

Urban Housing Policy in the 1990s

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Abstract

Recent decades have witnessed some resolution of certain long-standing concerns of urban housing policy. Other issues, including the limited availability of affordable rental units, mortgage finance-related constraints on homeownership, reduced housing and income assistance to very low income populations, and problems of equal opportunity to housing and housing finance, remain at the forefront of the national policy debate.

A variety of initiatives provide opportunities for efficiency gains in the pursuit of housing policy goals. These include the reformation of the Federal Housing Administration, consolidation of U.S. Department of Housing and Urban Development programs, transformation of the public housing system, enhanced underwriting flexibility by government-sponsored enterprises, and their introduction of new mortgage instruments. However, sizable cuts in federal rental housing and income supports, together with the loss from the stock and the diminished production of low-income rental housing, will undoubtedly result in economic distress among the lowest income renter populations.

Keywords: Policy; Housing; Markets

Introduction

Recent decades have witnessed some evolution in both the focus of and the approaches to urban housing policy. Certain housing problems have seen some resolution, and other issues remain at the forefront of the national policy debate. Some improvement has been recorded in the physical characteristics of the housing stock, overall housing conditions, and problems of residential overcrowding. However, the limited availability of affordable rental units, mortgage finance-related constraints on homeownership, reduced housing and income assistance to very low income populations, problems of public housing and low-income housing preservation, and issues of equal opportunity in housing and housing finance markets remain at the forefront of the current housing policy debate.

Overview of housing conditions: Adequacy, quality, and overcrowding

By various measures, the adequacy of the nation's housing stock has registered significant improvement since World War II. For example, more than 40 percent of U.S. housing units were without complete plumbing facilities at the end of World War II; by 1980, such units had fallen to less than 1 percent of the U.S. housing stock.¹ According to the 1990 decennial census, approximately two-thirds of the U.S. housing stock was single-family units; the vast majority of homeowners lived in single-family units. In contrast, housing units in structures with four or more stories constituted only about 10 percent of all existing housing units. Census data indicate that some 16 million single- and multifamily units were added to the housing stock over the 1980s at an average pace of 1.7 million units per year. The average size of those newly constructed units increased by over one-fifth, from 1,720 to 2,080 square feet.²

Over the remainder of the 1990s, the National Association of Home Builders (NAHB) forecasts that the sum of single- and multifamily housing starts will average about 1.4 million units per year. That forecast provides for a moderate strengthening in housing starts from the average annual pace of 1.2 million units recorded over the 1990–94 period. The forecast roughly coincides with an average anticipated growth in households of about 1.3 million over the 1995–99 period.³ While recent periods have witnessed some perceptible improvement in multifamily housing starts from the relatively weak levels observed in the latter half of the 1980s and the early part of the 1990s, the anticipated strengthening in total starts derives largely from the single-family market, which should average about 1.1 million starts per year during the 1996–99 period (Megbolugbe and Simmons 1995).

Although measures of residential overcrowding trended downward over much of the century, evidence from the 1990 census reveals some slight increase in the incidence of overcrowding

¹ In 1989, the median age of the housing stock was 26 years; about one-fourth of existing units were built before 1940, and some 30 percent were constructed after 1975.

² The data cited in this paragraph are derived from Devaney (1991).

³ The discrepancy between the housing starts and household formation forecasts is roughly accounted for by anticipated changes in vacancies and net removals from the housing stock.

during the 1980s. In 1940, the first census of housing indicated that some 20 percent of all residential units were overcrowded, defined as more than one household member per room.⁴ By 1980, that measure of overcrowding had decreased to about 4.5 percent, but then it rose slightly to about 5 percent in 1990. As would be expected, higher crowding rates are found in metropolitan areas with large numbers of Hispanic and Asian immigrants, reflecting the tendency of those groups to surmount housing affordability difficulties by sharing quarters.⁵

Overall housing quality has been enhanced during recent decades not only by the addition of new, higher quality units to the stock, but also by the removal of deficient units. About 6 percent of substandard units were eliminated from the housing stock from 1974 to 1985; that period also witnessed a 46 percent decline in the number of inadequate units renting for under \$300 (1988 dollars) (see Apgar 1991). In contrast, units renting for \$350 or above (1988 dollars) increased by about 5 percent from the mid-1970s to the mid-1980s.

However, ongoing reductions in the number of low-quality rental units have exacerbated the shortage of those units as well as problems of housing affordability among very low income populations. Between 1989 and 1993, the number of very low income renters with pressing housing needs (households paying more than half of their income in rent or residing in substantially substandard housing) rose by 700,000 to 5.6 million. As discussed below, housing assistance to very low income populations—including preservation of low-income rental housing and a rethinking of the role of public housing—remains a critical housing policy issue.

Homeownership opportunities

Public opinion surveys repeatedly indicate strong household sentiment in favor of homeownership. Homeownership is viewed as the key investment of typical U.S. households; further, it is widely believed that homeownership contributes to neighborhood quality and an improved residential environment. Homeownership goals are central to U.S. housing policy, and their achievement has been facilitated through a variety of policies affecting tax liability, mortgage finance instruments, and financial

⁴ This measure counts all rooms except bathrooms, hallways, closets, and porches. For more information, see Baer (1976).

⁵ For additional discussion of this point, see Myers and Wolch (1994).

institutions. Those provisions are generally well known and include the federal income tax deductibility of mortgage interest as well as the availability of long-term, fully amortizing, and low down payment mortgages, which facilitate homeownership through reductions in down payment and monthly mortgage servicing requirements. The availability of mortgage finance has been enhanced through the development of specialized housing finance institutions in the primary mortgage market; secondary mortgage market institutions also have served to greatly expand the liquidity of primary market lenders and hence the flow of funds to the housing sector. In so doing, the government-sponsored housing finance agencies have significantly reduced nonprice mortgage credit rationing and concomitant cyclical fluctuations in housing activity.

Partly because of those policies, homeownership rates trended upward throughout the post-World War II era to about two-thirds of all households during the early 1980s, but then eased downward during the mid-1980s. The decline was concentrated among younger and middle-aged households. Among cohorts in the 15–44 age range, homeownership rates declined by 4 to 7 percentage points during that period. In contrast, rates of homeownership increased during the mid-1980s among older households. In general, younger households are more mobile than older households and hence are more likely to change their tenure status in response to a change in the relative price of owning to renting. Further, younger households experienced a perceptible decline in real incomes during the first half of the 1980s. Those declines in real income resulted in greater difficulties in mortgage qualification for first-time buyers, in terms of both accrual of wealth for down payment and monthly mortgage servicing requirements. Rates of homeownership in 1992 remained below their 1982 levels for all age cohorts below 54 years. In contrast, homeownership rates rose in the groups over age 55. Rates of homeownership vary significantly by household race and ethnicity. In 1990, rates for white households were close to 70 percent; in contrast, black and Hispanic households had homeownership rates in the low to mid 40 percent range. The overall rate of homeownership started rising again in 1993, and for the third quarter of 1996 it reached 65.6 percent, nearly equal to its 1980 peak of 65.8 percent (U.S. Census Bureau 1996). An average of forecasts by Fannie Mae, Freddie Mac, the U.S. Department of Housing and Urban Development (HUD), and the NAHB had predicted that the homeownership rate would not return to its 1980 peak until the year 2000.

Research suggests that household tenure choice is driven by a variety of economic and demographic variables, including availability of liquid assets for down payment and, perhaps most important, the relative costs of owning to renting over the expected length of stay in the house. Economists calculate homeownership costs on a full after-tax or user-cost basis, which accounts for mortgage-servicing costs, fees, and closing costs of homeownership, maintenance, depreciation, opportunity costs associated with the down payment, expected housing asset appreciation, and the like. Of those components of homeownership user costs, expected housing asset appreciation typically displays the greatest volatility and is often the determining factor in the home purchase decision. For example, during the mid- to late 1980s, homeownership rates registered the largest increases in areas of high expected rates of housing asset appreciation. Conversely, during the early 1990s, the substantial house price declines recorded in many metropolitan area markets resulted in significantly dampened near-term expectations of housing investment returns as well as concomitant falloffs in the demand for owner-occupied housing.⁶

Even in cases of high expected rates of housing asset appreciation (and hence low homeownership user costs), homeownership may be impaired by low levels of nominal housing affordability, as reflected in onerous down payment or mortgage-servicing (debt-to-income) requirements. In urban areas that experienced house price runups during the mid- to late 1980s, nominal affordability requirements became an insurmountable barrier to homeownership for many potential home buyers.⁷ Despite some retreat in house prices in many areas during the early 1990s and mortgage interest rates that remain at levels lower than those recorded during much of the 1980s, nominal housing affordability remains a barrier to homeownership among large segments of the renter population.⁸

Although homeownership rates have traditionally been depressed among immigrant and other underserved populations,

⁶ Of continuing interest here is the process by which households form expectations of housing investment returns and hence the appropriate time frame and weighting of prior-year house price fluctuations in the calculation of homeownership user costs.

⁷ For the nation as a whole, changes in quality-adjusted new home prices substantially exceeded the rate of growth in the Consumer Price Index for all urban consumers during 1986 and 1987. The opposite held true for the 1988–93 period.

⁸ For example, in 1989, only about 14 percent of Los Angeles households could afford the median-priced existing home in the county, which sold for

immigrant groups have recently made significant progress in attaining ownership status. For instance, recent immigrant populations boosted their homeownership rate from about 24 percent in 1980 to almost 55 percent in 1990 (Joint Center for Housing Studies of Harvard University 1995). Among black and Hispanic households, however, homeownership rates fell during the 1983–93 period. Homeownership rates among black and Hispanic households remain substantially below those of white households, even after adjusting for variables such as income level.⁹ As such, there remains significant potential for homeownership gains among minority and immigrant groups; it is estimated that if minority and immigrant households were to achieve homeownership at the same rate as their U.S.-born white counterparts (adjusting for age, income, and family status), an additional 2 million households would become homeowners (Joint Center for Housing Studies of Harvard University 1995). In the context of continued macroeconomic expansion, the outlook for overall improvements in homeownership is guardedly positive, but only in the context of public and private mortgage finance initiatives that meet the particular needs of these and other groups.

To that end, a variety of efforts are currently under way to address the nominal affordability constraints of lower income, first-time buyer, and underserved populations. Notable here are current efforts by the government-sponsored enterprises (GSEs) to support low down payment conventional loan programs to enhance access to homeownership among households with limited accrued wealth but demonstrated mortgage-carrying capacity. Along with this effort is an attempt by the GSEs to generally enhance the flexibility of the conventional mortgage underwriting guidelines and qualify a broader spectrum of households. The new mortgage designs are consistent with the chartered responsibilities of the GSEs to service the full spectrum of the potential home-buying market, including lower and moderate-income households. Further, the promotion of innovative mortgage designs and marketing efforts on the part of the GSEs reflect their recognition of the ever-expanding diversity of households,

approximately \$200,000 or about twice the national average. Owing largely to house price declines during subsequent years, some 37 percent of households in Los Angeles could afford the median-priced home by 1995. Nationally, about half of all households could qualify to purchase the median-priced existing home.

⁹ In 1993, about 43 percent of all African-American and 40 percent of all Hispanic households were homeowners, compared with 70 percent of all white non-Hispanic households. Sizable racial disparities in homeownership remain after adjusting for household income levels.

lifestyles, and living arrangements in the 1990s. That diversity likewise creates new market opportunities for the secondary market agencies.

The GSEs and others continue to review the sensitivity of mortgage loan performance—relating to default, prepayment, and expected magnitude of loan losses in the event of early loan termination—to their loan underwriting guidelines. The analyses indicate the mortgage portfolio performance tradeoffs associated, for instance, with lower down payment and higher monthly payment-to-income ratio loans. Current efforts to reduce down payment burdens and to enhance the flexibility of secondary market mortgage underwriting come in the wake of a proliferation of variable-rate mortgages during the 1980s. The lower initial rate of those variable-rate loans enabled larger numbers of home buyers to surmount nominal qualification requirements. Other innovative mortgage designs—perhaps including price-level adjusted mortgages evaluated in recent years by HUD—would similarly provide higher levels of nominal housing affordability at interest rates well below those of conventional fixed- or adjustable-rate loans. The GSEs also are actively reviewing the effects of home buyer education programs in helping to mitigate default and loan losses among the new, lower down payment loan programs.

Homeownership also has been aided in recent years by new housing designs that target the first-time buyer and lower income markets with higher density and more affordable housing products. This is particularly true in high land price areas such as California, where builders are experimenting with such innovative designs as the placement of up to 18 single-family units per acre. The reduced land component of such high-density developments enables pricing at levels far below that of comparable single-family homes. Increasingly, nonprofit real estate development corporations and local redevelopment agencies seek to finance and develop affordable housing using a combination of public and private monies. In many cases, those organizations have succeeded in providing mortgage financing to borrowers not well qualified for conventional loans. For example, homeownership opportunities for lower income households can be enhanced through a variety of “soft second” programs, through which funds for a second mortgage can be acquired from a state, local, or not-for-profit agency. Repayment terms of those second mortgages are generally more lenient than those required by first-mortgage lenders. Such opportunities are limited in scope, however, and are often directed at younger, first-time buyers. Pent-up demand for affordable ownership units remains strong in many parts of

the country, further suggesting a significant demand-side impetus to the development of affordable housing among traditional for-profit builders.

Housing very low income renters and preserving federally assisted low-income housing stock

Recent research indicates that roughly one-fourth of the nation's renters—some 4.4 million households—receive some form of government assistance and have low incomes (Wallace 1991). Of that number, about one-third are elderly and about one-half are minorities or families with children. A 1990 survey of tenants of 202 public housing authorities by the National Association of Housing and Redevelopment Officials further indicated that two-fifths of tenants were on welfare, whereas about one-half were classified as working poor or Social Security recipients.

Given this vast requirement for housing assistance among the nation's renter population, concern has focused on the preservation of the nation's federally assisted low-income housing stock. Preservation of existing assisted units became increasingly important in the wake of reduced production of those units during the 1980s; Apgar (1991) estimated a reduction by 2.8 million between 1974 and 1985 in the number of low-rent unsubsidized units affordable to a poverty-threshold family. During the 1980s, concerns about the mortgage prepayment and subsequent conversion to market rate use of approximately 600,000 assisted housing units led to the passage of emergency federal legislation in 1987 and 1990. That legislation recognized that mortgages on approximately 360,000 federally insured and financed units and 75,000 state-financed units would reach their 20-year prepayment date during the 1990s. Accordingly, the legislation established a program to refinance or sell some of those assisted and at-risk units to other "qualified" public, non-profit, or tenant buyers.¹⁰ A variety of factors, including reductions in the supply of unassisted low-rent housing units, decreased additions to and increased losses from the stock of assisted units, and reductions in federal government income

¹⁰ See the Emergency Low-Income Housing Preservation Act of 1987 and Title VI—the Low-Income Housing Preservation and Resident Homeownership Act—of the National Affordable Housing Act of 1990. Incentives for the preservation of federally assisted low-income housing contained in the 1990 act include insured or direct capital improvement financing, provisions for an equity takeout loan, an 8 percent return on preservation equity, investor access to reserves, higher levels of Section 8 and non-Section 8 rents, and insured acquisition loans and grants to qualified purchasers.

supports of low-income households, together serve to place low-income renters in a precarious position.¹¹

The 1990 Low-Income Housing Preservation and Resident Homeownership Act requires sizable commitments of federal funding for rehabilitation and preservation of eligible assisted housing units. In effect, substantial portions of the existing Section 236 housing inventory are being recapitalized. That effort constitutes one of the larger federal housing funding programs of the current decade. The federal funding enables improvements in capital infrastructure, financing, and property management to retain a large number of units in the assisted housing stock over the long term.

Another potentially fruitful direction for preservation of assisted housing involves the active participation of state and local governments (Koebel and Bailey 1992). Koebel and Bailey discuss the various elements of a comprehensive state and local strategy to preserve assisted units, such as assessing inventory, developing lists of potential priority buyers, providing state-level technical assistance, assisting in predevelopment and equity funding, training in property management, and providing buyers of last resort. In so doing, state governments seek to identify and to enhance the capacity of localities, nonprofit organizations, and tenant groups to participate in preservation activities. In general, an enhanced state role in preserving federally assisted housing is one element among a variety of innovative low-income state housing preservation programs enacted in the wake of the ongoing retrenchment in federal funding.¹²

Further, it is estimated that approximately 1.4 million public housing units may be in jeopardy due to aging and depreciation (Schnare 1991). According to Schnare, about one-third of the existing public housing stock is more than 25 years old; a recent estimate suggested that about 15 percent of all units have renovation needs of \$20,000 or more. In many cases, maintenance and repair have been deferred since the date of construction. An estimated \$12.2 billion (1990 dollars) would be required to put all public housing in an acceptable physical condition with all existing building systems operational. In many of the large

¹¹ For example, the Joint Center for Housing Studies of Harvard University (1995) estimates that in San Francisco some 51 percent of all low-income renters pay more than half of their incomes for rent. Many of those low-income renters receive no form of government assistance.

¹² According to recent estimates, over 300 new state-level housing programs were implemented during the 1980s. See, for example, Nenno (1991).

metropolitan areas, those public housing units constitute 10 percent or more of the total rental stock.

Various strategies have been proposed to address the critical physical needs of public housing units to retain them in the low-income housing stock. Those approaches are based on the recognition that a significant infusion of funds is undoubtedly required to address public housing capital needs. However, the difficulties of many public housing authorities cannot be solved by money alone nor are all those units necessarily worth saving. According to HUD estimates, approximately \$1.75 billion per year in expenses on mandatory needs (e.g., lead-based paint abatement, handicapped access, mandatory modernization) is required in addition to the approximately \$12 billion necessary to put public housing units in an operational condition (HUD 1989). HUD further estimates that renovation is not cost-effective for about 10 percent of public housing units; in those cases, renovation expenses exceed the costs of new construction. HUD also compared the development and maintenance costs of public housing with the ongoing costs of a Section 8 certificate. Findings suggest that preservation of about 80 to 90 percent of all public housing units would be cost-effective relative to the ongoing budgetary commitment for a demand-side housing voucher. Units that fail the cost-effectiveness test could account for as much as 20 percent of required renovation expenditures for public housing.

As suggested above, infusion of financial capital for renovation and modernization of public housing is only a partial solution, since management improvements are required for a number of troubled public housing authorities. Further, those housing authorities must be provided a new set of management incentives for effective capital planning because the funding process has traditionally rewarded the accumulation of severe and pressing needs. Alternatively, the life-cycle needs of public housing units could be budgeted in response to anticipated maintenance and other requirements. Any such life-cycle allocations, however, must contain the proper incentives for cost containment. More fundamental, policy analysts and lawmakers must view preservation of public and assisted housing not as a one-time capital investment, but rather as one requiring infusions of capital at ongoing and predictable stages in the life of the property.

As will be discussed in greater detail below, HUD proposed a major initiative to transform public housing as part of its 1995 "reinvention plan." In 1996, the agency sought to consolidate public housing accounts into programs for capital management

improvements and operations. Approximately 3,300 public housing agencies that were performing well were given substantial local autonomy to determine which units to demolish and which to modernize. At the other end of the spectrum, HUD sought new receivership powers to intervene aggressively with approximately 100 public housing authorities (PHAs) that have severe management and operational difficulties. Later, the capital and operating accounts will be converted to project-based assistance to expose the management of the PHAs to the rigors of local rental market conditions. Ultimately, HUD will seek to convert those project-based subsidies into tenant-based assistance and, in so doing, will require the PHAs to compete directly with rental housing supplied in the private sector. The HUD plan is both ambitious and costly: It seeks to phase out the highly inefficient centralized control of public housing while enabling residents of public housing to achieve higher levels of economic welfare through the choice of public or private units in a variety of locations.

As an alternative to public housing, existing tenant-based rental assistance in the form of certificate and voucher programs provides a mechanism by which to meet the housing needs of very low income households. In 1994, about 1 million households received assistance through HUD's Housing Certificate Program, and another 300,000 households were aided through the Housing Voucher Program (Goering, Stebbins, and Siewert 1995). These programs target households with incomes of less than 50 percent of the metropolitan area median level. The federal mandate gives priority to households that have been involuntarily displaced, are homeless or live in substandard housing, or pay over half of their income in rent. The Rental Assistance Program has been ongoing since 1974; the voucher program was established in 1987. The vouchers permit greater flexibility in household location by allowing households to use their rent subsidies in areas where rents exceed the market area's fair market rent (as determined annually by HUD).¹³ HUD contracts with approximately 2,500 PHAs nationwide to administer these programs.

More recently, Section 153 of the Housing and Community Development Act of 1992 asked HUD to evaluate the potential efficacy of rental certificate and voucher programs in helping low-income households to move out of inner-city poverty areas.

¹³ The Rental Assistance Program provides a monthly payment to the landlord equal to the difference between the tenant's contribution (the greater of 30 percent of net income, 10 percent of gross income, and the portion of welfare assistance designated to housing) and the gross rent (including utilities). Certificates may be applied to any rental unit that meets HUD's

That inquiry seeks to build on results of a small number of dispersion programs (such as Chicago's Gautreaux program) that document a range of improved socioeconomic outcomes (higher employment rates and wages, improved rates of high school graduation, higher overall levels of household satisfaction) among households that succeeded in moving away from segregated and very low income inner-city areas. Results of a recent HUD study (Goering, Stebbins, and Siewert 1995) strongly support the desirability of expanding low-income household housing choice (beyond areas of concentrated poverty) through the HUD Rental Assistance Program. A variety of social, market, and other barriers continue to limit the choice sets of very low income and often minority households. Accordingly, HUD should be encouraged to assess (and offer policy proposals in response to) the variety of impediments to low-income housing choice. Similarly, it would be useful to ascertain the relative efficacy of various dispersion strategies currently used in particular metropolitan areas, including housing search counseling, outreach to landlords, and provision of information on rental housing opportunities. HUD has undertaken a demonstration program, entitled "Moving to Opportunity for Fair Housing," which attempts to relocate about 2,000 families away from areas of concentrated inner-city poverty through a combination of efforts, including rental certificates and vouchers, counseling, and help in moving. Evaluation of this experimental program, together with new research on the impediments to residential mobility and the factors that affect housing choice of low-income households, should figure importantly in future policy designs that will enable households to use their rental assistance to break from areas with high concentrations of poverty and limited economic opportunities.

Discrimination in housing and mortgage markets

In recent years, there has been widespread controversy and policy debate concerning the fair and equal access of low-income and minority households and neighborhoods to housing opportunities and mortgage finance. On the housing side, the debate derives in part from the publication of numerous studies providing compelling statistical evidence of racial discrimination in

quality standards and does not exceed the fair market rent (FMR) of the area. HUD calculates the FMR as the annual adjusted average rent of modest but unsubsidized units in the market area. In contrast, the newer Housing Voucher Program allows the tenant contribution to exceed the ceilings that govern the certificate program and in so doing provides opportunities in higher rent areas for families willing to take on that added burden.

rental housing markets.¹⁴ On the mortgage side, allegations of discrimination in mortgage lending stem in part from analyses of Home Mortgage Disclosure Act (HMDA) data, which reveal wide disparities in the volume of lending activity across individuals and neighborhoods stratified by race. Virtually identical racial disparities are revealed in the home mortgage purchase patterns of the secondary market agencies.¹⁵

Numerous recent studies, using more comprehensive data, seek to carefully evaluate discrimination hypotheses. Although results of those studies are far from uniform, virtually all studies of loan origination, loan performance, and loan instrument choice—controlling for objective indicators of mortgage default risk—find significant and sizable differences in mortgage market activity across applicants or borrowers stratified by race or neighborhood racial composition. In particular, a 1992 study by the Federal Reserve Bank of Boston found statistically dampened rates of mortgage loan origination among black applicants, after having controlled for a wide variety of borrower, loan, and locational default risk characteristics (Munnell et al. 1992). Results of that study provide support for allegations of discrimination in Boston loan markets. However, findings across a relatively large number of recent mortgage discrimination studies are far from uniform; it is often suggested that the significant race coefficients in studies of lending discrimination may reflect in part indicators of borrower creditworthiness that are correlated with borrower race but are omitted from the statistical analysis. For example, Berkovec et al. (1994) found higher rates of default and higher loan losses among minority borrowers, all things equal. Those results are not consistent with the hypothesis that marginally qualified minorities are systematically held to a higher standard of creditworthiness than other borrowers (Berkovec et al. 1994). Regardless, the widespread statistical evidence of racial and neighborhood disparities in mortgage lending has led regulators and policy makers alike to pursue more aggressive and proactive strategies aimed at the achievement of fair lending outcomes.¹⁶ Policy initiatives focus on improved detection of discriminatory practices and better enforcement of existing fair housing and fair lending legislation. Various ongoing and proposed initiatives are discussed below.

¹⁴ For further information on this topic, see Yinger (1990) and Fannie Mae Office of Housing Policy Research (1992).

¹⁵ See, for example, Canner and Gabriel (1992).

¹⁶ It should be further noted that disparate treatment can and does arise at various other junctures in the housing search and loan origination process,

Detection

The financial institution audit and examination process currently includes improved methods of detecting discrimination. New statistical models developed by the Federal Reserve Board allow bank auditors to test application files for systematic evidence of unwarranted disparities in mortgage loan origination.

Discrimination in loan origination may also be evaluated through the application of statistical models to mortgage loan performance data. As mentioned above, such studies have been undertaken for the FHA-insured single-family loan portfolio by the Federal Reserve Board; also, a limited test of such models for conventional mortgage loans has been performed by Freddie Mac.

HUD and the U.S. Department of Justice have successfully applied tester methodologies in the detection of housing market discrimination. Large samples from tester studies have enabled HUD to indicate the incidence of housing discrimination across metropolitan areas.

Enforcement

The U.S. Department of Justice has demonstrated a willingness to prosecute cases of housing and lending discrimination. Some of those cases have been well publicized and may serve as a signal to those engaging in illegal discriminatory practices.

In recent years, the Federal Reserve Board has held up bank merger proposals because of the failure of lending institutions to fulfill requirements of the Community Reinvestment Act regarding the spatial, income class, and racial distribution of lending activity.

Other policy proposals

Secondary mortgage market agencies have pledged to evaluate the accuracy and appropriateness of their underwriting guidelines as well as the extent to which those guidelines have resulted in racial or neighborhood disparities in mortgage loan

including realtor racial steering, real estate advertising, loan product development and steering, loan underwriting, and attempts by lenders to “work out” problems in the credit report.

origination. More generally, the GSEs are seeking to inject flexibility into their underwriting guidelines and to more fully ascertain how those guidelines are related to loan performance.

Similarly, the secondary market agencies have sought to provide liquidity for low down payment loan products that better serve the income and wealth constraints of low-income, inner-city, and minority populations. Origination of those loans is sometimes coupled with mandatory home buyer education and loan counseling to help the GSEs mitigate the risks associated with low down payment loans.

Initiatives sponsored by secondary market agencies such as Fannie Mae seek to enhance the training and participation of minorities in the mortgage lending, underwriting, and brokerage fields. The premise is that improved minority representation in these fields will reduce disparities in mortgage lending evident in the HMDA data.

Closing remarks: The new national housing landscape

The priorities and directions of housing policy have undergone some evolution in the wake of the 1994 Republican ascendancy in Congress. Those same federal policies had previously come under review because of Clinton administration efforts both to rein in deficit spending and to improve the efficiency of government agency functions. The administration remains committed to the policy objectives outlined in earlier sections of this article, including preservation of low-income rental housing, enhancement of neighborhood choice among low-income assisted renters, transformation of the role of public housing, enhancement of homeownership opportunities among low- and moderate-income households, and enforcement of fair housing and fair lending legislation. However, HUD's ability to make good on those commitments may be severely constrained because of cutbacks in appropriations to the agency and an evolved political agenda.¹⁷ While HUD continues to exist, reductions in federal government housing appropriations significantly reduce the number of poor and low-income households receiving housing and income assistance, raise rent levels in federally assisted housing, and

¹⁷ The new agenda was evident in the Federal Housing Reform and Local Empowerment Act, proposed by a task force of first-term Republicans and then-Senate Majority Leader Robert Dole, which sought to eliminate the U.S. Department of Housing and Urban Development.

deny home heating and cooling assistance to a large number of low-income households.¹⁸

Overall, the budgetary and political environment surrounding housing policy has largely evolved in the post-1994 context. Philosophically, the new legislative environment seeks to diminish the federal government role in (and funding of) housing policy and instead emphasizes enhanced flexibility in the control of the reduced funding commitments at the state and local levels. In addition, bipartisan support is expressed for initiatives that make government function in a less bureaucratic, more efficient, and more businesslike manner. The devolution in federal government control over housing programs (both programmatic and budgetary) presumes that lower levels of government have the knowledge and ability to make more efficient use of previously earmarked housing funds. While that sometimes may be the case, it also is true that such a policy will result in cuts to programs that are critical to needy households and communities. Much of the initial impetus for federal government housing intervention emanated from acknowledged and compelling individual and community needs coupled with the recognition that little in the way of expertise, resources, or initiatives was available or likely to be forthcoming at lower governmental levels. At a minimum, calls for devolution in federal government spending and controls should be accompanied by evidence of how state and local agencies might succeed in providing adequate local solutions to recognized local problems.

HUD policy makers have responded to the new political agenda and to critiques of agency operation through the development of a "blueprint" for reinvention of the agency (HUD 1995). In large measure, that document focuses on transformation of public housing, enhancement of homeownership opportunities among targeted populations, privatization of the Federal Housing Administration (FHA), and performance measurement of HUD programs. The HUD plan proposes to phase out direct subsidies to public housing and instead provide direct assistance to the residents of public housing, allowing them greater mobility and housing choice (as discussed above). The plan would also force public housing authorities to compete with private landlords for subsidized and unsubsidized tenants. Anticipating downsizing of the agency, the plan specifies other initiatives, including consolidation of 60 major HUD programs over the next few years into three performance-based funds: the Community Opportunity

¹⁸ Further targeted for sizable cutbacks are programs designed to fight violence and drug abuse in public housing.

Fund, the Affordable Housing Fund, and the Housing Certificates Fund. The Community Opportunity Fund will focus on community economic revitalization and will encompass all current Community Development Block Grant and economic development initiatives. Consistent with congressional intent and with agency efforts to enhance program flexibility and reduce bureaucracy, HUD program grantees (states and localities) will have broad authority in the use of federal resources. The Affordable Housing Fund will encompass all HUD grant programs for the development of low- and moderate-income housing. Finally, the Housing Certificates Fund will combine all current housing assistance programs (including public housing, assisted housing, and Section 8 rental assistance), which will be administered largely through public housing agencies. HUD anticipates completing the consolidation activities by fiscal year 1998; public agencies will be given additional time if necessary to fully convert to tenant-based subsidies.

Also central to HUD's overall reform efforts are initiatives to restructure the FHA and to reform numerous multifamily operating procedures that pertain to portfolio restructuring, property disposition, preservation, and enforcement. The various FHA restructuring proposals and their implications are discussed in some detail in a collection of articles by Vandell (1995), Retsinas (1995), and Weicher (1995). Broad consensus exists regarding the set of fundamental issues to be addressed in the context of any FHA restructuring. In brief, a variety of government and research reports have indicated the critical lack of up-to-date FHA management control and data processing systems, related inefficiencies in important FHA functions of insurance processing and asset management, and the accrual of substantial losses to the FHA multifamily loan insurance fund. It is also widely appreciated that the basic FHA single-family program is actuarially sound. Also, consensus exists that the FHA should remain true to its basic mission of providing credit enhancements to expand housing opportunities among higher risk and low- to moderate-income households and that the agency requires greater autonomy to accomplish that broadly defined goal.

The HUD proposal is to reinvent the FHA in the form of a wholly government-owned corporation within HUD to be known as the Federal Housing Corporation (FHC). Because of its status as an entity of the federal government (and therefore its access to lower cost capital), the new FHC is expected to carry out its broadly defined mission without any government credit subsidy. Specifically, the FHC would attempt to maintain ongoing federal

government housing finance commitments to low- and moderate-income households, particularly those households and areas deemed too risky to be served by the private sector. In so doing, it would also seek to smooth cyclical fluctuations in mortgage supply, demonstrate and introduce innovative mortgage products, and further enhance competition in the supply of mortgage funds. However, it would undertake those activities in a more efficient, business-oriented manner devoid of current FHA statutory constraints on mortgage offerings.¹⁹

The FHC will undertake a substantive review of all single-family, multifamily, and health care facility markets with the aim of defining appropriate instruments and strategic market share over the near to middle term. Regardless of the precise organizational and legal structure of the new government housing finance entity, the critical problems of the multifamily insurance and subsidy programs need to be addressed; in fact, numerous analysts and policy makers suggest the outright elimination of the multifamily insurance program. Such an argument may indeed be appropriate, given the inability of the multifamily program, with its lower cost of funds, to operate on an actuarially sound basis as required by statute. The magnitude of FHA multifamily insurance in force is about one-eighth of that in the single-family portfolio; in terms of overall market share, the FHA insured about 7 percent of all multifamily mortgage originations in 1994 (Weicher 1995).

The anticipated FHC market niche will continue to evolve, given the enhanced flexibility of underwriting and lower down payment loan products currently being promoted by the GSEs. Although the FHC will undoubtedly continue to emphasize loan products that facilitate homeownership opportunities for underserved populations and neighborhoods, the FHC will compete more directly with those new and more flexible conventional loan instruments currently being underwritten by the GSEs. However, to be true to and effective in its basic mission of promoting homeownership among risky and lower income borrowers, the new entity must maintain its status as a government agency. It is only in the context of the lower cost of funds afforded by such status that the FHC could continue to serve those underserved market segments. Any equivocation of the current federal government guarantee of FHA insurance would

¹⁹ Currently, each FHA mortgage product is labeled according to the section of the National Housing Act in which it is described. In contrast, it is anticipated that the design of mortgage products by the FHC would not be done by statute; the new entity would be given a broad authority to enhance credit consistent with its articulated financial and programmatic goals.

jeopardize attainment of those fundamental and long-standing housing policy goals.

In the wake of this evolution in the priorities and pragmatics of federal housing policy, substantial uncertainty abounds concerning implications for housing outcomes. Enhanced flexibility of GSE underwriting and the introduction of new, lower down payment mortgage instruments similarly should support homeownership among minority, low- to moderate-income, and immigrant populations. Improved flexibility and local control in the management of public housing, together with the introduction of tenant-based subsidies and the increased utilization of rental subsidies outside inner-city poverty areas, should increase economic welfare among very low income renter populations. Consolidation of HUD programs will offer improved efficiency as well, and devolution of funding and programmatic responsibility to state and local levels may sometimes provide local solutions to local problems.

However, sizable cuts in federal government rental housing and income supports will undoubtedly result in economic distress among the lowest income renter populations. Those difficulties will be further reinforced by the loss from the stock and diminished production of low-income rental housing units. Given the scarcity of affordable rental units, the housing problems of very low income renter populations will spill over to increased homelessness and additional burdens on the criminal justice system. Overall, the combination of lower levels of housing funding and increased local control will likely substantially reduce a variety of long-standing federal housing commitments and services. It is hoped that the national commitment to the pressing housing needs of low-income renter populations is not too greatly eroded, and that the hoped-for efficiency gains at HUD become evident, to realize the long-standing housing policy goals of improved homeownership and rental housing opportunities for the large number of traditionally underserved American households.

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The author is grateful to Steve Hornburg for helpful comments on an earlier draft of this article.

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