



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

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“Mortgage” Has Become Another Word for Trouble

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)

| Loan with 401K | Loan Term | Interest Rate | LTV | Home Price | Monthly PITI (incl. MIP) | Monthly Principal (first mo.) | Monthly Matched 401K savings |
|----------------|-----------|---------------|---------|------------|--------------------------|-------------------------------|------------------------------|
| WBHL | 15 yrs | 1.875% | 100.00% | \$169,091 | \$1325 | \$814 | \$353 |
| FHA | 30 yrs | 4.00% | 96.75% | \$184,335 | \$1237 | \$252 | \$353 |

Assumptions for the table:

Annual household income: \$53,000 (median for the US).

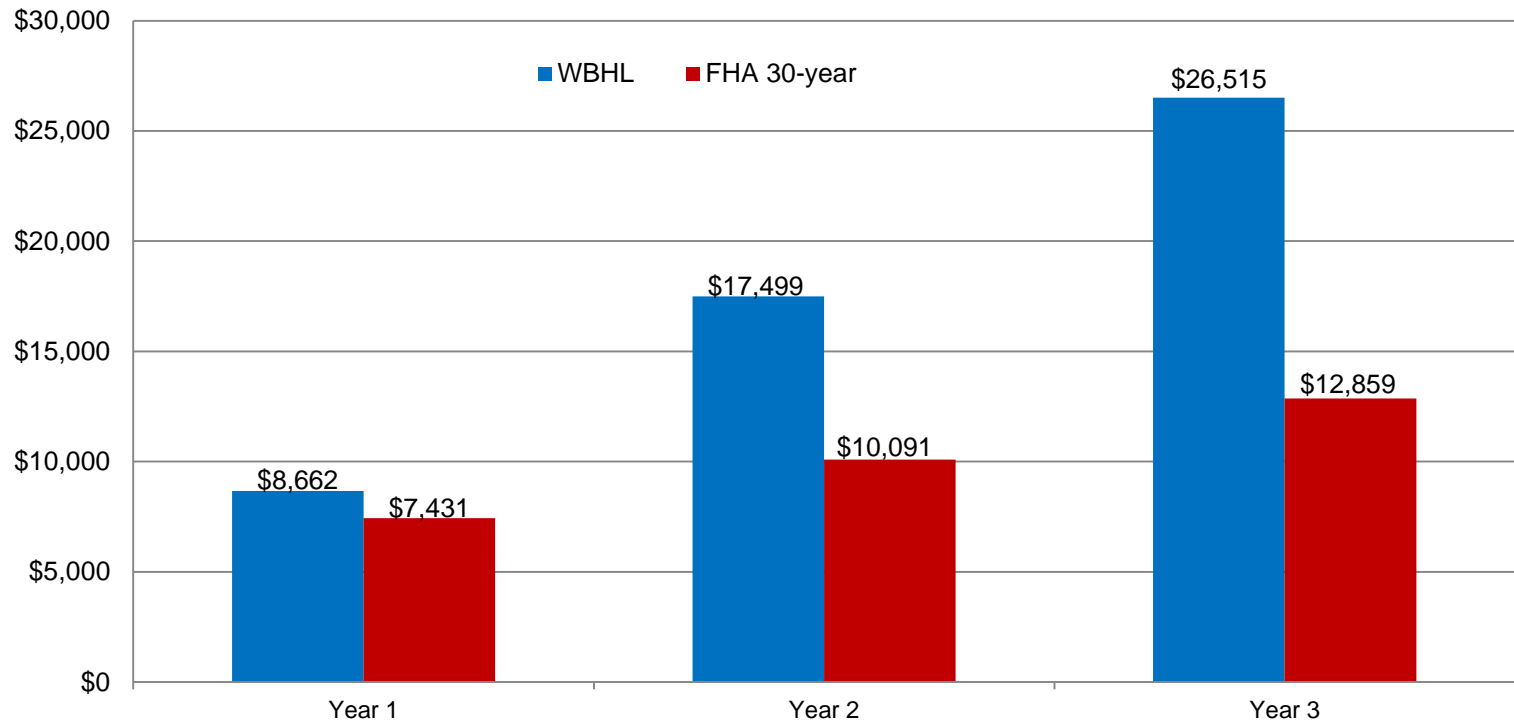
30-year FHA loan: Initial LTV of 96.75% (5% down, offset in part by 1.75% upfront fee that is financed) and 1.3% annual mortgage insurance premium (MIP).

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



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.

| Loan | Share of homes after 7 years with negative equity of: | | |
|----------------|---|---------------|---------------|
| | Any amount | More than 10% | More than 20% |
| FHA (30-year) | 90% | 70% | 32% |
| WBHL (15-year) | 10% | 1% | 0% |

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