# Understanding the Wealth Gap: How Did We Get Here?

By Gabriella Chiarenza, Federal Reserve Bank of San Francisco, and Solana Rice, CFED

In the news and among the public, recent discussions have focused on the income gap between the rich and the poor in the United States. Yet the deep and growing divide between American households in terms of wealth – the sum of assets, such as retirement savings or a house, minus debt – has received less attention, even as it is proving deeply disruptive and quite difficult to reverse. Accumulated wealth and diversified savings can be far more important than income for keeping household finances stable through volatile shifts in the economy.

The damaging impact of the foreclosure crisis and recession on homeownership – the main pathway for building wealth, especially for low-and moderate income (LMI) households – brought this point into stark relief. Many financially-constrained households concentrate their wealth solely in their homes,[1] and the broader housing market upheaval changed the prospects for prosperity for those Americans whose hold on financial stability was tenuous at best. African American and Latino households were particularly vulnerable to the crisis and experienced substantial losses during the recession, with fully half of the total wealth of African American families and 67 percent of the total wealth of Latino families lost between 2007 and 2009 thanks to foreclosure or deteriorated home equity.[2] LMI households and households of color depending on home equity to finance their children's education are coming up short. Those reliant on selling their home to retire comfortably may be finding a less competitive buyer's market.

There are a growing number of programs and policies, however, including those described in the articles that follow in this issue of Community Investments, aimed at supporting families in stabilizing and growing their overall net worth and protecting it for future generations. At the same time, it is critical to recognize that homeownership remains one of the largest and most vital assets for many families. In this article, we detail the traditional role of homeownership in building overall wealth, explain why LMI households and households of color found themselves vulnerable to loss during the recession, and discuss why it is critical to restore and support affordable and sustainable homeownership options for LMI households.

## Lower-Income Households, Households of Color, and the Housing Crisis

What accounts for current wealth gaps? In part, they can be traced to the effects of a long history of housing discrimination tactics including redlining, racial covenants, and denial of financing that blocked African American and other ethnic minority households from entering into homeownership in many places with long-lasting consequences. Scholars assert that the homeownership rate differential between whites and blacks – 73.3 percent versus 43.8 percent, respectively – owes in part to these factors.[3] Additionally, recent research shows that white households have owned their houses eight years longer, on average, than households of color. The difference in total years of homeownership between whites and blacks accounts for nearly a third of the overall wealth gap between the races, according to an Institute on Assets and Social Policy (IASP) study.[4]

Differences in the mortgage loan products new homeowners purchased also became a dividing factor in the years leading up to the recession. For loans originated between 2004 and 2008, African Americans were three times more likely and Latinos twice as likely as white households to obtain a loan with a higher rate, according to the Center for Responsible Lending.[5]

Yet this pattern of increases in subprime lending to lower-income and

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minority populations became evident fully a decade before the current recession. In 1993, subprime loans accounted for three percent of mortgage loans received by low-income borrowers and eight percent of those received by African American borrowers, compared to one percent each for white and high-income borrowers. By 1998, those proportions had increased to 26 percent of loans for low-income borrowers and 51 percent of loans for African American borrowers, compared to nine percent of white borrowers' loans and seven percent of high-income borrowers' loans.[6] Recent evidence also suggests that many of these borrowers who received subprime loans in fact had credit scores high enough to qualify for conventional loans with better terms.[7] When many of those with subprime loans lost their homes to foreclosure, the cumulative result was a one trillion dollar aggregate loss in property wealth to communities of color – accounting for half of the overall amount of property wealth lost in the United States during the recession.[8] "The paradox," the IASP study notes, "is that even as homeownership has been the main avenue to building wealth for African Americans, it has also increased the wealth disparity between whites and blacks."[9]

Furthermore, because economic growth since the financial crisis has been uneven across sectors, with recovery in financial assets far outstripping real estate recovery, households that lost their homes without other assets to fall back on are now doubly disadvantaged as they try to stabilize and build their net worth. A recent Federal Reserve Bank of San Francisco research brief notes that the value of U.S. financial assets (including bank accounts, money market funds, stocks, and bonds) grew by 31 percent from a 2009 low to $54.4 trillion in 2012; real estate value, however, grew just nine percent from a 2011 low to $19.9 trillion in 2012.[10] The growth of financial assets has been of little benefit to households of color, who by and large do not own stocks and mutual fund shares. Recent data indicated that only six percent of African American and four percent of Latino households own such assets, compared with 25 percent of white households.[11] Even African American and lower-income households that did hold stocks in the form of retirement savings accounts may now be finding themselves at a disadvantage, as they were more likely to withdraw funds from such accounts during the early years of the recession when facing financial blows, thus depleting from their portfolios the very assets that are now quickly generating wealth for others.[12]

Taken together, these factors have contributed to widening wealth gaps between upper-income and LMI households and between white households and households of color in recent years. "The top 20 percent of earners now hold more than 55 times the wealth of the bottom 20 percent ($277,473 compared to $5,022, respectively)," according to a recent CFED report.[13] The IASP study also notes that between 1984 and 2009, the wealth disparity between white and African-American households grew three-fold, from an inflation-adjusted gap of $85,000 to $236,500.[14]

## Why Stable Homeownership Remains Important for Lower-Income Households

In their 2012 study of the Community Advantage Program (CAP), a homeownership initiative that issued 46,000 mortgage loans with good terms to lower-income homebuyers, Allison Freeman and Janneke Ratcliffe observe many positive, wealth-building effects stemming from stable homeownership, even through the recession period. The authors compared wealth outcomes for both renters and homeowners following the housing downturn and found that homeowners emerged with much more of their net worth intact.[15] The authors also point out that overall the CAP homeowners experienced lower levels of financial stress, higher levels of financial satisfaction, and more continuous household stability through the housing crisis, despite some wealth losses.[16]

Homeownership can be a wealth-building and stabilizing strategy for many LMI households who are ready to own a home, and is often an important base from which to build additional wealth and assets. A Center for Responsible Lending report adds that in general, a stable mortgage amounts to a "forced savings" plan for lower-income homeowners, allowing them over time to lower their debt and build equity. Homeowners can also take advantage of the mortgage interest deduction, while no comparable tax deduction exists for renters.[17] Finally, both reports emphasize that stable homeownership often provides a financial cushion for lower-income households through financial downturns, as they have more wealth accrued than renters.[18]

Freeman and Ratcliffe stress that the key to sustainable lower-income homeownership, however, is in securing the right type of mortgage loan – a stable, long-term, fixed-rate loan – and entering the market at the right time. Lower-income homebuyers who used riskier mortgage products to purchase homes in the midst of a volatile

market fared worse than those with fixed-rate loans.[19]

Ongoing "sustainable homeownership" or post-purchase support programs (PPSPs) for lower-income homeowners and homeowners of color who are not delinquent or in default also appear to show promise for helping such buyers stay steady with their loan payments and build equity in their homes. PPSPs are often offered through community housing organizations and local and state government agencies, and include trainings on such topics as developing a household budget, managing home repairs, and dealing with unexpected costs.[20] Unfortunately, few studies exist on the effectiveness of these programs; more recent research attention has been focused on foreclosure prevention counseling programs for those already behind on their mortgage payments.

Still, one extensive survey of existing sustainable homeownership initiatives describes PPSP components that have proved successful in many places. Some of these programs offer participants a financial incentive for attending post-purchase workshops. Others offer loans with certain contingencies, such as requiring that new homebuyers take part in regular post-purchase counseling sessions or maintain a savings account specifically for home repairs.[21]

These observations suggest that rather than taking homeownership off the table for LMI households, attention would be better focused on helping homeowners secure loans they can afford and developing support strategies to help LMI homeowners to keep and build wealth from their homes.

## Homeownership Still Out of Reach for Some Households

Yet tightened lending standards and requirements for higher credit scores mean fewer households qualify for mortgage loans. CoreLogic recently reported that the share of first-lien purchase loans made to those with credit scores below 620 fell from 29 percent in the more typical market of February 2004 to just 0.3 percent of all loan originations in October of 2013.[22] Between 2007 and 2013, average borrower credit scores increased considerably from 694 to 751 for Fannie Mae-backed loans and from 640 to 693 for FHA loans, according to the Joint Center for Housing Studies of Harvard University (JCHS).[23] While a higher threshold for mortgage qualification is not in and of itself problematic, recent studies reveal troubling evidence that higher credit scores correlated to communities with higher per capita incomes and fewer minority households.[24] (These reports observe no "causal relationship between race and credit scores," but rather emphasize the centrality to this dynamic of longstanding discrimination in housing, jobs, and education, along with issues stemming from marred credit and a lack of credit history).

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JCHS reports corresponding increases in mortgage loan denial rates for lower-income households and households of color, while denial rates have fallen for white borrowers and those with moderate and higher incomes.[25]

Home prices in many areas are once again on the rise, serving as yet another barrier for lower-income households in attaining homeownership. In every U.S. state and the District of Columbia, and in 94 of the largest 100 metro areas, home prices increased between mid-2013 and mid-2014; nationally, May 2014 was the 27th consecutive month in which home prices increased. Out of all U.S. states, prices rose most significantly in the 12th District states of Hawaii, California, and Nevada.[26] An increase in the median home price combined with rising interest rates drove up the monthly payment on a 30-year fixed rate mortgage loan by 23 percent between late 2012 and late 2013.[27] At the same time, nearly half of all home sales in the United States in the first quarter of 2014 were all-cash purchases, and over half of those were sales to absentee and second-home buyers.[28] Even with down-payment assistance, LMI buyers have difficulty winning bids against all-cash offers.

At the same time, the state of the current rental market makes it much harder for those who are shut out of the homeownership market to build savings and wealth. Between 2001 and 2012, median renter income in the U.S. dropped by 13 percent to $31,500, while median rent increased four percent to $880 over the same timeframe.[29] Rent spikes between 2008 and 2014 have been far more extreme in many metropolitan areas, including increases of nine percent in Honolulu and Miami, 18 percent in San Francisco and Austin, and 20 percent in Seattle.[30] In these more expensive rental markets, the vast majority of the lowest income renters (those with annual incomes below $35,000) face severe housing cost burdens, paying far more than 30 percent of their incomes on housing (the standard measure of affordability).[31] For these renters in particular, restoring stable and affordable homeownership options and developing other asset-building opportunities not dependent on homeownership will be essential to improve their financial wellbeing.

## Conclusion

Bolstering LMI homeownership opportunities and stabilizing existing and new LMI homeowners continue to be valuable ways to help close the wealth gap. As discussed above, however, investing solely in a single asset such as a home can be detrimental to household wealth if that asset is lost. By further diversifying their assets beyond physical property alone, LMI homeowners therefore may be able to better maintain long-term financial security. It is also important to acknowledge that homeownership is not a viable or preferred asset building option for some Americans. For all of these households, a continuum of wealth building approaches beyond homeownership offers opportunities to establish, diversify, and grow their asset portfolio.

This issue of Community Investments focuses on the efforts that help households build on their earnings and invest in their future. Highlighted here are programs and policies that expand consumer access to more affordable financial products; support renters in building their credit history; and provide assistance to families investing in their futures through children's savings accounts, entrepreneurship, and retirement.

Earning, saving, investing, and protecting assets are building blocks that add up to what CFED refers to as the Household Financial Security Framework.[32] By targeting policies and programs toward each of these critical building blocks, more families and communities and even the nation as a whole can realize sustained financial stability. While it may be difficult to imagine a U.S. economy in which homeownership is not the major asset for most households, the strategies presented in this issue reflect the emergence of a new landscape of sustainable, wealth-building opportunities that promise improved access to a variety of assets for a wider range of American households. CI

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### Native Americans and the Low Income Housing Tax Credit Program: Lessons from the California Tribal Pilot Program


1 See <http://www.nahma.org/Leg%20area/National%20Consensus%20Letter%20LIHTC%20ACTION%208-26-11_FINAL.pdf>

2 For final pilot language, see California Tax Credit Allocation Committee, "Regulations Implementing the Federal and State Low Income Housing Tax Credit Laws," California Code of Regulations, Title 4, Division 17, Chapter 1, Section 10315(c)(2), <http://www.treasurer.ca.gov/ctcac/programreg/2014/20140129/regulations.pdf>