Executive Summary

Unaffordable mortgages, a credit crunch, house price declines and job losses created a foreclosure pandemic in the late 2000s.

At the same time, thousands of low-income working families across the United States who were given sound, affordable mortgages had remarkable repayment rates – rates at or near those of prime borrowers.

Their success – even during the worst housing crisis since the Great Depression – confirms that sound products and servicing practices are the keys to successful home lending. They offer a model on which the United States can rebuild a vibrant and sustainable housing system.

And that’s good news. Because, given the choice, most Americans today would still prefer to own their own home than pay rent. Fannie Mae’s National Housing Survey shows 65 percent of Americans continue to think that buying a home is a safe investment, 69 percent think now is a good time to buy a home and 85 percent consider ownership better than renting.1

Homeownership does entail certain risks, including the cost of repairs, greater transaction costs from relocating and problems of debt. However, homeownership also has considerable benefits. Over the long run, homeownership still represents the primary way for most households to build financial security.

Even through the nearly unprecedented national decline in house prices, UNC Center for Community Capital research found, many lower-income homeowners experienced financial gains.2 Of the 46,500 loans made under Self-Help’s Community Advantage Program, for instance, the median borrower gained more than $16,800 in home equity since origination, for an annualized return on equity of 25 percent as of the first quarter of 2011. Comparable renters studied over the same period did not accumulate comparable levels of alternative assets.

Center researchers also found that homeownership has non-financial benefits for lower-income households. Homeowners in the study have greater sense of control and less stress and are more likely to trust their neighbors3 and favorably rate and recommend their neighborhood than comparable renters in the study.4 Renters who become homeowners are almost three times more likely to become members of a neighborhood group than households who remain renters, despite no sign of greater civic engagement prior to buying.5 Homeowners are more likely to participate in local elections than renters, particularly in disadvantaged neighborhoods.6

If these economic, psychological and societal benefits of homeownership are to be realized, homeownership must be successfully sustained. Fortunately, there are ample examples of safe and sound lending to low-income and minority households to show the way.

Models of Successful Home Lending

The UNC Center for Community Capital examined the experience of several affordable mortgage programs that provide models of how to extend the benefits of homeownership broadly and successfully.

- **Self-Help’s Community Advantage Program.** A secondary market outlet that provides liquidity for community reinvestment lending has funded more than 50,000 mortgages made by 29 lenders in 48 states since 1998 without incurring widespread defaults.
- **Massachusetts’ ONE Mortgage Program.** An alliance of organizations pools resources and risks to reduce down payment requirements so more than 17,000 low-income households can become homeowners.
- **Housing Finance Agencies.** Since the 1960s, state agencies have used tax exempt bond financing to close market gaps in affordable homeownership, providing loans for more than 2 million low- and moderate-income families to purchase their first homes.
- **Homewise.** A full-service mortgage broker with a comprehensive, high-touch approach has helped more than 2,000 residents of New Mexico become successful homeowners while also demonstrating impressive portfolio performance.
- **Veterans Affairs Loan Program.** The Veterans Administration’s home loan guaranty program has helped 20 million veterans buy, build or repair a home with no down payment while maintaining one of the lowest foreclosure rates in the housing market.

In a series of case studies covering more than 22 million mortgages, we examine the motivations behind the programs, the ways in which they address market gaps and the keys to successful homeownership finance.

Successful Mortgage Lending Components

While these five programs contain unique features, they share several key elements that provide insights into how to rebuild a safe, sound and vibrant U.S. housing finance system. Among them are:

- **Sound mortgage products** – Thirty-year fixed-rate mortgages with fair terms as the gold standard.
- **Sensible underwriting and servicing** – Lenders who carefully underwrite loans to ensure borrowers can repay them and who proactively work with distressed borrowers to keep them in their homes, when possible.
- **Access to credit** – A strong secondary market for affordable mortgages that replenishes the supply of capital, allowing banks to make more traditional, fixed-rate loans to low-wealth families.

Implications for Policy

Restoring a sound housing market and economy will require rebuilding a U.S. housing finance system that extends mortgage credit as broadly as possible while minimizing risk.

These case studies and the experience of more than 22 million low-income homeowners provide a model on which to build sound, sustainable home lending policy.
Self-Help’s Community Advantage Program

A secondary market outlet that provides liquidity for community reinvestment lending has funded more than 50,000 mortgages made by 29 lenders in 48 states since 1998 without incurring widespread defaults.

Participants

- Self-Help Ventures Fund
- Ford Foundation
- Fannie Mae
- Mortgage Lenders
- UNC Center for Community Capital (Evaluator)

The Gap

Three stark facts motivated Self-Help’s commitment to providing mortgage loans to underserved households. First, the median household of color held around one tenth the net wealth of the median white household. Second, home equity was – and continues to be – the largest component of household wealth for families earning low or moderate incomes (LMI). And third, less than half of Hispanic and black households were homeowners in the mid-1990s, compared to around 70 percent of white households.

The homeownership gap translates into a gaping wealth disparity that far outstrips earning disparities in the United States. Self-Help recognized the role that disparate access to mortgage credit played in enabling lower-income and minority households to enter the ranks of homeownership and participate in its many social and economic benefits.

In the mid-1990s, inflexible secondary market guidelines formed a key barrier to mortgage lending to underserved households. Through Community Reinvestment Act (CRA) activities, banks were finding sustainable ways to finance affordable mortgages for more LMI and minority borrowers and communities, but they were often blocked from selling these loans in the secondary market and faced limits on the amount of such loans they could hold in portfolio. Self-Help recognized that facilitating the sale of such loans to Fannie Mae would open a major pipeline of affordable capital to communities that had long been left dry.

By the early 2000s, however, another wave of financing – subprime lending – was overtaking bank CRA and the affordable housing lending of government-sponsored enterprises in this segment and would ultimately grow into a tsunami. During these years, the lenders participating in CAP used this program to offer a standard, prime-priced, affordable fixed-rate mortgage alternative to the high-cost, high-fee, risky subprime products.

Closing the Gap

Self-Help Credit Union was founded in 1984 to address the credit needs of minority, rural, women-headed and lower-income households who were underserved by traditional lenders. Since its creation, Self-Help has directly financed $336 million in direct home lending to more than 4,500 homeowners. Over the years, the good performance of the mortgages extended by the credit union convinced the organization that low-resource households could successfully obtain and sustain homeownership.

This lesson was also being demonstrated by North Carolina banks through the 1980s and 1990s as they sought to meet CRA requirements by making mortgage loans in low- and moderate-income communities and to low- and moderate-income households. However, because the loans often did not conform to traditional underwriting standards (those established by Fannie Mae and Freddie Mac), they could not be sold on the secondary market. Though the programs performed well, even large commercial banks were constrained by the illiquidity of their growing portfolios of community mortgages.

The makings of a solution arose in 1994 when Self-Help purchased a portfolio of non-conforming loans from Wachovia, thus freeing capital for Wachovia to continue lending to more LMI borrowers.

Building on this model, the Community Advantage Program (CAP) emerged four years later with a
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$50 million grant from the Ford Foundation to establish a loan loss reserve fund. With this fund in place, Fannie Mae agreed to purchase mortgages with Self-Help’s recourse (a form of guaranty provided by the seller of the loans; in this case, Self-Help). The program launched in fall of 1998 with four lending partners.

Self-Help has since worked with almost 30 lenders across the country to finance $4.74 billion in mortgages to nearly 52,000 homeowners across the country.

Another important by-product of the CAP program is in-depth knowledge about the benefits, risks and opportunities of mortgage lending to low-income and low-asset families. The portfolio of CAP loans, along with detailed annual surveys of borrowers, has provided the basis for a wealth of research conducted by the UNC Center for Community Capital.

Who CAP Targets

In keeping with its founding purpose and income criteria, the Community Advantage Program targets low-income and minority households often shut out by conventional credit markets.

CAP homeowners are disproportionately likely to be minority (39 percent) and female-headed households (41 percent).

The median CAP borrower has an annual income of less than $30,800, or only 60 percent of area median income (AMI).

Only 8 percent earn more than $50,000. In addition, nearly one-third of borrowers also live in low-income (under 80 percent AMI) neighborhoods.

Due to lower incomes, the debt-to-income (DTI) ratios for CAP borrowers often well exceed those mandated under conventional underwriting guidelines. More than 42 percent of CAP borrowers have DTI ratios over 38 percent. Similarly, with a typical credit score of 681, and 44 percent with a credit score under 660, CAP borrowers would have not qualified for a mortgage or would have had to turn to the high-cost options to purchase a home.

The CAP Model

Self-Help provides credit enhancement and acts as a financial intermediary between lenders and investors. Mortgage lenders originate mortgages to low- and moderate-income borrowers using their own customized guidelines (approved by Self-Help). Self-Help then purchases approved loans from these lenders and sells or securitizes them with Fannie Mae.

Importantly, Self-Help retains the credit risk of the mortgages. If a borrower defaults, Fannie Mae can seek recourse and compensation, which highlights the importance of the loss reserve fund established with the help of the Ford Foundation. Fannie Mae can either hold the mortgages in portfolio or pool the loans into mortgage-backed securities and sell them to investors, who can be confident of the credit quality of the investment.

Products

As noted, CAP borrowers would likely be disqualified from prime mortgages by high debt-to-income ratios and low credit scores. Further, they often can only afford low down payments on a mortgage. Over 69 percent of CAP homeowners had loan-to-value (LTV) ratios in excess of 95 percent at origination. Conventionally, such borrowers would typically only qualify for subprime mortgages with high interest rates and other high-risk features, like prepayment penalties and interest-only or
negative amortization schedules. Nevertheless, Self-Help mostly offers very traditional mortgage products.

The CAP portfolio is predominately 30-year, fixed-rate mortgages, retail originated, for the purpose of purchasing a home. The cost of a typical CAP mortgage is comparable to the cost of a prime fixed-rate mortgage originated in the same period. No mortgage insurance or junior liens are needed. Participating lenders set their own guidelines (subject to Self-Help and Fannie Mae approval) to meet the needs of their markets and the risk management requirements of their organizations.

Performance

The use of proven, safe products has resulted in strong performance through the foreclosure crisis. Of CAP borrowers, two-thirds have never missed a payment and just 4.8 percent have resulted in a foreclosure sale.

In general, the serious delinquency rate is more similar to conventional prime mortgages than subprime mortgages, despite borrower profiles more similar to the later.

In fact, UNC Center for Community Capital research found that subprime loans were three to five times more likely to default than loans to comparable borrowers originated under the Community Advantage Program.1

Implications for the Future

The CAP experience clearly shows that home lending to lower-income, low-down-payment borrowers can be good and sustainable business, even in challenging economic times. The elements of success include offering traditional, prime-market-priced, fixed-rate, 30-year mortgages without hidden fees and penalties. They also include prudently underwriting borrowers for ability to repay and documenting income and assets and credit histories.

For the most part, the programs used by lenders in the CAP program were encouraged by CRA and Affordable Housing objectives. Both explicitly call for lenders to apply safety and soundness considerations while at the

same time finding ways to lend more flexibly. The results show that lenders can do both at the same time.

Significantly, the Self-Help pilot demonstrated how to bring a successful program to scale efficiently by using mainstream market participants. In particular, it underscored the critical importance of the secondary market in making affordable financing available to more families. If it had used the Ford grant to make direct mortgages, it might have served about 600 families. By instead offering a credit enhancement to encourage Fannie Mae to buy and securitized mortgages made by lenders around the country, it has helped nearly 50,000 families obtain financing.
Massachusetts’ ONE Mortgage Program

An alliance of organizations pools resources and risks to reduce down payment requirements so more than 17,000 low-income households can become homeowners.

Participants

- Massachusetts Housing Partnership (MHP)
- Massachusetts Affordable Housing Alliance
- More than 25 commercial banks and credit unions
- Commonwealth of Massachusetts
- Massachusetts Bankers Association
- More than 50 homebuyer counseling agencies

The Gap

In 1989, research from the Federal Reserve Bank of Boston uncovered a pattern of racial bias in mortgage lending. The authors wrote, “The findings show that housing and mortgage credit markets are functioning in a way that hurts black neighborhoods in the city of Boston.” The study generated public outrage and led the Massachusetts Housing Partnership, City of Boston, Massachusetts Affordable Housing Alliance and other community advocates to form a coalition to find innovative methods for expanding homeownership to underserved households.

Lack of assets for down payment and high house prices relative to income have long been recognized as the key barriers facing lower-income, lower-wealth families in attaining viable homeownership (Quercia, McCarthy and Wachter, 2003). The affordability gap in Boston, where the program was first conceived, has historically been among the worst in the nation with a current median house price that is more than five times area median income.

Closing the Gap

In 1990, the coalition introduced the SoftSecond Loan Program, an innovative and efficient way to increase the purchasing power of lower-income Massachusetts households. In 2014, this program was transformed into the ONE Mortgage loan program.

Massachusetts Housing Partnership (MHP), which had been founded in 1985 and managed the program, operated the Homeownership Opportunity Program, a conventional affordable housing program that used public funds to subsidize mortgage interest rates. The SoftSecond program, in which an average public investment of $5,000 leveraged nearly $200,000 in private mortgage financing, enabled more efficient use of public funds. Over the last two decades, the SoftSecond program financed $2.5 billion in mortgages to help more than 15,000 families buy their first home.

Through the new ONE Mortgage program, the coalition made changes to features of the original program to better match industry standards.

Chart 1: FY2014 Loan Volume by Program

Loan volume for the SoftSecond program drops as volume for the ONE Mortgage program grows.

Source: Homeownership Annual Demographics Report- FY2014 from the Massachusetts Housing Partnership.

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ONE Mortgage still serves low- and moderate-income borrowers and continues the SoftSecond legacy. Through June 2014, nearly $3 billion in mortgage lending through SoftSecond and ONE Mortgage helped more than 17,800 families buy their first home. As of mid-2014, 28 lenders have agreed to offer the ONE Mortgage program.

Chart 1 shows the phasing out of SoftSecond loans in 2014 and the rise of loans made under the ONE Mortgage program.

The ONE Mortgage Model

The ONE Mortgage model evolved from the SoftSecond model. Under the SoftSecond program, borrowers could receive financing for up to 97 percent of a home’s purchase price in two loans extended by one lender. The first loan was a standard conventional first mortgage for up to 77 percent; the second, the "SoftSecond," financed the remaining 20 percent. A down payment of three percent was required, but only half of that needed to come directly from the borrower.

Under ONE Mortgage, a lender originates a single loan that finances 97 percent of the purchase price (95 percent for a three-family property), as opposed to the two-loan system. By originating a single loan, mortgages conform better to industry standards and are more likely to be sold in the secondary market, while still providing a high loan-to-value loan product that does not require private mortgage insurance (PMI). The primary difference between the two models is that the 10-year-interest-only feature included in the SoftSecond loan was eliminated in the ONE Mortgage program.

Not only does the program address the down payment gap, it also eases the debt-to-income burden. The loans are 30-year, fixed-rate, fully amortizing and made at or below prime market rates. No points can be charged to the borrower and no loan-level price adjustments are made based on risk-based pricing models common in the market.

Additionally, some low-income borrowers qualify for a subsidized interest rate in the first few years of homeownership. In this case, the MHP provides an upfront payment³ to the lender to make up the difference and then adds a zero percent interest-rate subordinate lien to the financing. The funds are required to be repaid upon sale, but the repayment obligation allows borrowers to retain at least 80 percent of any net appreciation after five years of ownership. This feature is a continuation of the SoftSecond program, which provided a subsidy to eligible borrowers on their SoftSecond loan. During this program, UNC’s analysis of the SoftSecond program found no evidence that the subsidy increased the likelihood of default.⁴

Who takes on the risk of a ONE Mortgage loan in the absence of PMI? MHP funds a loan loss reserve account that is pooled by lender and is available to pay losses incurred by that lender in lieu of PMI.

Who ONE Mortgage Targets

Since inception, the SoftSecond and ONE Mortgage programs have helped more than 17,800 borrowers in Massachusetts, which MHP estimates is 10 percent to 20 percent of eligible households statewide.

³ This payment is equal to the discounted value of the reduced interest payments the lender expects to receive
The ONE Mortgage program is designed to help lower-income, first-time homeowners. The maximum eligible household income is 100 percent of area median income (AMI) and any household earning less than 80 percent of AMI is eligible for the interest-rate subsidy. The program particularly targets borrowers earning 60 percent of AMI or less, who account for 44 percent of the borrowers served in FY2014. Total household income averaged $56,700 in FY2014.

Historically, half the loans are to minority, first-time purchasers statewide, while in the Boston area that figure is two-thirds.

Product

ONE Mortgage loans must be discounted 30-year fixed-rate mortgages. The minimum down payment for single-family properties, condominiums or two-family properties is three percent of the purchase price. Under the ONE Mortgage program, requirements for three-family properties were tightened, as these types of loans were identified as having disproportionately high delinquency rates. Therefore, the program requires that loans for three-family properties have a minimum down payment of five percent, as well as a mandatory home inspection and mandatory one-on-one pre-purchase counseling.

In this manner, the ONE Mortgage program provides real affordability, in contrast to the illusion of affordability provided by disastrous, exploding-payment, adjustable-rate loans that were prevalent in the mid-2000s and wreaked financial havoc on so many households, communities and the economy as a whole. Such exotic loans regularly featured an artificially low initial rate (for which the borrower would be qualified) and unpredictable future payments that could more than double the initial rate, even within the early years of the loan.

Maximum allowable debt-to-income (DTI) ratios for single-family and condominiums are 36 percent on the front end and 43 percent on the back end. Generally, a minimum credit score of 660 is required. Furthermore, there is no potential for negative amortization. The long horizon and modest payment adjustments allow the household to plan and benefit from normal income growth.

In order to qualify, applicants for single-family properties, condominiums or two-family properties must complete a pre-purchase education class from one of 52 agencies approved by the Massachusetts Homeownership Collaborative. Classes take place over at least two days and include a minimum of eight hours of instruction. Applicants for three-family properties must also complete one-on-one pre-purchase counseling.

Mortgage delinquency and default are kept low through additional, post-purchase counseling, known as HomeSafe, developed by the Massachusetts Affordable Housing Alliance. Each ONE Mortgage homeowner is required to attend a workshop within one year of closing for guidance on budgeting, maintenance, security, managing credit and avoiding delinquency. Graduates are then eligible for discounts on homeowners’ insurance, appliances and other purchases. In the event of delinquency, the MHP notifies one of a network of counseling agencies that proactively reach out to contact the borrower to offer assistance.

Performance

Throughout the foreclosure crisis and through the beginnings of the recovery, the serious delinquency rate (90+ day delinquent or in foreclosure) of borrowers in the SoftSecond and ONE Mortgage programs has tracked below that of subprime loans and, until 2012, consistently below the delinquency rate for even prime loans in Massachusetts. Although delinquency rates for the SoftSecond and ONE Mortgage programs have tracked at or slightly above those for traditional prime loans since 2012, it is important to note that the foreclosure rate for MHP programs has consistently remained far below that of prime loans. The MHP believes this success is attributed to more thorough counseling and servicing at the first signs of distress. In cases of serious default, lenders retain some part of the credit risk, but a substantial portion is covered by loan loss reserve funds.
This program offers many lessons to take forward:

- A relatively small amount of public subsidy has leveraged private dollars to finance affordable homeownership for 17,800 households.
- A strong network of public and private institutions has made the program what it is today. It is the result of a long history and evolution of efforts to put homeownership safely within reach of more qualified households through access to safe, traditional mortgage products.
- The originating lenders have kept “skin in the game” while working with the public sector to mitigate their risks.
- Loans are well underwritten, and borrowers are supported in their responsibilities as homeowners through both pre- and post-purchase counseling.

While originally motivated to combat long-standing racial bias in access to home ownership finance, in recent years the program has also served to solve a new problem: neighborhood stabilization. In 2010, more than 40 percent of borrowers in the program purchased homes in cities hardest hit by foreclosures, playing an important role in the recovery of communities at a time when other sources of financing have pulled back. To date, the program has served 296 communities in the state of Massachusetts.

The ONE Mortgage program is a primary mortgage market innovation. Today, its most significant challenge is the inability of lenders to sell mortgages on a flow basis to the secondary market. Although the high performance of MHP program loans has kept lenders satisfied with keeping MHP mortgages on the books, a secondary market outlet would allow lenders to originate ONE Mortgage loans with fewer, if any, internal volume restrictions. If the mortgage secondary market entities (Fannie Mae and Freddie Mac) can agree to systematically buy these loans, the program’s reach and scale could be greatly expanded. It is MHP’s hope that the single loan structure of ONE Mortgage will make it more saleable in the secondary market.
Housing Finance Agencies

State-chartered agencies that offer affordable loan programs have made first-time homeownership possible for nearly 3 million families. The performance of these generally high loan-to-value loans to first-time and lower-income borrowers has been proven over a long history and sustained through the foreclosure crisis.

Participants

• State Housing Finance Agencies
• Bond Investors
• Mortgage Originators/Servicers

The Gap

The role of state Housing Finance Agencies (HFAs) has evolved with changing housing challenges since their emergence in the 1960s. During the civil rights reform era, concern arose over the lack of equal access to adequate, affordable and safe housing and the prevalence of housing discrimination, which came to be prohibited by The Fair Housing Act of 1968.¹

New York in 1960 established the first state agency dedicated to affordable rental property for low-income citizens. Other states subsequently established housing finance agencies to provide a mechanism for funding solutions to address local housing problems, originally focused primarily on rental housing. As mortgage rates began to rise, they also became active in home ownership finance. In 1974, Virginia became the first state to sell tax-exempt mortgage revenue bonds to provide affordable financing for the purchase of owner-occupied houses.²


South Carolina State Housing Finance and Development Authority

South Carolina State Housing Finance and Development Authority was founded in 1971 as a self-sustaining state agency and receives no state appropriations.

The powers of the authority are vested in a board of commissioners, which includes the governor and the state commissioner of the Department of Health and Environmental Control, or their designees, and seven members who have experience in the fields of mortgage finance, banking, real estate and home building.

From 2000-2011, the authority originated 11,802 loans for $1.1 billion. Through the foreclosure crisis, the authority’s foreclosure rate remained consistently lower than the statewide average.

By 1970, 11 states had created state HFAs. This number increased to 47 states by 1987. Today, all states, including Puerto Rico, the U.S. Virgin Islands and District of Columbia, have a housing finance agency.

During the foreclosure crisis, HFAs added programs to minimize foreclosures, demonstrating their potential to provide locally based responses to new challenges.

In the post-crisis environment of affordable mortgage rates and house prices, these agencies have enabled low-down-payment, lower-income borrowers to achieve homeownership when other sources of mortgage credit have been scarce.
Minnesota Housing

Minnesota Housing has worked since 1971 to provide access to safe, decent and affordable housing and to build stronger communities throughout the state. It finances home mortgage loans for first-time and repeat buyers plus affordable refinancing and home-improvement loans. Minnesota Housing also provides a wide spectrum of financing for multi-family rental housing and homelessness prevention programs.

The average annual household income for home mortgage loans was $48,500 in 2013, which is 65.5 percent of the state median income of $74,000.

From 2000 through federal fiscal year 2013, Minnesota housing provided home mortgage loans for more than 32,000 households at over $3.6 billion.

Mortgage Revenue Bond Model

While state HFAs operate a spectrum of housing finance activities, this brief focuses on their homeownership financing programs. The Revenue and Expenditure Control Act (1968) sparked the development of tax-exempt state-issued bonds to finance home ownership. These tax-exempt mortgage revenue bonds (MRBs) gave state HFAs a key vehicle for providing funds for first-time, low-income and minority borrowers to purchase homes. The below-market rate required by bond investors – typically institutional investors – enabled the HFAs to make affordable mortgage capital available through participating lenders.\(^3\)

Congress limits the available tax-exempt bond allocation and adjusts the limit annually. For example, in 2013, each state’s annual issuance of these bonds was capped at $95 per capita, with a minimum state allowance of $291,870,000.\(^4\)

Additionally, Congress restricts the mortgages financed by MRBs to first-time homebuyers who earn no more than the area median income (AMI), and homes purchased with MRB mortgages must be no more than 90 percent of the average area purchase price.

Distribution

Most HFAs do not have a mortgage origination staff, so they depend on mortgage originators to distribute their programs to consumers. Relationships with banks, credit unions and mortgage banks are critical for HFAs to succeed in their mission of providing loans to low-income borrowers.

\(^3\) The subsidy can take the form of a reduced interest rate or mortgage credit certificate (MCC) which is a program to help homebuyers qualify for a loan through a tax credit of a portion of mortgage interest paid during a given tax year.

Each HFA has an approval process for its originators and establishes program credit guidelines and pricing that the originator must adhere to.

Larger originators typically underwrite HFA loan files with the understanding that if a file does not follow program credit guidelines, the originator will repurchase that loan. For smaller originators, the HFA will often underwrite the loan file to ensure proper documentation. Once the loan file underwrite is complete and the loan closes, the originator sells the loan to the HFA.

HFAs can take an active role in overseeing servicing of their loans. While some have brought servicing in-house or to a centralized servicer, all have reported making changes to servicing procedures since the 2008 housing crash, with an emphasis on early intervention. These strategies seek to prevent foreclosures and minimize losses. FitchRatings in its 2014 Outlook reported a stable outlook for this sector and “sound financial reporting,” stating “SHFAs typically exhaust all workout options available for the homeowner, which is in keeping with their stated mission to promote and maintain homeownership.”

Who HFAs Serve

Mortgage loans funded through MRBs must serve first-time homebuyers with incomes at or below the area median income who are buying a house for which the price does not exceed 90 percent of the area average. The average median income of an MRB borrower in 2011 was approximately $39,000, or 77 percent of the United States median income.

5 82% of HFAs surveyed reported that they intervene within 30 days of missed payment and another 18% intervene within 30–60 days (Moulton, Stephanie, and Roberto G. Quercia. “Access and Sustainability for First-Time Homebuyers: The Evolving Role of State Housing Finance Agencies.” Chapter 8 in Homeownership Built to Last: Balancing Access, Affordability, and Risk after the Housing Crisis. Brookings Institution Press (2014)).


7 National Council of State Housing Agencies, 2014. https://www.ncsha.org/advocacy-issues/housing-bonds. Note that larger families can earn up to 115 percent of AMI.

Virginia Housing Development Authority

Virginia Housing Development Authority has financed more than 170,000 homes since its creation in 1972.

It has successfully offered free homeownership classes in both English and Spanish and provided active loss mitigation and counseling services at no cost to participants.

In the tax-exempt bond program, the median household income of borrowers is just over $45,000 and about 30 percent of borrowers are minorities.

Chart 1 shows how well HFAs extend credit to underserved markets.

Product(s)

A typical HFA loan is a low-down-payment FHA or conventional 30-year, fixed-rate, single-family first
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mortgage. Historically, HFA loans have provided borrowers a below-market interest rate due to their loans being funded by MRBs.8

An important decision for HFAs is how to cover the risk of loss from default. They can use private mortgage insurance, they can self-insure or they can fund loans that are insured by the federal government (Federal Housing Administration, Veterans Administration or U.S. Department of Agriculture Rural Housing Services).9

Somewhat related to the risk insurance mechanism, HFAs also vary what they use as the ultimate source of capital. They can hold whole loans, but the classic MRB approach — a bond-financed whole loan model — is only one funding source that HFAs may tap. They can also deliver the loans through secondary market conventional financing channels (Fannie Mae or Freddie Mac) or through Ginnie Mae.

Chart 2 shows how product offerings fluctuated due to changing market dynamics between 2006 and 2012. HFAs originated more FHA loans and fewer conventional loans in 2012 compared to 2006. When the recession hit in 2008, conventional mortgage underwriting guidelines tightened, which impeded the ability to originate conventional loans.10

Down payment assistance is a key feature of most HFA loan programs. Lack of sufficient wealth remains an obstacle to homeownership for many creditworthy aspiring borrowers. In 2011, 88 percent of HFAs offered some form of down payment assistance.11 And between the years of 2006 and 2012, HFA loans financed with down payment assistance increased to 70 percent.12

Pre- and post-purchase counseling is another common feature of HFA loans. In a recent survey, one-third of HFAs required homebuyer education and counseling for all loan programs, 49 percent required homebuyer education counseling for some of their loans programs and 12 percent provided incentives to take counseling courses.13

Performance

Historically, the HFA sector has experienced stability and highly rated bond programs due to sound risk management practices. In fact, a majority of HFAs surveyed believed that their viability depended on

Chart 3: Percent Loans 90+ Days Delinquent as of 6/30/12
HFA loan performance held strong during the downturn even given their lower-wealth borrower base.

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9 Moulton and Quercia, 2014
10 Moulton and Quercia, 2014
12 Moulton and Quercia, 2014
13 Dylla and Caldwell-Taugtes, 2012

Source: Access and Sustainability for First Time Homebuyers: The Evolving Role of State Housing Finance Agencies” by Moulton and Quercia, 2014
maintaining “strong lending standards” and “financial strength.” Though not immune to foreclosures and volatile capital shifts, HFA loan performance has held strong through the downturn, particularly considering their lower-wealth, lower-income borrower base.

For example, surveyed HFAs reported a 90+ day delinquency rate of 3.1 percent as of June 30, 2012, while subprime delinquencies were 9.16 percent and FHA delinquencies were 4.77 percent.

A 2013 analysis by Standard & Poors found that HFA loans have strongly outperformed subprime loans, reporting: “In 2006, when Standard & Poors began monitoring loan performance for the 33 whole loan bond programs we rate, the delinquency rate was 3.01 percent. The rate has been more than 6 percent since the fourth quarter of 2009 but has never surpassed 8 percent.” This compares to a subprime delinquency rate of 12.81 percent as of the second quarter of 2013. In fact, S&P found HFA loans to closely track the performance of comparable prime loans.

Implications for the Future

Despite many positives, the HFA model is challenged. The 2008 disruption of the financial markets exposed how heavily HFAs rely on institutional investor activity to fund their mortgage programs. New MRB issuance stalled due to lack of interest in the bonds. At the same time, declining Treasury yields drove conventional mortgage interest rates to all-time lows, erasing the interest rate advantage that HFAs historically offered to the consumer.

The U.S. Treasury in 2009 provided a source of funds for HFAs through its New Issue Bond Program (NIBP). This effort revitalized issuance of HFA bonds, provided stability to the housing market, maintained visibility of GSEs and state and local housing finance agencies, and promoted affordability and availability of housing resources for low- and moderate-income families. However, this did not provide a permanent solution. HFAs clearly have to identify longer-term secondary market alternatives and diversify their funding strategies.

Idaho Housing Finance and Finance Association

Idaho Housing Finance and Finance Association was founded in 1972 as an independent body even though it was created and is governed by Idaho statute.

Until 2008, Idaho’s programs were MRB-based, 30-year, fixed-rate loans.

Characteristics of Idaho’s borrowers are:

- Average Annual Income: $45,000
- Average Borrower Age: 36
- Average Family Size: 2.5
- First Time Homebuyer: 82 percent
- Female Head of Household: 15 percent
- Receiving Down Payment Assistance: 30 percent

Through the financial crisis, Idaho Housing’s foreclosure rate remained lower than 1 percent.

The need for HFAs in the affordable housing sector remains as vital as ever. Down payment assistance has been a vital tool in the current market and a stringent lending environment has depressed availability of mortgage financing for first-time, lower-wealth borrowers — HFA’s core market.

Their track record of funding quality loans for underserved borrowers has not gone unnoticed. HFAs have resorted to selling more whole loans to the GSEs. Fannie Mae has developed an exclusive program for HFAs, providing an outlet for a loan of up to 97 percent LTV — higher than for any other lenders — and with a risk share that avoids the requirement for mortgage insurance (as is typically required for loans greater than 80 percent LTV). For those able to participate in the risk-sharing, Moody’s argues, “this product provides HFAs with an attractive opportunity to increase their presence in the affordable housing market at a time when many HFAs have struggled to offer affordable loans through the sale of Mortgage Revenue Bonds (MRBs).”¹⁸

Meanwhile, in establishing the Ability-to-Repay rule, the Consumer Finance Protection Bureau recognized the quality and value of HFAs when it exempted their loans.¹⁹

HFAs have made low-down-payment loans for several decades and provided 2.9 million low-income households access to mortgage credit.²⁰ They have also demonstrated resilience during recession years and brought value to borrowers through down payment assistance, counseling and loss-mitigation programs. Their future depends upon adaptability to changing economics and creating sound funding sources to allow them to continue their good work.


¹⁹ Bureau of Consumer Financial Protection final rule on Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z) 12 CFR Part 1026: “The final rule provides an exemption from the ability-to-repay requirements for extensions of credit made pursuant to programs administered by a housing finance agency.”

²⁰ Moulton and Quercia, 2014
Homewise

**A full-service mortgage broker with a comprehensive, high-touch approach has helped more than 2,000 residents of New Mexico become successful homeowners while also demonstrating impressive portfolio performance.**

**Participants**

- Homewise
- Fannie Mae
- Investors and lenders

**The Gap**

In October 2007, Homewise published an eye-opening report, “Strengthening Santa Fe Through Affordable Home Ownership,” in which the nonprofit purported that Santa Fe was losing $301.6 million in local spending each year due to the number of people who worked in the city but resided in less expensive towns nearby.

“When a city’s housing mix has too little affordable housing and an oversupply of high cost units, the local economy will perform less efficiently than one with a better range of options,”¹ the report said.

In addition to its substantial impact on local spending, the shortage of affordable housing often forced essential workers, such as police officers, teachers and health care workers, to live outside of Santa Fe, impacting employee retention and recruitment in these vital jobs, the report said.

Commuting itself has a significant effect on families, impacting both discretionary money and personal time. A study by the Center for Housing Policy found that working families spent an additional 77 cents on transportation for every dollar that their housing costs decreased.² The Homewise report showed that some commuters in the Santa Fe area spend roughly 720 hours travelling to and from work over the course of a year. It valued their annual cost of commuting at $31,200.³ In addition to these financial impacts, commuting also directly affects children. Commutes lengthen workdays, and hours families spend at home together are often traded for hours parents must spend travelling to and from work.

**“When a city’s housing mix has too little affordable housing and an oversupply of high cost units, the local economy will perform less efficiently than one with a better range of options.”**

**Closing the Gap**

Homewise was founded as Neighborhood Housing Services of Santa Fe in 1986. At that time, the organization focused on home improvement services, with two employees working on projects in one Santa Fe neighborhood. Since then, Homewise has grown to a 50-employee organization offering a range of home purchase and home improvement services throughout northern New Mexico.

As a full-service mortgage banker, Homewise originates, closes and services loans. With offices in Santa Fe and Albuquerque, it has helped more than 2,800 residents of New Mexico become successful homeowners. The organization serves a market segment largely underserved by other lenders; its program involves intensive counseling, home buyer education courses, real estate sales services and capital commitment for loans.

¹ Homewise. “Strengthening Santa Fe Through Affordable Home Ownership.” October 1, 2007; pg. 2
³ Analysis of commuters travelling from Rio Rancho to Santa Fe. Total cost of commuting time valued at $20/hour ($14,400) plus auto cost of 120 miles round trip per day at $0.56 per mile in a 250 workday/year (IRS rate) ($16,800) = $31,200.
Through this service model, Homewise acknowledges the importance of helping working New Mexico residents become successful homeowners, an achievement that often results in financial security, stronger families and communities with increased economic and social vitality.

The Homewise Model

The Homewise Model combines careful borrower preparation and selection with favorable financing. Homewise engages with local and national banks who provide investment dollars in exchange for Community Reinvestment Act (CRA) credit. Homewise utilizes these investment dollars to fund loan program activities, particularly as capital to fund purchase money second mortgages that are the key to the Homewise financing model.

Who Homewise Serves

Santa Fe County’s population was 147,423 in 2013. The majority of the population was Hispanic, and a significant number of residents were also foreign born. The county’s homeownership rate was 69.6 percent from 2008 to 2012, with a median home value of $288,200 and median household income of $53,642.

The demographics of Homewise borrowers (see Chart 1) underscore the organization’s mission to serve low-income borrowers. In 2013, the median home purchase price for Homewise borrowers was $195,000, with an effective price of $175,500, while borrowers’ median income was $49,404.

Product

The mortgage product provided by Homewise makes innovative use of a first and second lien, which enables a low-wealth household to acquire a home with as little as 2 percent down. The first lien is a traditional 80 percent mortgage that is sold to Fannie Mae and serviced by Homewise, while the second lien is funded,
held and serviced by Homewise. Under this structure, the borrower does not need mortgage insurance, which typically increases costs, and faces fewer loan-level pricing adjustments based on such factors as loan-to-value ratio and credit score. These extra costs can price borrowers out of loans, forcing them to find less expensive houses in order to make the mortgage work.

Homewise, however, takes a different approach, and two key factors contribute to the success of its mortgage product. First, the organization provides individualized homebuyer preparation that helps clients address any credit or budget challenges until each person is considered “buyer-ready,” defined as achieving the criteria required by Fannie Mae’s Desktop Underwriter (DU). Individual sessions are supplemented with group education classes in both English and Spanish offered throughout the year. This one-on-one coaching process often takes months; however, Homewise is committed to investing time with borrowers to ensure they are financially ready to purchase a home, and this preparation is a key factor in the borrower’s success as a homeowner.

Secondly, Homewise employs realtors, brokers and servicers who are paid on salary while the organization itself earns commission on home sales or loan closings. When an individual is deemed “buyer-ready” by a Homewise home purchase advisor, a Homewise realtor is prepared to assist in the home-buying process, with a commitment to staying at or under the home sales price listed in the pre-qualification approval. Once a home is located, a Homewise mortgage broker then generates the loan file and follows the buyer through closing. The home-buying process is streamlined, simple and clear to the borrower; in addition, servicing is conducted in-house at Homewise, extending its hands-on approach to the entire process.

Performance

The high-touch, careful preparation shows up in the strong performance of Homewise’s portfolio as well as the marked changes in borrowers’ credit and savings profiles.

As of March 2014, Homewise counted 2,163 loans in its portfolio, representing a total of more than $175 million. Of these loans, only 30 were more than 30 days delinquent. This translates to a delinquency rate of 1.39 percent, significantly lower than the delinquency rate for all mortgages in New Mexico, which was more than 8 percent as of the first quarter of 2014. Additionally, Homewise’s delinquency rate is only one-twentieth the rate of delinquency among subprime loans and is even well below the state level for all prime loans of almost 5 percent.

This strong performance in terms of delinquency rates is attributable to the organization’s hands-on approach. The benefit of intensive, upfront preparation of borrowers and the model of in-house servicing enables Homewise to work closely with homeowners. Auto deduct is promoted as a means of making monthly mortgage payments and serves as a first line of defense against delinquency. If a homeowner does have trouble making mortgage payments, a workout committee quickly engages with the borrower, providing advice on available options through a process that adheres to Fannie Mae protocols.

According to Homewise’s analysis of its client data in FY2014, homebuyers showed that on average, clients increased their credit score by 17 points. For those who had a starting credit score below 640, the average increase was 83 points. Further, 78 percent of those buying homes last year increased their savings an average of $3,744.

Implications for the Future

Homewise’s performance clearly demonstrates the effectiveness of intensive homebuyer education and counseling designed to move individuals to buyer-ready status, and it also highlights the advantages of providing high-touch service throughout each step in the homeownership process. The biggest challenge for the Homewise model may be in terms of its scale – how a successful, high-touch program can be expanded
without compromising the elements of its success.

Homewise’s first expansion occurred down the road from Santa Fe in Albuquerque. This geographic proximity allowed many of the loan officers in Santa Fe to assist. The Albuquerque market is also similar demographically, enabling the organization’s expertise and understanding to translate well.

In addition to this local expansion, Homewise is working to identify other nonprofits with similar missions from around the country with the intent of offering a wholesale option to these organizations with the condition that they have the available capital to fund the second mortgage. As a step toward this, Homewise is beginning to license its loan officers in other areas.
Veterans Affairs Loan Program

A home loan guaranty program has helped 20 million veterans buy, build or repair a home with no down payment.

Participants

• U.S. Department of Veteran Affairs
• Service members and veterans
• Mortgage lenders

The Gap

The evolution of veterans' benefits has continued to evolve throughout U.S. history, but has not always provided exemplary services to service members and veterans, especially in the field of homeownership.

A hodgepodge of agencies existed to serve veterans until 1921, when all veterans' programs were consolidated to form the Veterans Bureau. After World War I, veterans returned from war earning a negligible allowance that offered little to no ability for earning a living, and homeownership was virtually unachievable.

Congress passed the World War Adjusted Act in 1924, which gave bonuses to veterans after a 20-year wait period beyond service. This exceptionally long wait period was unacceptable to veterans, many of whom took to the streets of Washington in protest during the Great Depression era. Although the marches were largely unsuccessful, they highlighted the nation's shortcomings in helping veterans adjust to civilian life. Around the same time, the Veterans Bureau was transformed into the Veterans Administration.

Years later, with the end of World War II imminent, congressional leaders desperately wanted to avoid the missteps from the prior war with the looming potential of 16 million men and women returning from war unemployed. They also wanted to prevent a potential social and economic crisis in the nation. In 1944, the Servicemen's Readjustment Act, better known as the GI Bill of Rights, was passed into law. While there were many benefits of the GI Bill, a notable one was the creation of the VA Loan Guaranty Program.

Closing the Gap

Today, the U.S. Department of Veterans Affairs (VA) offers one of the most comprehensive systems of assistance for veterans when compared to other nations. Since 1944, the VA Loan Program has made more than 18 million homes affordable for service members and veterans. The program is structured so that the VA is the guarantor of the loan program, which enables veterans to buy a home with no down payment.

Realtors play a strong role in steering borrowers to the VA loan program and supporting lending institutions. In 2013, the National Association of Realtors (NAR) established a realtor certification program, called the Military Relocation Professional (MRP), to educate realtors in how to best work with military families and their potential benefits, such as the VA program.

Lending institutions supply the VA loan program to potential borrowers. The VA currently has 1,500 lending institutions, including federal savings banks, national banks, farm credit system institutions, state banks, private banks, insurance companies and credit unions, that are allowed to close VA loans.

The VA Model

Under the VA model, the flow of credit to low- and moderate-income borrowers is enhanced through the secondary market. By acting as the guarantor, the VA offers zero-percent-down home loans that would ordinarily not qualify for the secondary market without the borrower purchasing private mortgage insurance (PMI). Mortgage insurance can quickly diminish affordability, as credit score and loan-to-value ratios are often used to calculate risk-based pricing. Additionally, the requirement of a down payment can often price a borrower out of the loan.

The VA used to approve every loan made under the

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program guidelines. However, due to the necessity to meet demand and close loans faster, the VA established lender standards for approvals of delivering loans automatically. Today, 99 percent of lenders are considered “authorized lenders.” Lenders pay participation fees to the VA to help defray the costs of administering the program, including an annual agent renewal fee of $100 and a processing request fee of $100.  

Once an authorized lender receives a Loan Guaranty Certificate (LGC), the VA guarantees up to 25 percent of the maximum loan limit for that borrower (but will cover a higher percentage for loans under the maximum limit). The VA does not set a maximum amount that an eligible veteran may borrow through the program, but loan limits must be used to calculate the VA’s maximum guaranty amount. VA loan limits are based off of median home values estimated by the Federal Housing Administration. The maximum guaranty amount (available for loans over $144,000) is 25 percent of the 2014 VA loan limit.  

Lender partners service loans on behalf of the VA according to its published servicing guidelines. Servicers are encouraged to work on behalf of the veteran in case of a hardship.

Who the VA Targets

Because the VA loan program has stipulations on borrower eligibility, program participants are limited to veterans, active duty service members and surviving spouses of a service member. After a certain period of service, some reservists and National Guard members may also be eligible for VA loans. More specifically, the program targets eligible borrowers interested in a loan for home buying, home repairs or refinancing.

Demographically, the population of qualified borrowers for the VA program reflects that of the military. In a comparison of origination years 2005 with 2012, the demographic makeup of the VA borrowers is represented in Table 1.

Geographically, five states drove 38 percent of the VA’s loan volume in 2012. Those states are California, Florida, North Carolina, Texas and Virginia, each of which has at least 15 military bases.

Product

The VA loan program offers the opportunity of homeownership to veterans and service members across a range of incomes. The option for financing the entirety of the loan amount provides credit access to eligible borrowers of low and moderate incomes. The program is directed to borrowers who will personally occupy the home.

All VA loans must be amortized if the maturation date is more than five years after the date of origination, and the maximum maturity for amortized loans is 30 years. Interest rates are settled upon by the lender and the borrower and are not mandated by the VA (although the VA does require re-underwriting for interest rate increases greater than one percent).  

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2. Other fees may include $200 annual recertification fee and $500 application processing fee if the lender is considered non-supervised. Lender’s Handbook, VA Pamphlet 26-7. Chapter 1. http://www.benefits.va.gov/WARMS/pam26_7.asp


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### Table 1: VA Loan Program Borrower Statistics, Years 2005 and 2012

<table>
<thead>
<tr>
<th>Loans Originated</th>
<th>% White</th>
<th>% African American</th>
<th>% Hispanic</th>
<th>Median Income</th>
<th>Median Loan Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005 143,265</td>
<td>70.2</td>
<td>14.1</td>
<td>7.7</td>
<td>$57,000</td>
<td>$150,000</td>
</tr>
<tr>
<td>2012 551,859</td>
<td>70.9</td>
<td>9.6</td>
<td>8.2</td>
<td>$74,000</td>
<td>$200,000</td>
</tr>
</tbody>
</table>

Source: Home Mortgage Disclosure Act data on home purchase loans and refinance loans
Unlike FHA, the VA does not charge an annual fee to the borrower for guarantying the loan. However, the VA does charge an initial funding fee of 2.15 percent to those using the program for the first time. The funding fee can be financed into the loan – allowing financing of up to 102.15 percent of the sales price.5

In order to qualify for a VA loan, borrowers must pass a residual income test. This underwriting requirement is one of the most lauded components of the VA loan program. The guideline requires that the borrower have sufficient excess income to cover the costs of unanticipated expenses that might cause the borrower to default. The Urban Institute believes “the residual income test can have applicability beyond the VA market…Residual income may also have applicability on the regulatory front.”6 However, it should be noted that the residual income test is a limiting factor for low-income borrowers to qualify for a VA loan.

In the aftermath of the housing crisis, the majority of VA loans have been refinance loans as opposed to home-purchase loans. Refinance loans dominated both VA loan production and the general loan market in 2012.6 In a comparison of years 2005 and 2012, the VA increased production by 285 percent.

Performance

It is the benefits of the VA loan product and the components of its model that have made the program experience not only a large growth rate, but also an excellent overall performance.7 In July 2014, the Urban Institute published a study of VA loan performance compared to FHA loan performance.8

The study utilized a comprehensive analysis on performance (combining Corelogic Data with HMDA data), controlling for different loan characteristics (i.e. FICO and income) to compare the VA and FHA programs. They found that the VA program had considerably lower default rates than the FHA program, even when controlling for income, credit and mortgage burden. They also found that geography did not impact loan performance.6

The Mortgage Bankers Association publishes National Delinquency Survey data, which shows “seriously delinquent loans.” These loans include 90+ days late or loans in the process of foreclosure as a share of all loans being serviced. Chart 2 shows how the VA has performed over time compared to different loan programs.

The majority of VA loans produced in the post-crisis period have been refinance loans.

![Chart 1: VA Loans by Product and Origination Year](chart1)

Source: Urban Institute

VA loans perform consistently than better than FHA loans and have delinquency rates similar to that of conventional prime loans.

![Chart 2: Seriously Delinquent Rate by Loan Product](chart2)

Source: Mortgage Bankers Association National Delinquency Survey Data

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5 The funding fee is waived for veterans who receive disability compensation. Also the funding fee increases for subsequent uses of the VA loan.

products; most notably, VA loans have tracked close to conventional prime loans and even below the rate for prime loans through the worst of the crisis.

The residual income test underwriting guideline is the critical factor that the Urban Institute believes to be impacting the performance of the VA program. Ensuring that borrowers have excess money on hand to pay for unanticipated events can protect a borrower from entering into a mortgage for which they might not be successful if an event occurs.\(^6\)

Another significant difference between the VA model and other mortgage programs is the appraisal. Despite issues raised by lenders, the VA requires that their agency’s process for ordering appraisals be used as opposed to a lender’s internal appraisal system. The VA remains firm that their appraisal process is one of the mechanisms that protected the VA performance during the mortgage crisis.

In addition, the Urban Institute asserts that VA borrowers have higher FICO® scores, income and loan amounts than FHA borrowers. However, when they analyzed mortgage payment to income, VA borrowers, surprisingly, fell more in the heavily burdened category.\(^7\) Even though VA borrowers were more stretched in the mortgage payment to income category, this difference did not affect loan performance.

Implications for the Future

An article from *Inside Mortgage Finance* reported that the “FHA lost more primary market share to private mortgage insurers and the Department of Veterans Affairs during the second quarter of 2014” due to high premium costs and lender overlays.\(^8\)

Continued success for the VA program will be dependent upon how well the agency can work within the confines of their channel partners and promote their perception of being easy to work with and fast to close.

Michael Frueh, director of the VA Home Loan Program, is well aware of historical misperceptions about the VA program. He refers to the old, inefficient VA processes as “my father’s VA.” Since assuming leadership in 2012, Frueh worked hard to poise the VA as a desirable mortgage option. He shortened appraisal turn times by increasing the number of appraisers approved by the VA. In addition, he decreased the number of days to close a VA loan to 38 days, just 10 more than a cash closing.

Frueh has even more improvements in the pipeline. His next task is for the VA to work more efficiently with lender partners by eliminating paper touch points and improving post-loan deficiency rates. His goal is for audits and reviews to be less intrusive and disruptive so that they flow more fluidly with partners’ processes. The VA also wants to employ technology to alleviate government forms and capture HUD 1 data electronically.

Realtors will continue to play an important part in the VA channel by steering potential borrowers to mortgage programs. Outreach and information sharing about improved VA efficiencies and future developments is critical. The VA is very active with realtor groups in providing education on VA lending and is likely to increase its market share as it refines processes and become more nimble.

With these improvements, and more along the way, the VA Home Loan program continues to provide a safe, sound and affordable mortgage loan option to veterans and service members. Furthermore, its laudable underwriting practices, such as the residual income test and appraisal method, have been recognized as mechanisms with market potential for increasing loan performance.

\(^{6}\) Frueh, Mike. Veterans United Network. April 9, 2013. https://www.youtube.com/watch?v=bV1grGbHyAQ


\(^{8}\) Frueh, Mike. Veterans United Network, April 9, 2013. https://www.youtube.com/watch?v=bV1grGbHyAQ
Looking Ahead: Remaking National Housing Policy

Throughout its history, the United States has taken steps to promote the ability to buy a home.

In the aftermath of the Great Depression, Congress created a government-supported mortgage system and introduced the long-term fixed-rate mortgage.

In 1977, the Community Reinvestment Act sought to extend the benefits of homeownership to more lower-income communities. Similarly, in 1992 Congress required a privatized Fannie Mae and its sibling, Freddie Mac, to devote a share of conventional mortgage purchases to underserved borrowers and communities.

The 1990s saw steadily increasing homeownership without any substantial increase in subprime lending, delinquencies or property prices – a sustainable housing market.

In the early 2000s, nontraditional, unregulated mortgage products financed through private-label mortgage-backed securities exploded. Many of these loans moved away from tenets of sustainable financing, with rates, fees and terms that made the loans much riskier.

As subprime and alt-A lending grew more than five-fold and a house price bubble built up, the lower-income homeownership rate only rose another one-tenth of one percentage point higher than in 2001 – before declining.

House prices, however, continued to rise for another two years, fed by speculation in the housing market.

The ensuing collapse of housing values and increase in unemployment has caused default rates to increase. But by using traditional mortgage products and processes, many of the programs lending to lower-income households have performed substantially better than market subprime loans.

Successful Mortgage Lending Components

These case studies and the experience of millions of low-income homeowners provide a model on which to build sound, sustainable home lending policy. Key elements include:

- **Sound mortgage products** – Thirty-year fixed-rate mortgages with fair terms as the gold standard.
- **Sensible underwriting and servicing** – Lenders who carefully underwrite loans to ensure borrowers can repay them and who proactively work with distressed borrowers to keep them in their homes, when possible.
- **Access to credit** – A strong secondary market for affordable mortgages that replenish the supply of capital, allowing banks to make more, traditional, fixed-rate loans to low-wealth families.

Restoring a sound housing market and economy will require rebuilding a U.S. housing finance system that extends mortgage credit as broadly as possible while minimizing risk.
Regaining the Dream: Case Studies in Sustainable Low-Income Mortgage Lending is a project of the UNC Center for Community Capital, with Ford Foundation funding, to document successful home loan programs that expand homeownership opportunity to low- and moderate-income people.

The UNC Center for Community Capital is the leading center for research and policy analysis on the transformative power of capital on households and communities in the United States.

The center’s in-depth analyses help policymakers, advocates and the private sector find sustainable ways to expand economic opportunity to more people, more effectively.

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