The Wealth Building Home Loan: A Straight, Broad Highway to Greater Wealth for Low- and Middle-Income Households

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The Current Approach to Promoting Homeownership

- Focuses on 30-year loans with small down payments
- Loads heavy debt burdens on borrowers, especially those with low income

Inherent Flaws in the Current Approach

- Buildup of housing wealth is slow and unreliable
  - Very slow paydown of mortgage debt with 30-year loan
  - House prices are volatile and rise only modestly on average
- High default rates, as borrowers often have little or no home equity and few options for remediation
- Onerous housing debt burden constrains personal saving, worsening borrower’s financial position
Solution: The Wealth Building Home Loan (WBHL)

Key Features

• 15-year, fixed rate, fully amortizing loan
• Requires no down payment with a broad credit box
• Down payment repurposed for a permanent interest-rate buydown
  – 5% upfront payment reduces rate by 1.25 percentage points permanently
  – For low-income households, financial assistance from lenders, foundations, or government can help with upfront payment
• Underwritten using the VA’s residual income and appraisal approaches

How the WBHL Solves the Problems Created by the Current Approach

• Much faster and more certain home equity accumulation than with a 30-year loan
• Greatly reduced default risk due to fast equity buildup, strong underwriting, and borrower incentive to stay in house to keep below-market interest rate
• Substantial equity promotes common-sense remediation options
• Underwriting leaves room for borrowers to save through 401(k) plans
**WBHL Provides Substantial Buying Power**

*Unsubsidized WBHL for middle-income borrowers has buying power almost comparable to a 30-year FHA loan (92% of FHA)*

<table>
<thead>
<tr>
<th>Loan with 401K</th>
<th>Loan Term</th>
<th>Interest Rate</th>
<th>LTV</th>
<th>Home Price</th>
<th>Monthly PITI (incl. MIP)</th>
<th>Monthly Principal (first mo.)</th>
<th>Monthly Matched 401K savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>WBHL</td>
<td>15 yrs</td>
<td>1.875%</td>
<td>100.00%</td>
<td>$169,091</td>
<td>$1325</td>
<td>$814</td>
<td>$353</td>
</tr>
<tr>
<td>FHA</td>
<td>30 yrs</td>
<td>4.00%</td>
<td>96.75%</td>
<td>$184,335</td>
<td>$1237</td>
<td>$252</td>
<td>$353</td>
</tr>
</tbody>
</table>

**Assumptions for the table:**

- **Annual household income:** $53,000 (median for the US).
- **30-year FHA loan:** Initial LTV of 96.75% (5% down, offset in part by 1.75% upfront fee that is financed) and 1.3% annual mortgage insurance premium (MIP).
- **WBHL:** Use FHA down payment funds to permanently buy down mortgage rate by 1.375 ppts (from initial rate of 3.25%). Assumes level annual private MIP of 0.5% for 7 years. Superior wealth building allows use of a slightly higher housing debt ratio (28% vs. 26% on 30-year).
- **401(k) savings:** 4% employee contribution and 4% employer match.
Rapid Buildup of Home Equity with the WBHL

Equity on a $150,000 Home at End of Years Shown

<table>
<thead>
<tr>
<th>Year</th>
<th>WBHL Equity</th>
<th>FHA 30-year Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 1</td>
<td>$8,662</td>
<td>$7,431</td>
</tr>
<tr>
<td>Year 2</td>
<td>$17,499</td>
<td>$10,091</td>
</tr>
<tr>
<td>Year 3</td>
<td>$26,515</td>
<td>$12,859</td>
</tr>
</tbody>
</table>

Note. WBHL has a 2% interest rate (after buydown) and 100% initial LTV. FHA 30-year loan has a 4% interest rate, 5% down, and a 1.75% upfront mortgage insurance premium rolled into the loan amount, for an initial LTV of 96.75%. Nominal house price is assumed to be unchanged.
WBHL Protects Against Negative Equity

*Simulation exercise: track equity on homes purchased at beginning of years 2004 through 2007 and held for 7 years after purchase, using house-level prices for more than 110,000 houses in Prince George’s County, MD.*

<table>
<thead>
<tr>
<th>Loan</th>
<th>Any amount</th>
<th>More than 10%</th>
<th>More than 20%</th>
</tr>
</thead>
<tbody>
<tr>
<td>FHA (30-year)</td>
<td>90%</td>
<td>70%</td>
<td>32%</td>
</tr>
<tr>
<td>WBHL (15-year)</td>
<td>10%</td>
<td>1%</td>
<td>0%</td>
</tr>
</tbody>
</table>

**Notes for the table:**

- **Initial LTV:** FHA loan, 96.75% ; WBHL, 100%
- **Mortgage rate:** FHA loan, average Freddie Mac 30-year fixed rate for year of purchase; WBHL, average Freddie Mac 15-year fixed rate for year of purchase minus 1.25 percentage points to reflect the upfront rate buydown
- **Home value** at purchase and in subsequent years based on estimates from FNC, Inc., and Weiss Residential Research.
WBHL Promotes Life-Cycle Saving and Spending¹

• Age 25-29: $24,000 in accumulated wealth by age 29
  – Participate in employer matched savings plan

• Age 30-51: $600,000 in accumulated wealth by age 51
  – Buy first home with a WBHL using savings for buy down, continue with savings plan
  – After 7 years, buy move-up home with WBHL, continue with savings plan²
  – At age 52, make final payment on move-up home purchased with a WBHL

• Age 52-56: $750,000 in accumulated wealth by age 56
  – Use freed up annual cash flow ($13,000 in 2014 dollars) for children’s post-high school education, continue with savings plan

• Age 57-64: $1,100,000 in accumulated wealth by age 64
  – Children complete post-high school education
  – Use 50% of freed up annual cash flow ($6500+ in 2014 dollars) to increase retirement savings

• Age 65:
  – Enter a comfortable retirement

¹Illustrative only. Assumes household income of $53,000 (US median) that increases 2% per year. Based on a 4% employee contribution through age 56 plus 50% of freed-up cash flow for ages 57-64 and a 4% employer match through age 64.
²Assumes move-up home that costs 35% more than price of home being sold and is purchased with a 25% down payment.
Project Status

• A trial WBHL program is already under way
  – Neighborhood Assistance Corporation of America (NACA), a national nonprofit, is originating WBHL-style loans
  – NACA program began one month ago

• Other trial programs: Discussions are ongoing with a number of lenders and mortgage insurers

• Ongoing discussions with industry groups and government agencies

• Issues to be addressed
  – Regulatory impediments
  – Extraction of home equity through second liens