opportunities—electing, for example, to reside in higher-income neighborhoods or near better schools or access to employment (HUD 1999a; Roisman and Botein 1993). Homeownership must therefore be made accessible to lower-income families.

For very low and low-income renters to become homeowners, however, a subsidy is often needed. Renters have not achieved parity with homeowners in a federal budget that accords $58 billion in mortgage interest and real estate tax deductions that primarily benefit upper-income homeowners. This regressive treatment has long been noted (Aaron 1972), yet continues without redress in tax policies. Currently, there are good models for homeownership subsidy programs and tax-side proposals that might correct this imbalance.[21] Also, in the past

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[20] Denton (1999) cites an estimate that the current generation of African Americans has missed out on $82 billion in wealth accumulation as a result of not having parity with whites in homeownership.

[21] The Joint Center for Housing Studies (1999b) has circulated a discussion paper on a homeownership tax credit, which proposes to allow tax credits for second mortgages. Such a measure would begin to restore equity in tax treatment for renters who aspire to be home buyers.

30 years, the housing industry has made great strides in underwriting loans to lower-income households, and there are good models for homeownership programs as well.

A relatively new program, the HOME Investment Partnerships program, authorized by the National Affordable Housing Act of 1990, is targeted to low-income families and appears to be meeting many of the goals of the Housing Act of 1968. Hispanics and African Americans receive 59 percent of program funds. However, the HOME program is not primarily for homeownership; further, the total number of homeownership units pales in comparison to the Section 235 program. On a positive note, however, the HOME program's homeownership units are deeply targeted: 54 percent of new homeowners subsidized by HOME have incomes below 60 percent of the median income, and most of them are purchasing homes in areas with low concentrations of poverty (HUD 1999a).

To expand opportunities for lower-income home buyers, innovative approaches to transition renters into homeownership need to be supported and evaluated. Lease-purchase programs, asset-building strategies such as individual development accounts, rental down payment credit programs, second mortgage programs, renter/home buyer subsidies, portable homeownership vouchers, and programs that enable renters to transition seamlessly from rental to ownership (and back as needed) should be encouraged.

Outreach to underserved populations

Despite record homeownership rates for the population as a whole, minority homeownership rates still lag behind those of non-Hispanic whites. While 73.4 percent of non-Hispanic whites are homeowners, the homeownership rate is 47.8 percent for African Americans and 45.7 percent for Hispanics. Moreover, slightly more than half (50.5 percent) of the residents of central cities are homeowners—in contrast to 73.8 percent in the suburbs (U.S. Bureau of the Census 1999/2000). The rate differentials are not fully explained by constrained income or other demographic factors alone (see the summary of research in HUD/Rutgers 1998).

Lower-income households are better served if given a choice of lenders and *price-competitive* mortgage offerings. That the FHA continues to serve such a high proportion of minority and lower-income homeowners speaks to the need for other sectors of the conventional lending market to develop better strategies to serve these households.

Reasons for disparities in loan denial rates for home mortgages can and should be studied; however, the undeniable fact is that there are borrowers who would prefer to own a home but cannot qualify. It is important that future research better identify reasons for denial and, more important, ways to remedy borrower deficiencies. Demographic projections reveal that new immigrants and "echo boomers" (children of baby boomers) will fuel future demand for homes (Frey 1999). Reaching out to new ethnic minorities will require new approaches. An effective, comprehensive cross-industry strategy needs to be developed to reach out to, counsel, prepare, and support these minorities, particularly Hispanic home buyers, who constitute a large percentage of the emerging homeownership market but may have language barriers and different real estate and mortgage traditions.

One of the greater challenges ahead is in the area of credit scores and risk-based pricing. Although credit scores can open opportunities for creditworthy home buyers who otherwise might not qualify, if improperly used, credit scores can result in disparate treatment and unfair mortgage pricing. Risk-based pricing should be elastic not only in the direction of the lender or insurer, but also in the direction of the borrower. As risk is mitigated for the lender, the borrower should reap the price advantage. Preparation for prospective borrowers and understanding of credit scores are critical, as is transparency of credit scoring standards to enable borrowers to correct their scores. Because credit scores are retrospective, not prospective, ongoing evaluation of their assumptions is essential.

Further, it is important to foster homeownership strategies appropriate to regional circumstances. Strategies are not always transferable from one area to another. In some neighborhoods, preventing house price depreciation may be the challenge. Neighborhood rehabilitation and economic development programs are appropriate for inner cities and areas where there are concentrations of poverty or a declining employment base. And as noted by the Joint Center for Housing Studies (1999a), homeownership correlates closely with education; therefore, housing strategies in these neighborhoods need to include efforts to improve educational opportunities for children and adults.

The increasing deterioration of the existing housing stock is a problem, particularly in aging suburbs, where rehabilitation programs will be needed. In rural areas, rehabilitation and new construction of single-family homes are required, since market risks and infrastructure limitations there often preclude multifamily housing.

Perhaps the greater housing challenge is in areas of the country where economic growth outpaces housing supply. In California, for example, the 1999 homeownership rate stood at 55 percent, the lowest of any state in the nation (and ironically, the same as the national rate when the Housing Act of 1949 was adopted).[22] In areas with hypergrowth, inducements to economic growth should include strategies to increase the housing supply to accommodate that growth. In regions where the lower-income labor force cannot exercise the effective demand to stimulate the private sector supply of housing and thereby bring down housing costs, strategies that stabilize residents' housing costs, such as government and employer-sponsored homeownership programs and nonprofit rental housing production, are to be encouraged.

Keeping existing homeowners

Although current 15-year projections for the national economy are favorable, regional economic downturns are a reality, even in an otherwise strong economy. It is important that homeowners not lose hard-earned equity. Poor underwriting or borrower qualification practices that severely constrain a homeowner's ability to withstand economic changes do a great disservice to lower-income borrowers. It must be recognized that although flexible underwriting standards are an important tool for expanding homeownership opportunities for lower-income households, a mortgage with a very high debt ratio does not serve the borrower or the lender. And of course, it is in the interest of both the public and private sectors to be ever vigilant in preventing and detecting predatory lending.

In recent years, greater attention has been paid to prepurchase counseling and the development of uniform counseling standards. These are important to minimize defaults and foreclosures. However, postpurchase support, default mitigation, and forbearance policies are equally important. In the coming years, as much attention needs to be paid to the servicing of a mortgage as to its origination. In this regard, the FHA can continue to play an important role in leading the industry. In 1996, Congress ended the FHA mortgage assignment program, in which the FHA took possession of foreclosed mortgages. In its place, the FHA instituted a loss mitigation and foreclosure avoidance program. The former is an opportunity for the FHA, perhaps in partnership with lenders and counseling agencies, to develop cost-effective but enlightened standards and practices to avoid fore-

[22] The 1999 governor's budget summary for California states that in the late 1980s, one new house was built for every 1.6 new workers. Since 1995, despite the economic recovery, permits have been issued for only one housing unit for 5.4 workers, and growth is taking place in areas with housing shortages. Homeownership in these areas becomes unattainable for the average person. In San Francisco, where the median home price approaches $500,000, the homeownership rate hovers around 33 percent. Growth might be better located in other parts of the state where both land and labor are more readily available.

closure. Lenders' timely sharing of default data with counseling intermediaries may forestall a greater crisis. Such an approach might not only benefit borrowers and be in the interests of good social policy, but there is some evidence that preventing foreclosure is more cost-effective for the lender than foreclosure.[23] More than 20 years ago, an internal HUD study stated that the FHA has a "historic role in demonstrating and supporting innovative mortgage instruments as well as serving discrete segments of the home purchasing market, which [others] have not or cannot assist" (HUD 1977). That role is as important now as it has been in the past.

Conclusion

Since the passage of the Housing Act of 1949, much progress has been achieved in the nation's housing delivery system. Mortgage markets have matured to an extent that was unimaginable a few decades ago. Capital for housing is no longer in short supply, and credit crunches are a phenomenon of the past. Although many Americans now enjoy a quality of housing that would have seemed luxurious to their grandparents, millions of Americans still face serious housing problems. For them, the goal of a decent home and suitable living environment is yet to be realized. However, if history has taught us any lessons, it is that through will and concerted actions the goal can become a reality.

Author

Sylvia C. Martinez is Associate Director, Division of Policy Development and Analysis, Federal Housing Finance Board.

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[23] The Mortgage Foreclosure Prevention Program operating in Minneapolis and St. Paul, MN, found that intensive counseling helped half of all delinquent mortgagors reinstate their mortgages. A study of the program (Family Housing Fund 1998) found that for an average cost of $2,800 to help a homeowner reinstate the mortgage, there was a savings in foreclosure costs to insurers ranging from $10,000 to $28,000.

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