Community Finance Brief

Crossing the Threshold for Homeownership with the Bond Market

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Homeownership is the embodiment of many things in the United States. A status symbol. The American Dream. A pathway to a better future. It is also America's preeminent path to the middle class, a route to generational wealth creation that has increasingly become a fault line of America's income inequality and racial barriers (see **Quick Takes**, right).

There is a preponderance of data that supports the positive outcomes for individuals and families that own a home in this country. Improved educational avenues, healthier lifestyles, overall happiness and a commitment to a community wherein one resides covers a broad swath of the research on this topic. Given the positive externalities of homeownership and the problems to owning under the current system, there has been a spring of new ideas on how to address housing in the country in recent years, especially in the wake of federal legislation that, among other things, looks to modernize housing and make it more affordable nationwide (specifically look at Downpayment Toward Equity Act of 2023 that was part of Build Back Better).

Yet, many of these ideas work within the same paradigm that has existed since the modern housing market began in the wake of the Great Depression in this country or are rendered useful only for publicly-sponsored programs.

Housing finance in the United States is robust: it is transparent, accessible, has depth, is liquid, open to innovation and has high hurdles in terms of consumer protection measures. Yet, the data is clear that this system does not necessarily work for low- and moderate-income (LMI) families in many cases. LMI ownership stands at 25.4% compared to 73.2% for high-income homes, while Black Americans' ownership sits at 45.0% compared to 73.7% for White people in this country.

Quick Takes

Less than half of Americans owned their homes at the start of 20th century while upwards of 65% currently do
– U.S. Census Bureau

Just under half of Americans said affordable housing was a major problem in their local community in 2021, up from 39% in 2018 with 70% saying young adults are having a harder time owing homes compared to the previous generation
– Pew Research

As of 2Q2022, homeownership for White households was 74% compared to 45% Black ones and 48% for the Hispanic population.
– U.S. Census Bureau, St Louis Fed

Between 2010 and 2020 housing wealth increased by $8.2 trillion with 71% of those gains going towards high-income earners, 26% to middle-income and 4% to low-income households
– National Association of Realtors

There were about $40 billion in affordable housing muni bonds issued in 2023
– Arizent

Hurdles to homeownership are extensive and representative of the larger obstacles to true equity in modern American society. For homeownership in particular the three key challenges are down payment, credit and affordability.

With this in mind, it is time to offer a new paradigm that can increase liquidity and capital availability to those who need it most while minimizing friction within the current mortgage industry. A proposition for change would be to marry the explosive growth in impact investing within the existing securitization model through scaleable mortgage assistance programs (MAP). A thoughtful secondary mortgage and/or down payment assistance tool for LMI families offers a new solution.

Impact investing has grown significantly this century, with the Global Impact Investing Network putting the U.S. market for 'impact' at $1.1 trillion in 2022 compared to $8.0 billion in 2007. The fastest growing trends in impact *are racial and gender equity, community development and affordable housing*, according to the same report.

The way in which debt markets have evolved is that they efficiently allocate capital at the systemic-level but access to credit at the micro (consumer) level remains anchored in a risk model that does not reflect the heterogeneity of the modern potential homeowner in America. The initial reaction from a risk profile would be to balk at second mortgages but there are pilots that are now illustrating a different picture, highlighting barriers breached and offering a new solution to helping LMI families access homeownership and potentially a path towards financial stability. These are now being seen more and more as a complimentary financial product to overcome many of these barriers.

"On housing, we must trust Americans with the responsibility of homeownership and empower them to weather turbulent times in the housing market," stated President **George W. Bush** at the 2008 State of the Union Address. "My administration brought together the HOPE NOW alliance, which is helping many struggling homeowners avoid foreclosure. And Congress can help even more. Tonight I ask you to pass legislation to reform Fannie Mae and Freddie Mac, modernize the Federal Housing Administration, and allow state housing agencies to issue tax-free bonds to help homeowners refinance their mortgages.

A November 2022 report by Freddie Mac pointed to 3.4 million Black Americans as "mortgage ready" based on credit history and income. A December 2023 update by the National Fair Housing Alliance to the same report pegged that figure at 1 million based on rate movement in the interim period. Meantime, Black home loan applicants in the 50 largest U.S. metropolitan markets are 1.6 times more likely to be denied than the overall population (LendingTree). This is a problem that cannot wait.

WHY HOUSING MATTERS

Homeownership plays a significant role in bridging income inequality in the U.S. In sum:

- Wealth creation: Homeownership is a primary way for people to accumulate wealth over time. As home values typically appreciate, homeowners build equity in their property, which can be used for retirement, education, or other financial goals. This wealth creation can significantly help close the wealth gap between different income groups.
- Stability and security: Owning a home provides a sense of stability and security, especially compared to renting. Homeowners are not subject to rent increases or landlords' decisions to sell the property. This stability can be particularly important for low-income families who may struggle to find affordable housing.
- Investment and tax benefits: Mortgage interest payments and property taxes can be partially deducted on federal income taxes, reducing homeowners' tax burden. Additionally, homeownership can be seen as an investment in one's future, potentially generating passive income through rental properties or appreciation in value.
- Community engagement: Homeownership can foster a sense of belonging and community engagement. Homeowners are more likely to be involved in local activities and contribute to the social fabric of their neighborhoods. This can be especially beneficial in low-income communities where residents may feel disconnected or marginalized.

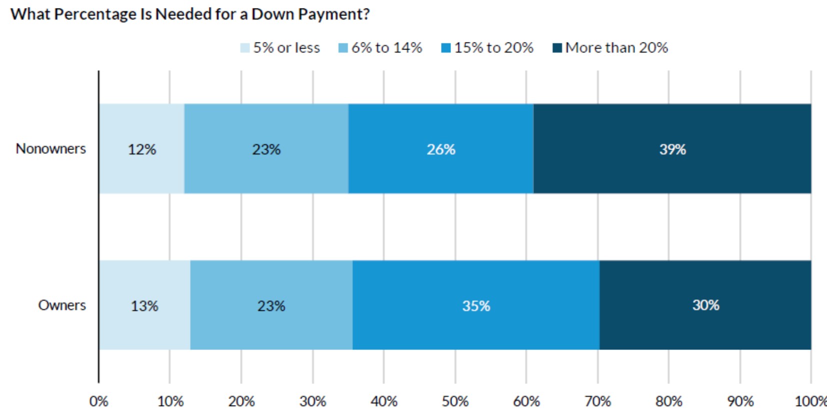
Viewing homeownership through the lens of social infrastructure shifts the paradigm. The future value of owning a home for a community and the people that live in that home is a seed that communities looking holistically at equity cannot do without and makes a compelling impact investment thesis.

"The CommonWealth Builder Program is a key component of MassHousing's broader efforts to promote sustainable homeownership across Massachusetts," said MassHousing Board Chair **Jeanne Pinado.** "By encouraging homeownership production in underserved neighborhoods, and creating new mortgage solutions for first-time homebuyers, we are investing in communities, and creating new opportunities for generational wealth creation."

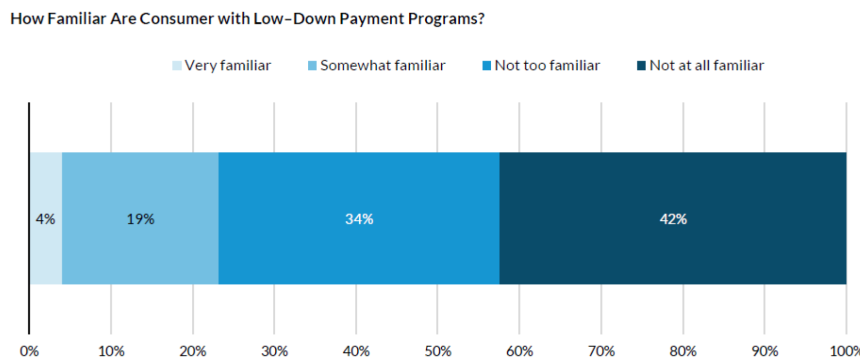
Read how municipal bonds support affordable housing in Massachusetts **here**.

BARRIERS TO ENTRY

The headline in this country currently is the high cost of homeownership, largely the result of a supply/demand imbalance coupled with increasing interest rates. Yet, the statistics show that homeownership is only just below its peak. The real concern by many is *who* is buying homes. It is largely concentrated in the middle- to upper-class segments of income ranges and with White- and Asian-Americans.



Sources: National Association of Realtors and the Urban Institute.



Sources: 2015 Fannie Mae American Housing Survey and the Urban Institute.

If we move past the headline and focus on LMI and/or minority potential homeowners, the issue is that of liquidity. While the 80/20 split of down payment is not as hard as it used to be (**see figure**, left), the numbers around the cost of homeownership versus median incomes in communities around the country simplify the problem.

To illustrate the challenges: in the District of Columbia, the median home price was $657,000 in June of 2021 while the average household income was $139,500. The average White household income was $150,380 while the average Black household was $67,850.

Even when D.C. homebuyers can come to the table with a Federal Housing Agency (FHA) loan requiring only 3.5% down, a median family spends more than 40% of its income on paying their mortgage. Most D.C. homebuyers access a mortgage through a conventional loan (83.3%) meaning their rates are lower than that of a FHA.

There are limited instances wherein these figures allow for homeownership unless there is a generational pass down of wealth (one-third of first-time homebuyer receive assistance from family on the down payment). This is where MAPs have come into play. To recall, a MAP is any number of programs that support people in owning or keeping homes through a variety of financial tools, usually helping those undergoing financial hardship. **CSG** breaks them down into the following financial support mechanisms:

- **Low-Interest Loans**: Down payment assistance may be offered in the form of low-interest or forgivable loans. These loans have more favorable terms than traditional loans, and in some cases, a portion or the entire loan amount may be forgiven over time, provided the homebuyer meets certain conditions, such as staying in the home for a specified period.

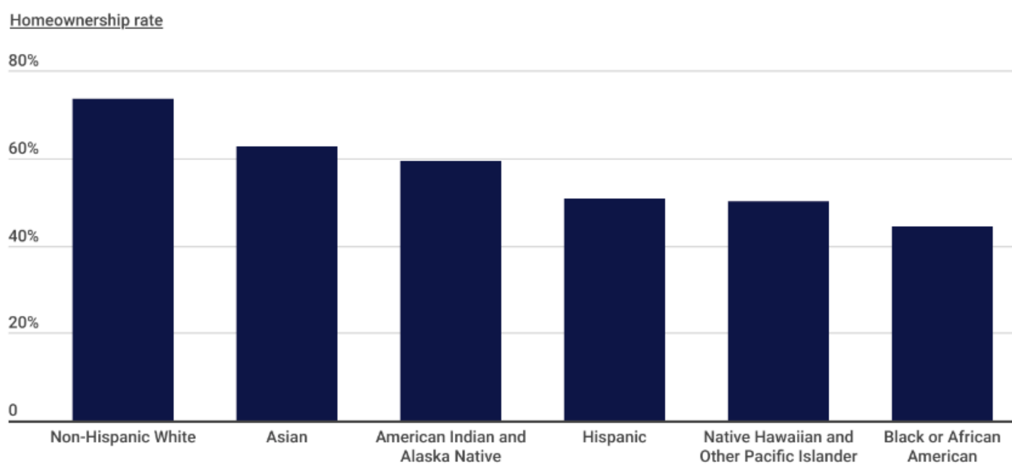
- **Employer Assistance Programs**: Some employers offer down payment assistance as part of their benefits package to help employees become homeowners. This can be in the form of grants, loans, or other financial incentives.
- **Government Programs**: Various federal, state, and local government agencies administer down payment assistance programs to promote homeownership. These programs may be targeted at specific groups, such as first-time homebuyers, low-income individuals, or those purchasing homes in designated revitalization areas. Federal legislation under the Biden Administration has increased the volume of these incentives.
- **Nonprofit Organizations**: Many non-profit organizations work to make homeownership more accessible by providing down payment assistance (sometimes in the form of grants). These organizations may collaborate with government entities or operate independently to offer financial support to qualified homebuyers.

In the for-profit space, there are newer models of shared appreciation that provide upfront capital in exchange for a percentage of a property's value or there are accessible first-trust mortgage programs that lower the down payment and the credit needed to qualify but generally charge more per-month or have other additional fees.

This is the crux of the issue at hand - the private industry that can help LMI families own homes, either charge extra premiums onto the transactions that grow mortgage payment as a percent of household income to dangerous levels, takes out some of the equity in the home through shared programs, or the public housing authorities that do it are slow and extremely inefficient in addressing the problems in their communities.

THINKING OUTSIDE THE BOX

Fair private solutions to support primary mortgages are scarce. This has largely fallen to public MAPs or been cost prohibitive as these are secondary indentures that are inherently more risky and thus expensive. According to the U.S. Census Bureau, in 2021 about 12% of all homes in the United States had a second mortgage or a home equity loan on top of the initial mortgage. That is a drop from around 20% in 2010.



The vast majority of these are privately offered and in the wake of 2008, they were viewed as a financing tool that allowed for real estate speculation but there are now those who are looking at the tool as a way to support LMI families. Many public housing authorities offer support for LMI and offer auxiliary loans that are essentially a secondary mortgage, but they are hard to come by.

The second-lien privately-offered marketplace in its currently limited form come by way of a home equity line of credit, which is primarily a bank portfolio product and require a very high credit score, or a closed-end second lien (popular during the housing bubble but largely disappeared in the last 15-years due to tight credit). As for closed-end second liens, between January and August of 2022, a mere $53 billion were originated, per Equifax, which was a 50% increase from 2021. Of these, 15% of the originations had credit scores above 780, making them more accessible to a wider audience but to-date, remain on the sidelines of the broader mortgage marketplace.

Now, there are some organizations that are looking at ways to expand on the secondary mortgage as an effective way to cross the liquidity threshold for many potential homeowners. Mission-driven City First Enterprises have been leading the way in this space for years.

CITY FIRST ENTERPRISES: A CASE STUDY

Launched in 2023, a new initiative, "Homes by CFE" is City First Enterprises' down payment assistance program (DPA) aimed at closing the homeownership gap for Black and Latino households in the Washington, DC and Baltimore metropolitan areas. The program's main features are:

- Up to a maximum of 20% of the purchase price in down payment assistance up to a maximum of $100,000.
- For buyers who fall at or below 100% AMI, it provides assistance of 50% of closing costs, up to $10,000. This optional additional assistance is included in the total loan amount and is repaid upon transfer of ownership or refinance. Purchase assistance funds may be used for closing costs or debt repayment.
- The total Loan to Value (LTV) (total of all mortgage loans and all additional assistance financed) must fall below 105% of the purchase price of the property.
- The total balance of the loan is then repaid upon transfer of ownership (sale of property) or refinance with no prepayment penalty.
- The interest rate is determined by the rate set on one's first trust mortgage minus 2%. The current rate floor for the program is 4%. The interest rate charged on DPA Program assistance is evaluated quarterly to ensure affordability to program participants.
- Borrowers receive a 5-year interest deferred period with no required monthly payment. The loan term is 30 years, and the loan is amortized over 25 years.
- The financial product is available only to Black and Latino first time homebuyers under a Special Purpose Credit Program designation, a federal provision permitting a creditor to extend credit to applicants who meet eligibility requirements such as an economically disadvantaged class of persons.

On this small sample size, CFE points to the following trends:

- Average loan is 17% of the property's purchase price;
- Average home is $397,000 and the average loan is $65,000;
- New owners moved an average of 6 miles from their previous address;
- The buyers assets averaged $17,000; and
- 85% of buyers had above 660 FICO scores;

In determining the value of this program from an impact perspective, consider first that the buyer's assets were an average of $17,000. The median average assets of an American homeowner was $396,000 in 2022. Further, these FICO scores are well below the average of 768 as of the 3rd quarter of 2022. In the launching of this financial product, CFE has clearly found a segment of the marketplace that was not being addressed but most importantly, these are the types of LMI families that needed support to cross the threshold to ownership. And finally, the displacement issue, or lack thereof is a key feature to recognize. Relocation of families for affordable housing is a key detriment to many of the positive externalities associated with homeownership. Continuity in communities in spite of challenges to homeownership should be elevated as a focal point for this issue.

CFE is not alone in this space. There are public agencies such as MassHousing (**see quote**, above) that are engaging more on the DPA process and as part of Build Back Better, there are numerous public agencies (Maine, Rhode Island, Colorado, New Jersey to name some). Other non-government mission driven entities such as Self-Help or Homewise are also engaging in similar activity with a focus on secondary liens to a targeted LMI population.

The increased presence of Community Development Finance Institutions (CDFI) because of the Inflation Reduction Act and other mission-driven approaches to closing the homeownership gap are making noise, albeit on the sidelines. The CFE experience demonstrates that with the proper diligence, the liquidity issue is attended to with down payment assistance, the credit profiles are reviewed beyond the headline number and the affordability of a home is addressed with terms that are reasonable.

Still, programs such as these are unable to scale because the market has yet to develop a securitization process to grow them. Pooling secondary mortgages is not traditionally what a bank portfolio will maintain. As such, we will explore the potential role impact investors could have in such a security that could properly attach data to monitor and evaluated investments over time so as to quantify just how impactful these mortgages could be to communities. The work of MassHousing and other state housing agencies in issuance of municipal bonds (of which some have green or sustainable labels to them) is just the tip of the iceberg when it comes to the future of community finance.

Part two will be published next week.