



How to prevent mortgage default without skin in the game: Evidence from an integrated homeownership support nonprofit[☆]

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ABSTRACT

We test the assumption that borrowers need sufficient “skin in the game”, or a large down payment, to perform well on their mortgages. To do so, we estimate the effects of a homeownership support organization's attempt to help low- and moderate- income households purchase homes through a range of integrated services, including the provision of a second mortgage that allows for a low down payment with no mortgage insurance. Using client-level data from the homeownership support organization, Homewise, and controlling for income and other demographics, we first show that the organization's clients successfully avoid the savings barrier to home purchase – a barrier which impedes many low-income households from obtaining a mortgage. We then combine Homewise administrative data with CoreLogic and Home Mortgage Disclosure Act (HMDA) data to compare the post-purchase behavior of participating households to those of similar households using a propensity score matching technique. Results indicate that Homewise's clients perform better on their loans than other similar borrowers in their region. For every 100 home purchasers, clients purchasing homes through Homewise have 6.3 fewer 30 day delinquencies in the first two years of their mortgage than a matched comparison group of purchasers, 2.3 fewer 60 day delinquencies, 1.8 fewer 90 day delinquencies, and 1.1 fewer 180 day delinquencies. These results show that with the correct combination of homeownership support services, low- and moderate-income households can sustain a mortgage with a low-down payment.

1. Introduction

An amortizing mortgage is the most important savings vehicle most low- and moderate-income Americans will own. Even after the foreclosure crisis, housing represented the largest source of net worth for most Americans (Herbert and Belsky, 2008; Rappaport, 2010), and given current interest rates and tax policy, it is often less expensive to purchase a home than to rent (Kolko, 2014). As a result of these factors, home equity represents nearly half of nonannuitized (i.e., non-Social Security and nondefined benefit pension) net worth for all households upon retirement (Poterba et al., 2013) and, of course, an even larger share for owner-occupants. For those in the bottom quintile of the income distribution, home equity represents 60 percent of total net worth, even though only 27 percent of these households are homeowners (Soto, 2010).

Beyond financial gains, evidence has also shown that homeownership provides benefits for both homeowners and for their communities.

For instance, owner-occupied properties are better maintained than other properties (Galster, 1987; Harding et al., 2007), homeowners invest more in social capital than non-homeowners (Green and White 1997; Haurin et al., 2002), and children growing up in owner-occupied dwellings have higher high school graduation rates and cognitive test scores than those who do not (Green and White, 1997; Haurin et al., 2002). Coulson and Li (2013) find that transitioning a home from rental to ownership in a typical neighborhood would create about \$1,327 per year in externality value to surrounding properties. Although other recent studies have indicated that the benefits of homeownership may be more related to selection and other factors than a true causal effect (Mohanty and Raut, 2009; Holupka and Newman, 2012; Barker and Miller, 2009; Engelhardt et al., 2010), increasing the rates of homeownership remains a goal for many policymakers and practitioners.

However, barriers to home purchase exist for low- and moderate-income households that make it difficult or even impossible for them to become homeowners. To purchase a home, a household must have

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adequate savings, low levels of debt, good creditworthiness, and a steady source of income. A rich literature exists exploring these barriers, with most finding that savings poses the greatest barrier to homeownership, followed by low creditworthiness and income constraints (Barakova et al., 2003; Calem et al., 2010; Haurin et al., 1996, 1997; Herbert and Tsen, 2007; Linneman and Wachter, 1989; Listokin et al., 2002; Quercia et al., 2003; Rosenthal, 2002). However, less is known about how to remove these barriers and how households fare once the barriers are removed.

In this paper, we examine the effects of a homeownership support nonprofit in New Mexico's attempt to help low- and moderate-income households purchase homes through a range of services, including the provision of a second mortgage that allows for a low down payment with no mortgage insurance. We examine whether this lowdown payment option, combined with other services provided by the nonprofit, called Homewise, allows prospective home purchasers to purchase a home even if they have a traditional barrier to home purchase (lack of savings, high debt, low creditworthiness, or too little income). We also examine the effect that the program has on the loan performance of purchasing households.

Using client-level data from Homewise and controlling for the demographic characteristics of the clients, we first estimate the impact that each barrier (debt, savings, creditworthiness, and income) has on the likelihood that an individual or household will purchase a home. We then merge Homewise administrative data with a separately matched data set of CoreLogic proprietary mortgage data and Home Mortgage Disclosure Act (HMDA) data to examine what effect the program has on the post-purchase behavior of buyers compared other similar households using a propensity score matching technique. This unique matched data was developed by the Urban Institute to combine the rich borrower demographic information from HMDA with borrowers' credit profile and loan performance information from CoreLogic's proprietary mortgage database.

Results indicate that Homewise's clients successfully avoid the savings barrier to home purchase, but that debt, creditworthiness, and income remain significant barriers. And although prior studies show that mortgages associated with down payment assistance exhibit significantly higher rates of default (Kelly, 2008; GAO, 2005; IFE, 2014; Lee and Steele, 2007), our results show that Homewise's clients actually perform better on their loans than similar borrowers. For every 100 home purchasers, clients purchasing homes through this program have 6.3 fewer 30 day delinquencies in the first two years of their mortgage than a matched comparison group, 2.3 fewer 60 day delinquencies, 1.8 fewer 90 day delinquencies, and 1.1 fewer 180 day delinquencies.

Although it is unclear whether these results are due to the selection of nonprofit clients into home purchase by the program or the direct effects of the program itself—both of which are valuable functions for Homewise to perform—these results challenge the assumption that low income individuals need to be able to provide a large down payment to sustain a home purchase. Some households can actually perform better on their loans than purchasers with larger down payments, given the correct support, structure, preparation, and selection.

2. The Homewise model

The home-buying assistance nonprofit that our data comes from, Homewise, is a vertically integrated organization, which means that they work with individuals through the entire home buying process from initial inquiry through final financing or refinancing. Homewise offers in-house counseling, homebuyer education, real estate development, real estate sales, mortgage origination, and loan servicing, as well as an in-house incentivized savings program. Each function is aligned in sequence, with early steps intended to build the foundation for customers' long term financial security. However, clients need not participate in every step; they can access some components of the model and not the others. For example, clients are not required to use one of

Homewise's realtors or purchase a home developed by Homewise to access financing through the organization. However, all clients are required to participate in financial counseling and anyone who purchases a home is required to take homebuyer education.

In addition to providing financing for low- and moderate-income households to purchase their homes, Homewise works to improve potential buyers' knowledge, creditworthiness, and savings through classes and counseling. New customers work individually with program staff to assess their current levels of savings, income, debt, and creditworthiness, and select the house that will fit their needs yet will be financially feasible. As clients work to improve their finances, they continue to meet with their counselor to discuss their progress. These meetings are augmented by classes hosted by Homewise to teach aspiring homeowners the basics of buying and financing a home. Once the client is financially ready to buy, Homewise has realtors to help find and purchase a home. These realtors are not paid on commission and therefore do not have an incentive to encourage buyers to purchase a home when they are not ready or a home that is too expensive for them to afford.

To finance the purchase of a home, Homewise issues two mortgages – the first is for the first 80% of the home value and the second is for 18%. The first mortgage is resold on the secondary market to raise capital for additional clients, and Homewise holds on to the riskier second mortgage so that the client pays only a 2% down payment while still eliminating the need for mortgage insurance.¹ Homewise services both loans so that they can monitor loan performance on both loans and intervene early if there is a problem. Using this low down payment, in combination with counseling and incentivized savings programs, Homewise attempts to remove the savings barrier for the client and keep the monthly cost of owning a home at a reasonable level through removing the monthly mortgage insurance costs.

3. Previous research on homeownership support and mortgages with low down payments

Renter households that desire homeownership are generally required by mortgage lenders to accumulate enough liquid savings to satisfy loan down payment requirements. Down payments provide lenders not only a cushion against default, but also serve as an underwriting measure of how prepared prospective borrowers are for homeownership. More specifically, cash down payments serve as an indicator of borrower capacity to repay a loan as agreed and to carry out essential functions of homeownership, such as saving for expected maintenance and unexpected repairs. Down payments also give borrowers a stake in the property from the day of purchase ("skin in the game"), which in turn strengthens their commitment towards general upkeep of the home.

However, the ability to save for a cash down payment has also proven to be the most critical barrier to homeownership, especially for low- and moderate-income households and first-time homebuyers. Research shows that historically, lack of wealth poses a higher barrier to home ownership than having low income relative to area house prices, or having a poor credit history (Barakova et al., 2003; Calem et al., 2010; Haurin et al., 1996, 1997; Herbert and Tsen, 2007; Linneman and Wachter, 1989; Listokin et al., 2002; Quercia et al., 2003; Rosenthal, 2002). Static incomes and high rents make saving for a down payment even more difficult today (Thompson, 2014; Seidman, 2014). Traditional ways for prospective homebuyers to save for a down

¹ Conventional loans with an LTV of more than 80 percent often require the borrower to purchase private mortgage insurance (PMI). This monthly PMI premium is added to the mortgage payment until the borrower has accumulated enough equity in the home that the lender no longer considers them high risk (when the LTV reaches 78 percent). FHA backed loans require an upfront mortgage insurance premium (UFMIP) of 1.75 percent of the base loan amount and a monthly insurance premium (MIP) which varies based on the amortization term and the LTV ratio.

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