Neighborhood Redlining and Homeownership

Lesson Author

Diego Mendez-Carbajo, Ph.D., Federal Reserve Bank of St. Louis

Standards and Benchmarks (see page 10)

Lesson Description

The lesson focuses on the practice of redlining residential neighborhoods for the purpose of determining access to residential mortgages. Students evaluate data on home values for four different neighborhood types to determine how the grading system used by the Home Owners' Loan Corporation (HOLC) influenced the value of real estate assets. Through a guided discussion and review of data, students learn how the practice of racial segregation concentrated African Americans in the lowest-graded, or redlined, neighborhoods. Because of this segregation, homeownership rates among African Americans are currently the lowest among all racial and ethnic groups. As an assessment, students use various data series in FRED® to compare the value of homes owned by different racial groups.

Grade Level

High School or College

Economic Concepts

Interest rates

Role of government and market failure

Objectives

Students will be able to

- define mortgage, collateral, and redlining;
- describe how mortgages are used to purchase homes;
- explain why riskier loans command higher interest rates than safer loans;
- explain how the practice of redlining made access to credit more difficult for non-Whites;
- identify the impact of redlining and segregation on homeownership rates; and
- use FRED® to find data and compare home values by neighborhood.

Compelling Question

How did the practice of redlining residential neighborhoods impact the homeownership rates of African Americans?

Time Required

30-40 minutes

Materials

- PowerPoint slides 1-4 (which contain the visuals)
- Handouts 1-2, one copy of each for each student
- Handouts 1-2 Answer Keys, one copy of each for the teacher
- Laptop, phone, or tablet for each student
- Access to the following for the teacher and students: FRED®, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/

Preparation

- Make sure you are comfortable navigating around FRED®, finding values for data series used in this lesson, and identifying data sources. A demonstration is located at https://fredhelp.stlouisfed.org/.
- Go to https://research.stlouisfed.org/publications/page1-econ/2021/09/01/neighborhood-redlining-racial-segregation-and-homeownership to learn about neighborhood redlining, racial segregation by neighborhood, and the economic benefits of homeownership.
- Go to https://www.stlouisfed.org/~/media/Files/PDFs/Great-Depression/the-great-depression-wheelock-overview.pdf to learn about the scale and impact of the Great Recession.
- Go to https://dsl.richmond.edu/panorama/redlining to see interactive examples of the HOLC maps.
- Follow the instructions on Handout 1 to use FRED® to plot historical home values across HOLC-graded neighborhoods. (The URL to the completed version of the graph is provided on the Handout 1 Answer Key in the graph's source note.)

Procedure

1. Tell the class that today's topic will cover the practice of residential redlining. Explain that the term "redlining" is derived from the color used in 1930s city maps to mark residential neighborhoods where lenders were most likely to lose money when making mortgage loans.

2. Ask a student to define mortgage. (*Accept any plausible answer.*)

3. Discuss the following:
    - How do you think most people pay for a home? Do they pay the full price in cash or borrow money from a bank? (*Most students are likely to say "borrow."*)
    - The bank loans used to finance the purchase of a home are called mortgage loans. What happens if the borrower does not pay the loan back in full to the lender? (*Accept plausible answers.*)

4. Display Slide 1. Discuss the following:
    - Every time a lender makes a loan, the lender faces the risk the borrower will not be able to pay it back.
    - Mortgage loans are made available under the condition that the property being purchased becomes the collateral for the loan. Collateral is something of value that the lender is able to keep if the borrower fails to repay the loan.
    - In the case of a mortgage loan, if the borrower does not repay the loan in full, the lender becomes the owner of the property.
    - Borrowers are worse off when that happens because they lose the money they had put toward buying a home and also need to find a new place to live.
    - Lenders are worse off when borrowers do not repay the mortgage loan because to recover their money, they need to sell the property and frequently lose money in the process.

5. Discuss the following:
    - The interest paid on a loan usually varies based on the borrower's credit rating. A credit rating reflects the likelihood that a borrower can repay a loan. In other words, a credit rating reflects the risk that the borrower won't be able to repay a loan. People with good credit ratings can usually borrow at relatively lower interest rates than people with bad credit ratings.
    - Imagine living in the 1930s. There are no credit ratings, cellphones, or computer databases. How can mortgage lenders protect themselves against the possibility of making loans that are not likely to be repaid? (*Accept plausible answers.*)

6. Explain that the Home Owners' Loan Corporation (HOLC) designed a set of rules to value homes in a neighborhood based on the age and quality of the homes as well as on the characteristics of the residents. These rules assigned risk levels to whole neighborhoods. Between 1935 and 1940, the HOLC drew color-coded maps for 239 U.S. cities, based on those risk levels.

7. Show the website https://dsl.richmond.edu/panorama/redlining and search for your own city or the nearest largest city. If possible, ask a student to find the approximate location of your school on the map.

8. Tell the students that they are going to compare the median home values in HOLC-graded neighborhoods between 1930 and 2010. Explain that the "median home value" is the typical home value in a neighborhood. Technically, median value means that in that neighborhood half of the houses are priced above that value and half are priced below that value.

9. Divide the class into small groups for the remainder of the lesson. Do not organize the student groups by racial or ethnic origin. If short on time, randomly assign students to groups. Distribute *Handout 1: Instructions for Group Work* to each group. Allow time for students to work.

10. Invite students from different groups to share their answers. Refer to *Handout 1: Instructions for Group Work—Answer Key*. Discuss the following:
    - Between 1930 and 1990, home values were the lowest in neighborhood category D.
    - Between 1930 and 2010, home values were the highest in neighborhood category A.
    - Neighborhood and property features that make a residence more attractive or comfortable will add to the residence's value and help it retain value over time. Conversely, unattractive neighborhoods and worn-down dwellings will make residences lose value over time.
    - The HOLC system for grading neighborhoods was used to inform mortgage lenders about the risk they faced when making loans in those areas.

11. Display Slide 2. Discuss the following:
    - Residential properties in neighborhoods graded A held the most value over time. That classification made them the most desirable for homeowners taking on mortgages and the least risky for lenders.
    - Residential properties in neighborhoods graded D held the least value over time. That made them the least desirable for homeowners and riskiest for lenders.
    - Mortgage lenders protect themselves against the risk of the borrower failing to repay the loan by charging higher interest rates to riskier borrowers.

12. Invite students from different groups to share their answers to the last question on Handout 1: Imagine you want to buy a home to live in. In which neighborhood category would you prefer the home to be in? Why? (*Answers may vary, but the majority of students are likely to say "A."*)

13. Show the FRED graph at https://fred.stlouisfed.org/graph/?g=ERL1 or display Slide 3. Discuss the following:
    - Over time, African Americans were segregated into the D-graded neighborhoods.
    - In those neighborhoods, interest rates were higher, so it was more expensive to borrow to pay for a home. As a result, fewer residents could afford one. Also, because the areas had few attractive features, residents wanted to move out—but racial segregation prevented them from moving to higher-graded neighborhoods.

- The shares of African Americans in A- and B-graded neighborhoods gradually increased after the 1960s because new laws in the 1960s and mid-1970s set federal policies aimed at preventing discriminatory housing and financial practices.
- However, as of 2010, the proportion of African Americans residents in A-graded neighborhoods is only half that of D-graded neighborhoods.

14. Show the FRED graph at https://fred.stlouisfed.org/graph/?g=CjKv or display Slide 4. Explain that even though discrimination in housing and access to credit based on race, color, religion, national origin, sex, marital status, or age, or because one receives public assistance, were outlawed during the late 1960s and mid-1970s, their legacy is visible in the persistently low rates of homeownership among African Americans.

Closure

15. Review the key points of the lesson by discussing the following:
    - A mortgage is a bank loan used to finance the purchase of a home.
    - Collateral is something of value that a lender is able to keep if a borrower fails to repay the loan.
    - When a mortgage loan is not paid in full, the lender has the right to sell the property to recover the money loaned.
    - Between 1935 and 1940, the Home Owners' Loan Corporation drew neighborhood maps to grade the risk of properties losing value over time and mortgage loans not being paid back. The least-desirable neighborhoods where graded "D" and colored red on maps.
    - Because making mortgage loans in higher-risk neighborhoods potentially exposed lenders to financial losses, lenders charged higher interest rates to protect their businesses. That practice made borrowing money more expensive for people in those neighborhoods.
    - Over time, African Americans were segregated to D-graded neighborhoods, which were the least appealing.
    - As a consequence of decades of residential segregation to neighborhoods with relatively low-value property and expensive borrowing costs, African Americans have lower homeownership rates than other racial and ethnic groups.

Assessment

16. Distribute a copy of *Handout 2: Residential Redlining Assessment* to each student. Assign the handout as homework or allow time for students to complete it individually in class. For answers, see *Handout 2: Residential Redlining—Answer Key*.

Handout 1: Instructions for Group Work

Build a graph:

- Go to https://fred.stlouisfed.org/.
- Under the search bar and under "Browse Data By," click on "Release" and then browse the list: Click on "next" until you find the "The Effects of the 1930s HOLC 'Redlining' Maps" release, and then select it. (Do not use the search box. You must find the release in the list.)
- Click on "Summary Statistics."
- Under "Panel C. Home Values," check the box to the left of each of the four HOLC neighborhood categories. Next, click on the "Add to Graph" button.
- Click on "Edit Graph" and select the "Format" tab.
- Under "Recession shading," select "Off."
- Assign the following colors to each line:
    - Green for Median Home Values in HOLC Neighborhood A
    - Blue for Median Home Values in HOLC Neighborhood B
    - Yellow for Median Home Values in HOLC Neighborhood C
    - Red for Median Home Values in HOLC Neighborhood D

1. Based on the graph, answer these questions:

    a. Between 1930 and 1990, in which neighborhood category were home values the lowest?

    ____

    b. Between 1930 and 2010, in which neighborhood category were home values the highest?

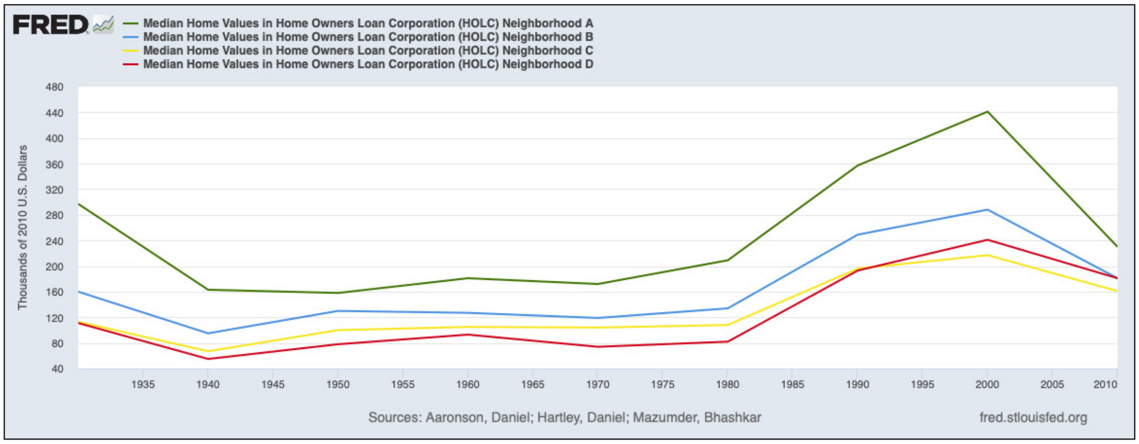
    ____

2. Consider the following list of features that influence the value of a home. Write a plus sign (+) next to each feature that adds value to a home and a minus sign (–) next to each feature that subtracts value from a home:

The house is near a factory.	The house is near a park.
The house is near a library.	The house is near a railroad.
The house has no garage to park a car.	The house is on a street with many trees.
The house has old plumbing that leaks.	The house has a new roof and new windows.

3. Imagine you want to buy a home to live in. In which neighborhood category would you prefer the home to be in? Why?

Handout 1: Instructions for Group Work—Answer Key



SOURCE: FRED®, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/graph/?g=ERH5.

1. Based on the graph, answer these questions:

   a. Between 1930 and 1990, in which neighborhood category were home values the lowest?

      Neighborhood D

   b. Between 1930 and 2010, in which neighborhood category were home values the highest?

      Neighborhood A

2. Consider the following list of features that influence the value of a home. Write a plus sign (+) next to each feature that adds value to a home and a minus sign (–) next to each feature that subtracts value from a home:

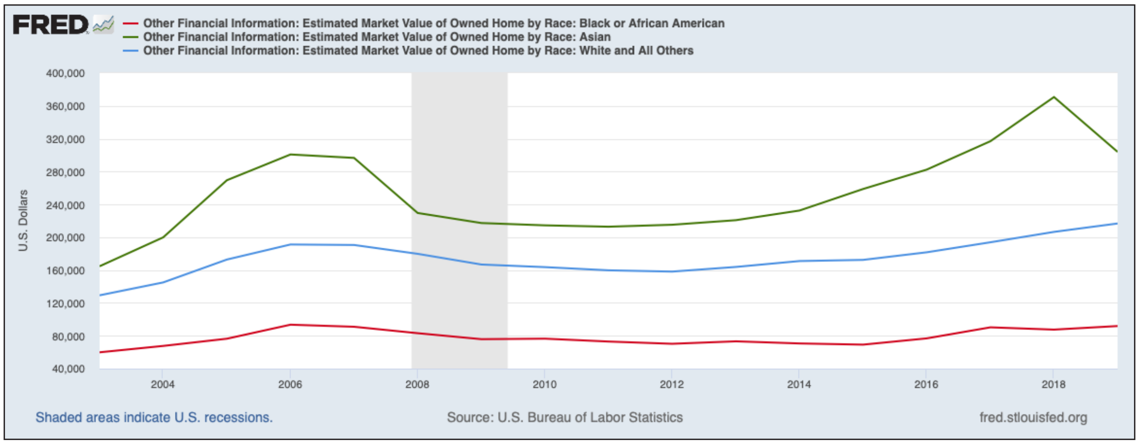
The house is near a factory. (–)	The house is near a park. (+)
The house is near a library. (+)	The house is near a railroad. (–)
The house has no garage to park a car. (–)	The house is on a street with many trees. (+)
The house has old plumbing that leaks. (–)	The house has a new roof and new windows. (+)

3. Imagine you want to buy a home to live in. In which neighborhood category would you prefer the home to be in? Why?

   Answers may vary, but the majority of students are likely to say "A." "A" neighborhoods are generally more desirable because these neighborhoods and the homes in them tend to have better features: no factories nearby; parks and libraries nearby; houses with garages; newer plumbing, roofs, and windows; no railroads nearby; and tree-lined streets. Homes in "A" neighborhoods tend to hold the most value over time, making them the most desirable for homeowners taking on mortgages to pay for them.

Handout 2: Residential Redlining Assessment

Estimated Market Values of Owned Homes by Race



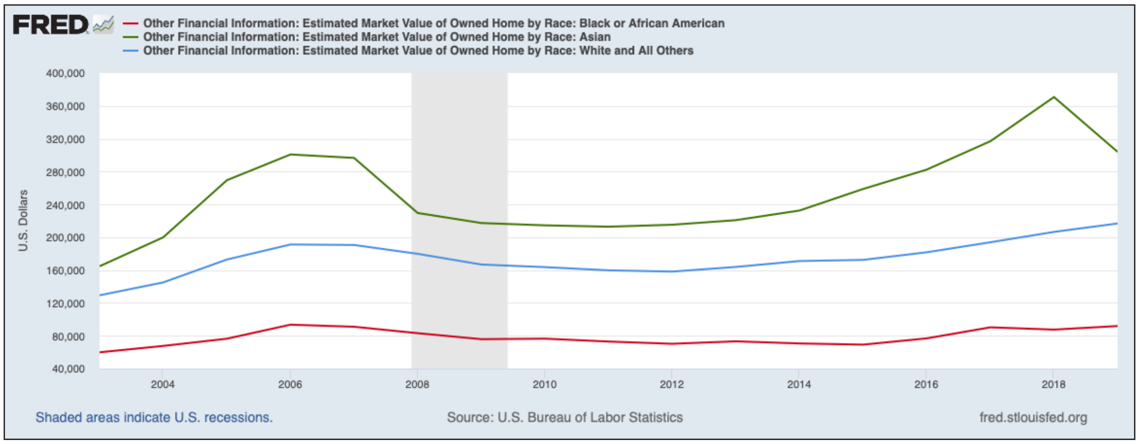
SOURCE: FRED®, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/graph/?g=EQKm.

The FRED® graph shows the estimated average market value in dollars of homes owned by different racial groups: red line, Blacks or African Americans; green line, Asians; and blue line, Whites and all others. There is a noticeable difference in those values.

Write a short explanation of this phenomenon based on the historical practice of residential redlining.

Handout 2: Residential Redlining Assessment—Answer Key

Estimated Market Values of Owned Homes by Race



SOURCE: FRED®, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/graph/?g=EQKm.

The FRED® graph shows the estimated average market value in dollars of homes owned by different racial groups: red line, Blacks or African Americans; green line, Asians; and blue line, Whites and all others. There is a noticeable difference in those values.

Write a short explanation of this phenomenon based on the historical practice of residential redlining.

The historical practice of racial segregation of African Americans into the lowest HOLC neighborhood category, which was labeled "D" and colored red on assessment maps, resulted in low average home values for that population group.

Standards and Benchmarks

Voluntary National Content Standards in Economics

Standard 12: Interest Rates

- **Benchmarks: Grade 12**

    4. Riskier loans command higher interest rates than safer loans because of the greater chance of default on the repayment of a risky loan.

Standard 16: Role of Government and Market Failure

Benchmarks: Grade 12

8. Government laws establish the rules and institutions in which markets operate. These include such things as property rights, collective bargaining rules, laws about discrimination, and laws regulating marriage and family life.