

# Financial Innovation: Wealth Building Home Loan: A Straight, Broad Highway to Building Wealth for Working Class and Middle- Income Families

Mortgage Contract Design

Sponsored by Federal Reserve Bank of NY and NYU Stern School of  
Business, Center for Real Estate Finance Research

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## Use the Mortgage Tool Box

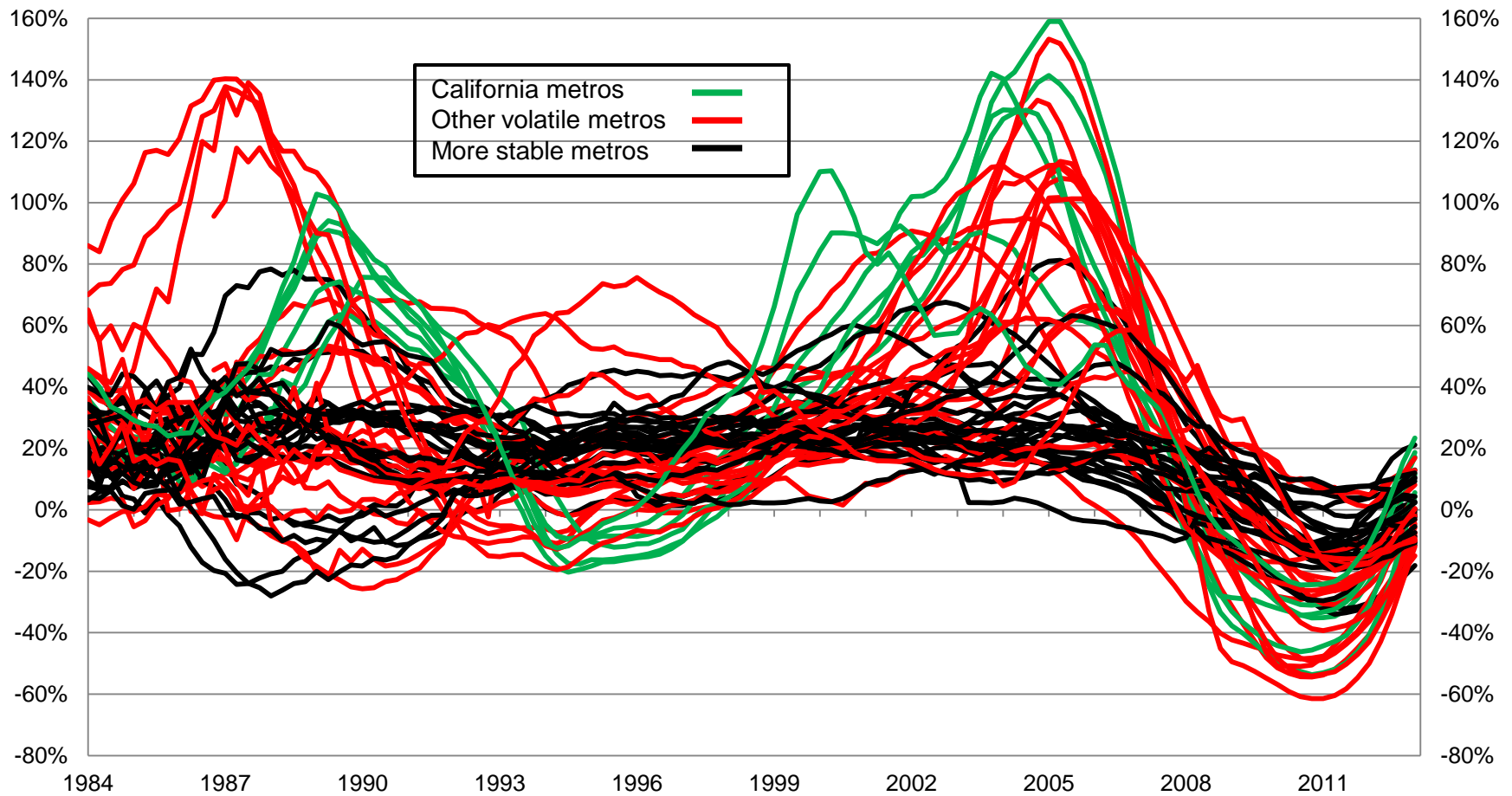
- Examples:
  - 15, 20, and 30 year terms
  - Buy-down points
  - Two-step rate
  - Residual income
  - Private mortgage insurance
- Why
  - Market acceptance
  - Regulatory acceptance
  - Speed – 14 weeks
  - Expense – minimal beyond time and travel

*We cannot solve our problems with the same thinking we used when we created them – Albert Einstein*

- 1940 to 1960 saw progress in sustainable home ownership for all races:
  - Non-farm ownership rate (all) rose from **41.1%** in 1940 to **61.0%** in 1960
  - Non-farm ownership rate (Black) rose from **23.9%** in 1940 to **38.4%** in 1960
    - Black household growth (33%) exceeded white growth (22%) from 1950 to 1960
- By 2015 the homeownership rate has returned to its 1960s level:
  - Homeownership rate (all) stood at 63.7% in Q1:15 (**62.1%** when adjusted for seriously delinquent borrowers) compared to **61.6%** in 1960
  - Homeownership rate (Black) stood at 41.9% in Q1:15 (**39%** (est.) when adjusted for seriously delinquent borrowers) compared to **38.4%** (non-farm) in 1960
  - An estimated 12 million foreclosures have taken place

# House Price Volatility, 50 Largest Metro Areas

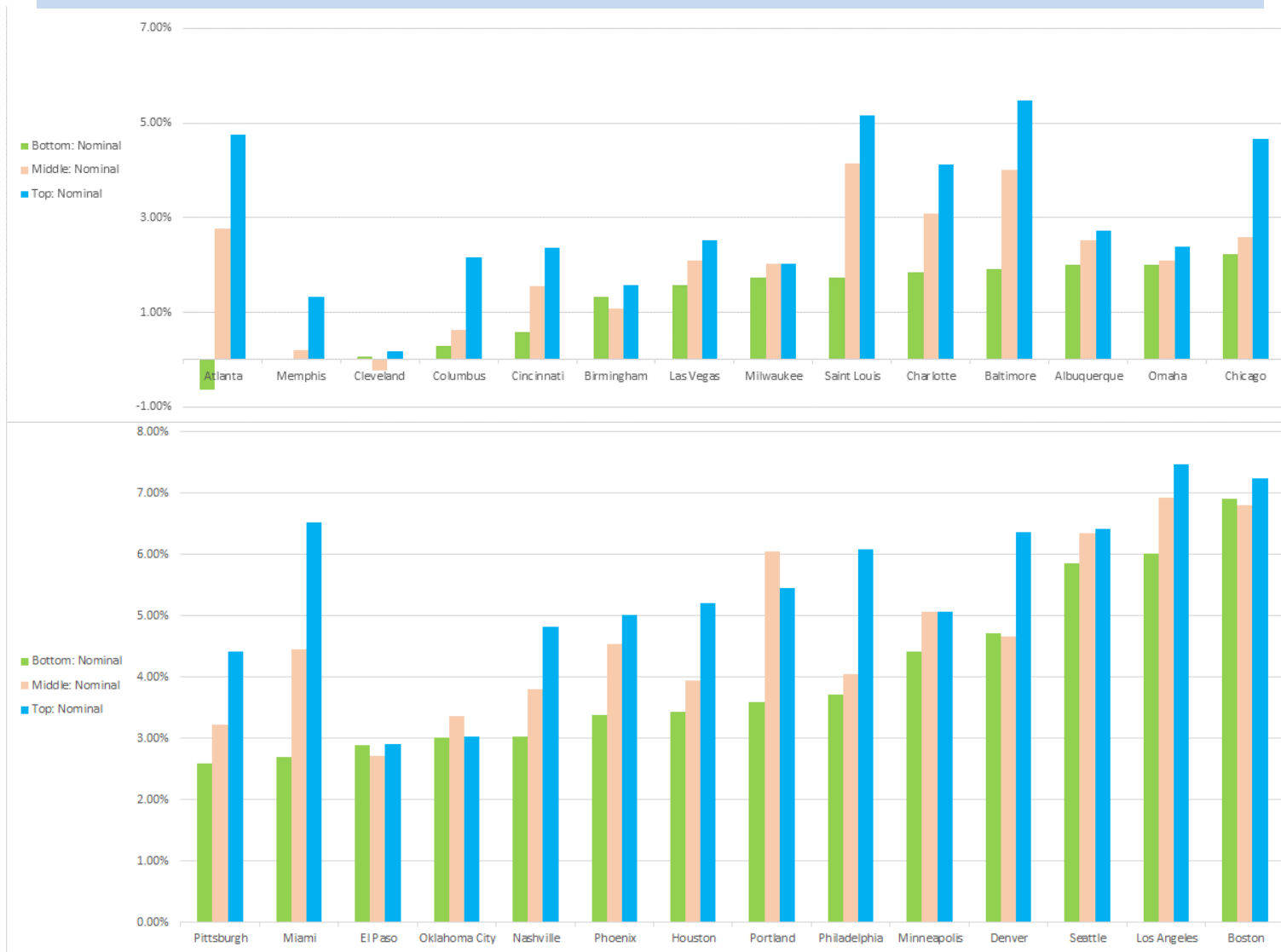
***House prices are very volatile in many metro areas, less so in others. But even in the more stable metros, there is substantial variation across neighborhoods.***



Note: Each series shows the percent change from 20 quarters (5 years) earlier. Volatile metros are defined as those for which the difference between the highest and lowest annual percent changes is more than 30 percentage points. All other metros are in "more stable" group.

Source: AEI International Center on Housing Risk, [www.HousingRisk.org](http://www.HousingRisk.org), using data from Zillow.com

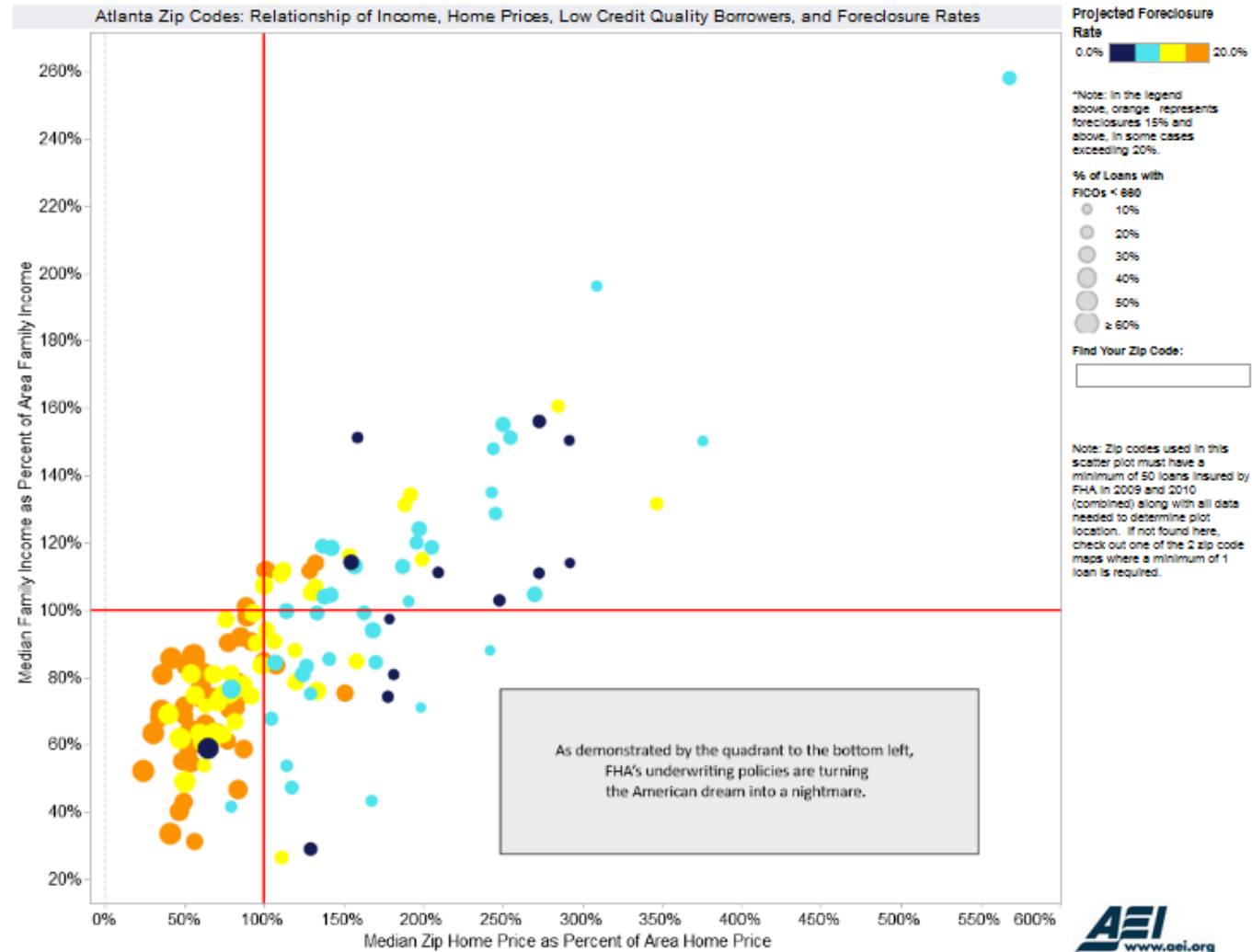
# Nominal percentage increase in house prices per annum for 28 cities, Apr. 1996-May 2014



Weighted average across zips, with weights based on number of owner-occupied housing units the zip. Zips divided into 3 price tiers based on median zip home price. Only zips in the city proper were used in computations. Source: Zillow 5

# Income and home prices are correlated; default risk increases when both low

## Atlanta, Georgia



# Wealth Building Home Loan (WBHL)

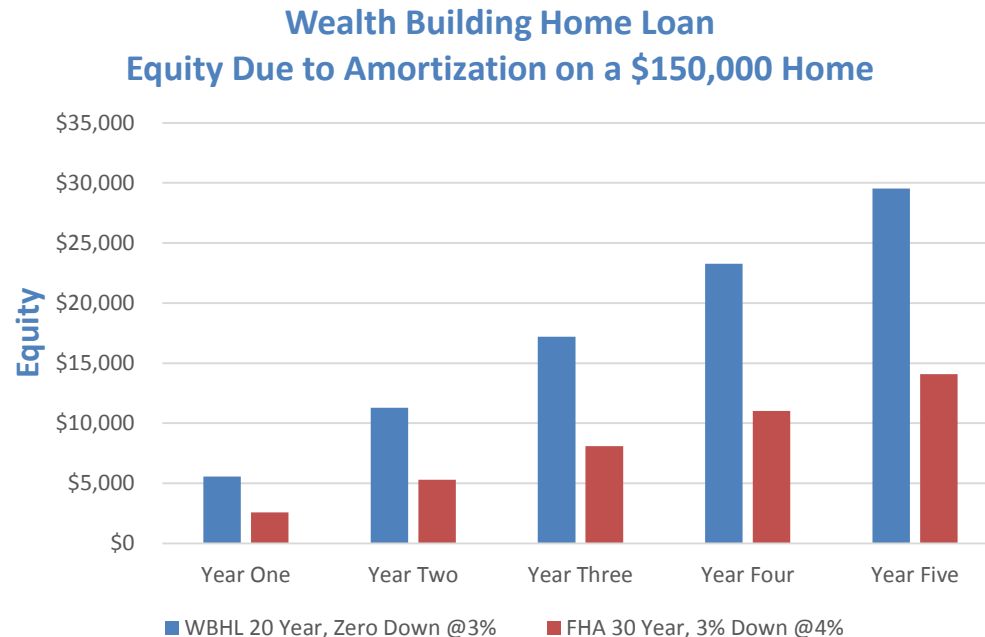
- Working class and middle-income families need a straight, broad highway to wealth building
  - Wealth is the antidote for poverty
  - Wealth equals one's accumulated savings
- Wealth building has been ignored for 50 years:
  - “Policy makers often focus on income and overlook wealth, but consider: the racial wealth gap is three times larger than the racial income gap.<sup>1</sup>
  - By year two, a 20-year \$150,000 WBHL has amortized over \$11,000, greater than the median net worth of Black households in 2013
- Fixed rate, high LTV 15- and 20-year loans accumulate wealth quickly and perform well<sup>2</sup>

<sup>1</sup>The racial income gap is three to one, while the wealth gap is nine to one. *Less than Equal: Racial Disparities in Wealth Accumulation*, Signe-Mary McKernan, Caroline Ratcliffe, Eugene Stanley, and Sisi Zhang, Urban Institute, April 2013

<sup>2</sup> <http://blog.metrotrends.org/2014/01/fast-pay-off-payment-loans-perform/>, FHFA's Private Mortgage Insurer Eligibility Requirements (2015)

# What is the Wealth Building Home Loan?

- Requires little or no down payment with broad credit box
- Monthly payment nearly or as low as on a 30-year, fixed rate FHA loan
- 15- or 20-year fully amortizing loan
- Fixed rate for 1<sup>st</sup> 7 years, one rate step up in 8<sup>th</sup> year with minimal pay shock
- Much lower foreclosure risk-faster amortization & common-sense underwriting
- In the first three years of a 20-year WBHL 57% of monthly mortgage payments pays off principal, creating equity, while on 30 year loan 68% goes to interest



***Unlike Most Loans, You Build Substantial Equity In Just A Few Years  
Move-up in 5-7 Years or Own Your Home Free And Clear In Just 20 Years***



## WBHL and the Mortgage Toolbox

- A 15- or 20-year loan is considered “expensive” because the higher monthly payment is really a means of savings which builds wealth through scheduled amortization
- Four components from the mortgage tool box combine to increase the 20-year WBHL’s buying power to 97%:
  - Conventional 20-year loan rate 0.30% below FHA 30-year rate
  - Lower annual credit risk expense
  - A maximum LTV of 100% allows for repurposing 3% down payment to fund rate buy down
  - After 7 years, bought down rate steps up; one-time payment shock under 2% on an annualized basis
- Addition of a modest targeted subsidy of 3 points increases buying power to 100% for low- and moderate income borrowers

## WBHL Status

- One market rate offering to date by Androscoggin Bank (Lewiston, ME)
  - Market reaction has been enthusiastic
- Neighborhood Assistance Corporation of America offering CRA eligible loans through Bank of America and Citibank
  - Market reaction has also been enthusiastic
- About a dozen additional financial institutions in 8 states are making preparations to launch
- Six private MI companies have agreed to insure
- In discussions with a number of FHLBs
- Press coverage has been widespread and positive

# Loan Comparison

\$100,000 home purchase price (for ease of comparison)	FHA 30 year*	15 year 2-step**	20 year 2-step***
LTV	96.5%	100%	100%
Rate/P&I (+MIP for FHA)	3.875%/\$532	1.75%/\$632	3.0%/\$555
Pre-tax annual income/ Buying power vs. FHA	\$27,247/ 100%	\$31,553/ 87%	\$28,233/ 97%
Net equity after 7 years (10% selling expenses, 2% annual appreciation)	\$19,073	\$46,798	\$31,814
<97% LTV reached in month?	9	7	10
<90% LTV reached in month?	53	21	32
<80% LTV reached in month?	106	40	61
Payment shock (year 8)	NA	13.3% (1.9%/ yr.)	12.6% (1.8% per yr.)

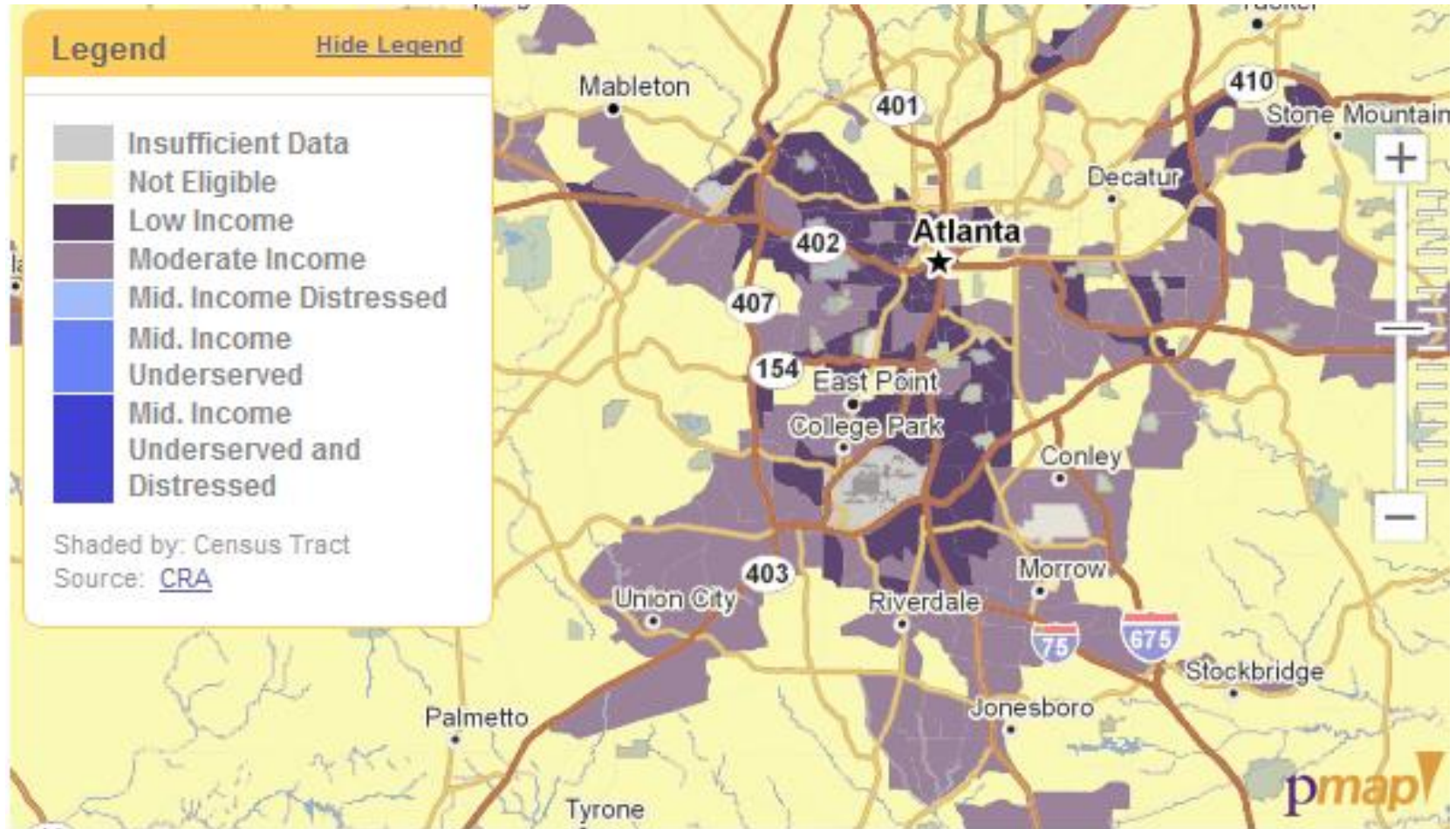
\*96.5% LTV + upfront fee, with 0.80% annual MIP. Income based on 28% housing debt-to-income (DTI).

\*\*100% LTV plus 3 buydown points. Rate fixed for years 1-7, steps to 5% for years 8-15. Income based on 28% housing DTI.

\*\*\*100% LTV plus 3 buydown points. Rate fixed for years 1-7, steps to 5.0% for years 8-20. Income based on 28% housing DTI.

# Atlanta, GA

## Broad areas qualify as low- and moderate-income



Low: tract median family income less than 50% of area median family income

Moderate: tract median family income greater than or equal to 50% and less than 80%

<http://www.policymap.com/blog/2010/08/a-closer-look-cra-eligible-tracts-and-tract-median-family-income/>