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BUILDING SUSTAINABLE OWNERSHIP: RETHINKING PUBLIC POLICY TOWARD LOWER-INCOME HOMEOWNERSHIP

Alan Mallach

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* Nonresident Senior Fellow, Metropolitan Policy Program, the Brookings Institution, and Visiting Scholar, Community Affairs Department, Federal Reserve Bank of Philadelphia. The author would like to thank Dede Myers and Mitchell Berlin of the Federal Reserve Bank of Philadelphia and Carolina Katz Reid of the Federal Reserve Bank of San Francisco for their valuable comments on the draft of this paper. The views expressed here are those of the author and do not necessarily represent the views of the Federal Reserve Bank of Philadelphia or the Federal Reserve System.

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INTRODUCTION: FRAMING THE QUESTION

For nearly two decades, turning lower-income households[1] into homeowners has been a central goal of housing policy in the United States. Indeed, until recently, it has arguably been the *only* consistent goal of national housing policy. Policies to further lower-income homeownership took many forms, including imposing requirements on the two government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac to increase access to mortgage financing for lower-income borrowers (Congressional Budget Office 1996; White 2009);[2] encouragement through the Community Reinvestment Act (CRA) and other means to modify mortgage underwriting standards (Liebowitz 2008); and use of public funds such as HOME, the American Dream Downpayment Initiative, and housing choice vouchers to subsidize homeownership for lower-income people. Both the Clinton and Bush administrations used the bully pulpit of the presidency to espouse a doctrine of wider homeownership and a rethinking of lending policies and practices, characterized as furthering the "democratization of credit."[3]

These policies had an effect.[4] Homeownership rates rose steadily during the 1990s and well into the new millennium, peaking at 69 percent of American households in the first half of 2004.[5] Between 1994 and 1999 the number of low-income minority owners rose by more than 800,000, accounting for nearly 11 percent of the net growth in homeowners (Belsky and Duda 2002a). Between 1994 and 2004, although remaining well below homeownership rates for non-Hispanic whites, homeownership rates for both Latino and African-American households increased at double the rate of non-Hispanic white households (Garriga 2006). This increase coincided with dramatic increases in house prices in much of the United States between 1998 and 2006, unprecedented in the long-term history of American house price trends (Shiller 2008). Both phenomena were closely associated with so-called mortgage innovations, in particular, the growth in the subprime mortgage sector, which accounted for more than 20 percent of all home purchase mortgages in 2005 and 2006 (Joint Center for Housing Studies 2008).

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[1] The term 'lower-income' is used generally in this paper to refer to households earning less than 80 percent of the median income in their metropolitan area, roughly the lower 40 percent of the nation's households.

[2] Under the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, HUD was given authority to establish targeted lending goals for the GSEs. For the period 1997-2000, 42 percent of the units financed by the GSEs' mortgage purchases were required to be for families with incomes at or below the area median income (AMI), while 14 percent were required to be either (a) for families at or below 60 percent of AMI, or (b) for families at or below 80 percent of AMI in low-income areas. These targets were increased to 50 percent and 20 percent, respectively, for 2001-2003 (U.S. Department of Housing and Urban Development, 2001).

[3] The origins of this widely used catchphrase are unclear. The earliest citation that I have uncovered is an article by the economist Lawrence B. Lindsey in 1995 in the magazine *Mortgage Banking.* From 1996 on, Eugene Ludwig, then Comptroller of the Currency, used the phrase frequently in his public appearances. The phrase is used less often today.

[4] There is some disagreement as to the extent that specific policies or practices, such as the increase in risk-based lending, actually drove the increase in the homeownership rate from the late 1990s through 2004. While there is no question that subprime lending peaked in 2005-2006, after the homeownership rate reached its highest point, there appears to be at least some association between the growth in subprime lending and the homeownership rate.

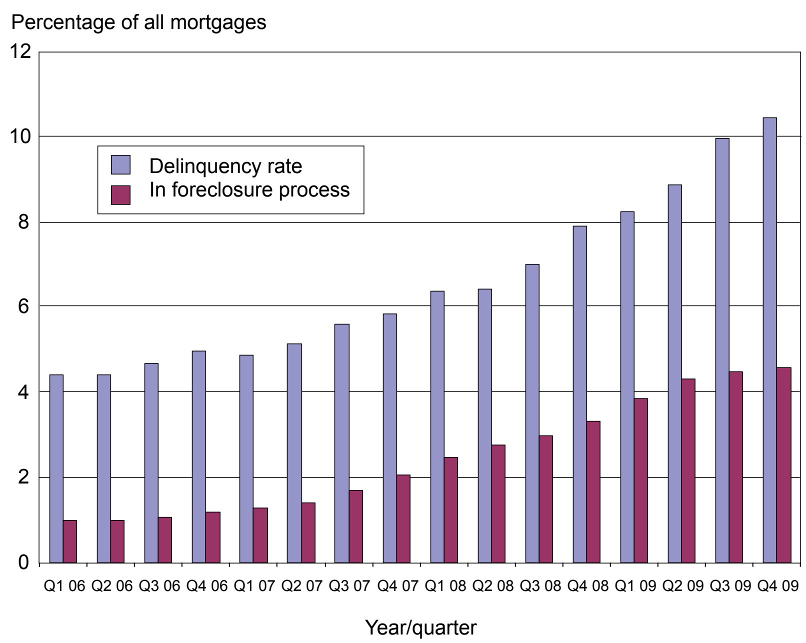
[5] The national homeownership rate remained at that level, fluctuating within the statistical margin of error, through the end of 2006. Since 2006, the homeownership rate has declined, and by mid-2010, it had reverted to its 1999 level. See http://www.census.gov/hhes/www/housing/hvs/historic/files/histtab14.xls.

Increases in house prices and homeownership rates abruptly came to an end in 2006,[6] as the housing bubble burst, with devastating consequences for homeowners, lenders, and the national economy. Since then, house prices have plummeted, and the collapse of large parts of the housing market and housing finance system has plunged the nation into an economic tailspin that has come to be known as the Great Recession. Foreclosures have skyrocketed, and by the end of 2009, one out of every 23 mortgages was in foreclosure, and one out of nine mortgages not in foreclosure was delinquent (Figure 1) (Mortgage Bankers Association 2010). The consequences of this collapse are likely to be most severe for lower-income, minority, and first-time homeowners, reflecting in part the extent to which subprime lending was disproportionately concentrated in areas with large African-American populations (Hershaff, Wachter, and Russo 2005; Gerardi and Willen 2009)[7] as well as lower-income communities and census tracts (Goldstein 2004; Calem, Gillen and Wachter 2004; Gramlich 2004).

The bursting of the housing bubble and the unraveling of the subprime mortgage market, with their erosion of family wealth and neighborhood destabilization, have raised fundamental questions about the policies that were in place during the preceding decades. Many specific practices that contributed to the increase in homeownership have come under sharp scrutiny. Few people in 2009 still defend many practices that were widely seen as acceptable and even socially desirable only a few years ago. But beyond those specific practices, the entire idea of the federal policy goal of furthering low-income homeownership has been called into question. If the rationale of that goal is that homeownership is a reliable path to asset- and wealth-building, can that goal still be justified in light of the evidence of asset erosion over the past three years?

While public policies seeking to further lower-income homeownership had an ideological dimension, rooted in the so-

FIGURE 1.
Foreclosure Trends, 2006-2009



Source: Mortgage Bankers Association National Delinquency Survey

[6] There is some difference of opinion about the point at which house prices peaked. While the high point of the Case-Shiller 20 cities index was reached in July 2006, the Federal Housing Finance Agency (formerly OFHEO) index did not peak until the second quarter of 2007, reflecting in all probability the difference in coverage between the two indices.

[7] Another factor, which has yet to be studied in detail, is likely to be the extent to which lower-income and minority buyers were disproportionately *recent* buyers and thus disproportionately likely to be at risk of foreclosure and holding mortgages in excess of the value of their homes (or "under water") as house prices have declined. A recent study found that nearly 8 percent of all African-American recent borrowers (borrowers in 2005-2008) have lost their homes, compared with 4.5 percent of white borrowers (Bocian, Li, and Ernst 2010).

called "American Dream" of homeownership[8] (Vale 2007), they also reflected the conviction that lower-income households would realize significant and tangible benefits for themselves and their children by becoming homeowners and that their neighborhoods would also be improved as a result (Goetz 2007). Those convictions were in part grounded in a belief that homeownership was a reliable vehicle for asset-building, but they also drew on the findings of a body of research that since the mid-1990s has attempted to isolate the effects of homeownership on such diverse matters as civic engagement, child outcomes, and the appreciation of surrounding properties.

That body of research should be carefully considered as policymakers begin to think through the future role of the public sector with respect to homeownership for lower-income people. For that reason, this paper begins by focusing on the findings and implications of that research. The next section summarizes the salient features of the research on the costs and benefits of homeownership. That section is followed by a discussion of the critical issue that needs to be addressed if research is to be relevant to this public policy issue, namely, how those costs and benefits are affected by the income of the homebuyer and thus may have different implications for lower-income households than for the rest of the population. While the first is largely a review and commentary on the literature, the latter attempts to go beyond that and suggest the outlines of a framework for evaluating the effect of income on the costs and benefits of homeownership. The final section of this paper uses that framework to define principles, strategic directions, and specific recommendations for public policy.

Lower-income homeownership has benefits, as well as risks and uncertainties. Public policy can play an invaluable role in enabling future lower-income homeowners to realize more of those benefits. To that end, I argue that public policy and resources should be directed less toward maximizing the *number* of lower-income homeowners and more toward maximizing the *quality and stability* of the homeownership experience for lower-income owners, by creating an environment in which homeownership becomes a more stable and sustainable experience, rather than a revolving door fraught with risk and uncertainty. This proposition should be a starting point for designing specific programs and initiatives at the federal, state, and local levels.

THE BENEFITS OF HOMEOWNERSHIP

Homeownership is widely perceived as offering many benefits, ranging from higher self-esteem for homeowners and improved outcomes for their children, to higher levels of neighborhood engagement and, last but not least, the ability to build wealth and pass it on to future generations. These benefits have been the subject of considerable research, particularly since the 1990s. This research has focused on two distinct forms of benefits potentially associated with homeownership:

(1) The social or psychological benefits to families and family members associated with homeownership as a non-economic good;
(2) The economic benefits of homeownership, particularly with respect to accumulation of personal and family assets.

These benefits can accrue to the community or the neighborhood as well as to the individual, as a result of an increase in the number of homeowners or the conversion of households in the area from renters to owners. Potential benefits, all of which find at least some support in the literature, can be broken down and categorized (Table 1).

[8] I characterize this as "so-called" not to suggest that it does not make up part of the American ethos but to suggest that it is inappropriate to treat the desire for homeownership as another example of American exceptionalism. Indeed, homeownership rates are higher in most EU nations than they are in the United States, and in many cases, significantly higher. That notwithstanding, homeownership does not appear to play as central a symbolic or ideological role in many of those countries (although not all) as it does in the United States.

TABLE 1.
Potential Benefits of Homeownership

	Individual Benefits	Community Benefits
Social	• Increased satisfaction • Improved psychological health and self-esteem • Improved physical health • Improved child outcomes	• Greater neighborhood stability • Greater civic participation and social involvement • More socially desirable youth behavior
Economic	• Improved housing quality • Improved neighborhood quality • Lower housing cost • Greater wealth accumulation • Greater access to credit	• Increased neighborhood house value appreciation

Adapted from William Rohe, Shannon Van Zandt, and George McCarthy, *The Social Benefits and Costs of Homeownership: A Critical Assessment of the Research*, Harvard University, Joint Center for Housing Studies, 2001.

Research on the social benefits of homeownership has established that there are moderately strong positive relationships between ownership and residential satisfaction (Galster 1987; Rohe and Stegman 1994; Rohe and Basolo 1997) as well as between homeownership and physical health (Rossi and Weber 1996), but far more ambiguous relationships between homeownership and measures of psychological health such as self-esteem (Rohe and Stegman 1994; Rohe and Basolo 1997). Much of the research has found that homeowners are more satisfied with their dwelling units, "even after the influences of household, dwelling unit and neighborhood characteristics are controlled for," as Rohe, Van Zandt, and McCarthy (2001) summarize an extensive body of research on the subject.

It is not clear, however, what mechanisms, social, psychological, or otherwise, lead to these outcomes. They could include the satisfaction that might result from having achieved a goal — homeownership — that is highly prized by society or that which comes from one's ability to improve or customize one's home.[9] Alternatively, if housing is indeed a means of building wealth, higher levels of satisfaction might be associated with the knowledge that by becoming a homeowner, one has improved one's own and one's family's economic security or status. It is debatable, however, whether this finding, however strong and consistent, is in itself a credible basis for the allocation of public resources.[10]

The research that supports positive associations between homeownership and both psychological and physical health is more limited and the associations less consistent. While Rossi and Weber (1996) and others have found positive associations, much of the research, as discussed further below, failed to control for potentially important social and economic variables that could well influence either physical or psychological well-being or both. Rohe and Stegman (1994) and Rohe and Basolo (1997) compared a sample of homebuyers and a sample of renters with similar incomes in Baltimore over a three-year period. While the homebuyers consistently stated that becoming homeowners had made them feel better about themselves, there was no statistically significant difference between results for homebuyers and renters on a standardized self-esteem index. Wong (2008), in a comparative study

[9] This is somewhat circular. To the extent that people in the United States have been subject to a fairly steady diet of messages suggesting that homeownership is associated with higher respectability and social status than renting, it would only be logical for people to internalize that message; in that case, one could argue that it is not that homeowners have higher levels of satisfaction but that renters have lower ones.

[10] This raises an interesting point, that is, the extent to which maximizing individual happiness is in fact a legitimate goal of public policy. Since the ruler of the small kingdom of Bhutan framed the concept of measuring "gross national happiness" in the 1970s, this concept has received some attention. See Brooks (2008) for a discussion of happiness and public policy in the United States.

of owners and renters, found "little evidence that home owners are happier by any of the following definitions: life satisfaction, overall mood, overall feeling, general moment-to-moment emotions (i.e., affect) and affect at home."

The behavioral effects of homeownership on the homeowner's children appear to be more firmly established than the effects on the homeowner herself. Initial research suggested a relationship between homeownership and positive youth behavior, including greater educational attainment, lower drop-out rates, and lower rates of teen pregnancy (Green and White 1997), while Boehm and Schlottmann (1999) found, after controlling for other factors that are normally hypothesized to affect an individual's education and earnings, that the children of homeowners are significantly more likely to achieve higher levels of education and subsequent earnings. The children of homeowners are also more likely to become homeowners themselves. This research has been reinforced by findings that the children of homeowners, after controlling for a variety of economic, demographic, and social factors, have higher levels of cognition and fewer emotional and behavioral problems (Haurin, Parcel, and Haurin 2002; Boyle 2002).

Other research has supported claims that homeownership confers community social benefits. In addition to the community benefits presumably derived from better-behaved and higher-achieving youth, studies support propositions that homeowners are more likely than landlords to make repairs (Galster 1987) and have higher levels of civic participation, reflected in familiarity with local political leaders, organizational involvement, and voting (DiPasquale and Glaeser 1999). Also relevant to the potential role of homeownership in distressed neighborhoods are findings from recent European research, which show inverse relationships between homeownership and crime rates in Denmark, even when controlling for a variety of economic and demographic variables (Lauridsen, Nannerup, and Skak 2006), and a German study that found less acceptance of deviant behavior and greater readiness by homeowners to intervene in cases in which such behavior is observed (Friedrichs and Blasius 2006).[11]

In light of the widespread belief that an increase in the level of homeownership in an area increases property values, it is interesting that this issue has not been studied as extensively as one might expect, a fact that may be attributable to the difficulty of separating the effect of the homeownership rate from other variables affecting property values. Two studies have found that the construction of new subsidized housing for owner-occupancy increased property values. Ellen et al. (2002) found positive spillover effects from the construction of a critical mass of affordable homeownership units in Brooklyn under the Nehemiah program, while Ding and Knapp (2003) found that investment in construction of new housing in Cleveland during the early 1990s had a positive effect on the value of nearby homes. Since these studies dealt with the construction of new homes, rather than with changes in the homeownership rate within the existing stock, much of the effect may have been attributable to factors other than homeownership, such as the replacement of vacant lots or derelict buildings with shiny new homes.[12] Rohe and Stewart (1996) found, however, that increased homeownership rates within the existing housing stock also had a significant effect on neighborhood property values, while Coulson, Hwang, and Imai (2002, 2003) identified a significant "neighborhood ownership effect on housing prices, even after controlling for self-selection and unobservable characteristics" (2003). Looking at the same issue from the opposite direction, Ding and Knapp also found that the out-migration of homeowners from Cleveland neighborhoods had a negative effect on those areas' property values. While not definitive, this research, taken as a whole, offers a strong basis for arguing that homeownership

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[11] Both Denmark and Germany have among the lowest homeownership rates of the industrialized nations (in both cases under 50 percent of all households), suggesting that self-selection for homeownership may play a greater role in those countries than in other nations where homeownership rates are significantly higher.

[12] This suggestion is consistent with the finding in the study by Ellen and her colleagues that the positive spillover effect tends to diminish over time.

has a positive, and arguably strongly positive, effect on neighborhood health or stability.[13]

Finally, homeownership is widely seen as a means, arguably the principal means, by which households build wealth, through house price appreciation and the leveraging effect of low-down-payment mortgage borrowing.[14] There is no question that household wealth is strongly associated with homeownership (Di 2001) and that over time many American families have increased their wealth through house price appreciation. At the same time, the volatility in rates of appreciation over time and the volatility in individual housing markets are both considerable, and losses can outweigh gains (Li and Yang 2010). A study that looked in detail at the returns from home sales in Philadelphia, Boston, Chicago, and Denver between 1982 and 1999 paints a bleak picture.[15] When sales prices were adjusted for transaction costs and inflation, over 50 percent of the owners lost value in the first three cities, while 41 percent lost value in Denver (Belsky and Duda 2002b). Remarkably, as Belsky and his colleagues note, "Unfortunately, there are no studies that have estimated the frequency distributions of actual historical returns to homeowners in general or low-income homeowners in particular" (Belsky, Retsinas, and Duda 2005).

Still, looking at long-term trends, one can make a credible argument that over *most* periods, in *most* American housing markets, most homeowners generate reasonable, if not always spectacular, long-term gains. This is supported by the preliminary research I have done using the Case-Shiller index to compare the outcomes associated with different annual buy-sell dates between 1987 and 2010 for a number of different cities.[16] As shown in Table 2, the great majority of outcomes were positive; between 65 percent and 79 percent of potential buy-sell combinations during that period showed an annual rate of appreciation (in current dollars) in excess of 3 percent. Indeed, in Boston, over half of the buy-sell combinations yielded a return in excess of 5 percent per annum.

TABLE 2.
Probability of Appreciation on Resale, 1987-2010

Average annual appreciation (% of all buy-sell options)		Boston	Chicago	Las Vegas
Negative		16%	6%	7%
Marginal appreciation	(0-3%)	13%	15%	28%
Moderate appreciation	(3-5%)	19%	37%	28%
Strong appreciation	(>5%)	52%	42%	37%

Source: Analysis by author of data from the S&P/Case-Shiller Home Price Index

[13] The terms "neighborhood health" and "neighborhood stability" do not have precise or widely accepted definitions. If neighborhood stability is seen as essentially synonymous with neighborhood health, that is, a cluster of variables that define an area as having a good quality of life and thereby considered desirable by both the neighborhood's residents and potential in-migrants (communities of choice), it is arguably a mistake to conflate residential stability, in the sense of length of tenure, with neighborhood stability, as Rohe and Stewart (1996) appear to do. Conversely, I would argue that property values are highly correlated with other measures of neighborhood health and can serve to a considerable extent as a surrogate for a more global measurement of health or stability.

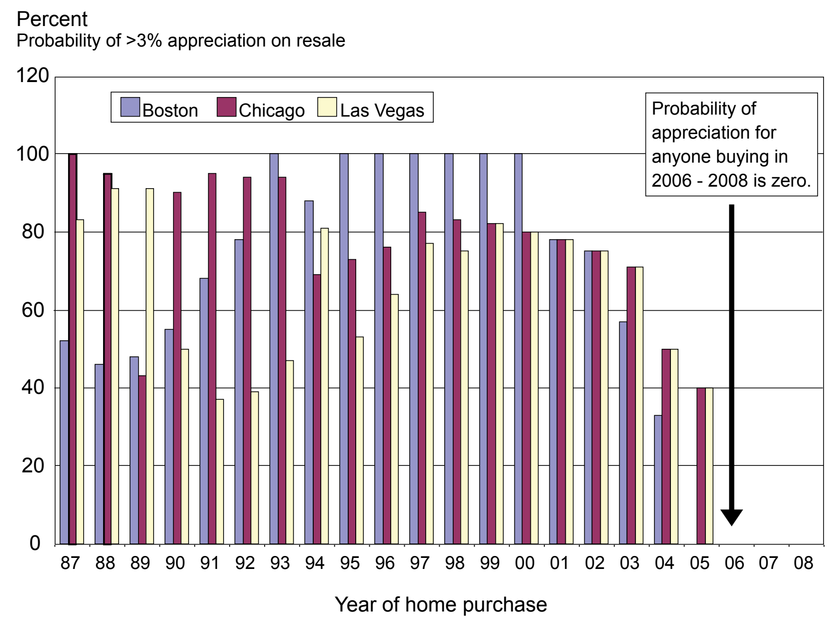
[14] There is less evidence that homeowners save money on *current* housing costs compared with renters; indeed, the most recent evidence, since the housing price run-up that began in the late 1980s, would suggest the opposite.

[15] The study was limited to owners who sold within 8.5 years after purchasing their home. The authors suggest that the outcomes might have been better for owners who held their homes for longer periods. If nothing else, longer holding should reduce the extent to which transaction costs dilute appreciation.

[16] Specifically, I looked at the difference in the index from January of the "buy" year to January of each subsequent year and computed the annual rate of appreciation in each case; thus, there would be 23 possible outcomes for a 1987 buyer, 22 for a 1988 buyer, etc., for a total of 276 possible outcomes. I am grateful for the research assistance of Brian Tyson in preparing and analyzing these data.

Timing, however, is everything. While usually a sound investment, purchasing a home is far from the all but certain path to wealth as it is often characterized by various interest groups. As Table 2 shows, a household buying a house in Boston in January 1987 and selling it at some point between then and January 2010 would have only a slightly better than 50-50 chance of realizing 3 percent or greater annual appreciation on resale. A household buying a house in Chicago in 1987, however, and – again – selling it at some point between then and 2010 would be all but certain to realize at least that level of appreciation on resale. By contrast, households that bought houses in Las Vegas between 1990 and 1993 would have less than a 50-50 chance of seeing that level of appreciation on resale, despite the intense but short-lived bubble that the city experienced in the early 2000s (Figure 2).

FIGURE 2.
Probability of Realizing Appreciation on Resale by Year of Purchase



Source: Author's analysis of data from S&P/Case-Shiller Home Price Index

As Table 2 also shows, since 2006, homeowners in these three areas have seen no appreciation; in Las Vegas in particular, property values have plummeted since then. Thus, while it may be true that most homeowners have experienced reasonable levels of appreciation in the past, with the housing market potentially heading into a long period of slow growth in many, if not most, parts of the United States, that may be less true in the future.

Various features of the research on the benefits of homeownership have come under question. In some cases, the research may have failed to isolate the homeownership effect from that of other social and economic variables that could have led to similar outcomes (Rohe, Van Zandt, and McCarthy 2001). While many of the studies have made credible efforts to control for critical variables such as income, family characteristics, race, and educational level, the effects of endogeneity and selection are difficult, if not impossible, to completely rule out (Rohe and Stewart 1996). A further question is raised by the possible conflation of the effects of homeownership and residential stability.

Homeownership in the United States is strongly associated with residential stability in the specific sense of greater length of residence in the same dwelling. As of 2000, the median duration of homeowner stays in the same home in the United States was 9.3 years, compared with 2.5 years for renters (U.S. Bureau of the Census 2000). Between 2002 and 2003 only 7.4 percent of owner-occupants relocated, compared with nearly 33 percent of renters (U.S. Bureau of the Census 2004). In more settled areas, such as the Northeast, median owner-occupancy tenure is much longer, at 11.3 years in New Jersey and 12.5 years in Massachusetts.

Residential stability has been increasing steadily since the 1960s. This reflects, in part, the higher homeownership rate but even more the trend toward longer spells of homeownership.[17] The conventional wisdom that Americans move on the average every five years reflects mobility patterns typical of the period between the mid-1940s and the mid-1960s. Since that time, mobility has been steadily decreasing, with only 11.9 percent of Americans changing their residence between 2007 and 2008 (Cohn and Morin 2008).

The association between homeownership and greater residential stability is clearly significant in itself; a literature survey conducted for the National Association of Realtors noted that a "consistent difficulty of many research studies is to separate the impact of homeownership from that of stable housing." The Realtors' study concluded that "if it is in fact the case that housing stability matters more than homeownership in bringing social benefits, then the policy implication is not necessarily to promote homeownership but to assist in residential stability" (National Association of Realtors 2006). Stability, rather than tenure as such, is likely to be the salient factor leading to some of the benefits cited in the literature, particularly those associated with improved youth outcomes, where the deleterious effects of high mobility have long been recognized (Simpson and Fowler 1994). Barker and Miller (2009) found that by adding control variables – including mobility – to a number of the data sets used to establish the association between homeownership and favorable child outcomes, the association was substantially reduced, strongly suggesting that the link between those outcomes and residential stability may be more significant than with the form of tenure, and that at least part of the seemingly powerful association of those social benefits with homeownership as such may be spurious.[18]

There is some evidence, however, that homeownership itself, independent of other significant social and economic variables, has a statistically significant effect on mobility (U.S. Bureau of the Census 2004; Rohe and Stewart 1996).[19] In that light, even if some of the benefits of homeownership are derived from stability rather than tenure as such, if promoting homeownership is an effective way of promoting stability, doing so would represent a legitimate public policy objective. That leads, in turn, to two questions with important policy implications.

First, to the extent that the benefits of homeownership are the product of stability, it becomes particularly important to focus not on homeownership *per se* but on *stable* homeownership, since a spell of homeownership of only short duration is unlikely to yield the social or economic benefits of a more extended spell of homeownership. Second, the question arises whether policies that might foster stability of tenure through means other than conventional homeownership would have the same beneficial effects. Such policies could take a variety of forms, including offering incentives for renters to remain longer in their homes, or encouraging the use of intermediate tenure models, sometimes referred to as "shared-equity homeownership," such as mutual housing, co-operatives, or community land

[17] The median tenure for homeowners increased nationally from 7.5 years in 1960 to 9.3 years in 2000; median tenure for renters, however, remained almost the same, increasing only from 2.3 to 2.5 years.

[18] To the extent that mobility is associated with workforce flexibility and its positive economic effects, factors that increase residential stability and reduce mobility can also be seen as having negative effects. The extent to which homeownership actually has a negative economic effect because of its effect on mobility is uncertain. While Oswald (1996) found a strong positive relationship between homeownership and unemployment in a number of industrialized European countries, the relationship has not been confirmed by subsequent research in the United States and Australia (Green and Hendershott 2001; Flatau et al. 2002). It appears unlikely that whatever effect homeownership may have in reducing mobility has a significant effect either on the American economy or on the well-being of American households, except under conditions where the housing market is particularly weak or where large numbers of households are "under water," and where households are constrained by their inability to sell their homes. The residential stability fostered by homeownership may also have negative psychological effects arising from a homeowner feeling "trapped" in an undesirable home or neighborhood, something that potentially may disproportionately affect lower-income homeowners.

[19] While this is clearly influenced by the substantially higher transaction costs associated with changing homeownership compared with changing rental tenure, it is likely to be influenced by other factors, including some of the social/psychological associations of homeownership mentioned earlier.

trusts (Davis 2006). There has been little or no research, however, that makes it possible to separate the benefits of stability *as such* from the benefits of stability resulting from homeownership or from other housing or social policies.

THE EFFECTS OF INCOME ON THE BENEFITS OF HOMEOWNERSHIP

Since most research on the benefits of homeownership comes from studies of middle- and upper-income households, it cannot simply be generalized to lower-income households (Shlay 2006). Homeownership can bring potentially significant costs as well as benefits, increasing the cost of homeownership or reducing the value of its benefits. While some of the costs may affect homeowners generally, others are likely to be more pronounced among lower-income households and among those predominantly lower-income households that live in distressed neighborhoods, potentially affecting the extent to which these households are likely to reap the benefits of homeownership.

The critical difference between low-income and other homebuyers is that the former have less wealth and income than the latter. For that reason, if they are to become homeowners, they are compelled to purchase the least expensive units available within a region's housing market. These units are disproportionately likely to be older than the average unit, often subject to inadequate maintenance over the years, and often located in distressed areas such as inner-city neighborhoods (Louie, Belsky, and McArdle 1998; Retsinas 1999).[20] As one writer notes, "Most low-income families only have the financial resources to buy rundown houses in distressed neighborhoods marked by few jobs, high crime rates, a dearth of services and poor schools" (Karger 2007).[21] The neighborhood effects of homeownership for lower-income and minority households have recently been studied in greater detail by Van Zandt (2007), who reached the conclusion that "lower income buyers can purchase homes only in neighborhoods that are more distressed than the ones in which they are renting."[22] It should be noted, however, that the sharp declines in real house prices since 2007 have increased the size of the pool of housing available to low-income households (at least those earning over 50 percent of area median income), making this particular issue less salient than it was just a few years earlier.

The consequences of the constraints on lower-income households' housing and neighborhood choices can be problematic for the homeowner. Both property taxes and insurance costs are typically higher, as a percentage of house value, in distressed urban areas than in their more affluent surrounding communities. Maintenance and repair costs are also likely to be high, further burdening households that typically have little savings and little excess disposable income.[23] Thus, over and above the cost to buy the property, continued homeownership may impose a

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[20]An exception should perhaps be made to this point, at least with respect to housing if not neighborhood quality, for affordable homeownership units created with public subsidies. These units represent, however, only a minuscule percentage of those units purchased by lower-income homebuyers.

[21]A similar pattern of low-income buyers purchasing similarly old and poorly maintained houses in rural areas is likely to exist, but the number of such buyers is likely to be substantially smaller than the number of low-income buyers in urban or inner ring suburban areas. Lower-income rural households are also more likely to buy mobile homes rather than conventional houses than are urban or suburban households.

[22] It should be noted that while this has historically been true, the decline in housing prices since 2006, coupled with the extremely low mortgage interest rates obtainable during 2010, has meant that in many metropolitan areas around the United States (in most areas outside the Pacific Coast and Northeast), the range of housing choices currently affordable to households earning below 80 percent of area median income has increased significantly. It remains to be seen whether this will be a long-term or merely a temporary change.

[23] Or, in the alternative, forcing low-income homeowner households to live in substandard or even hazardous conditions for lack of money to make needed repairs.

significant and disproportionate financial drain on a lower-income homeowner. Many lower-income owners experience unexpected costs within a short time after purchasing their home, with a large percentage of those owners being unable to afford making the repairs (Rohe et al. 2003).

While being disproportionately burdened with the costs of homeownership, lower-income or minority owners may gain fewer of the economic benefits of ownership. Much of the research into the homeownership experiences of low-income households has found that their financial returns from ownership are modest.[24] Their lower incomes mean that they will realize far fewer tax benefits, while nonetheless paying a price for their housing that is likely to reflect the imputed value of those benefits. The regressive effect of the home mortgage income tax deduction is significant (Li and Yang 2010).[25] The Van Zandt study cited above also found that minorities "appear to be buying in neighborhoods with lower median housing values and values that have declined over time." The average value of housing units owned by low-income homeowners increased by only 30 percent over a 10-year period, less than the "riskless" return on Treasury bills and only slightly more than half of the appreciation experienced by middle- or upper-income owners (Reid 2004).

The relationship between the rate of appreciation of houses of lower and higher value is unpredictable. As Herbert and Belsky (2008a) conclude, "Taken as a whole, the literature leads fairly convincingly to the conclusion that no consistent difference is evident in appreciation rates between low-income and high-income market segments." Studies that compare appreciation rates at lower and higher ends of the price scale in different market areas have come to very different conclusions.[26] The relationship cannot only vary from one market area to the next but from one price cycle to the next in the same market area (Case and Marynchenko 2002). Belsky and Duda (2002b) found that while the purchasers of lower-cost homes had a higher probability of realizing gains than their sample of owners as a whole, they were also likely to have gained less during their homeownership tenure in terms of housing and neighborhood quality.

The question remains whether, even if appreciation of low-value houses over time is comparable to overall appreciation rates, lower-income buyers realize the full extent of that appreciation. The literature tends to concentrate on price movements within markets over time, rather than on examining actual resales. The evidence suggests that the ability to control the timing of one's purchase of a home as well as its sale is a critical element in determining whether a homeowner is likely to realize a significant economic gain from the transaction (Case and Marynchenko 2002; Shlay 2006). Timing is an area in which lower-income homeowners appear to be at a particular disadvantage. In the final analysis, therefore, while some lower-income buyers do realize some gain, and a few may have realized significant windfalls when their neighborhoods became "hot" in the boom of the early 2000s, on the whole, they may

[24] Another factor affecting this is the significantly higher percentage of lower-income households that purchase manufactured housing when buying a home. While offering decent value for money, such housing units, particularly when located in a manufactured housing community (otherwise known as a mobile home park), show significantly less appreciation compared with conventional housing and often outright depreciation (Herbert and Belsky 2008b).

[25] The low utilization of the deduction by lower-income homeowners reduces their effective rate of return relative to more affluent owners. Moreover, it is widely recognized that the income tax deduction for mortgage interest does not increase the propensity for homeownership but increases the amount of home consumed, and therefore the price of housing, by changing the ratio between the price and the carrying cost of the house (Glaeser and Shapiro 2003), as well as instilling a preference for borrowing over equity in home purchases. Since it is likely that the pricing effects of the deduction would be distributed throughout the housing market, they would also affect those low-end houses for which the likelihood of the buyer benefiting from the deduction would be small.

[26] Another factor that may account for some of the variation between study findings is the difference in how studies segment the market. Some studies define "low value" as the bottom quintile of the market, while others may define it as the bottom third, and still others in terms of affordability to lower-income households.

be less able to realize potential gains than can more affluent homebuyers.[27]

The lower probability of appreciation is matched by considerably higher housing costs[28] as a percentage of income. In 2008, 72 percent of all homeowners earning less than $20,000 per year spent over 30 percent of gross household income for housing costs (American Community Survey (ACS) 2008). Few of these households recaptured any significant part of these costs through the income tax benefits available to higher-income households.[29] Moreover, the trend in housing costs for homeowners with mortgages shown in Table 3 means that far more homeowners are spending a much larger share of their income for housing today than in earlier years. Although not shown in the table because of the absence of comparable data for earlier years, the 2008 ACS found that 15 percent of all homeowners with mortgages, or 7.5 million households, were spending over 50 percent of gross income for housing costs.[30] Among very low-income households with a mortgage, high costs were all but universal; even among households earning under $20,000 a year *without* a mortgage, over half were spending more than 30 percent of gross income for housing costs (Table 4).

TABLE 3.
Change in Distribution of Homeowners with Mortgages by Percentage of Income for Housing Costs, 1990-2008

	1990	2000	2008
<20%	46.4%	44.1%	33.9%
20-24.9%	17.6%	17.3%	16.0%
25-29.9%	12.2%	11.9%	12.4%
30-34.9%	7.5%	7.5%	8.9%
35%+	16.4%	19.2%	28.8%

Source: U.S. Census 1990 and 2000; American Community Survey 2008

The benefits of homeownership to lower-income households are further vitiated by their significantly greater risk of losing their home. As Reid (2004) points out, homeownership generally "is an incredibly fluid category," but particularly so for low-income households, which are at far greater risk of returning to the rental market than middle- or upper-income owners.[31] Of the low-income households in her sample who became homeowners, within only two years, 36 percent were no longer owners, and after five years, over 50 percent no longer owned their home (Reid 2004).

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[27]Another consideration, for which only anecdotal evidence appears to be available, is the extent to which lower-income homeowners in areas of rapid appreciation are compelled to sell prematurely as a result of property tax increases or other pressures, such as a more stringent code enforcement, affecting their ability to continue to carry their property.

[28] Selected monthly housing costs are the sum of the owner's payments for mortgages, real estate taxes, insurance, utilities, fuels, and condominium fees.

[29] Few low-income homeowners take the mortgage interest tax deduction. Only 4 percent of homeowners with incomes under $20,000 and 13 percent of those with incomes between $20,000 and $29,999 claimed the mortgage income tax deduction in 2003 (Li and Yang 2010). It is not clear how many of the households not taking the deduction do so because they are unable to benefit economically by doing so and how many would benefit if they did so.

[30]An additional 1.5 million homeowners *without a mortgage* were spending 50 percent or more of their income on housing.

[31] It is worth noting that there is considerably more movement back and forth from homeownership to rental to homeownership among all sectors of the American population than is widely recognized or than is reflected in the conventional wisdom that the "normal" middle-class trajectory is a movement from rental to homeownership, and from the first owner-occupied "starter" home to a second owner-occupied "move-up" home, and so forth (Boehm and Schlottmann 2008).

TABLE 4.
Percentage of Homeowners Spending 30% or More for Monthly Housing Costs by Mortgage Status and Income, 2008

Income range	With a mortgage	Without a mortgage
Under $20,000	97.7%	56.7%
$20,000-$34,999	81.9%	14.5%
$35,000-$49,999	60.3%	4.4%
$50,000-$74,999	39.3%	1.2%
$75,000 or more	16.8%	0.2%

Source: American Community Survey 2008

A second study found similar disparities between white and African-American homeowners. Tracking a cohort of individuals for 21 years, Haurin and Rosenthal (2004) found that the latter had markedly shorter spells of ownership and longer spells during which they rented or lived with others over that period. This study concluded that a greater part of the difference between white and African-American homeownership rates was attributable to this phenomenon than to disparities in the frequency with which each group became homeowners in the first place, a finding fraught with significant policy implications that have been largely ignored by public policymakers.[32]

A third study found extremely high rates of foreclosure within a sample of low-income homebuyers who participated in a city-assisted program for first-time buyers in Philadelphia (Newburger 2006). The data sets used in all of these studies largely preceded the rise of subprime lending; notably, the Philadelphia study found lower, although still elevated, rates of foreclosure among those buyers who participated in specially designed mortgage programs for lower-income borrowers. All of these issues have been exacerbated by the disproportionate weight of subprime lending on lower-income and minority households and the disproportionate extent to which they have been harmed by the subsequent foreclosure crisis.

These factors materially reduce the benefits of homeownership for lower-income households. The higher cost and shorter duration of ownership reduce the likelihood of owners realizing any financial gain from homeownership as well as the other social and economic benefits associated with homeownership, while the greater frequency with which homeownership is lost carries with it significant negative effects as well, particularly when the loss is involuntary resulting from economic difficulties. One study has found an association between difficulty making mortgage payments and reduced well-being and physical health (Nettleton and Burrows 1998), while a more extensive study has concluded that "at an individual level, in most instances arrears and possession[33] are at best stressful and in some cases traumatic" (Ford, Burrows, and Nettleton 2001). A recent American assessment summarized the effects of foreclosure on borrowers as both financial, in terms of direct loss of funds and assets as well as the future losses associated with diminished credit capacity; and nonfinancial, including "the emotional and physical stress of managing the foreclosure process; the psychological effects of a dramatic and public 'failure'

[32] Although Haurin and Rosenthal examined some of the demographic and economic characteristics that appeared to affect the length of homeownership spells, their data set did not permit them to examine what factors led to the termination of homeownership, an important issue in its own right. In view of the negative features of low-income homeownership noted earlier, such as lower neighborhood quality and high housing costs, it would be valuable to explore the extent to which terminations may have reflected dissatisfaction with neighborhood or housing conditions or difficulty covering the costs of homeownership.

[33] The study was conducted in the United Kingdom. The terminology is the British equivalent of "default and foreclosure."

at one of life's key milestones and simultaneous reduction in socioeconomic status; and negative effects on children in households forced to move as a result of foreclosure" (Apgar, Duda, and Gorey 2005).

It is more difficult to tease out differences in the social benefits of homeownership by income, and less work has been done in this area. Harkness and Newman (2002, 2003) found that homeownership had significant positive effects on a number of child outcomes for lower-income households but also that much of the benefit was lost if the homeowner lived in a distressed neighborhood.[34] Even there, however, they found that homeownership conferred some benefits. With respect to civic participation, some evidence suggests that lower-income homeowners show lower levels of engagement than more affluent homeowners (Herbert and Belsky 2008a), while there is little evidence available from which one can draw even tentative inferences about income differences with respect to the effect of homeownership on other social or psychological factors.[35]

These findings are summarized in Table 5, which I have created by drawing inferences from the research findings summarized above and comparing them to each of the benefits initially outlined in Table 1. Many of the potential differences cited in Table 5, however, are far from firmly supported in the literature. Further research that would better establish as well as measure these disparities would not only be of value in itself but would have significant implications for public policy.

In conclusion, the costs and benefits of homeownership are highly situational, in that the extent to which a household actually reaps those benefits or suffers those costs depends on their financial status, the housing market area in which they live, the quality of the house they purchase and of the neighborhood in which it is situated, the nature of the financial transaction through which they purchase their home, and their ability to sustain homeownership over time.

The evidence is reasonably strong, although not unequivocal, that *as a general proposition*, fostering homeownership can provide a variety of benefits both to the individual and to the community. The evidence for the benefits of homeownership *for lower-income households* is more mixed, with the benefits often less and the costs often greater than those for more affluent households.

While the research raises questions about the overall balance of costs and benefits of homeownership for lower-income households, it can also be useful to policymakers who are seeking to find ways to increase the benefits of homeownership to lower-income people and reduce the costs. It strongly suggests that *under circumstances that foster stability of tenure*, lower-income homeownership remains a sound policy goal, and that public action can contribute significantly to creating those circumstances. How that can be achieved will be addressed in the final section of this paper.

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[34] Neighborhood distress was determined on the basis of poverty rate, homeownership rate, and neighborhood residential stability.

[35] A particularly interesting study on the effect of homeownership on the values and beliefs of lower-income households arose from a unique set of circumstances in Argentina, where – for reasons utterly unrelated to any actions or decisions by households living in a squatter community near Buenos Aires, but for reasons arising from legal disputes between the government and the owners of the land under the community – roughly 60 percent of the squatters received title to the land under their homes (the owner group), while the remaining 40 percent did not (the nonowner group). There was no significant difference either in the demographic characteristics of the two groups or in the characteristics of the parcels (size, proximity to amenities, etc.) on which their homes were situated. In a survey conducted a number of years after the conveyance of title, researchers found that the attitudes of the owner group on a series of market-related questions, involving such matters as individual efficacy, the significance of money, and their level of trust of other people, were significantly different from those of the nonowner group and, indeed, comparable to a general sample of the Buenos Aires population. This study appears to be the "purest" evidence of a distinct property-ownership effect on values and beliefs among lower-income individuals (DiTella, Galiani, and Schargrodsky, et al. 2007).

TABLE 5.
Income Disparities in the Benefits of Homeownership

HYPOTHETICAL BENEFIT (from Table 1)	POTENTIAL DIFFERENCE IN BENEFIT FOR LOW-INCOME HOMEOWNERS
Residential satisfaction	Satisfaction may be lower because of lower satisfaction with neighborhood conditions.
Psychological health and self-esteem	While the initial effect of becoming a homeowner may not be different, the long-term effect on psychological health and self-esteem may be lower because of shorter ownership tenure, lower satisfaction with neighborhood conditions, and greater risk of negative psychological effects resulting from difficulty making payments or from foreclosure.
Physical health	Not enough information
Child outcomes	Homeownership may improve outcomes for children of lower-income households, but much of the benefit is lost if the home is in a distressed or high-poverty neighborhood.
Housing quality	Housing quality may be lower because homes bought by lower-income buyers are more likely to be in poor condition and in need of repair.
Neighborhood quality	Neighborhood quality is likely to be lower than for more affluent homeowners but may be equal to or greater than neighborhood quality for lower-income renters.
Housing cost	Housing cost benefits are less because lower-income buyers spend a higher percentage of income for housing costs and benefit less from tax advantages.
Wealth accumulation	Wealth accumulation may be less because lower-income households are less able to time purchase and selling decisions, have shorter spells of homeownership, and are more subject to foreclosure and involuntary sale.
Improved access to credit	Access to credit by lower-income buyers is likely to be less enhanced because of higher current costs and reduced wealth accumulation, as well as greater risk of losing the home.
Neighborhood stability	Not enough information
Civic participation	Low-income homeowners are less likely to be engaged in neighborhood and civic affairs.
Appreciation in neighborhood house values	Not enough information. Preliminary findings show no consistent pattern.

Source: Analysis by author based on review of research cited in this paper

RETHINKING LOWER-INCOME HOMEOWNERSHIP POLICY

A. Introduction

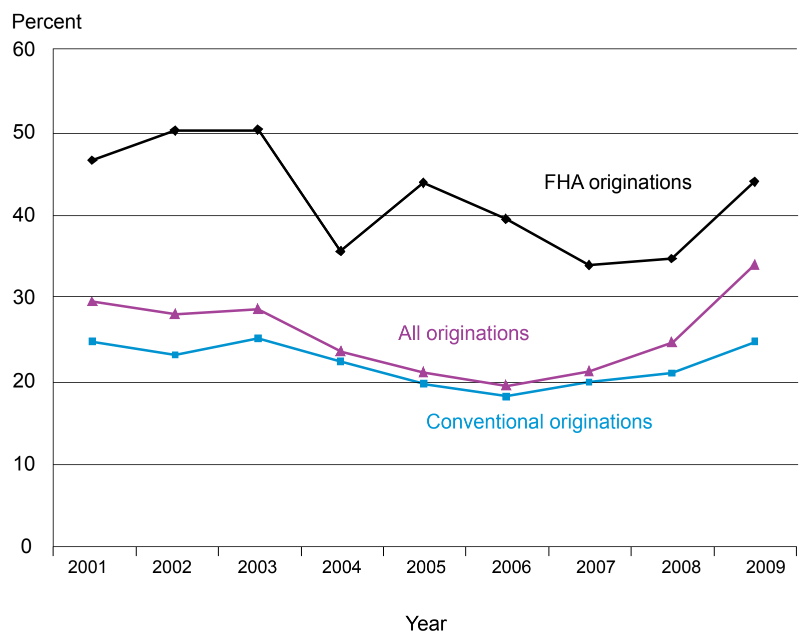
Homeownership can, in fact, benefit many lower-income households and their neighborhoods, a proposition that supports the argument that fostering lower-income homeownership is a legitimate, even valuable public policy objective. Many of those benefits, however, do not flow automatically from homeownership per se but are derived from particular elements of the homeownership experience. Those elements, which include the stability of the family's tenure, the financial terms under which it acquires the home, and the quality and location of the home, collectively define the value of the experience and the extent to which it is likely to benefit the homeowner, her family, and her community. These elements are highly variable, and all can be influenced by public policy.

As I suggested at the beginning of this paper, this conclusion provides compelling support for a public policy proposition, specifically, that public resources should be less directed toward maximizing the *number* of lower-income homeowners and more toward maximizing the *quality* of the homeownership experience for lower-income owners. The value of public-sector intervention to increase the number of lower-income homeowners is questionable. Between 2001 and 2009, nearly 11 million lower-income households,[36] or 1.2 million per year, received mortgages to purchase homes, the great majority of which received no public-sector support in the form of subsidy, down payment assistance, or otherwise. On a year-by-year basis, these households accounted for between 20 and 30 percent of all home purchase mortgage originations (Figure 3). In 2009, lower-income households accounted for 34 percent of all originations, the highest level reached in the decade, most probably reflecting the extent to which house price declines and low mortgage interest rates have made the housing inventory in most parts of the United States highly affordable to lower-income households[37] and strongly suggesting that the tighter underwriting standards imposed since the bursting of the bubble have not disproportionately affected lower-income buyers.

Two inferences can be drawn from these data. First, the great majority of lower-income households that become homeowners do so without public-sector assistance. Second, more speculatively but plausibly, many of those who do receive public-sector assistance might well have become homeowners sooner or later without that assistance.[38] Either way, it raises serious doubts about the value of public strategies designed to increase the number of lower-income homeowners.

Whether with respect to the initial home purchase or the ongoing process of owning a home, the central goal of public policy toward lower-income homeownership should be to foster a sustainable model of homeownership for lower-income households. While the term "sustainable" is overused and susceptible to having many different meanings, it is particularly appropriate in this context. I would define it as follows: *Sustainable homeownership occurs when owning a home confers social and economic benefits on the owner at a cost that does not impose unreasonable financial stress and*

FIGURE 3.
Lower Income (≤ 80% AMI) Percentage of All Home Purchase Mortgage Originations, 2001-2009



Source: Home Mortgage Disclosure Act data

[36] Defined as earning less than 80 percent of AMI. Of this total, roughly one-third had incomes under 50 percent of AMI. These data come from the HMDA National Aggregate Report, available at www.ffiec.gov.

[37] A September 2010 analysis by the author of Multiple Listing Service listings in the Allentown, Pennsylvania, area found that 66 percent of the houses listed for sale were affordable to households earning 80 percent of AMI or less, based on current mortgage interest rates and city of Allentown property tax rates.

[38] This issue, which has significant implications in terms of the use of public funds, has not been the subject of a formal research study to my knowledge, but such a study would not be unduly difficult to design and carry out.

where the risk of an involuntary end to the homeownership spell has been significantly reduced. Specific recommendations to that end are summarized in Table 6 and discussed in detail in the rest of this paper.[39]

B. Sustainable Home Purchase

Sustainable homeownership begins with the conditions under which the home purchase takes place. If the initial purchase conditions are such that they accentuate risk or minimize benefits, the buyer's future predicament is unlikely to be remediable in the future. Sustainable home purchase is a function of two separate factors. The first, which has been widely recognized since the onset of the subprime mortgage[40] and foreclosure debacle, are the terms of the mortgage with which the home is purchased; the second, less often addressed, is the quality and condition of the home being acquired and of the neighborhood in which it is located.

An important goal for a public policy that fosters sustainable homeownership is to have a housing finance system that simultaneously provides access to mortgages while discouraging or banning mortgages and underwriting procedures that place homebuyers at undue risk of involuntarily losing their homes. The recent history of the subprime boom and bust offers an instructive object lesson in what public policy should not be and a frame of reference for what it should be going forward. While recent legislation and regulatory action at the state and federal levels should help protect against the most abusive practices emerging once again after the current crisis has run its course,[41] preventing abuses, however essential, is not in itself a policy to further lower-income homeownership. Such a policy demands that sound alternative mortgage products and other services designed to minimize rather than exacerbate default risk be available to lower-income borrowers.

Financing Sustainable Homeownership. Creating a policy framework to foster sustainable homebuying by lower-income people dictates that the nature and choice of mortgage products and the terms on which they are made available be carefully reconsidered. Such mortgages should typically be fully amortizing 30-year loans at or near market interest rates, either with fixed rates and monthly payments, or adjustable within carefully defined and narrow limits. The starting point for any such framework is the ability to offer lower-income borrowers mortgage instruments that truly reflect their ability to pay and do not require them to spend an excessive percentage of their income on housing costs. While recognizing that many lower-income households that are legitimate candidates for homeownership will still represent higher risks than the average homebuyer, it is important to recognize that many other households may not be good candidates for homeownership or may not be able to shoulder its financial

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[39] Many of these recommendations are for activities that have rarely been pursued or pursued at most on a scattered, unsystematic basis, up to now. As a result, there is little research on many of these activities; when there is, it is cited in the discussion of that activity in the text below.

[40] An important distinction should be made at this point. To the extent that subprime lending may be defined to include all programs that extended the opportunity to purchase or refinance a home to borrowers who might not have qualified under traditional underwriting criteria, *some* such activities were arguably legitimate and desirable, where the extension of credit to lower-income borrowers took place – as with many bank CRA programs – under reasonable mortgage terms coupled with solid homeownership education and counseling by a nonprofit. The same cannot be said of the subprime lending industry as it emerged in the 1990s and early 2000s, epitomized by the mortgage underwriting practices of firms such as Countrywide or Ameriquest Mortgage.

[41] At the federal level, the most important steps have been the adoption of amendments to Regulation Z by the Federal Reserve Board in 2008 and, above all, enactment of the Dodd-Frank legislation on financial regulatory reform in the summer of 2010, with its abolition of yield spread premiums and the creation of the Bureau of Consumer Financial Protection. Legislation embodying different consumer protection provisions has also been adopted in a number of states, including Massachusetts (House Bill 4387), Ohio (Senate Bill 76), Minnesota (Chapter 18, Laws of 2007), and North Carolina (Session Law 2007-352). While states are pre-empted from regulating the practices of nationally regulated banking institutions, state law governs the activities of mortgage brokers, which have originated a majority of the home mortgage loans made in recent years.

TABLE 6.
Summary of Policy Recommendations to Further Sustainable Lower-Income Homeownership

CATEGORY	RECOMMENDATION
Mortgage lending	Develop data-based criteria for responsible mortgage lending to lower-income homebuyers, including mortgage terms and underwriting standards
	Adopt standards for responsible mortgages for lower-income homebuyers based on certain criteria
	Prohibit secondary market access and use of public-sector funds in conjunction with mortgages that do not meet responsible standards
	Conduct educational and outreach activities to make prospective borrowers aware of responsible mortgage products
	Increase availability and visibility of meaningful pre-purchase education and counseling resources
Public subsidies for lower-income homeownership	Provide public subsidies to build or rehabilitate housing for lower-income homeownership sparingly, only when (1) adequate housing at affordable prices is not available on the private market; and/or (2) the housing will serve a compelling neighborhood revitalization or other public purpose
	Use public funds for down payment or closing cost assistance rarely if at all
	Conduct research on the extent to which public down payment or closing cost assistance actually expands homeownership or provides meaningful net benefit for lower-income homeowners
Increase housing quality	Increase efforts to inform prospective homebuyers about home-buying options
	Provide easy access to affordable home inspection services for prospective homebuyers
	Enact local ordinances requiring certificate of occupancy inspections or similar requirements for new purchases
	Create programs with public funds to provide small loans to lower-income homebuyers to make home repairs and improvements to newly purchased homes
Foster sustainable ownership	Expand availability of ongoing post-purchase counseling and crisis intervention services for homeowners
	Create emergency assistance programs similar to the Pennsylvania HEMAP program at the state and local levels
	Explore the use of mortgage products and property tax changes to mitigate the effect of income disruptions or price shocks on homeowners
	Explore wider use of shared-equity homeownership models such as limited equity cooperatives and community land trusts

burdens, and that it is bad policy to entice such households into homeownership through unduly relaxed underwriting standards.

Far more systematic thought needs to be given to the extent to which underwriting criteria should be modified to further lower-income homeownership. While the restrictive practices of former generations may have been unreasonable and discriminatory, it can be argued that during the 1990s and early 2000s, the pendulum swung too far in the other direction, with major organizations encouraging what ultimately came to be recognized as problematic, or even irresponsible, lending practices.[42] At the same time, there is solid evidence that under appropriate circumstances, lending can be extended to borrowers who may not meet traditional criteria while maintaining acceptable default rates.[43]

The more liberal the underwriting criteria, the greater the number of households that are likely to become homeowners. Also, the greater the likelihood that more of them will default and lose their homes. This is now generally recognized. What has not been resolved, however, is the underlying question: *What is a proper balance between expanding homeownership opportunities and increasing the likelihood of default?*

No set of plausible conditions will yield a zero foreclosure rate. Some parties, however, have been far too sanguine about far higher foreclosure rates than appear to be reasonable, as in the case of a former senior Bush administration housing official quoted late in 2007 that "subprime mortgages democratize credit, and so we don't want to throw that option away. Not all of these loans result in foreclosures. Only a fifth of those subprime mortgages are at risk of default." [44] Leaving aside the statement's inaccuracy in light of actual default rates,[45] the speaker was implicitly arguing that a 20 percent loss rate on subprime mortgages is acceptable in light of the benefits obtained.[46] While that argument is patently flawed in light of the actual circumstances of subprime borrowers, could one conclude that a 20 percent default rate *might* be acceptable if nondefaulting lower-income borrowers do obtain significant benefits from becoming homeowners? If not, which appears reasonable in light of the loss of value resulting from foreclosure, what then is an acceptable default or foreclosure rate? [47]

This paper will not attempt to answer that question. We now know a great deal, however, with respect to the relationship between different risk factors and ultimate foreclosure rates, as well as something, although less, about the costs and benefits of homeownership. This information should make it possible to explore the ramifications of that question in order to begin making rational decisions with respect to what deviations, if any, from normative — that is, pre-subprime — standards should be considered acceptable in the interest of expanding the

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[42] An example of this was a publication by the Federal Reserve Bank of Boston: *Closing the Gap: A Guide to Equal Opportunity Lending.* Boston, MA, 2003.

[43] A number of studies have shown that public-sector or nonprofit-based lending programs aimed at such borrowers can be successful in placing lower-income households into homeownership with subsequent default rates not significantly greater than prime lending default rates. One study looked at nonprofit first mortgage programs such as those administered by Self-Help in North Carolina or Neighborhood Housing Services (Abromowitz and Ratcliffe 2010), while another looked at a cluster of public-sector mortgage assistance, principally second mortgage, programs (Reid 2009). While the results of these programs are encouraging, more research is needed to determine what particular factors may be most strongly associated with the low default rates reported.

[44] Former HUD Assistant Secretary Darlene Williams, quoted in an AP report from Singapore, dated September 24, 2007, from CNNMoney.com.

[45] A 2009 study found that 32 percent of all subprime mortgages made in 2005 and 44 percent of subprime mortgages made in 2006 were in default after 21 months (Amromin and Paulson 2009).

[46] It is hard to imagine that default rates in this range would have been even remotely acceptable to the lenders making the loans had it not been for the unregulated use of securitization to pass the risk along to third parties. If lenders are to be held accountable for the losses on mortgages they originate, it is likely that they will insist on substantially more careful underwriting than was the case during the recent bubble years.

[47] This point was raised in a communication from the National Consumer Law Center to the House Financial Services Committee flagging the increase in foreclosures already apparent in December 2003; in that letter, NCLC Managing Attorney Margot Sanders wrote: "At what point does lending which stands a high risk of causing the loss of a family's home become unacceptable? Does this Congress condone mortgage lending which has a 10% chance of foreclosure? Should it be legal for mortgage lending to be permitted with the anticipated risk that the family will stand a 20% chance of losing its home? In the past Congress has expressed concern when the foreclosure rate for FHA loans reached 3%. What has changed?" http://www.nclc.org/images/pdf/forclosure_mortgage/archive/oxley_letter.pdf

availability of mortgage credit. Such an exploration should take into account such matters as the minimum down payment that should be required, the maximum percentage of gross income that should be spent on mortgage and total debt, which nontraditional factors might be appropriate in establishing a credit history, and under what circumstances mortgages other than conventional 30-year fixed-rate loans should be offered to prospective buyers. The lessons of the programs reviewed by Abromowitz and Ratcliffe (2010) as well as similar programs elsewhere should be explored in greater detail. Existing norms, such as front-end and back-end ratios used by the FHA and other lenders, should be re-examined in the course of this assessment. This is an area of research that should be of great interest to HUD, Fannie Mae, and Freddie Mac, as well as all federal and state supervisory agencies.

The goal of this exercise should be to create a body of research-based parameters to govern responsible mortgage lending to lower-income homebuyers, which could then be adopted by Fannie Mae, Freddie Mac, and the FHA,[48] from which point it would be likely to filter down to private lenders.[49] While private lenders would not be barred from offering mortgages that did not meet those parameters, they could be discouraged by rules that (1) mortgages to lower-income buyers that failed to meet responsible parameters would not be treated as conforming for purposes of access to the GSE secondary market; and (2) federal subsidies such as HOME or other public funds, as well as tax-exempt bonds, could be used only in conjunction with responsible mortgages, as well as requirements that lenders disclose to prospective borrowers that the mortgage terms are not considered sound by public-sector regulators.[50] Education and outreach efforts should also be pursued, to warn prospective buyers against the risks of taking out nonconforming mortgages.

Meaningful homeownership education and counseling, which has been shown to significantly reduce mortgage delinquencies (Hirad and Zorn 2002; Quercia and Spader 2008), should play an important role.[51] It is important to stress the word “meaningful,” since as both studies establish, there is no evidence that the workbook and telephone “counseling” that is treated as such by much of the lending industry has any effect on credit risk or stability. Counseling cannot only better prepare a prospective buyer for homeownership, but it can also provide the prospective buyer with enough information to evaluate whether homeownership is indeed an appropriate step and to change course without having incurred any liability. The pre-ownership period can also be used as an opportunity for credit repair, to enable the prospective homeowner to qualify for a mortgage. While participation in pre-purchase homeownership education and counseling should not be made a condition of obtaining a mortgage, it should be strongly encouraged; as is already widely the case, it should be a condition of access to public subsidy for home purchases. Moreover, the availability of pre-purchase education and counseling should be increased and more widely publicized, so that prospective buyers who plan to buy in the private market unassisted are both aware of its availability and encouraged to seek it out.

Public Subsidies for Lower-Income Homeownership. The use of public funds to subsidize affordable homeownership should be thoroughly re-examined. Using public or nonprofit funds to provide down payment and

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[48] FHA default rates, particularly on loans made since 2006, have been skyrocketing along with the volume of FHA mortgages, raising serious issues with respect to that agency’s financial stability (Streitfeld and Story 2009).

[49] There appears to be far less evidence of difficulty with state FHA mortgages than with the GSEs, arguably because the reliance of the former on revenue bonds for their capital served as an effective form of fiscal discipline.

[50] It may be appropriate to further provide that any lender that made nonconforming mortgages to lower-income borrowers would forfeit its eligibility for public funds or its access to the secondary market, in general.

[51] Homebuyer education and counseling was a central element in the programs described by both Reid (2009) and Abromowitz and Ratcliffe (2010).

closing cost assistance, often to the point where buyers have little or no money of their own in the transaction, has been a popular way of expanding homeownership – or giving the appearance of doing so – at relatively low public cost. The benefits of these programs need to be dispassionately evaluated. The extent to which reducing the borrower's personal investment sharply increases the risk of default has long been well-established (Quercia and Stegman 1992; Deng, Quigley, and Van Order 1996; Newburger 2006; Kelly 2008). Kelly found particularly high default rates among the beneficiaries of nonprofit down payment assistance programs who made no down payment of their own. While these programs have undoubtedly made it possible for some families to become homeowners, they have also created a large pool of high-risk owners. Fortunately, the most common form of down payment assistance, which was in essence a roundabout version of seller-financed down payment assistance (the nonprofit provided the buyer with the assistance and then billed the seller, who added the cost to the price of the home), was effectively abolished by Section 2113 of the Housing and Economic Recovery Act of 2008.

This does not necessarily mean that down payment assistance should never be available. After all, many middle-income first-time homebuyers receive down payment assistance from relatives, an option less readily available to lower-income buyers,[52] while Reid (2009) found that well-structured public-sector programs had low default rates. The fact remains, however, that we have no idea whether the beneficiaries of these programs would or would not have found the money sooner or later to become homeowners on their own, or whether those who would not have found the money were appropriate candidates for homeownership. These programs need to be subjected to a rigorous evaluation of their relative costs and benefits, first, to determine the extent to which they expand lower-income homeownership opportunities at all, and second, to determine the net benefit resulting from their expansion of homeownership opportunities relative to the costs that may result from increasing the instability of those opportunities.

Public funds are also widely used to subsidize housing for lower-income homeownership directly, filling the gap between the cost of building or rehabilitating houses and the price at which they are affordable to lower-income homebuyers. The cost of such programs is considerable and can be in excess of $100,000 per unit.[53] The New Homes for Chicago program, for example, provides multiple layers of assistance to participating developers, including the sale of city-owned lots for $1, waiver of city fees, city-provided site improvements, state tax credits to the donors of private subsidy funds and energy assistance funds, property tax abatements, and a city-funded capital subsidy of $10,000 to $80,000. Although it is difficult to put a price tag on some of these items, the public-sector cost – either in direct outlay or in loss of potential revenues – for each house is estimated to be $150,000 to $200,000 (Mallach 2009).[54]

With public subsidy funds for lower-income homeownership in short supply, it may make more sense to use them to help lower-income households buy houses on the private market. In many metropolitan areas today, houses of good quality (or which can be brought to that level with a small additional investment) are available on the market for substantially less than the cost to build a new house using public funds.[55] This is true not only in the weakest

[52] A 1998 study estimated that transfers from family members provided down payment assistance for 20 percent of first-time homebuyers, accounting, on average, for half of the down payment (cited in Case, Quigley, and Schiller 2006).

[53] A recently proposed condominium project that would create one- and two-bedroom units for affordable homeownership in an affluent Westchester County, New York, community will require a public subsidy of roughly $135,000 per dwelling unit.

[54] One could argue that much of the waiver of taxes, fees, or land costs is not an actual loss because those revenues would not be realized in the absence of the development. That is questionable because in the sort of strong market environment that might justify expending such funds to create affordable housing, the sites used for that purpose would be likely to also have significant value for market-driven development.

market areas such as Detroit or Cleveland, where houses are available for less than the cost of a good-quality used car, but stronger market areas as well. The Minneapolis area, for example, offers large numbers of single-family houses and condominiums at or below $150,000, a price affordable to a household earning 50 percent of the 2009 Minneapolis area median income.[56] There are far more market areas in the United States that resemble Minneapolis, after the price declines of the past three years, than there are areas where the cost of a modest home on the market exceeds the cost of creating a new one. In many of the former areas, encouraging the purchase of homes on the market by lower-income families will also help stabilize markets that have been destabilized by foreclosures and contain an excess of housing supply over demand.

These programs, therefore, raise the question of whether the considerable expenditure of public funds that they represent for each incremental homeowner can be justified by the public benefits of homeownership for lower-income households. The question is rendered more complicated, and the value of these programs called even further into question, by the fact, as noted earlier, that the great majority of lower-income families that become homeowners – even in many strong market environments – do so with no public-sector assistance. It can reasonably be conjectured that of the families who receive public-sector assistance to become homeowners, many would sooner or later achieve that goal on their own, thus rendering the public-sector cost per net incremental homeowner — that is, households that would not have achieved homeownership without assistance — that much greater. The value of public-sector assistance for homeownership is further vitiated by the likelihood that at least some percentage of households receiving assistance are poor candidates for homeownership and lose their home sooner rather than later.[57]

Given the substantial disparity between the unit costs for creating new housing units targeted to lower-income buyers, and providing any of a variety of alternative vehicles to help families prepare for homeownership, find adequate homes in the private market, and sustain their homeownership over time, sound public policy would dictate that the former be pursued only rarely. Circumstances that might justify public-sector investment in building new homes for lower-income buyers might include those in which they are a key part of a targeted neighborhood revitalization or market-building effort or in those few areas where market constraints have placed the cost of existing housing out of reach, but where the cost of production is still not unduly high. With arguably less need to use public funds for down payment assistance as well, it should be possible to redirect more funds toward "soft" activities, including pre-purchase counseling and education and the development of a robust post-purchase support system for lower-income homeowners.

Finally, one other approach to financing lower-income homeownership that has been proposed should be noted but without endorsement. During the past decade, the shared-equity mortgage, under which the lender

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[55] New construction or substantial rehabilitation of housing for lower-income occupancy under public subsidy programs is often substantially more expensive than volume market construction, because projects tend to be small scale, often on urban infill sites, and lack the market discipline that motivates builders in a competitive market.

[56] A search of Realtor.com on December 19, 2009 found 1,643 listings in the Minneapolis area at or below $150,000, of which 943 were single-family homes (mostly three-bedroom units) and 700 condominium or co-operative units (mostly one- or two-bedroom units). At current mortgage and Minneapolis property tax rates, assuming an FHA mortgage with a 3.5 percent down payment, the monthly cost of a single-family house selling for $150,000 is just over $12,000 per year, which represents 30 percent of a gross income of $40,000 per year. The 2009 HUD median income for a family of four in the Minneapolis MSA is $83,900.

[57] To illustrate this point, assume that a public-sector program provided households with an average of $20,000 per household in down payment and closing cost assistance, but that two-thirds of the households would have become homeowners eventually without assistance; and that one-quarter of those who would not have become homeowners were high-risk buyers who lost their homes before receiving any tangible homeownership benefits. The public-sector cost per net benefiting household is not $20,000, but $80,000.

shares the future equity appreciation on the property with the borrower in return for a smaller debt or lower mortgage payments, has been advocated as a way of reducing the entry costs of homeownership. *Shared-equity mortgages* are a very different matter from *shared-equity homeownership*, a term used to refer to homeownership models designed to preserve long-term affordability of homes to lower-income buyers, discussed below on page 28.

Widely used in the United Kingdom in both the unsubsidized and subsidized housing sectors, shared-equity mortgages can be structured in a variety of ways, including models under which the borrower can "buy back" the lender's equity share, either by direct cash payment, or by continued timely mortgage payments over some number of years. While past financial analyses have suggested that shared-equity mortgages would be a potentially attractive option for the investment community (Caplin et al. 2007), that seems far less likely today in light of the massive loss of home equity since 2007. A lender would only be likely to accept a significantly lower annual rate of return on his equity share if he has higher than normal expectations of appreciation, in other words, if he shared the bubble mentality that led to much of the current crisis. It is hard to see a role for shared-equity mortgage financing in a future strategy for sustainable lower-income homeownership, except perhaps as a vehicle for recapturing some of the public dollars that may be used to subsidize home-purchase transactions.

Fostering Housing Quality. While the financial terms under which a buyer becomes a homeowner may be the most important factor in creating sustainable homeownership, the quality of the house and the neighborhood are also significant, both with respect to sustainability and to the benefits, both social and economic, that the household gains from ownership. Buying a house in poor condition puts the owner at risk for burdensome and potentially untenable repair costs, while buying a house in a distressed neighborhood can reduce the social benefits of ownership as well as potentially reduce the likelihood of future appreciation.

No one should be prevented from buying the home they want, in the community they choose. At the same time, public policy should encourage lower-income households to purchase homes in good condition or, at a minimum, have a full understanding of any conditions likely to result in repair or replacement costs within five years or so of initial purchase. Lower-income buyers are likely to have little discretionary cash to spend on repairs, and the houses within their price range are disproportionately likely to be older, with systems and fixtures in need of repair or approaching the end of their useful life, even if they do not violate any code.

Simply providing prospective buyers with information can in itself be important. Prospective lower-income homebuyers are potential victims of information asymmetry at many different levels. They are likely to be unfamiliar with many of the options that may exist within their housing market area, they may not be aware of the variety of largely web-based resources that may enable them to learn about alternatives, and they are less likely to get the full attention of real estate brokers and their sales personnel.[58] Some cities and community development corporations (CDCs) have made efforts to provide prospective buyers with information about home-buying options; many of the efforts by city governments, however, such as the Live Baltimore Home Center, have understandably focused more on marketing the city's housing stock to middle- and upper-income buyers.

A variety of modest steps can help improve the likelihood that lower-income buyers will be able to obtain houses of acceptable quality. Voluntary pre-purchase inspections can be offered by local nonprofits. Local governments can adopt ordinances requiring renewal of a certificate of occupancy with each transfer of title. The Miami-Dade County certificate of use ordinance requires a disclosure of findings report prepared by a licensed architect

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[58] Real estate brokers, whose business is entirely driven by commissions, tend with rare exceptions to give little attention to the low-value market in general and inner-city neighborhoods in particular. Many urban neighborhoods, and some entire older cities, lack full-service brokerages; as a result, listings from those neighborhoods and cities go to outside (usually suburban) brokers who not only have little understanding of urban neighborhoods but who will also be reluctant to devote much time to inner-city listings in view of the modest commissions – and hard work – that their sales entail.

or engineer for every house going through the foreclosure process, identifying any code violations on the property and providing a good faith estimate of the cost to remedy those violations.

A more pro-active approach, one in which houses chosen by lower-income buyers need repairs but the cost of the repairs is not substantial, is to use public funds to make those repairs before the new buyer moves in. An initial expenditure of $10,000 or less is often enough to ensure that the home will serve its new owner well; the funds can then become a second mortgage on the property, payable on resale from the appreciation in the house's value. If there is none, the loan is forgiven. Such a program, particularly if it could be brought to scale, could fit readily into the mission of many CDCs, as well as create employment opportunities for skilled workers in the community.

C. *Maintaining Stable Homeownership*

While fostering sustainable homeownership begins with the home-buying transaction, it does not end there. Creating a support system for lower-income homeowners may be as important as creating a responsible process by which they become homeowners in the first place. By definition, to be a lower-income homeowner is to be at risk. Lower-income homeowners have a smaller financial cushion with which to withstand the impact of negative life experiences, such as unemployment or serious illness, or to meet unanticipated repair costs, and, by virtue of their limited housing choices, are more likely to buy houses in need of repair, either immediately or within a few years of occupancy. Redesigning the home-buying process can reduce that risk but not eliminate it.

It is arguably more important to increase the sustainability of homeownership, once entered into, than to create new homeowners. As Haurin and Rosenthal (2004) write, "To have a lasting impact on overall homeownership rates, policies must promote new homeownership spells that are sustainable. Furthermore, policies that lengthen existing ownership spells will also raise the national ownership rate, even if the rate of attaining first time…. ownership is not affected." Longer and more sustainable spells of homeownership shift the balance between the costs and the benefits to the homeowner by increasing the owner's control over her tenure and increasing the benefits of stability and the opportunities for accumulating wealth.

Maintaining stable homeownership for lower-income households is likely to require the creation of a support system for that purpose. Post-purchase counseling is likely to be a central element of the support system, both on an ongoing basis and as a resource in the event of delinquency and foreclosure risk (Grover and Todd 2005). The effectiveness of ongoing counseling, as distinct from counseling triggered by a crisis, is unclear. Such programs are still recent and relatively few in number, and where they have been established, participation has typically been uneven and outcomes hard to measure (Wiranowski 2003). There is solid evidence, however, that the availability of such services when a crisis does occur, particularly with respect to preventing foreclosure, is both valuable and cost-effective (Quercia, Cowan, and Moreno 2005; Collins 2007). While many households are unlikely to avail themselves of such a system unless they are facing a crisis, effective program design and outreach may encourage many owners to see a homeownership support center as a place to which to turn for a variety of noncrisis questions or concerns regarding financial and home maintenance issues.

The creation of emergency assistance funds that can respond quickly to financial crises that put a family at risk[59] and access to affordable funds for urgently needed repairs or system replacement are also valuable elements

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[59] The most notable of such programs is Pennsylvania's Homeowners Emergency Mortgage Assistance Program, or HEMAP, which provides up to two years of assistance to a maximum of $60,000 to homeowners who are suffering from a financial hardship through a circumstance beyond their control and who can show a reasonable prospect of being able to resume regular mortgage payments within 24 months. From its establishment in 1983 through August 2006, the program has received 145,500 loan applications and assisted 37,100 homeowners with a total of $384 million in loans, with a 74 percent repayment rate.

of a support system. The latter may be particularly valuable in many urban areas where unscrupulous lenders and contractors prey on vulnerable lower-income, particularly elderly, homeowners (Cleary 2006). Other useful elements may include mortgage instruments that mitigate risks such as income disruptions by providing flexibility and the ability for the borrower to make up missed mortgage payments (Belsky, Retsinas, and Duda 2005), and property tax policies that limit tax increases in areas where homes owned by lower-income households may be seeing significant appreciation, and where such increases may have a destabilizing effect on the household's financial situation. All of these activities are likely to be cost-effective uses of public funds.

Finally, consideration should be given to shared-equity homeownership models such as community land trusts and limited-equity cooperatives as well as deed-restricted single-family homes or condominiums[60] as a strategy for increasing sustainable lower-income homeownership. An advantage of these models is that, in return for limiting the owner's equity return, they potentially offer a built-in support system that can protect the owner from many of the potential downsides of homeownership, and which may even enhance some of the noneconomic benefits of ownership (Davis 2006). In the only research on outcomes for former owners of properties in a community land trust, the authors found that, notwithstanding the limits on the properties' resale price, the majority of owners subsequently moved into houses bought in the open property market after selling their home in the land trust (Davis and Demetrowitz 2003).

Since, as noted earlier, many lower-income owners do not in fact obtain significant appreciation on the resale of their homes, limits on equity return, either in the form of a controlled resale price or the recapture of gain, may not be as great a loss as might be imagined, at least in the abstract. It may be difficult, however, to convince homebuyers of that unless they receive a clear tangible offsetting benefit, such as an initial purchase price significantly below market value. That, in turn, is unlikely to be the case except where a significant nonmarket subsidy has been applied to reduce the price of the unit.[61] While shared-equity homeownership is, therefore, an appealing vehicle for creating sustainable homeownership and maximizing the value of subsidy dollars where they are provided, its scope is inherently limited by its dependence on nonmarket subsidization.

Creating a system for sustainable lower-income homeownership in the United States will require that public agencies and nonprofit organizations focus on fostering sustainable homeownership for those who become homeowners rather than maximizing homeownership per se. It will require the development of new mortgage products and criteria and support programs based on solid research rather than on flawed mathematical models. It will not require additional public resources, but it will demand the redirection of existing federal and other public resources away from their present uses toward areas that are both more cost-effective and more likely to yield long-term gains in terms of sustainable homeownership. At the same time, it will require constant regulatory vigilance, as well as ongoing education and marketing, to ensure that new forms of predatory practice do not emerge to replace the ones that have undone the hopes of millions of homeowners and destabilized so many of America's neighborhoods.

If the American political system places a value on expanding homeownership, it should ensure, to the extent possible, that the expansion of lower-income homeownership takes place in ways that clearly benefit both the families involved and the communities in which they live. This is not only a rational economic imperative, it is an ethical one.

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[60] The most widely used shared-equity homeownership model is fee simple or condominium ownership, where the dwelling unit is sold subject to a deed restriction or covenant providing that for a specified period, usually 30 years or longer, increases to the resale price of the unit are controlled and subsequent buyers must fall below specified maximum income levels. This approach has been used with respect to the inclusionary housing constructed in California, New Jersey – largely as a result of implementing the Mt. Laurel decision – and elsewhere.

[61] While this includes projects built with public subsidy funds, it can also include inclusionary projects, where the price of the affordable units is brought down through public cost offsets such as density bonuses or fee waivers or through recapture of land value increments. Indeed, inclusionary developments are likely to represent the single largest potential source of shared-equity homeownership opportunities.

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