The Continuing Importance of Homeownership: *Evidence from the Community Advantage Program*

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Home equity forms the bulk of low- and moderate-income (LMI) homeowners' financial portfolios, making up 62 percent of the net worth of the average American family in the lowest income quintile while composing 44 percent of the net worth of the average family in the top income quintile.[1] For LMI families, the home might be the primary - or only - opportunity to build wealth, create retirement security, and pass an inheritance onward.

Of course, these outcomes are only possible if LMI families are able to hold on to their homes. Before the mortgage finance crisis, borrowers obtained mortgages from local institutions with which they had an ongoing relationship. The loans were carefully underwritten with a focus on borrowers' ability to repay, and they were issued for long-term affordability. The development of the 30-year, self-amortizing, fixed-rate mortgage is what made homeownership a cornerstone of the American dream: the predictable payments and the gradual paying down of both interest and principal made homeownership accessible to a new pool of Americans.

In the mortgage finance crisis, this stable approach to lending got turned on its head: mortgages with interest rates that exploded beyond affordability, interest-only mortgages, and option adjustable-rate mortgages left borrowers reeling under more debt than they could afford.

The results were disastrous. Access to credit constricted as the economy went into freefall, default rates soared, and the US housing market is only just beginning to work through the resulting foreclosure crisis.

Unfortunately, these issues have affected lower-income and minority households and communities disproportionately. While the majority of seriously delinquent home loans are held by white borrowers, minority borrowers are more than twice as likely as whites to lose their homes in the foreclosure process.[2] One study estimates that some $1.95 trillion in property value "has been lost or will be lost by residents who live in close proximity to foreclosures" and that communities of color will experience more than half of this loss.[3]

The losses associated with the mortgage finance crisis have left some questioning the efficacy of lending to LMI borrowers. However, one program, Self-Help's Community Advantage Program (CAP), provides clear evidence that LMI borrowers can enter into and sustain homeownership.

CAP is an affordable-loan secondary market program that was created in 1998 in a partnership between Self-Help, Fannie Mae, and the Ford Foundation. The loans in the CAP portfolio are purchase money, 30-year, fixed-rate mortgages. These loans were originated not by brokers, but by banks earning Community Reinvestment Act credit for such investments. The vast majority of loans in the CAP portfolio were made to lower-income and minority borrowers.

The CAP portfolio includes over 46,000 home loans, collectively worth more than $4 billion. The median origination loan balance was $79,000 and the median borrower household earns just $30,792. Borrowers put down very little money on these homes: the median loan-to-value ratio for the CAP loans is 97 percent, meaning that over half of CAP's borrowers made a down payment of three percent or less for their houses.

Despite borrower credit profiles that are almost unthinkable today – 88 percent of the borrowers in the CAP portfolio did not meet at least one of three traditional underwriting criteria, including loan-to-value ratios of 90 percent or less, debt-to-income ratios of 38 percent or less, and credit scores of at least 640 – the CAP loans have performed very well. During the fourth quarter of 2009, when subprime loans were experiencing their highest rates of serious delinquency, the CAP portfolio had a delinquency rate of just 9.6 percent. By comparison, in that quarter the rate for subprime adjustable-rate loans was 47.7 percent, for subprime fixed-rate loans it was 22.1 percent, and for prime adjustable-rate loans it was 18.1 percent. At the height of the mortgage delinquency crisis, the only loans outperforming the CAP portfolio were prime fixed-rate loans, with a default rate of 5 percent.

Owners' (N=724) and Renters' (N=509)* Median Net Worth 2012, by Net Worth in 2005

	Owners	Renters
<$0	$38,145	$266
$0-$10,000	$40,861	$1,331
$10,000-$20,000	$37,532	$8,777
$20,000-$30,000	$64,344	$15,246
>$30,000	$84,426	$16,089

**The owners and renters in this table are those whose tenure status has not changed since the CAP panel study began.*

Even more compelling than the performance of these loans, however, is the equity gains these borrowers have enjoyed. From origination through the first quarter of 2014, CAP's owners have seen a median annualized return on their equity of 21 percent; which has led to a median equity gain of $21,727. This return has exceeded the annualized growth rate of the Dow Jones Index (3.2 percent) and the 10-year T-bill (5.2 percent) during the same time. Analysis of the CAP portfolio suggests that home equity is a major driver of wealth gains for LMI people: when changes to the pre-crisis portfolios of comparable owners and renters are examined, researchers find that CAP's owners gained an average of $11,000 in net worth up to 2008, while renters' net worth increased an average of $742.[4]

An examination of how CAP participants have fared through the economic crisis suggests that the home might actually act as a buffer against financial loss during difficult economic times. When CAP's original owners and renters are matched by net worth in 2005 and their wealth is compared in 2012, it is clear that renters' median wealth levels having fallen far below those held by the owners.[5] For example, the group of owners who had net worth between $20,000 and $30,000 in 2005 saw their median net worth grow to over $64,000, while the group of renters with comparable net worth in 2005 saw their median net worth decline to just over $15,000.

While some have argued that the home imposes an opportunity cost on the investment choices of LMI families, preventing them from investing in other asset types, our research on the borrowers in the CAP study suggests that this is not the case. Descriptive analysis of the 2012 CAP data shows that the owners in the study hold a greater variety of investments than the renters do. For example, 24 percent of CAP's LMI owners hold stocks, bonds, or mutual funds, while only 11 percent of renter households do so, and while only 36 percent of CAP's renters have retirement accounts, over 66 percent of the owners do. An examination of these data also reveals that the median levels of owners' investments are higher than those held by the renters. Multivariate analysis of the CAP data has shown that affordable homeownership can act as a strong forced-savings tool for the families in the study, and has revealed little evidence that either alternative investments and/or savings are reduced as a result of this equity accumulation.[6]

For homeownership to work as an asset-building tool for LMI families, it must be both affordable and sustainable. Affordability and sustainability result from mortgage design and careful underwriting. The CAP portfolio suggests that the best way to ensure the wealth-building effects of homeownership for LMI families is a return to the common-sense practices of the past: the issuance of carefully underwritten 30-year, fixed-rate, self-amortizing loans that allow borrowers to remain in their homes and enjoy the returns associated with their investment. CI

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