At Prosperity Now, we believe homeownership is one of the primary ways for families in the United States to build wealth. Owning an affordable home can offer many stability and security, and is an asset that can be passed on to future generations. Similarly, eradicating racial homeownership rate disparities is one of the most effective ways to reduce the racial wealth divide. In this report, we review existing research to explore how downpayments are a significant barrier to homeownership and how matched savings programs like individual development accounts (IDAs) can help.

Benefits of Homeownership

In the wake of the 2008 financial crisis, the value of homeownership was put into question for millions of Americans. Though the housing market has largely recovered to pre-recession levels (Federal Housing Finance Agency 2018), the rate of homeownership is still lagging behind. Rates rose steadily in the early 2000s, reaching a high of 69% in 2004. However, by 2016, the percentage of homeowners in the US fell to 63.4%, the lowest it had been since 1965 (U.S. Census Bureau 2018). While homeownership has increased slowly for the past two years, there are still opportunities to facilitate continued and stable growth.

There are risks associated with homeownership that potential homebuyers, lenders and policymakers should consider in their decision-making processes, and homeownership may not always be the right choice. However, the benefits of homeownership still make it a worthwhile investment for most Americans. For many, particularly low- and moderate-income households, owning a home is the primary way to build wealth and obtain greater financial security. Not only do properties tend to increase in value over time (FHFA 2018), but owning a home also tends to result in lower overall housing costs. Though it varies significantly by housing market, the median U.S. household generally spends more on rent than mortgage payments as a percentage of income (Goodman et al. 2018).

Owning a home may come with additional costs compared to renting, such as general home maintenance and repairs to appliances, as well as property taxes and other fees. However, an analysis of lifetime housing costs suggests that renting adds an annual extra cost of 1.85% of a property's value compared to owning (Li et al. 2012). Subsequently, owning a home is still an effective wealth-building tool. Lower annual costs in most markets means that more money is available for savings or other assets. Even if a home falls to appreciate, a home sold for 80% of its purchase price still brings a greater return than the security deposit you might get back after renting.
This wealth-building benefit of homeownership may be even more pronounced for households of color, whose median wealth tends to fall well below that of White households (Asante-Muhammad et al. 2017). According to recent National Housing Survey data, 76% of White households own their home, compared to just 51% of Black and 54% of Latino households (McCabe 2018). However, in a study of 15 metropolitan areas across the U.S., home appreciation values were substantially higher for Black and Latino homebuyers than for White households (Immergluck, Earl, and Powell 2018). Similarly, Black and Latino households may be more likely than Whites to recognize wealth building and other advantages as reasons to buy a home (McCabe 2018).

**Barriers to Homeownership**

With the financial incentives of owning compared to renting, it would be reasonable to expect homeownership rates to at least level off as post-recession recovery continues in most housing markets (FHFA, 2018). However, this recovery has not been realized equally for various social and economic groups (Hyra and Rugh 2015; Williams, Galster, and Verma 2013). Major barriers still prevent many Americans from becoming homeowners who might otherwise be good candidates for a mortgage.

One of the biggest barriers to homeownership is credit, specifically poor credit scores or lack of credit history. Credit requirements for mortgages increased considerably after the housing market crash, with the median credit score for a mortgage rising from 696 in 2005 to 738 in 2018 (Goodman et al. 2018). However, flaws in how credit scores are determined may unfairly keep people from accessing homeownership if they don’t make the kinds of payments that have traditionally been included in credit reports (Newville and Chopra 2016). For example, though mortgage and credit card payments are regularly considered in traditional credit scoring models, recurring expenses like rent and utility payments are not. This flaw disproportionately affects low- and moderate-income households who are more likely to be renters.

Many potential homebuyers also carry a considerable debt burden (Li and Goodman, 2015). Student debt in particular appears to keep many younger families out of the market, or at least makes them believe that they are unable to afford homeownership (Larrimore, Schuetz, and Dodini 2016). Though mortgage costs tend to be more affordable than rents depending on the state or metropolitan area, rising home prices will make homeownership progressively less affordable, especially if interest rates also increase (Goodman et al., 2018).

Similarly, households of color are overly burdened by homeownership barriers when compared to White households beyond the immediate wealth disparity. Information barriers—such as language barriers and hidden fees—and faulty protections can make the homebuying process difficult or prohibitive. Similarly, households of color are disproportionately targeted by predatory lending practices and regulatory burdens such as exclusionary zoning, expensive fees and lack of affordable housing in urban centers (U.S. Department of Housing and Urban Development, 2010). Such barriers often overlap, creating a web of problems that contribute to a greater overall impediment to homeownership that disproportionally impacts people of color. For example, while student loan debt is associated with lower homeownership rates across racial groups, its effect is significantly more pronounced for young Black adults, who also tend to have more student loan debt than Whites ( Houle and Berger 2015).
Perhaps the most significant barrier to homeownership is the downpayment. In a nationally representative survey of renters, well over half (68%) said that their inability to afford a downpayment was a reason why they currently rent (Goodman et al., 2018). If renting tends to be as or more expensive than a mortgage, as discussed above, it would therefore be fair to frame homeownership as a savings challenge rather than an affordability problem for many Americans. Furthermore, it might not be as far off for people as they think. Over 60% of surveyed owners and non-owners believed a downpayment of 15% or more was required for a mortgage. However, nationally the median mortgage downpayment has dropped to just 5%, though it varies from state to state (Goodman et al., 2018). Similarly, only a quarter of consumers reported being at least “somewhat familiar” with low-down payment programs (Goodman et al., 2018).

**Downpayment Assistance**

Given the number of renters that struggle to save for downpayment and how downpayment requirements are lower than what most people expect, a modest form of downpayment assistance may bring homeownership within reach for many more Americans. This conclusion is supported by the findings of Freeman and Harden (2015), who found no statistically significant difference in mortgage performance between homeowners who did and did not receive downpayment assistance. In other words, their results suggest that there is no negative effect of downpayment assistance on the ability of homeowners to make mortgage payments. This is counter to the common argument that downpayment assistance recipients lack “buy-in” when purchasing a home and are therefore more likely to default on their loans.

Additionally, downpayment assistance programs may be particularly helpful for households of color. Compared to Black and Hispanic families, Whites are significantly more likely to receive downpayment assistance from their families and are less likely to use community grants (Freeman and Harden, 2015). This is likely due to the significant racial wealth gap, with children of White parents roughly three times as likely to receive financial transfers greater than $5000 dollars than children of Black or Hispanic parents (Lee et al. 2018). Such transfers have been found to increase the probability of homeownership by as much as 15.1% (Lee et al., 2018), and are particularly important when facing barriers to formal borrowing (Begley 2017). That these barriers also disproportionately affect households of color suggests that downpayment assistance programs could be an effective tool at reducing the racial homeownership disparities.

Downpayment assistance programs are common across the US: 2,527 different active programs are distributed by 1,304 organizations (Goodman et al., 2018). Examples of these programs include cash grants, second mortgages, tax credits and others. However, due to a lack of standardization, characteristics of these programs vary considerably across local, state and federal levels (Goodman et al., 2018). One type of program that does have a form of national guidelines, however, is an individual development account (IDA) program.

**Individual Development Accounts**

IDA programs are matched savings programs where a participant deposits money into an account that is matched at a predetermined rate. Much of this field was shaped by the Assets for independence (AFI) Act, which established a set of guidelines for IDA programs across the country. Though they are often used to save
towards purchases like a small business loan or higher education payments, the most common use of IDAs is as a downpayment for buying a home (Zielewski et al. 2009). A meta-analysis of IDA research across the country from 2009 offers insight into key design features common in IDA programs (Zielewski et al., 2009). The most common “match” rate for IDAs is 2:1, with two dollars deposited by the program for every dollar saved by the participant, though it commonly ranges from 1:1 to 8:1. Higher match rates are associated with higher savings deposit totals and decreased program dropout. Match totals are often capped around $4,000, and higher match caps are also associated with higher monthly savings amounts. Similarly, participants who established higher savings targets were associated with higher deposit frequency and totals.

IDAs also commonly include some form of financial education, though it varies by program (Zielewski et al., 2009). Financial education requirements within IDA programs are positively associated with monthly savings amounts and deposit frequency, with the average program requiring 12 hours. However, there are diminishing returns to more hours of education, with evidence suggesting 7-12 hours as most effective. Peer mentoring and direct deposit options may also correlate with greater savings amounts.

The current research on IDA outcomes is somewhat mixed. There is evidence suggesting that IDA program participants do save more than non-participants (Huang 2010; Zielewski et al. 2009). Whether those savings lead to increased wealth or other improved economic outcomes remains to be seen, due to inconsistent results in current research and a lack of studies into long-term effects (Zielewski et al., 2009). Furthermore, there is a significant gap in research available for post-recession years. Still, there is evidence that suggests IDAs can be effective at increasing homeownership rates for low- and moderate-income families. The 2009 meta-analysis of the field identified two out of three studies that found IDA completion was positively associated with homeownership rates (Zielewski et al., 2009). Other studies also suggest a correlation between IDA participation and increased homeownership. In one randomized experiment of participants with disabilities, the rate of homeownership for those in the IDA program was almost 10% higher than the control group (Huang et al. 2016). Additionally, an IDA program for low-income Native Hawaiians found program participation to be a significant predictor of homeownership (Rothwell & Han, 2010b), and a study of asset building programs among Hispanics found that IDA participation was associated with all asset growth, including homeownership (Shobe et al. 2017).

Additionally, IDA programs may have lasting effects beyond homeownership. IDA homebuyers were found to have significantly lower foreclosure rates than similar homebuyers within communities (McKernan et al. 2011). Similarly, in another study, IDA participants were found to have little trouble making mortgage payments, as well as greater confidence and capacity to make and meet financial goals when compared to a control group (Delgado 2015).

Discussion and Next Steps

The largest source of IDA funding dried up with the loss of AFI federal funding. While this has created a tremendous challenge for IDA practitioners across the country, it also presents an opportunity to reshape the standards of the field by creating a new program that builds on AFI’s successes and rethinks its challenging aspects.
While the amount of nationally representative research on IDA design is limited, there are nevertheless emergent trends that suggest which existing design features are effective. The crux of any IDA program is the match rate, and the literature surrounding its effect on savings behavior is still unclear. Some research has found that a match rate of 3:1 is associated with greater savings frequency than a 1:1 match but has no effect on monthly net savings (Grinstein-Weiss, Chowa, and Casalotti 2010). However, higher match rates may be associated with increased program enrollment (Sherraden et al. 2005).

Financial education also must be included in future IDA design. As mentioned above, AFI programs required financial education of some kind, and have been found to be positively associated with increased savings amounts and deposit frequency. Results from those programs suggest a total of seven to twelve hours of financial education provides the most efficient return on program resources (Zielewski et al. 2009). Additional research also suggests that guided classes are more effective than classes in which participants guide themselves at their own pace (Grinstein-Weiss, Chowa, and Casalotti 2010).

Future homeownership IDAs may be able to further leverage their education components by specifically offering education about the homebuying process. This may be especially effective given that knowledge gaps are a significant barrier to homeownership for households of color (HUD 2010). Furthermore, technology-assisted delivery (phone and/or internet) of credit counseling has been found to be no worse or even better than in-person delivery (Barron and Staten 2012). Similarly, a meta-analysis found that peer mentoring groups are also positively associated with monthly savings amounts (Zielewski et al. 2009). Though not the same content as financial education, it may be helpful for programs to consider alternative delivery methods to meet the needs of their clients.

Other design features that have been found to effect IDA program outcomes include maximum match amounts, monthly savings targets, availability of direct deposit, high-touch vs low-touch services, and length of the savings period. Higher maximum match amounts were found in a meta-analysis to be positively associated with increased monthly deposits, as are higher monthly savings targets for participants (Zielewski et al. 2009). Some research has suggested that direct deposit has no effect on savings behavior, while other research has found a strong association between the two (Zielewski et al. 2009). Similarly, unbanked IDA participants have been shown to save in lower amounts and less frequently than banked participants, though this disparity may be the result of the interaction of other variables such as race, education, car ownership and savings targets (Grinstein-Weiss, Yeo and Zhan 2008).

A review of outcomes and cost effectiveness in the Canadian IDA program (learn$ave) looked at the difference between a traditional “high-touch” IDA program with ancillary services like financial education, and a streamlined “low-touch” program design with the matched savings feature alone. High-touch servicing for the program delivered slight increases in savings at moderate increases in administration costs. However, the high-touch servicing may provide additional benefits to participants over time in a way that is not captured by the program’s cost evaluation (Leckie et al. 2010).

Interestingly, shorter savings periods have been associated with increased likelihood of becoming a homeowner. However, this may be the result of shorter savings periods being more selective in the program admission process. Alternatively, a review of IDA literature found that programs with longer matched savings periods are
associated with lower program dropout (Zielewski et al. 2009).

However, it is important to recognize that efforts to rethink parts of the AFI design have already been met with some difficulty. One study testing innovative strategies to increase savings amounts in IDA programs found little effect for all four new strategies tested (Loibl et al. 2015). The strategies included follow-up calls before and after deposit deadlines, increased deposit frequency from monthly to bi-weekly, a lottery-based match rate, and a progressive match rate increase over the course of continued program participation. A follow-up study had similar results, with a lottery match system associated with small but statistically significant increases in savings frequency and totals. This lottery match system had an average match rate of 1.5:1, with participants guaranteed a 1:1 match rate and a chance to win a 3:1 (20% chance) or 15:1 (1% chance) match rate every two-week deposit period (Loibl, Jones, and Haisley 2018).

The authors speculated that the lack of meaningful results was due to the economic status of participants, whose incomes ranged from $20,000 to $25,000, who may not have had the ability to meaningfully save within their budgets (Loibl et al., 2015). In follow-up interviews, participants stated that the biggest barriers to savings were not lack of understanding about the program but unanticipated financial troubles such as lapses in employment or unexpected costs (Loibl, Jones, and Haisley, 2018). This suggests that economic means were the primary barrier to savings, rather than a lack of knowledge about the programs.

Similarly, follow-up interviews of participants in an IDA program for Native Hawaiians showed that the biggest source of program drop-out was also unanticipated financial burdens. Furthermore, participants cited lack of program flexibility as the reason for their drop-out, with their participation cancelled when they were unable to meet minimum savings goal (Rothwell, Bhaiji, and Blumenthal 2013). A study of IDA program applicants also found that households with both children and a negative net worth as well as households without a vehicle were more likely to not enroll in the program (Rothwell and Han 2010). Consequently, future IDA programs should consider the financial characteristics of their intended participants. As there is little an IDA program can do to address income, it may be helpful for a program to consider specific income cohorts (by AMI or absolute income) and/or include built-in flexibility for unexpected or emergency financial needs.

Homeownership is still one of the best pathways for families to build wealth and may be particularly helpful at bridging the racial wealth divide. While it provides safety, stability and savings to millions of Americans already, many good homeownership candidates remain shut out. IDA programs create an opportunity to expand homeownership to many by reducing the barrier of downpayments while increasing financial literacy. Further research should continue to explore IDA program design and outcomes in order to better inform future program design.
References


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