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Homeownership Done Right

What Experience and Research Teaches Us

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Introduction and summary

In the wake of the U.S. housing crisis that began in 2007 and still reverberates across the country today, as many as 12 million families may lose their homes to foreclosure. Our national homeownership rate could well drop from a high of over 69 percent in 2004 to below 64 percent by the time we are done, which would be the lowest rate since 1968. All this is happening while nearly 100 million Americans live in households spending more than 30 percent—and many more than 50 percent—of their incomes on shelter.[1] This is hardly a path to encourage what for many is part and parcel of the American Dream.

Nor need it be. Evidence abounds that lower-income homeowners benefit from well-designed affordable homeownership programs, many of which are weathering the foreclosure crisis reasonably well. For example, a 2009 examination of the foreclosure experiences of five city-based affordable homeownership programs in Boston, Chicago, Los Angeles, New York, and San Francisco found that out of nearly 9,000 low-income families who turned to these programs to purchase their homes, the overall default rate was below 1 percent. All of these lending programs boasted default rates below the average for their cities.[2] Similarly, a recent report on New York City's affordable homeownership program showed only 13 foreclosures out of more than 20,000 homes sold to low-income buyers since 2004.[3]

Research confirms these are not isolated successes. The University of North Carolina Center for Community Capital compared the performance of home loans in a large, national portfolio of 36 lenders' prime-rate mortgages offered to lower-income and minority borrowers, to that of subprime home loans in a mortgage industry database that covers about two-thirds of the market. Their analysis of borrowers with similar profiles (such as comparable lending risk factors, the size of down payments, and local property market conditions) shows that the borrowers who obtained subprime loans were three to five times as likely to default as their counterparts who had received the prime, affordable mortgages. Of particular note: The study found that adjustable rate mortgages, prepayment penalties, and broker origination were features associated with increased risk of default, with the layering of these features generally magnifying default risk[4] (see Figure 1). These risky features are more commonly found among the subprime and toxic mortgages that precipitated the housing crisis, and avoided in homeownership programs that work.

Unfortunately, many business leaders and policymakers may be leaping to a flawed conclusion based on the massive numbers of foreclosures. Some seem to believe that we should give up on efforts to help working families become homeowners. Not only is that view a misreading of what went wrong, it is also blind to many things that have gone right in the homeownership area—even amid the worst housing crisis since the Great Depression.

In short, the salient lessons from the research and programs we have reviewed are these:

- The irresponsible surge in subprime lending from 2001 to 2007 cannot be blamed on lower-income borrowers or on federal, state, and local affordable homeownership programs that worked to help increase homeownership among historically underserved borrowers during the prior decade.
- The subsequent foreclosure epidemic also cannot lead us to the specious notion that lower- and moderate-income families should have never been owners to begin with.
- Examples abound of consumer-oriented homeownership programs that, by contrast with predatory loans, work well for low- and moderate-income homebuyers.

This is not to say that there were not borrowers who consciously took out loans that were high risk for their particular income or assets, or that there was no fraud or misrepresentation by borrowers. But the evidence is overwhelming that subprime risky lending was driven by mortgage brokers and investment banks eager to originate high-priced loans, package them up as Triple A-rated mortgage-backed securities for sale to institutional investors worldwide, and take away lucrative fees in the process.

High-risk mortgage features were much more common among the subprime mortgages they peddled—predatory mortgages that were frequently targeted at lower-income and minority borrowers. Federal Reserve Board Governor Ned Gramlich said it best when he asked:

> *Why are the most risky loan products sold to the least sophisticated borrowers? The question answers itself. The least sophisticated borrowers are probably duped into taking these products.*[6]

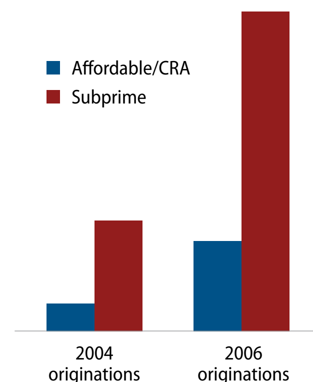
But that does not explain how lenders, policymakers, regulators, and investors lost sight of the difference between making mortgages possible and making *as* many mortgages *as* possible.[7]

Sensible policymaking requires a clear understanding of the real facts of a situation. This paper will provide a short, direct summary of the studies, data, and other available evidence regarding home mortgage products and programs designed to build homeownership among first-time homebuyers in our minority and lower-income communities and then evaluate what works. As will be demonstrated in the pages that follow, many affordable housing programs, including Community Reinvestment Act lending by regulated financial institutions worked as intended (see box below on CRA). These successes can help point the right way forward out of the U.S. housing crisis.

FIGURE 1

Affordable mortgages work

A comparison of delinquency rates among homeowners who borrowed through affordable housing and Community Reinvestment Act programs against similar borrowers who tapped subprime loans



Note: Predicted serious delinquency 24 months after origination.

Community lending and subprime loans to similar borrowers.[5]

Estimation is based on a borrower with a FICO score between 580 and 620 with the mean value of other regressors. Controlling variables include borrower DTI, FICO_score, home equity, loan age, loan size, area credit risk, area unemployment rate, and interest-rate environment. Values indexed to 2004 affordable/CRA 24-month default risk.

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