

## **Reflections: Place Matters**



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\* The views expressed here are my own and not necessarily those of the Federal Reserve System or my colleagues on the Federal Open Market Committee.

Today, I would like to share some reflections on place and why it matters when working toward expanding economic opportunity and inclusion.

### **Place Matters**

If you watch a lot of old movies like I do, you'll often find people described as coming from "the wrong side of the tracks." This phrase was a way of saying that someone came from a lower-income or lower-class background. Its interpretation relied on something that is still true in many parts of the country: namely, that neighborhoods are often divided by natural or artificial boundaries and that those unlucky enough to live on the wrong side of those barriers are stuck with lower-quality housing; poorer-quality schools; less access to healthcare, food, and public transportation; and fewer neighborhood amenities such as parks, playgrounds, and other green space. Since employers are often drawn to places that will attract workers, those in lower-quality neighborhoods typically have less access to good jobs, making it harder for them to invest in improving conditions in their own neighborhoods or to move to better areas.

A body of research has shown that economic opportunity is tied not only to individual circumstances but also to place. Upward mobility – the probability that a child will be better off economically than his or her parents – is dependent not only on the family's characteristics but also on neighborhood characteristics such as neighborhood income, the quality of schools, access to social services, and racial integration.

A discussion of racial integration naturally brings us to housing and housing finance. Housing is a vital determinant of the economic well-being of families, communities, and the overall economy, and so it is of keen interest to the Federal Reserve System. The Federal Reserve, along with the other federal bank supervisors, is charged with implementing the Community Reinvestment Act (CRA). This act was passed in 1977 and reaffirmed that banks must serve the communities in which they are chartered to do

business, including low- and moderate-income areas, helping to ensure equitable access to credit for all individuals and neighborhoods.<sup>1</sup> The act was intended to help to address the illegal practice of redlining.

Redlining refers to the practice denying loans or financial services to people living in neighborhoods that are predominantly nonwhite. The term derives from maps constructed in the 1930s as part of the government's response to limiting foreclosures in the wake of the Great Depression. These maps indicated the credit risk of neighborhoods based on risk-related factors, including house prices and age of the homes, but also on demographic characteristics, including race and ethnicity. The lowest rated neighborhoods were outlined in red and often had a majority of Black residents. In fact, it was official policy to keep neighborhoods segregated: for example, a 1938 Federal Housing Authority Underwriting Manual said: "If a neighborhood is to retain stability, it is necessary that properties shall continue to be occupied by the same social and racial classes. A change in social or racial occupancy generally contributes to instability and a decline in values."<sup>2</sup> The thinking of the day was that integration hurt property values. This idea permeated throughout the structure of realtors, brokers, appraisers, and housing policymakers. Redlining and similar practices led to greater segregation and deterred investment in minority and low-income communities, resulting in lower homeownership rates, house prices, and rents in these neighborhoods. These communities found it hard to attract employers, which lowered economic opportunity for people living in these areas. Housing is an important way that families in the U.S. build wealth, so barriers to homeownership harmed wealth creation, and also limited access to credit for people of color.

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<sup>1</sup> For more on the historical context of the CRA, see Braunstein (2008) and Federal Reserve System (2014).

<sup>2</sup> See Federal Housing Administration (1938), section 937; also quoted in Bostic (2020).

## Problems continue

The effects of these policies continue even today, well after enactment of fair housing and lending legislation in the 1970s meant to address the scourge of redlining and discrimination in credit markets. In fact, Federal Reserve research finds that the redlined neighborhoods still show worse housing market outcomes compared to similar neighborhoods that were not redlined.<sup>3</sup> They have lower homeownership rates, house values, and rents; they also exhibit higher racial segregation. In addition, it is still the case that whites have better access to credit and higher homeownership rates compared to nonwhites, even when you control for income and other factors that affect creditworthiness.<sup>4</sup> According to the Economic Innovation Group's Distressed Communities Index, while some progress has been made since 2000, it is still the case that over a third of the Black population lives in economically distressed zip codes; in the Midwest the share is greater, at about half.<sup>5</sup>

A deteriorating housing stock in distressed neighborhoods can lead to other risks that can affect longer-term economic outcomes. One example is lead toxicity, which at elevated levels causes brain damage and has significant adverse effects on a child's ability to learn.<sup>6</sup> Another is school quality. Because local property taxes are a primary mechanism for funding schools, communities that are segregated by income and by race can have substantially different levels of school resources. The recently approved Ohio state budget has changed the funding plan for schools to try to address the disparity in funding across school districts.<sup>7</sup> One change is that the local district's funding share is now based not only on property tax value but also district residents' income.

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<sup>3</sup> Aaronson, Hartley, and Mazumder (2020).

<sup>4</sup> For a discussion of the racial gaps in homeownership rates, see Choi (2020) and Haughwout, et al. (2020).

<sup>5</sup> See Economic Innovation Group (2020).

<sup>6</sup> A study of Chicago neighborhoods found that even though the incidence of lead poisoning in children has fallen significantly over time as a result of public health policy, it is still the case that those neighborhoods with the highest levels of toxicity are predominantly Black neighborhoods. See Sampson and Winter (2016).

<sup>7</sup> See Welsh-Huggins (2021).

Despite the fact that the Fair Housing Act of 1968 outlawed discrimination based on race, religion, national origin, or gender, evidence indicates that there continues to be racial bias in appraisals of home values. The same house can be appraised for different values depending on whether a white or Black person is present at the time of the appraisal.<sup>8</sup> A study by the Brookings Institution indicates that in U.S. metropolitan areas, even controlling for home quality and neighborhood amenities, homes are valued at 23 percent less in majority Black neighborhoods compared to neighborhoods with few or no Blacks.<sup>9</sup> Since appraised value is an important driver of the cost of refinancing a mortgage, this bias compounds racial differences that exist in access to credit, which in turn makes it harder for Blacks to build generational wealth and invest in education, which perpetuates income disparity.

Racial differences are also seen in the pricing of mortgage credit. Various studies have found that compared to whites, Blacks and Hispanics typically receive higher mortgage rates when they take out a mortgage, even after accounting for factors related to credit risk, such as income and credit score. One Federal Reserve study found that this racial difference at origination is actually quite a bit smaller than the racial difference in the average interest rate paid on the stock of outstanding mortgages.<sup>10</sup> The reason is that when mortgage rates fall, Blacks and Hispanics are much less likely to refinance to take advantage of the lower rates. Why this is the case is beyond the scope of the study and remains a topic for further research. A potential partial explanation is offered by the results of a field experiment conducted by a Cleveland Fed researcher and co-investigators, which found systematic differences in the information offered by mortgage brokers to white and Black borrowers.<sup>11</sup> This information discrepancy could place Black borrowers at a disadvantage when it comes to refinancing. Another possible explanation of systematic racial differences in refinancing behavior is the systematic racial differences in appraised

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<sup>8</sup> See McMullen (2021).

<sup>9</sup> See Perry, Rothwell, and Harshbarger (2018).

<sup>10</sup> Gerardi, Willen, and Zhang (2020).

<sup>11</sup> Hanson, et al. (2016).

home values. Further research is needed to determine if there are other barriers to refinancing that prevent nonwhite borrowers from taking full advantage of the option to refinance when rates move down and whether possible remedies, such as greater reliance on adjustable-rate mortgages, which automatically reprice when interest rates change, would alleviate mortgage cost discrepancies.

Zoning restrictions, some of which stem from past discriminatory practices, have made it harder to produce affordable housing and improve the housing stock in low-income areas. Restrictions on the density and type of housing – for example, zoning that allows only single-family housing – can make it difficult to locate affordable housing near schools, jobs, and transportation. Zoning restrictions affect not only urban areas but also rural areas. Although they get less attention, rural areas have a disproportionate share of the country’s occupied substandard housing stock.<sup>12</sup> And according to analysis by the Economic Innovation Group, the share of the country’s rural population living in distressed communities rose over the past two decades, while the comparable share of the urban population fell.<sup>13</sup>

## **Solutions**

Efforts are being made to address some of the lingering disparities across housing markets. One example is a partnership between the Auditor’s Office in Franklin County, Ohio, and the Kirwan Institute for the Study of Race and Ethnicity to help eliminate inequalities in the appraisal process.<sup>14</sup> The appraisal industry is also taking steps to increase diversity in the industry as a way to address implicit bias. In some places, including Oregon, California, and Minneapolis, zoning laws are being reconsidered to allow for greater density and increased investment in lower-cost quality housing, giving people more options than just single-family homes, which may not be affordable, and allowing for more inclusive neighborhoods.

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<sup>12</sup> National Rural Housing Coalition (2021).

<sup>13</sup> The share of the country’s rural population living in distressed communities rose from 10.9 percent in 2000 to 23.6 percent in 2020. The comparable share of the urban population fell from 34.3 percent to 21.7 percent. See Economic Innovation Group (2020).

<sup>14</sup> See Hopkins (2020).

Some consideration is also being given to limiting the time that derogatory information remains on an individual's credit report to give those who had credit problems in the past a second chance at getting a mortgage or other types of credit.

Several programs now in place across the country aim to lower the degree of segregation in neighborhoods by making it easier for people to relocate to places where there are greater economic opportunities. The largest federal public housing program in the U.S. is the Housing Choice Voucher program, which offers recipients rental subsidies in the private market. As discussed by Cleveland Fed researchers, until recently this program set a single, metro-area-wide cap on the subsidy, which tended to keep disadvantaged families in disadvantaged neighborhoods in the metro area.<sup>15</sup> A relatively recent change in the program allows the subsidy cap to rise and fall with local rents, and this has allowed some recipients to move to higher-opportunity neighborhoods. The Cleveland Fed researchers suggest that the addition of well-designed housing mobility programs could make the voucher system more effective in reducing segregation. Their analysis indicates that the programs most successful at encouraging mobility are those with a regional focus; such programs encourage moves across several counties and not just within the central city. Tenant and landlord counseling is also a key ingredient of success, making landlords more willing to accept subsidized tenants and helping tenants find subsidized units in neighborhoods offering higher opportunity. The U.S. Department of Housing and Urban Development is now experimenting with this more active engagement.

Not everyone wants to move out of their neighborhood, so other programs focus on improving housing conditions in distressed neighborhoods for the people who live there. Federal Reserve researchers estimate that it would cost about \$780 million to repair owner-occupied and renter-occupied housing units in the Cleveland metropolitan area, with an average cost of about \$2,700 per household with repair

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<sup>15</sup> See Aliprantis, Martin, and Tauber (2020).

needs.<sup>16</sup> Lead is a particular problem in parts of Cleveland. The Lead Safe Cleveland Coalition and the city of Cleveland have been working to prevent lead poisoning in the city, and in July 2019, Cleveland City Council passed legislation requiring, among other provisions, that landlords pay for private inspections and certifications that their occupied units are lead-safe, with penalties for noncompliance.<sup>17</sup> Much of the housing stock in need of repair is owned or rented by households with children, older families, or people living below the poverty line.<sup>18</sup> In several municipalities, programs offer low-income homeowners grants or forgivable loans to make home repairs for major issues like cracked foundations, broken windows, or other safety-related situations. One such program is the Challenge Fund Loan Guarantee, offered by the Home Repair Resource Center, a nonprofit based in Cleveland Heights, which guarantees bank loans on home repairs for those homeowners who can make a monthly payment but cannot qualify for a bank loan because of past credit quality problems, not enough equity in the home, or other reasons.<sup>19</sup> Another program, offered by CHN Housing Capital for homeowners in Cuyahoga County, provides home repair loans as a zero percent deferred second mortgage payable upon resale of the home.<sup>20</sup>

Programs such as these tend to have limited resources relative to the need, and it is clear that improving economic opportunities for families living in low-income communities requires further investment in these areas. One potential avenue is through the Community Reinvestment Act (CRA). Lack of access to credit has been found to have long-lasting negative effects on a neighborhood's economic health,<sup>21</sup> and a body of evidence indicates that the CRA has provided some tangible benefits to low- and moderate-

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<sup>16</sup> Divringi (2021) and Divringi, et al. (2019).

<sup>17</sup> See Dissell and Zeltner (2019).

<sup>18</sup> Divringi (2021) and Divringi, et al. (2019).

<sup>19</sup> See Ohio Fair Lending Coalition (2021) and Home Repair Resource Center (2021).

<sup>20</sup> See Ohio Fair Lending Coalition (2021) and CHN Housing Capital (2021).

<sup>21</sup> See Aaronson, Hartley, and Mazumder (2020).

income neighborhoods.<sup>22</sup> The Federal Reserve, along with the other federal banking regulators, is currently undertaking a review of the ways in which we assess how banks are meeting their CRA obligations. The last substantial revision to the framework for assessing CRA compliance was in 1995, over 25 years ago. Both the banking industry and the community development field have changed in many ways since then. Reforms to the framework will seek to clarify what activities count as CRA activities, incorporate technological innovations such as mobile and internet banking, increase financial inclusion, and strengthen the engagement between banks and their communities. CRA modernization will enhance the act's effectiveness in bringing needed investment and financial services to low- and moderate-income areas. Increasing investment in low- and moderate-income areas will enhance economic opportunity in these communities and help to build a stronger regional and U.S. economy that works for all of us.

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<sup>22</sup> Mester (2018) discusses the effects of the CRA on outcomes.

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