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Neighborhood Redlining, Racial Segregation, and Homeownership

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GLOSSARY

Asset: A resource with economic value that an individual, corporation, or country owns with the expectation that it will provide future benefits.

Collateral: Property required by a lender and offered by a borrower as a guarantee of payment on a loan.

Default: The failure to promptly pay interest or principal when due.

Depression: A severe and long-lasting economic downturn that is worse and deeper than a recession; a severe reduction in gross domestic product (GDP).

Liquidity: The quality that makes an asset easily convertible into cash with relatively little loss of value in the conversion process.

Mortgage: A loan for the purchase of a home or real estate.

Wealth: The value of a person's assets accumulated over time.

> "If young people are not taught an accurate account of how we came to be segregated, their generation will have little chance of doing a better job of desegregating than the previous ones."
> —Richard Rothstein[1]

In the 1930s, the Home Owners' Loan Corporation (HOLC) drew maps of residential neighborhoods across the United States. The maps classified each neighborhood into one of five categories, from least to most likely to **default** on a **mortgage** loan. In those maps, the neighborhoods most likely to default were shaded red and over time these neighborhoods had the largest concentrations of African Americans. Because the lending classifications determined individual access to credit, the residents of redlined neighborhoods paid high interest rates and had a hard time becoming homeowners and keeping their homes in good condition. From 1968 to 1974, Congress passed several federal laws and policies preventing lending discrimination by race and gender, and the pattern of residential segregation started to change.

Mortgage Lending and Default Risk

Because homes are very expensive **assets** to buy, when buying a home, people generally borrow money—in the form of a mortgage loan—to finance the purchase. When making a loan, the lender faces default risk.[2] Default risk is the risk that the borrower may fail to promptly pay the interest or principal when due. For a mortgage loan, a house or another piece of real estate is offered as **collateral**, meaning the lender can seize ownership of the collateral if the borrower fails to repay the debt. Nonetheless, real estate is not considered to have much **liquidity**, because it is not easily convertible into cash without losing some value in the process.

During the economic contraction known as the Great **Depression** (1929-33), many mortgage holders could not repay their debts and lost ownership of their homes.[3] In turn, the banks and financial institutions that had lent the money ended up with many real estate properties they could not sell without experiencing a large loss. At the time, when lenders appraised the value of a home and assessed the default risk of a loan, they lacked good information about real estate values and borrowers' ability to repay. As a result, lenders' losses from defaulted loans were high and general property values for borrowers in neighborhoods with many defaults were unstable.

Neighborhood Maps and Residential Segregation

In 1932, as part of a broad effort to address the financial crisis brought about by the Great Depression, the federal government created several agencies tasked with overseeing the work of residential lenders. One of those new agencies was the HOLC. This organization designed a set of rules to appraise the value of residential properties, taking into consideration local housing market conditions as well as neighborhood demographic and economic characteristics. Mortgage lenders were required to follow those rules; otherwise, they would not receive financial backing from the Federal Home Loan Bank Board.

Between 1935 and 1940, the HOLC used those rules to draw maps of 239 cities across the United States.[4] In each city, neighborhoods were graded (and shaded) as follows:

- Grade A: "Best" (shaded green), where properties were expected to increase or maintain a high appraised value. This grade represented the lowest default risk for lenders.
- Grade B: "Still desirable" (shaded blue), where properties were expected to maintain their appraised value. This grade represented an acceptable risk of default for lenders.
- Grade C: "Declining" (shaded yellow), where properties were expected to lose their appraised value. This grade represented a high risk of default for lenders.
- Grade D: "Hazardous" (shaded red), where properties were old or close to unattractive or unhealthy industrial areas, therefore having minimal value. This grade represented a dangerous risk of default for lenders.

The appraisal manuals used to create the HOLC grades made blatant use of bigoted language, relating the value of the housing stock to the race and ethnicity of the residents. For example, to describe an A-graded area in Chicago, Illinois, the HOLC agents stated "The buffer of the Illinois-Central (IC) Main [railroad] Line prevents any undesirable infiltration [by minority residents]."[5] By contrast, in a B-graded area in Decatur, Illinois, the area description file notes a particular subsection as "probably the worst part of [the] area, with [the] Polish and laboring class predominating."[6] Similarly, when describing a C-graded area in Philadelphia, Pennsylvania, it was noted that the "Infiltration of Jewish into [the] area have depressed values."[7] As for a D-graded area in Tacoma, Washington, the description of the map states that "This might be classed as a 'low yellow' area if not for the presence of the number of Negroes and low class Foreign families who reside in the area."[8]

Economic Consequences

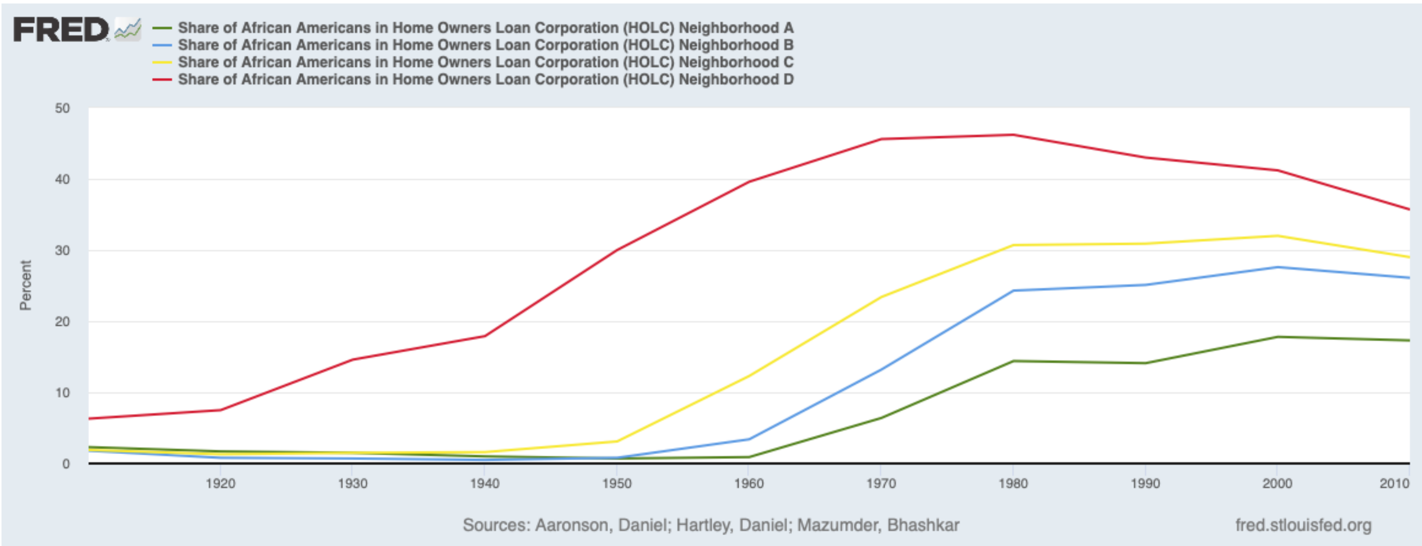
Research on the impact that the HOLC maps had on where people either chose to or were driven to live has found clear evidence of segregation.[9] A study from the Federal Reserve Bank of Chicago tracked the number of African Americans residing in HOLC-graded neighborhoods across the country between 1910 and 2010.[10] That research found that the largest concentrations of African Americans were in the lowest-graded areas and that very few resided in neighborhoods where real estate values were either stable or growing.[11] Figure 1 shows that between 1910 and 1970, the percentage of African Americans in redlined neighborhoods increased to 46 percent, while in bluelined and greenlined neighborhoods it only increased above 1 percent after the 1950s.

The consequences of this residential segregation were dire. Because the properties in redlined neighborhoods were appraised as having minimal value, the collateral lenders would hold in case of default had very little value. Thus, to protect themselves from potential loses, lenders charged higher interest rates than in higher-graded neighborhoods. Because credit was more expensive, fewer African American households could afford to own a home or borrow to keep their properties in good condition. And homes in these neighborhoods didn't tend to increase in value. These factors have had a long-term impact on the ability of residents in these neighborhoods to accumulate **wealth**, afford other expenses such as a college education, and bequeath an inheritance to the next generation. In short, redlining negatively affected the social and economic mobility of those living in these neighborhoods.[12]

Policy Reforms

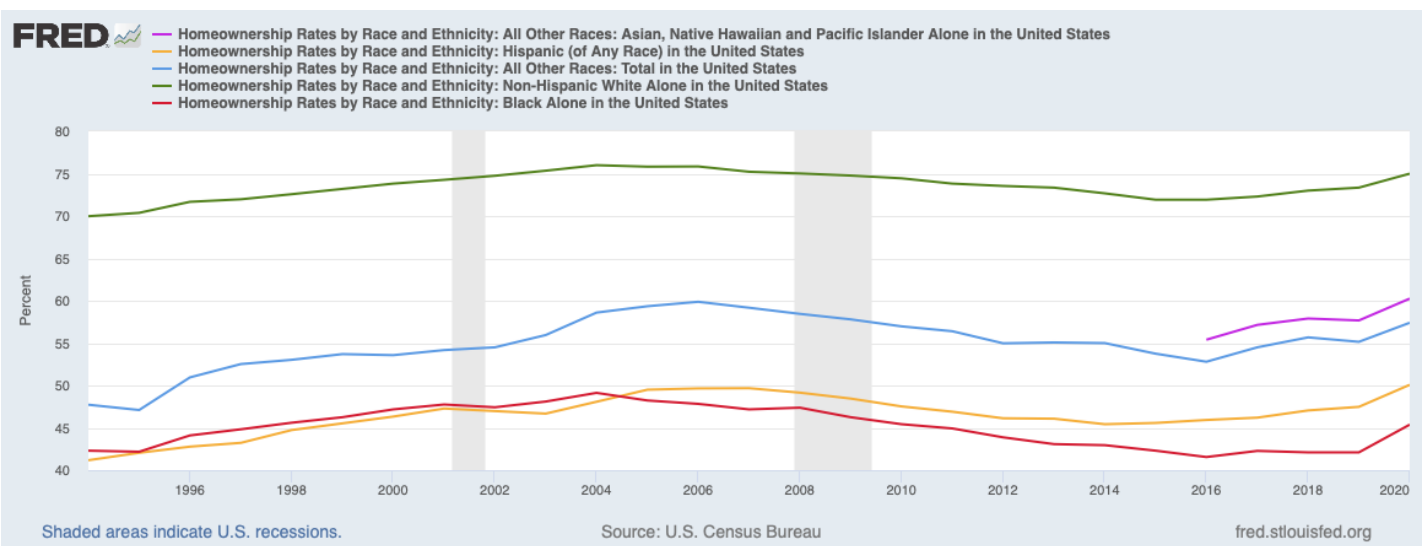
In the 1970s, a new set of federal policies aimed at preventing discriminatory housing and financial practices

Figure 1
Shares of African Americans in HOLC Neighborhoods



SOURCE: Aaronson, Hartley, and Mazumder (2020) via FRED®, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/graph/?g=ERL1, accessed July 16, 2021.

Figure 2
Homeownership Rates by Race and Ethnic Group



SOURCE: U.S. Census Bureau via FRED®, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/graph/?g=CjKv, accessed March 25, 2021.

partially reversed those patterns. The Fair Housing Act of 1968 bans discrimination concerning the sale, rental, and financing of housing based on race, religion, national origin, sex, and (as later amended) handicap and family status.[13] The Equal Credit Opportunity Act of 1974 prohibits credit discrimination on the basis of race, color, religion, national origin, sex, marital status, or age, or because the person receives public assistance.[14] The Community Reinvestment Act of 1977 requires the Federal Reserve and other federal banking regulators to encourage financial institutions to help meet the credit needs of the communities in which they do business, including low- and moderate-income neighborhoods.[15]

The influence of these policies on reversing residential segregation can be observed in Figure 1. In the 30 years after enactment of the acts, the African American population has become more evenly distributed across all HOLC-graded neighborhoods. Nevertheless, the decades of limited access to affordable credit and good quality real estate has had long-lasting effects. Figure 2 shows that, as of 2020, African Americans have the lowest homeownership rates of all racial and ethnic groups in the United States.

Conclusions

Redlining classified neighborhoods as risky investments if deemed the most likely to default on repayment of a mortgage loan. Houses in redlined neighborhoods were generally old or too close to unattractive or unhealthy industrial areas. Because of those factors, the houses held little value as collateral and lenders would only offer mortgage loans at above-average interest rates. Over time, these neighborhoods had the largest concentrations of African Americans. Residents in redlined neighborhoods could not afford to buy homes or pay for their upkeep and thus could not become or stay homeowners and accumulate wealth at the rates other groups did. Only when the federal government passed laws banning discrimination in housing and banking did the segregation of African Americans to specific neighborhoods start to ease up. Nevertheless, the decades of redlining have left a deep mark on the amounts and types of wealth held by African Americans. ■

Notes

[1] Rothstein, Richard. *The Color of Law: A Forgotten History of How Our Government Segregated America*. First Edition. Liveright Publishing Corporation, 2017, p. 199.

[2] For more on risk, see the following article: Mendez-Carbajo, Diego. "Measuring Financial and Economic Risk with FRED®." Federal Reserve Bank of St. Louis *Page One Economics®: Data Primer*, September 2020; https://www.stlouisfed.org/education/page-one-economics-classroom-edition/measuring-financial-and-economic-risk.

[3] For a description of the scale and impact of the Great Recession, see this brief essay: Wheelock, David C. "The Great Depression: An Overview." Federal Reserve Bank of St. Louis, (n.d.); https://www.stlouisfed.org/~/media/Files/PDFs/Great-Depression/the-great-depression-wheelock-overview.pdf.

[4] For examples of those maps and an interactive map of the areas the HOLC graded in each city, see https://dsl.richmond.edu/panorama/redlining.

[5] For the complete area description file, see https://dsl.richmond.edu/panorama/redlining/#loc=10/41.89/-88.105&city=chicago-il&area=B107.

[6] For the complete area description file, see https://dsl.richmond.edu/panorama/redlining/#loc=13/39.849/-89.004&city=decatur-il&area=B6.

[7] For the complete area description file, see https://dsl.richmond.edu/panorama/redlining/#loc=11/40.015/-75.359&city=philadelphia-pa&area=C14.

[8] For the complete area description file, see https://dsl.richmond.edu/panorama/redlining/#loc=12/47.236/-122.596&city=tacoma-wa&area=D7.

[9] For a study about the prevalence of Black residents in redlined neighborhoods, see this working paper: Fishback, Prince; LaVoice, Jessica; Shertzer, Allison and Walsh, Randall. "Race, Risk, and the Emergence of Federal Redlining." NBER Working Paper No. 28146, National Bureau of Economic Research, November 2020; https://www.nber.org/system/files/working_papers/w28146/w28146.pdf.

[10] Aaronson, Daniel; Daniel Hartley, and Mazumder, Bhashkar. "The Effects of the 1930s HOLC 'Redlining' Maps." Working Paper 2017-12, Federal Reserve Bank of Chicago, August 2020; https://www.chicagofed.org/publications/working-papers/2017/wp2017-12.

[11] For a study about the economic effects of the maps on the long-run trajectories of neighborhoods, see Aaronson, Hartley, and Mazumder (2020).

[12] For a study about the social and economic effects of neighborhood credit-worthiness ratings, see this article: Aaronson, Daniel; Faber, Jacob; Hartley, Daniel; Mazumder, Bhashker; and Sharkey, Patrick. "The Long-Run Effects of the 1930s HOLC 'Redlining' Maps on Place-Based Measures of Economic Opportunity and Socioeconomic Success." *Regional Science and Urban Economics*, January 2021; https://doi.org/10.1016/j.regsciurbeco.2020.103622.

[13] For a complete description of "fair housing" policies, see https://www.hud.gov/program_offices/fair_housing_equal_opp/fair_housing_act_overview.

[14] For a complete description of equal credit opportunity rights, see https://www.consumer.ftc.gov/articles/0347-your-equal-credit-opportunity-rights.

[15] For a complete description of regulators and regulations related to the Community Reinvestment Act, see https://www.federalreserve.gov/consumerscommunities/cra_about.htm.

Name____ **Period**________

Federal Reserve Bank of St. Louis *Page One Economics*®:

"Neighborhood Redlining, Racial Segregation, and Homeownership"

After reading the article, complete the following:

1. When a person financing the purchase of a home through a mortgage fails to pay interest or principal when due,
   a. the lender takes ownership of the home, which served as collateral.
   b. the loan is sold to an investor and the borrower's wealth increases.
   c. the borrower's credit score goes up.
   d. the lender loses ownership of the home.

2. The purpose of the neighborhood ranking system created by the Home Owners' Loan Corporation was to classify borrowers
   a. by race.
   b. by default risk.
   c. by gender.
   d. by nationality.

3. "Redlining" refers to the use of red shading on maps to classify neighborhoods based on having
   a. the lowest default risk.
   b. the largest numbers of foreign-born residents.
   c. the highest default risk.
   d. the largest numbers of U.S.-born residents.

4. Which of the following is true about redlined neighborhoods?
   a. As of 2010, they have had a higher percentage of African Americans than other neighborhoods.
   b. Properties in these neighborhoods have been expected to maintain a high value.
   c. Old houses in need of repair have made them very appealing to residents.
   d. As of 1970, they have had a lower percentage of African Americans than other neighborhoods.

5. Which of the following is a consequence of the relatively high interest rates charged to residents in redlined neighborhoods?
   a. These neighborhoods had more homeowners than other neighborhoods.
   b. The residents were more likely to accumulate wealth in the form of real estate assets.
   c. It was easier for the homeowners to afford other expenses such as a college education.
   d. It was harder for the homeowners to bequeath an inheritance to the next generation.

6. According to the Equal Credit Opportunity Act of 1974, the only acceptable reason a lender has for limiting access to credit is
    a. sex.
    b. race.
    c. the ability to repay the loan.
    d. religion.

7. As of 2020, which of the following racial or ethnic groups has the lowest homeownership rate?
    a. Hispanics or Latinos
    b. Non-Hispanic Whites alone
    c. Blacks or African Americans alone
    d. Asians, Native Hawaiians, and Pacific Islanders alone