

Comment on Donald R. Haurin and Hazel A. Morrow-Jones’s “The Impact of Real Estate Market Knowledge on Tenure Choice: A Comparison of Black and White Households”

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Abstract

Haurin and Morrow-Jones analyze a sample of survey respondents from Columbus, OH, and find that additional knowledge about real estate markets increases the likelihood of homeownership. They conclude that differences in real estate knowledge contribute importantly to explaining some of the racial gap in homeownership rates; this finding leads to their conclusion that the racial gap can be addressed through public policy interventions, including financial counseling programs.

Their research broadly addresses three questions: Why does the racial gap in homeownership exist? Why does it persist? What can be done to reduce it? We compare their findings with those of other researchers and conclude that improved financial literacy may well be an important tool for reducing the gap, but that the causes for its existence and persistence are complex and that improving financial literacy alone may not be sufficient to have a significant and lasting impact.

Keywords: Discrimination; Homeownership; Minorities

Differences in homeownership rates by race and ethnicity

For the past several years, the homeownership gap between non-Hispanic white households and minority households has been a public policy issue that unites policy makers, regulatory agencies, government-sponsored enterprises with a focus on housing, and researchers. This puzzling gap provides a compelling rationale for the research of Haurin and Morrow-Jones.

A comparison of homeownership rates from 2003 to 2006 indicates that not much has changed over that period (U.S. Bureau of the Census 2006). In the first quarter of 2003, the homeownership rate for all households was 68 percent; for non-Hispanic whites alone, it was 75.0 percent¹; for blacks alone, it was 47.7 percent; and for Hispanics of any race, it was 46.7 percent. For the second quarter of 2006 (the most recent data available), we find that the overall homeownership rate has increased marginally to 68.7 percent. The homeownership rate for non-Hispanic whites is now at 75.9 percent. For blacks alone, it has fallen to 47.2 percent, while it has increased to 50.0 percent for Hispanics of any race.² Given these figures, the importance of the research by Haurin and Morrow-Jones is evident.

Fundamentally, the research in this area attempts to address three questions.

1. Why does the racial gap in homeownership rates exist?
2. Why does it persist?
3. What can be done to reduce it?

The existence of the gap clearly depends in large part, but not entirely, on long-standing socioeconomic differences by race in the United States, including differences by race and ethnicity with respect to income, wealth, and education. Haurin and Morrow-Jones focus on a very particular difference—education and knowledge about the real estate market.

The Haurin and Morrow-Jones analysis

Using a sample of black and white respondents in Columbus, OH, the authors examine differences in real estate and mortgage market knowledge. Next, they estimate a tenure choice model that includes a measure of real estate knowledge, finding that additional real estate knowledge increases the likelihood of homeownership. From this result, they conclude that enhanced financial literacy might help reduce the homeownership gap between minorities and others.

The authors demonstrated considerable care in the sampling process. They oversampled blacks and weighted appropriately the sample responses. They also included a comprehensive set of explanatory variables in the models. However, their tables 1 and 2 present some surprising findings. For those with

¹ Race alone indicates that the respondent reported only a single race.

² The homeownership rate is the proportion of owner-occupied households. It is computed by dividing the number of housing units that are occupied by owners by the total number of occupied units.

limited education (12 years or less), there were almost no differences by race with respect to barriers to homeownership—only lack of income is significant. For those who were better educated, perceptions about racial discrimination and lack of real estate information did differ between black and white respondents.

In comparing real estate information levels by race (in their table 2), we observe few significant differences by race among owners, while for less well educated respondents, black renters were significantly less likely to know the interest rate and to know about credit scores. These are very specific knowledge differences that might well be addressed by counseling programs and access to sources such as <http://www.myfico.com>. Haurin and Morrow-Jones also find that poor credit quality varies by race and that black renters are less likely to have parents who owned homes. In comparing means among the four key groups of respondents (by race and tenure), black renters stand out as the group with the lowest income, negative wealth, the worst credit, and the least education; they are the least likely to be married and also have lower mean values for several other variables. This argues for recognizing that the movement from renter to homeowner is a very complex problem and that a simple change in real estate knowledge is unlikely to have a large effect unless underlying socioeconomic variables change as well.

Even given skepticism about the robustness of the results due to the small and focused sample, the approach taken by Haurin and Morrow-Jones reflects a thoughtful and well-informed understanding of the complexity of the issues surrounding the homeownership gap. While the impact from increased counseling and improved counseling effectiveness cannot be measured from this research, the authors provide more evidence in a growing body of literature indicating that increased financial literacy might well help reduce the homeownership gap and that an effort should be made to ensure that the programs necessary to improve financial literacy are made available to minorities.

In essence, Haurin and Morrow-Jones attempt to address all three of the important questions mentioned earlier. Before we discuss these questions in turn, however, we will address an underlying issue confronting all research in this area—the lack of good data.

Data

One of the most difficult issues that researchers face in identifying and measuring racial gaps and their causes is the scarcity of data on the many stages of the process involved in moving from renter to homeowner. The only nationally representative data set that includes information on race and ethnicity on

mortgage applications and originations derives from Home Mortgage Disclosure Act (HMDA) data and is available only back to 1992. Moreover, changes in the data reporting requirements over time make comparisons from 1992 to 2006 difficult. Creditworthiness data are difficult and costly to procure. While credit bureau samples can be purchased from credit reporting agencies, it is very difficult to link these data to loan-level mortgage data that include information on race and ethnicity. Even in the few cases where data have been linked, obtaining supplemental information on why particular outcomes occur is difficult. For example, are there differences in parental influence or behavior that impact homeownership expectations and aspirations? Are there differences in levels of education? Are there differences in mobility? Are there differences in the distribution of wealth, income, and education?

One of the best features of the analysis by Haurin and Morrow-Jones is the care they took in compiling answers to a series of thoughtful survey questions. They directly address the linkages between respondent behaviors, financial literacy, and financial outcomes with a series of questions on aspirations toward homeownership, family encouragement of homeownership, information and knowledge about real estate markets, and income and demographic information about respondents. Such a broad set of information is not typically found in any publicly available data set.

There are, however, clear shortcomings in the data used. The most significant is the particular focus on a single metropolitan statistical area and on a single group of minority respondents (blacks). There are only 1,002 households, composed of equal numbers of renters and homeowners. Hispanics are not included. While the authors recognize that generalizations should be made only with appropriate caveats, one can easily be persuaded by some of the compelling findings to forget those caveats.

Clearly, the availability of a large data set that includes behavioral and outcome information on borrowers and potential borrowers would greatly enhance our ability to understand many of the unexplained outcomes we observe in real estate markets. Given the lack of such data, the initiative shown by Haurin and Morrow-Jones in developing the survey instrument, collecting the information, and carefully analyzing it is impressive.

What causes the gap?

The causes determined by Haurin and Morrow-Jones are similar to those found in previous research—lack of wealth, lack of income, job instability, labor market mobility, and unaffordable housing. Their research suggests that about 8 percentage points of the gap in homeownership rates can be explained

by racial differences in real estate knowledge. Given that the current gap measures almost 27 percentage points, this constitutes a significant explanation. The other categories to which they attribute the gap are differences in average income (11.9 percentage points of the gap), differences in credit quality (8.3 percentage points), years of education (4.3 percentage points), rate of marriage (5.2 percentage points), house prices (−10.8 percentage points), and mobility (4.6 percentage points). Relative to these factors, the size of the gap attributed to knowledge about real estate markets (8.5 percentage points) is large.

Haurin and Morrow-Jones address financial literacy, but focus on real estate knowledge, which is only one of many approaches to solving the puzzle of racial gaps in homeownership. All evidence suggests that the gap has existed for some time. The authors note that Herbert et al. (2005), for example, found that the white-black gap in 2000 was 26.1 percentage points, and they point to other evidence that the gap is rising rather than falling. They also cite other research that examined the causes of the racial gap in homeownership rates, and their current study increases our understanding of why racial disparities in housing continue to exist.

Which tool should be used to address the gap?

The racial gap, while recognized and studied by many, has been remarkably persistent over time. Unfortunately, while improving financial literacy, with a focus on real estate market knowledge, may address some portion of that gap, addressing financial literacy in isolation is unlikely to have a significant or lasting impact. Different approaches have been tried over the past several decades: changing relevant legislation, improving financial literacy, and litigating when other approaches do not succeed.

For more than a decade, concerned observers have attributed some of the racial gap in homeownership to discriminatory behavior on the part of lending institutions. Considerable legislative effort in the form of the passage and enforcement of the Community Reinvestment Act, HMDA, and the Fair Housing Act has focused on preventing discrimination in lending.³ Research designed to investigate discrimination in lending includes the seminal Boston Fed Study, which looked at lender-specific underwriting practices that might influence the availability of mortgages (Munnell et al. 1996). Subsequent research focused on whether disparate treatment by lenders might reduce the

³ See Federal Financial Institutions Examination Council 2006 for a description of applicable Community Reinvestment Act and fair lending laws and U.S. Department of Justice, Civil Right Division, 2006a for recent enforcement actions.

odds of minorities being approved for mortgages (see Courchane, Nebhut, and Nickerson 2000 and LaCour-Little 1999). Higher denial rates because of discriminatory behavior might well impact the racial gap in homeownership rates.

Recent research published by the Federal Reserve Board indicates that racial gaps in mortgage availability and affordability remain. Using data made available pursuant to HMDA, researchers at the Federal Reserve Board note that minorities continue to be more often denied mortgages, to be more likely to receive a higher-priced loan, and, for those with higher-priced loans, to pay more on average for those loans (Avery, Brevoort, and Canner 2006; Avery, Canner, and Cook 2005). For example, Avery, Brevoort, and Canner (2006) find that the gross difference between denial rates for black and non-Hispanic white borrowers is 15.9 percentage points, which is reduced by about half when lender- and borrower-related characteristics are taken into account. A large gap remains.

Similarly, they find that for purchase-money loans, the gap between black and non-Hispanic white borrowers receiving higher-priced loans was 7.0 percentage points in 2004 and 10.0 percentage points in 2005 (Avery, Brevoort, and Canner 2006). Blacks continue to find it harder to qualify for a mortgage and continue to pay more for those loans, even after controlling for borrower credit characteristics. Careful monitoring for regulatory compliance so that lenders' actions do not have disparate impacts on minorities is critical.

A second strategy, increasing financial literacy, might help improve borrowers' creditworthiness or negotiating skills when searching for a home. Haurin and Morrow-Jones focus specifically on this strategy. To the extent that improving financial literacy works primarily to improve creditworthiness, this will affect outcomes such as homeownership gaps only if those gaps are due to differences in the creditworthiness of borrowers of differing races and ethnicities. To the extent that gaps remain after controlling for credit, it may be more difficult than expected to reduce them.

A third approach to reducing the racial gap is by enforcement of legislation—through litigation—to create a more equitable environment for minorities in the pursuit of homeownership. Typically, the fair lending and anti-predatory lending laws and regulations work to improve minorities' ability to receive mortgage financing and to improve the terms of that financing. Recent complaints brought by the National Community Reinvestment Coalition (NCRC) with the U.S. Department of Housing and Urban Development, for example, have addressed the minimum value and row house restrictions imposed by lenders on mortgage financing in Baltimore and Philadelphia (*NCRC v. Regions Financial Corporation, Regions Bank, Regions Mortgage, EFC Holdings Corporation, EquiFirst Corporation* 2006). The NCRC action

was brought under the Fair Housing Act of 1968, as amended (42 U.S.C. § 3601 et seq.).

Other regulatory actions that result from implementing the fair housing laws can be found at the Web site of the Civil Rights Division of the U.S. Department of Justice. In an October 13, 2006, matter, the U.S. government filed a complaint and proposed consent order under the Fair Housing Act in *United States v. Centier Bank* (N.D. Ind.). The complaint alleges that Centier Bank has avoided serving the lending and credit needs of majority minority neighborhoods, most of which are located in Gary, East Chicago, and Hammond (IN). Among other requirements of the more than \$4 million proposed consent decree, Centier was instructed to “invest \$500,000 to provide credit counseling, financial literacy, business planning, and other related educational programs targeted at the residents and small businesses of African-American and Hispanic areas” (U.S. Department of Justice, Civil Rights Division, 2006b). This consent decree, like others in the fair housing area, directly links discriminatory actions by lenders to the need for improved financial literacy.

Clearly, the use of multiple strategies for reducing the gap may be essential. While legislative efforts have been effective, they have not succeeded in ensuring equitable access to credit. Litigation can resolve some of the more egregious issues that remain. Beyond that, improving financial literacy for all potential and current homeowners can make a difference as well. The proposed consent decree in *Centier* reflects the fact that the judicial system also presumes that improved financial literacy can help reduce discrimination and the housing gap. Haurin and Morrow-Jones’s research provides empirical evidence to support this presumption.

What can be done to reduce the gap?

Do other research studies offer as much positive support for the need for improved financial literacy? We can offer results from two papers that support, at least partially, the claims by Haurin and Morrow-Jones.

Financial knowledge

In one recent paper, “Consumer Literacy and Credit Worthiness” (Courchane and Zorn 2005), we directly linked financial knowledge, both subjectively and objectively measured, to the likelihood of impaired credit.⁴ Our

⁴ Our measure of subjective knowledge was based on a series of questions that asked respondents to assess their own financial knowledge. The objective measure was derived from

maintained hypothesis was that improved literacy would enhance financially responsible behavior and lead to improved (nonimpaired) credit. The survey data we used had over a third of the 12,140 respondents, by design, with impaired credit. On the basis of this information, we estimated a recursive model with credit outcomes as a function of financial behavior, which, in turn, is a function of self-assessed or objective financial knowledge. We estimated each of the equations in the recursive model with all respondents and then by racial or ethnic category.

In our data, there were some differences in subjective (self-assessed) knowledge and objective knowledge by race. For black and non-Hispanic white respondents, those results are displayed in figures 1 and 2. We find that nearly the same percentage of black and non-Hispanic white respondents believed that they had a “fair amount” of financial knowledge, while our objective knowledge quiz indicated that nearly twice as many non-Hispanic white respondents actually scored correctly on the objective financial knowledge questions. This argues for the need to account for misperceptions when evaluating survey responses dealing with levels of knowledge and literacy.

In our estimates, we modeled self-assessed and objective knowledge as functions of reference variables (education, age, gender, family status, race), income- and wealth-related variables (income, wealth, employment status, homeownership status, income relative to family of origin, and expected or past variation in income), and other survey variables that might contribute to attainment of knowledge. These include learning from parents, saving regularly, having after-school jobs or student loans, getting credit counseling, benefiting from a safety net, and taking money management courses.

Next, we estimated behaviors as a function of financial knowledge and additional factors that would affect behavior. The Behaviors variable summarizes financial self-control as indicated by answers to several survey questions determining, for example, whether the respondent followed a budget or saved, controlled spending, paid bills on time, planned for the financial future, provided for self and family, bought only things that were necessary, or borrowed for things that were not important. We also included “locus of control”—whether or not respondents felt in control of the events that affected their lives.

questions requiring respondents to demonstrate understanding of present value discounting, critical determinants of credit scores, and nominal and real interest rates. Respondents were considered to have impaired credit if they were late by 90 days or more or in derogatory status on one trade line in the past 24 months and if they were late by 30 days or more on another trade line in the past 24 months. Therefore, this group fell behind on payments on at least two separate accounts in the past two years and in at least one of these instances became as much as 90 days’ delinquent.

Figure 1. Distribution of Self-Assessed Knowledge by Race

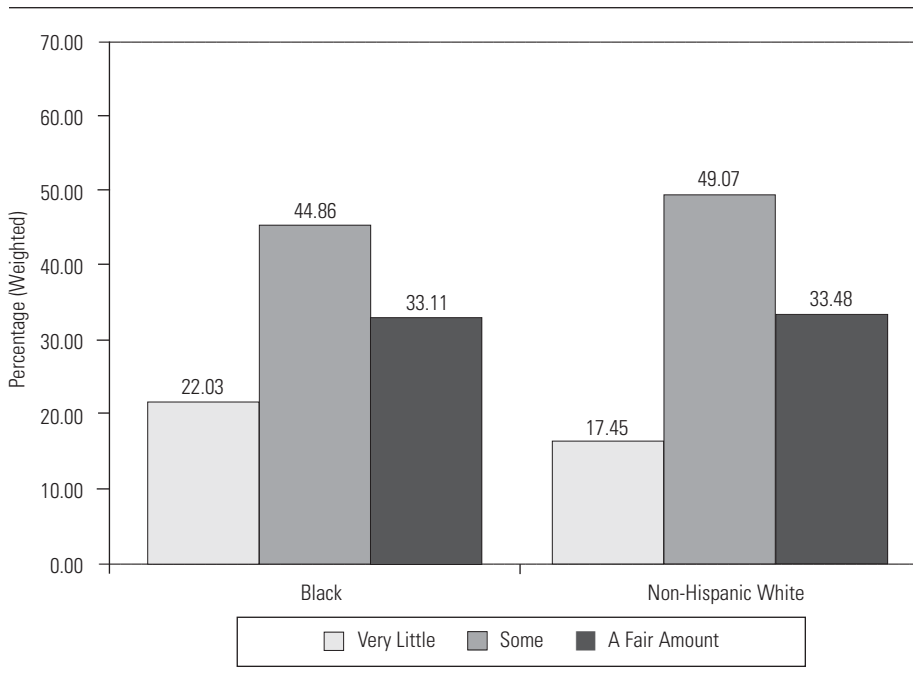
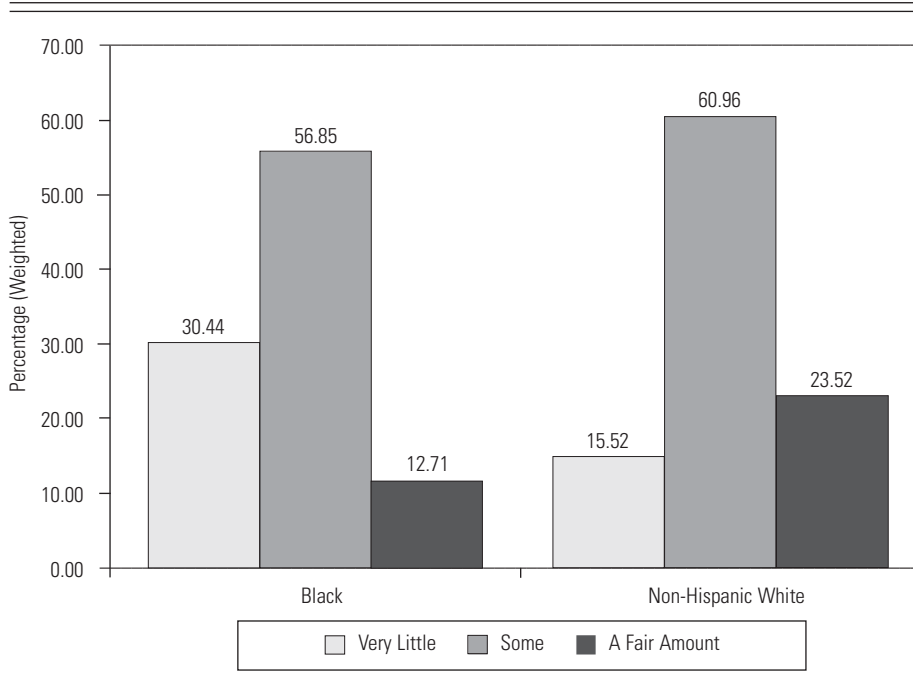


Figure 2. Distribution of Objective Knowledge by Race



Finally, our financial equation estimated the outcome for each respondent using impaired credit as the dependent variable. In addition to financial self-control and the predictors discussed earlier, we included in the financial outcome equation variables describing impacts from divorce and the status of unpaid bills following divorce, intrahousehold management, and financial decision making. We also included factors grouped to indicate learning from the “school of hard knocks.” These survey questions elicited responses on bad financial events (eviction, bounced checks due to insufficient funds, utility cancellations, credit denials, creditor calls, repossessions, late payments, collections, and bankruptcy). Finally, we included bad external events such as major medical expenses, theft or property destruction, or major legal or tax problems.

One interesting set of results, obtained by comparing the structural model results with reduced form results, allows us to look at groups of variables that affect credit. We look at the sole impact of the set of variables in contributing to the explained variation and then at the marginal impact of that group. A summary of those findings follows in table 1. Consistent with Haurin and Morrow-Jones’s research, we found that financial literacy and formal education variables do have significant effects. Here we measured the impact on credit outcomes. In their research, Haurin and Morrow-Jones measured the impact on the decision to own or rent (tenure choice) and found little significance from parental coaching and encouragement. We had a few questions relating to parental influence and found that while talking to parents did not matter, observing their behavior, saving as a child, and getting an after-school job all mattered in small but significant ways. (See Courchane and Zorn 2005 for additional details.) This argues for early financial training (e.g., adding money management to health classes in high school).

Table 1. Impacts of Groups of Variables on Credit Outcomes

Variable Group	Percentage of Explained Variation of the Dependent Variable	
	Impact of the Variable Group Alone	Effect When Controlling for Other Variables
Behaviors	32.37	5.68
External events	32.51	5.79
Hard knocks	1.70	1.31
Income and wealth	53.06	12.81
Variability in income and wealth	9.84	2.67
Spousal behaviors	29.06	3.33
Education	16.75	4.76
Demographics	25.24	10.56

Our results, in some sense, form the background for Haurin and Morrow-Jones. We look directly at the influence of the survey questions on impaired credit, and we do not look at tenure choice. We find that financial literacy affects behavior and risk taking, as do other variables, and that behavior will affect credit outcomes. It follows logically that the existence of impaired credit and savings behavior that affects funds available for a down payment also affects tenure choice.

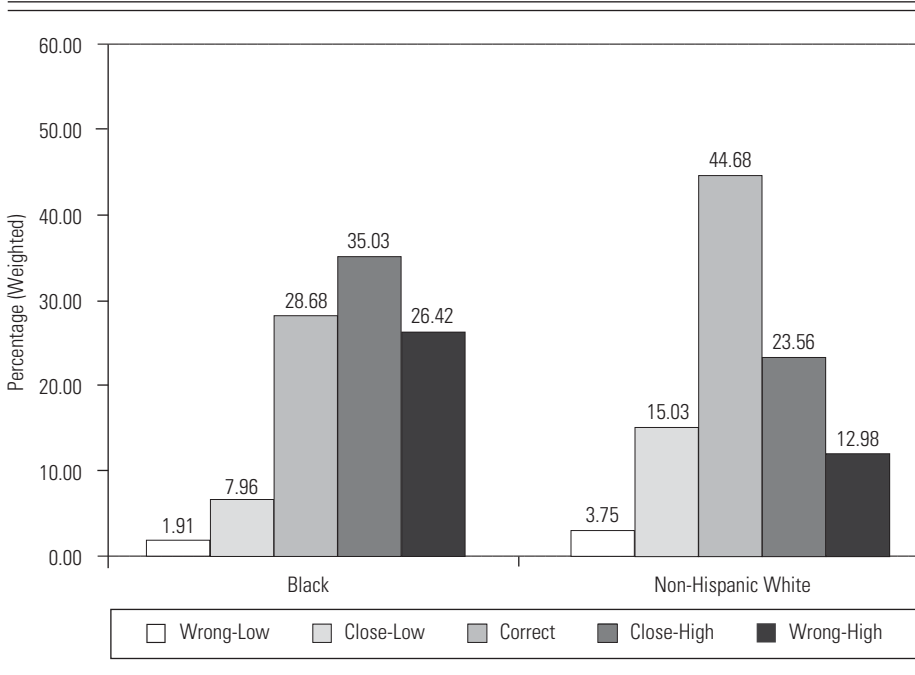
Self-assessed credit and mortgage market outcomes

A second paper—“Consumer Literacy: What Price Perception?” (Courchane and Zorn 2006)—takes the financial literacy argument one step further. Here we looked at the error in self-assessment of credit by comparing actual credit scores with respondents’ perceptions. We explored three related questions in mortgage lending.

1. How accurate are households in self-assessing their credit?
2. What are the characteristics of households that are more likely to self-assess with error?
3. Does inaccurate self-assessment (or self-assessment in general) have any impact on mortgage market outcomes, including the likelihood that those who self-assess inaccurately will receive loans in the subprime mortgage sector or that they will pay a higher price (annual percentage rate) for loans?

We compared black and non-Hispanic white respondents on the basis of their underlying credit profiles. We found that both groups had self-assessment errors, with blacks considerably more likely to over assess their credit and non-Hispanic whites more likely to under assess, as demonstrated in figure 3. About 26 percent of blacks over assess their credit, while only 13 percent of non-Hispanic whites did. About 3.75 percent of non-Hispanic whites under assess their credit, while only 1.91 percent of blacks erred in that direction. Overall, about 83 percent of non-Hispanic white respondents self-assessed at least close to their actual underlying credit profile, but only about 72 percent of blacks were this accurate.

Using the information from the survey, we imputed values of self-assessed errors to borrowers who obtained mortgages in 2004 and 2005. We estimated the likelihood of receiving that mortgage from a subprime compared with a prime lender and estimated the annual percentage rate for a loan. Our preliminary findings indicate that there is little evidence that incorrect self-assessments result in substantially different mortgage outcomes. We do find, however, some

Figure 3. Distribution of Self-Assessed Credit by Race (Actual Credit Buckets)

evidence that borrowers with self-assessment errors relative to others in their peer group are more likely to obtain subprime mortgages, and when the errors are over assessments, borrowers are more likely to have lower annual percentage rates. This might result from the confidence and persistence with which these borrowers conduct their financial transactions. To the extent that borrowers are more confident of their own good credit, they might not accept the first mortgage offer they receive and might argue successfully for a lower rate with that lender or shop with alternative lenders to get a better rate. Those who under assess credit, even if wrong, may not feel that they have many alternatives and are so grateful to obtain a mortgage offer that they are not willing to risk it by searching further.

To summarize, while we agree that financial literacy affects credit outcomes, we find in our research that financial counseling is only one of the tools needed to address the racial gap in homeownership. Our findings indicate that financial literacy is an important contributor to credit outcomes, but that other factors are at least as important in determining whether households can qualify for an affordable mortgage that allows them to become and remain homeowners. This offers limited support for Haurin and Morrow-Jones's conclusion that improved literacy could help reduce the homeownership gap.

Broader implications

Reducing the homeownership gap that persists by race and ethnicity presents a challenge. Regardless of the combined efforts of housing advocacy groups, dedicated government-sponsored enterprises, researchers, and legislators, the gap remains large. Analysis of causes and solutions remains hampered by limited data. Haurin and Morrow-Jones, to their credit, took the initiative in obtaining what data they could to pose a set of questions to a group of black and white homeowners and renters that would help us understand the barriers to homeownership and the differences by race and tenure that can affect the homeownership gap.

Few will find the solution they offered in their article unappealing. Increased knowledge of financial markets, and particularly real estate markets, can only improve borrowers' ability to obtain fair and affordable mortgages. We would caution, however, that improved financial literacy might not necessarily have as large an impact on the gap as Haurin and Morrow-Jones suggest. The mortgage transaction, the movement from renter to owner, and even the desire to own a home are all complex processes, and research needs to continue on many fronts to address perceived inequities and lack of affordability.

Extensions to this research would include broadening the distribution of the survey to other geographic areas and to other races and ethnicities. Studies on the effectiveness of prepurchase counseling would also be welcome. Research on the need for and the effectiveness of postpurchase counseling is now virtually nonexistent, and efforts on that front might help improve the ability of borrowers, once in a home, to stay there. Some research looks at the servicing of mortgages and solutions that might help homeowners with delinquencies recover and maintain homeownership. There is no research yet that examines equitability in servicing among borrowers of different races or ethnicities. This could be a useful extension as well.

A direct investigation of the relationship between financial and real estate education and discrimination in the housing and mortgage markets would also be useful. Discrimination is often credited with some portion of the racial homeownership gap. Haurin and Morrow-Jones seem to suggest implicitly that real estate education explains some of the gap often attributed to discrimination. A more direct investigation of how treatment in the housing and mortgage markets varies with levels of financial and real estate education would help us better understand this relationship and the range of benefits from improving financial and real estate education. This would require a data set that includes measures of discriminatory outcomes and the financial education of the mortgage applicants or borrowers who received the disparate outcomes. Such a data set may be difficult to obtain.

Finally, a recent concern focuses on mortgage products. While it is important to increase opportunities to purchase homes, it is equally important that borrowers who succeed in getting a loan remain in homes they continue to find affordable. The federal agencies regulating banks, thrifts, and credit unions have just published guidance on nontraditional mortgage loans, recognizing that the introduction of new products such as interest-only loans, hybrid adjustable-rate mortgages, and 40-year terms all offer complexities that may not be well understood by borrowers (Board of Governors of the Federal Reserve System et al. 2006). As complexity in the market increases, there is an ever-greater need to improve financial literacy. Haurin and Morrow-Jones's research is a step in the right direction. It increases our understanding of differences among homeowners and potential homeowners and provides support for the idea that improved financial literacy might well help overcome some persistent barriers to homeownership. As always, however, the need for more research in this area remains.

Authors

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