POLICY BRIEF

The Role of Real Estate in Economic Opportunity for the African American Population

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Acquiring real estate is long associated with the American Dream and wealth creation.

Andrew Carnegie famously said, “90% of millionaires got their wealth by investing in real estate.” But is that the reality? Red Oak Development Group Research estimates that the vast majority “of all millionaires invest in some form of real estate.”

With a large percentage of millionaires owning real estate, there must be lessons that, once extracted and applied to a traditionally disadvantaged population, will generate upward movement on the economic ladder.

For the majority of Americans, their most valuable asset is their primary residence. But Black Americans have historically been at a disadvantage, given restrictions on land inheritance, redlining, and discrimination in lending practices. Overcoming these historical disadvantages and applying lessons from modern successes to a broader audience is challenging but necessary.

Highlighted Facts

+ The white homeownership rate is 74% compared to the Black homeownership rate, which is 44%
+ The 2008 housing market crash returned white homeownership numbers to those of the late 1990s, but Black homeownership returned all the way to its 1960s level
+ 77% of millionaires own real estate, and 35% say they hold a real estate-related investment like a Real Estate Investment Trust (REIT)

Significant Issues in Black Home Ownership

According to the National Community Reinvestment Coalition homeownership data, between 1940 and 2010, there has been a semi-steady increase, with some periods of slow growth, in Black homeownership. In those 70 years, Black homeownership increased from the low of 20% to nearly 50%. Homeownership of every other race dropped after the 2008 crash, until 2016, when it started growing again. As of 2022, the white homeownership rate is 74% compared to a 44% Black homeownership rate.

Despite this consistent increase in homeownership, there has been a 20% to 30% gap between Black and white homeownership rates. This gap is constant, and upward movement is independent of Congressional action during this time. For example, during the 1960s, Black homeownership became stagnant. This fact remained despite the 1968 Fair Housing Act, which attempted to directly address past injustices in Black housing practices and laws.

Black homeownership was disparately affected by negative economic stresses. The 2008 crash lowered white homeownership numbers equal to the rates seen in the late 1990s, while Black homeownership returned to 1960s levels. By 2014, white homeownership levels recovered to their pre-crash level, while Black homeownership has failed to return to pre-crash levels, even as of 2021. Moreover, The National Community Reinvestment Coalition states, "If holding the current rates of Black homeownership formation and loss constant, then it would require approximately 165,000 additional new Black homeowners annually over the next 20 years to get to 60% Black homeownership by 2040." Even at 60% homeownership, the Black homeownership rate would be below the current 74% white homeownership rate.

Another issue when considering Black homeownership rates is the location and cost of these homes. Black buyers are more likely to purchase homes in distressed areas and use a smaller down payment. In 2020, the Urban Institute showed that Black first-time buyers averaged a home value of $127,000.00 and carried a $90,000.00 mortgage; in contrast, first-time white buyers averaged a home value of $139,000.00 with a $75,000.00 mortgage.

This difference in home value results in the average Black buyer having a higher mortgage payment and less value in their home after paying off their mortgage. With less value in their homes, this gives Black homeowners fewer options in leveraging their most significant asset in reasonable ways for wealth creation.

One solution that appears to have merit, developed by the National Community Reinvestment Coalition, is targeting Blacks in demographics that are likely to maintain homeownership. For example, Black homeowners under 35 years old are more likely to return to renting than maintain homeownership. The data shows 59% of young Black homeowners rent again after achieving homeownership but, after 40 this trend is not as prevalent. By having relief programs and homeownership efforts target previous Black homeowners over the age of 40, statistically, there is a greater chance at success in those efforts.

Moreover, when looking for households that have the potential to maintain homeownership, it is important to be strategic. For example, people who maintain credit scores between 600 and 700 have a more realistic opportunity to qualify for a mortgage. So, focus on this group is important. Also, targeting household incomes between $50,000.00 and $100,000.00 provides a more reasonable expectation that cash flow could consistently cover a typical first-time buyer mortgage payment. People with these criteria frequently can handle a mortgage.

Role of Real Estate Investment in Wealth Creation

Real estate is one of the best and most consistent asset classes concerning wealth creation. In their 2014 survey, Morgan Stanley showed that 77% of millionaires own real estate and 35% say they hold a real estate-related investment like a Real Estate Investment Trust (REIT). Few investments offer the flexibility and benefits of real estate.

For example, most investors who invest in a stock, bond, crypto assets, or in a private company rely on outside factors for gains. A typical investor in Apple has very little control over the management of the company they invest in, how the company uses its investment, and what benefits they will have. However, in real estate ownership, owners can make improvements, and then choose to rent or sell their property. Owners enjoy a tax benefit for their mortgage interest, any cost for improvements of the property, the price of running their real estate investment business, and the depreciation of their property. An investor may frequently refinance the home to remove some of their original capital or leverage the equity created by their improvements to purchase another home, to restart the process.

Home equity is a key part of economic growth and wealth creation. There are many other examples of how homes are used to create wealth and increase upward mobility. Home equity value can also be used to start a business or buy a franchise, or can be withdrawn and invested in the stock market to provide diversity in an overall portfolio.

Opportunity Zones

Opportunity Zones attempt to address problems in distressed neighborhoods by encouraging investors to use their capital gains for improvement projects in these areas. The Opportunity Zones were created via the Tax Cuts, and Jobs Act of 2017, which established parameters for states to designate areas as an Opportunity Zone. The IRS defines an Opportunity Zone as “an economically-distressed community where new investments, under certain conditions, may be eligible for preferential tax treatment.”

When an investor uses their capital gains for improvement in a qualified Opportunity Zone, they can delay tax payments on those gains until they sell their investment or December 31, 2026, whichever is earlier. This incentivizes long-term investment in these communities. Communities that frequently have gentrification issues typically come from short-term property flippers. This is because home flippers frequently do not have an investment in the community.

They purchase a distressed property, improve it without regard to the needs of the community, then quickly sell these properties at a higher price. Opportunity Zone laws state that if the asset is held for five years, there is a 10% exclusion of the deferred gains, and at the seven years mark, the exclusion becomes 15%, to dissuade the quick flipping of homes.

Investors also benefit from a ten-year step-up cost basis. A cost basis is the original amount invested. To illustrate, if someone buys a house at $50,000.00 and sells it at $75,000.00, their cost basis is $50,000.00, and their capital gains are $25,000.00 (the difference between the first invested amount and the amount for which the investment is sold). Typically, that $25,000.00 of capital gains is taxed. This benefit changes the cost basis to the fair value amount of the asset when it is sold, called a step-up basis, reducing capital gains, and thereby reducing the amount of tax owed.

This law creates a strong incentive for long-term investments in distressed communities. The law applies to both real estate and businesses. Adding improved housing and new jobs to a community where investors are looking for long-term gains has already shown dividends for many communities.

Opportunity Zones are not without their critics. The most common criticism is that they speed up gentrification and push families out of their homes to accommodate newer builds. So far, there has been little empirical evidence that supports this assertion.

Even though gentrification has not been proven, if gentrification had occurred, then the people living in these communities would see their home values increase, giving them more equity, that is, greater wealth. If there is no gentrification, these homeowners still enjoy the increase in the value of their most significant asset. One of the best things Congress can do is renew this law before it expires, and add a provision to measure the benefit to the community.

CONCLUSION

With the financial benefits, stability, and longevity homeownership provides it is not surprising that homeownership is an essential wealth-building tool for most portfolios.

It is natural to examine real estate for its benefits in advancing economic opportunity for historically disadvantaged groups like African Americans. If we fail to sufficiently evaluate how we can increase homeownership in the African American community, we fail to set up the foundation for economic empowerment.

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George Ferris III, MBA is a Fellow for Economic Empowerment with the Joseph Rainey Center for Public Policy. For the last decade, he has been a rising star in campaign strategy and policy throughout the state of Utah. He has worked with Senator Mike Lee, former Congresswoman Mia Love, and many other political leaders at every level of Utah's government. Moreover, George was an integral part of the campaign which successfully elected America's First African American Republican woman in Congress. This success launched him to be the co-founder of Election Season, a campaign consulting firm in Salt Lake City.

Growing up in Modesto, California, in a single mother home, George learned about the struggles of living on government assistance. During this time he also gained a love of public policy and good governance.

He holds a BA in Political Science from Utah State University and a Master's in Business Administration from Western Governors University. Currently, George resides in Salt Lake City Utah. In 2014 George married his wife Anna and in 2021 they welcome their first child Bevan to the world.

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