Don't Mandate Large Down Payments on Home Loans

Proposal Would Harm the Economy, Housing Market, and Middle-Class Families

CRL Brief *2-25-11*

Recent proposals call for requiring prospective homeowners to make a 10-20 percent down payment when purchasing a home. This is seen—mistakenly—as "getting back to the way mortgages used to be made." In fact, low down payment home loans[1] have been a significant and safe part of the mortgage finance system for decades, bearing little resemblance to subprime and other alternative mortgage products that crashed our economy. And responsible low down payment loans are also a key to the recovery of our nation's housing market and economy.

A few key points:

- Between 1990 and 2009, more than 27 million mortgages were made with low down payments. These loans did NOT carry the risky features found in subprime loans.
- Increasing down payment requirements would materially shrink the mortgage market with little increase in loan performance.
- Based on average home prices, it would take 14 years for the typical American family to save enough money for a 20% down payment.
- Homeownership remains a key driver of personal and national economic prosperity, and will be fostered by responsible low down payment loans.

Low down payment is NOT subprime

The desire to "get back to basics" is a response to the excesses of the mortgage market in the mid-2000s, especially ruinous subprime lending. However, there are major differences between a typical low down payment loan and the average subprime loan made during that period.

Comparison of Typical Loan Terms and Underwriting Standards	
Low Down Payment Loan	**Subprime Loan**
Fixed rate loan or 7/1 adjustable rate loan (initial payment stays same for first seven years)	2/28 ARM loan – payment adjusted after 2 years and then every 6 months
Documented borrower income and assets	"Stated" (undocumented) income and assets
Assessment of borrower ability to repay the loan	No evaluation of borrower ability to repay
Total debt allowed up to 41% of annual income	Debt allowed as high as 80%+ of annual income
Monthly payments included taxes and insurance	Monthly payments excluded escrows for taxes and insurance
Complete property appraisals	Incomplete appraisals, often with inflated property values
No second-lien mortgage	"Piggyback" second mortgage on top of first lien

Subprime loans' risky loan terms and weak underwriting standards have resulted in record default rates. In contrast, research has shown that significant reductions in default rates are achieved by full underwriting documentation and reasonable debt-to-income ratios.[2] This suggests that **mortgage loan performance will improve under new origination standards in the Dodd-Frank Act without having to add on additional higher down payment requirements.**

Low down payment loans have been originated safely for decades.

Low downpayment loans have been originated for over 50 years, but they expanded in volume with the growth of the secondary mortgage market in the 1980s. **Over 27 million low downpayment loans were made between 1990 and 2009** (excluding FHA/VA loans).[3] This represents almost one-quarter of the loans purchased by Fannie Mae and Freddie Mac and 13 percent of total mortgage originations during this period.

Because of these low downpayment loans, millions of low-to-moderate income families became successful homeowners. Mortgages generally performed well, producing limited losses for lenders, investors and taxpayers, while expanding the middle class.

Research shows that mandatory down payments will materially shrink the mortgage finance market, with only minimal improvement in loan performance:[4]

Impact of Increasing Down Payment Requirements from 5% to 10%:							
Origination Year	2002	2003	2004	2005	2006	2007	2008
Improvement in % of non-performing loans (90+ days delinquent & defaults)	0.2%	0.1%	0.3%	0.3%	0.2%	0.5%	0.2%
% of Market Lost	7.6%	6.6%	9.0%	8.4%	10.9%	14.7%	8.4%

Limiting low down payment loans will close the door to homeownership for middle-class families

In 2009, the median sales price of a single-family home was $172,100. Even with a substantial savings commitment ($3,000 per year), it would take a family 14 years to accumulate the cash needed for a 20% down payment.[5]

	20% Downpayment	10% Downpayment	5% Downpayment
Sales price	$ 172,100	$ 172,100	$ 172,100
Cash required at closing (downpayment + 5% closing costs)	$ 43,025	$ 25,815	17,210
Monthly savings amount	$ 250	$ 250	$ 250
Approx. # years required to build downpayment	**14**	**9**	**6**

While $3,000 in savings per year may not sound significant, it represents a personal savings rate of 7.5% per year for the average middle class family (2009 real median household income in the U.S. was $49,777.) For Latino and African-American households, this would require savings rates of 9.9% and 11.5%, respectively.[6] Currently, the savings rate for U.S. households is 5.8%, one of the highest savings rates since the early 1990s.[7]

Safe, stable growth in homeownership is key to a strong economy and communities

The social benefits of homeownership have been well-documented: these include better educational achievement and civic participation, improved household health, lower crime rates, and more stable communities, among others.[8]

In addition, as a leveraged investment (with even modest appreciation and a built-in savings mechanism), homeownership represents the best way for households to build wealth.[9] This value is especially large for lower and middle-class families: among households earning between $20,000 and $50,000, those who own homes have 19 times the wealth of those who rent.[10] Overall, real estate holdings comprise the greatest share of assets held by U.S. households.

Finally, residential fixed investment (construction and home purchases) are key drivers of our local and national economies. From 2005 to 2009, residential fixed investment dropped 53.7%, reducing GDP by one percent in 2007 and 2008, and 0.7 percent in 2009.[11] Severe as this drop was, it would have been much worse absent the estimated 7.5 million homes purchased or refinanced with low down payment loans during this period.

1 In this analysis, low down payment loans are defined as those with less than 20% down (80% Loan-to-Value) and excluding FHA/VA loans

2 Genworth Financial comments to U.S. Department of the Treasury on *Public Input on Reform of the Housing Finance System*. July 21, 2010.

3 Private mortgage insurance volume as reported by *Inside Mortgage Finance Mortgage Market 2009 Statistical Annual*

4 *Risk Retention and Qualified Residential Mortgage*. Genworth Financial. 2011.

5 Assumes interest paid on savings is offset by increase in home prices.

6 African-American and Latino 2009 household median incomes were $32,584 and $38,039, respectively. Assumes 15% federal tax rate and 5% state tax rate.

7 U. S. Bureau of Economic Analysis.

8 *Social Benefits of Homeownership and Stable Housing.* National Association of Realtors. August 2010

9 Testimony by Janneke Ratcliffe, UNC Center for Community Capital before the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, US House of Representatives, Hearing on *Future of Housing Finance: The Role of Private Mortgage Insurance.* July 29, 2010.

10 *The State of the Nation's Housing 2010*. Joint Center for Housing Studies.

11 Ibid.

About the Center for Responsible Lending

The Center for Responsible Lending (CRL) is a national nonprofit, nonpartisan research and policy organization dedicated to protecting home ownership and family wealth by working to eliminate abusive financial practices. CRL is affiliated with Self-Help, one of the nation's largest community development financial institutions.

For additional information, please visit our website at **www.responsiblelending.org**.