

Putting Home Ownership Back Within Reach

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The subprime lending crisis in the United States has had disastrous implications for families and entire residential communities across the country. Over 7 million families now hold subprime mortgages, and one in five of the subprime mortgages made in 2005-2006 are projected to end in foreclosure. As it now stands, 2.2 million families with a subprime loan made from 1998-2006 have already lost their homes to foreclosure or will in the next few years.

Even more disturbing is the impact on African American and Latino families. Over *half* of all 2006 home purchase loans to African American families in 2006 were subprime, compared to 41 percent for Latinos and 22 percent for white families.¹

Families struggling to live the American Dream through home ownership have fallen prey to the subprime market's high interest rates, excessive fees, and expensive loans. Without serious intervention, the problem will only worsen – and America's most vulnerable families will be the ones hit particularly hard. The share of troubled loans has risen rapidly since 2005 and will most likely continue to grow since defaults take place several years after the loans are made.

The severity of this problem is alarming and calls for immediate action. Many organizations such as the National Urban League are working tirelessly to clean up what has become a devastating mess for minority and low-income communities around the country, and the Initiative on Financial Security at the Aspen Institute (Aspen IFS) applauds these efforts. Furthermore, recent legislation introduced by Senator Christopher Dodd to curb predatory lending practices and protect home owners is an important step in the right direction. Fighting for better disclosure, an end to predatory lending, and fair treatment for those who have defaulted on their loans are all extremely important and worthy causes – especially as millions of families are losing their homes unfairly and struggling to rebuild their lives.

However, as we react to the current crisis and take measures to address it, the focus cannot just be on fixing the subprime market – that is, on addressing the debt side of the ledger; we must build the savings side of the home ownership ledger, as well. And, the current mortgage lending crisis should not be used to call into question the fundamental value of home ownership for all Americans, but instead should serve as a wakeup call to address the underlying issues and promote increased savings.

Savings, Not Just Debt

Given the severity of the subprime mortgage crisis, some might be inclined to back away from promoting home ownership for less affluent households. It is just too risky, they may argue, and very difficult for families to bounce back from the potential fallout.

Such an attitude would be regrettable. Home ownership is a cornerstone of a household's long-term financial security. It epitomizes the American Dream and the opportunity to build better lives for our children. And home equity, as a financial asset, can be a springboard to the acquisition of other important assets like a college education, a small business and a secure retirement

1 Center for Responsible Lending, "A Snapshot of the Subprime Market," Available at <http://www.responsiblelending.org/issues/mortgage/quick-references/a-snapshot-of-the-subprime.html>.

But while home ownership represents an important milestone that helps establish solid membership in the American middle class, it remains largely out of reach for many families. The numbers are astounding and speak for themselves: according to the Joint Center for Housing Studies at Harvard University, more than a 25 percent gap exists between the 2006 home ownership rate for Whites (75.8 percent) and Blacks (48.4 percent), and the data reveal a similarly grim picture for Hispanics and other minorities (49.7 percent for Hispanics, 60.8 percent for Asians and other minorities, and 51.3 percent for all minorities). In fact, Black home ownership actually decreased slightly from 2005 and was exactly the same in 2001, showing no improvement over a five-year period.²

One explanation for the gap in home ownership rates has been the difficulty many have in making a large down payment. – a high hurdle, indeed, especially for low- and moderate-income families. But those households who are able to bring more to the table for a down payment on a home are far better off over the long-term. A down payment is fundamental to a lower interest rate and a more secure mortgage. And savings is the key to a down payment.

IFS Approach to Home Ownership Challenge

Housing advocates have advanced many different approaches to stimulating homeownership. Aspen IFS initially considered three different approaches to the home ownership challenge: (1) encouraging the use of alternative data to improve creditworthiness of consumers with poor, little or no credit history; (2) using tax credits to encourage lenders to provide soft second mortgages; and (3) using a matched, down payment account to encourage savings by low- and moderate-income households. We worked with a 12-member Advisory Board comprised primarily of CEOs and senior executives from the financial services industry to determine which of these three approaches would have the maximum impact and be the most feasible.

After close examination of all three proposals, Aspen IFS concluded that a matched down payment savings account – or Home Accounts – would be the best route to promoting home ownership. Going back to basics and focusing on the down payment may seem to oversimplify the issue when so many other options exist. However, although zero- or low-down payment mortgages eliminate the initial down payment hurdle, they require homebuyers to assume more debt and increase the ultimate costs and risk. Working families would be better served by saving more and borrowing less – which Home Accounts would help facilitate.

Saving over time also gives families a greater ownership stake – both figuratively and literally – in the asset they have sacrificed to own, and it instills a savings mindset that may extend to other important asset goals such as education and retirement.

The Possibility of Savings

The IFS Home Accounts proposal builds on the positive results of years of experiments with Individual Development Accounts (IDAs), which provide matching dollars to reward personal savings toward a home, small business or education. Their success has shown that there is both capacity and interest among working families to save in a more structured way.

The results of the controlled study portion of the American Dream Demonstration, an IDA study funded by the Ford Foundation, the Charles Stewart Mott Foundation and others, show a significant positive impact on home ownership. Among participants – all of whom had an average household income of under \$18,000 – the home ownership rate increased by 14 percent compared to non-participants, with an even greater impact on African

2 Joint Center for Housing, “The State of the Nation’s Housing 2007,” Harvard University, Joint Center for Housing Studies, 2007.

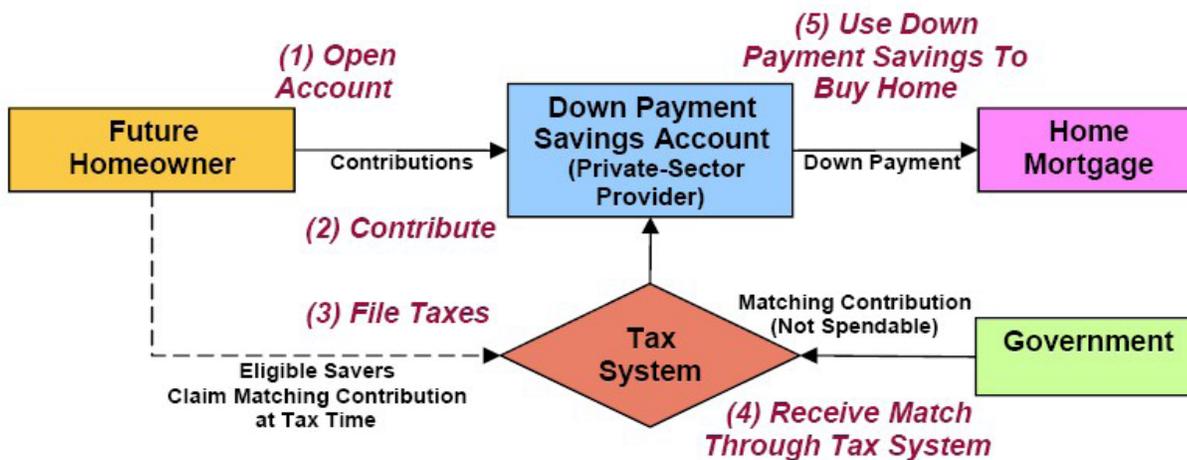
American participants.³ In fact, IDA programs for home ownership have been successful even in high-cost housing markets like San Francisco.

Other research clearly shows that match is a powerful driver of increased savings, even among lower-income families who may find it most difficult to save. H&R Block has tested the impact of matching contributions on saving by low- and moderate-income Americans through its Express IRA. The company found that, when given the right opportunity and incentive, low-income households will save some or all of their tax refunds in an IRA. More customers contributed to the IRA when a higher match was offered, and these customers also tended to have higher savings rates than those offered a lower match (or no match at all).⁴

Basic Features of Home Accounts

Aspen IFS builds on the success of IDAs and other matching programs through its Home Accounts proposal, which would encourage millions of low- and moderate-income Americans to save for a down payment on a home. A Home Account is a simple savings account at a bank or credit union that could be used only for a down payment and closing costs for first-time homebuyers.⁵ Low- and moderate-income savers would be eligible for a 50 percent government match of their own savings, up to a lifetime cumulative cap of \$5000.⁶ If an individual maximized the government match, account funds would reach at least \$15,000. Matching contributions would be delivered through the tax system and deposited directly into accounts. Home Accounts would be FDIC-insured and interest rates paid on these accounts would vary by participating financial institutions.

Down Payment Savings Account Structure



3 Gregory Mills, Rhiannon Patterson and Donna DeMarco. "Evaluation of the American Dream Demonstration: Final Evaluation Report," Abt Associates Inc., 2004.

4 Esther Duflo, William G. Gale, Jeffrey Liebman, Peter Orszag and Emmanuel Saez, "Savings Incentives for Low- and Moderate-Income Families: Evidence from a Field Experiment with H&R Block," The Retirement Security Project, Policy Brief No. 2005-5, May 2005.

5 Penalties apply for withdrawals used for other purposes, but accounts could be converted into retirement accounts.

6 Households earning under \$75,000 per year or single filers earning under \$50,000 would be eligible for matching contributions.

For families struggling to save, Home Accounts are a sensible way to bring the dream of home ownership closer to reality. Making the savings side of the home ownership equation more robust is a smart use of public dollars to help create a pipeline of financially prepared homebuyers. Furthermore, prospective homeowners will have an alternative to zero-down-payment mortgages through a structured and matched savings program.

Account Dynamics – Private Sector Analysis

Home Accounts take the successful IDA experiments one significant step forward by delivering matching contributions directly into a savings account. While these accounts may be modest in size (\$15,000 if the full match is gained), they could represent an important new market of savers for the private sector. And because the Community Reinvestment Act provides credit for lending to underserved communities, it is also possible that an additional CRA credit could be offered to institutions that offer the account.

As part of its original research and analysis, Aspen IFS built a financial model projecting savings and home purchases of prospective homebuyers as well as the market size and government costs for an entire market of down payment savers. Based on conservative assumptions regarding the number of people who would participate as well as the accumulated savings by prospective homebuyers, the model shows that Home Accounts would create at least four million new homeowners over ten years. These modest savings accounts would leverage \$64 billion in mortgages after five years and \$457 billion after ten years, at a cumulative government cost of \$28 billion over a ten-year period.⁷

Home Accounts in the Real World

For a better understanding of how Home Accounts could facilitate savings for a down payment and result in home ownership, it is useful to consider an individual case:

Mary is single, 29-years old, and lives in Jackson, Iowa. She earns about \$28,000 a year (in today's dollars) as a receptionist at a doctor's office, and would like to buy her own home. She opens up a Home Account and contributes \$2,000 each year for five years and earns a \$1,000 match from the federal government each year, too.

After five years, Mary has over \$16,000 in her account – the result of her savings, her interest and \$5,000 of government matching money which she tapped each year at tax time. She uses her entire account to make a down payment and pay closing costs on a house costing \$110,000. Mary gets a 30-year fixed-rate mortgage of 6.125 percent, which gives her monthly mortgage payments of \$571 – even lower than what she had been paying in rent. She now has home equity valued at \$14,000 in her home.

This example illustrates the potential impact of Home Accounts at the individual level. For lower-income, working Americans, these matched savings accounts could make a significant difference in their ability to achieve their home ownership goals with just modest savings over time. And bringing more to the table in the form of a down payment will protect consumers from risky loans and potential default.

Sensible Solutions

Home Accounts embody the Aspen IFS slogan: *Smart solutions for a savings society*. We believe that a sound national savings policy is essential to achieving the American Dream. And the opportunity to save at every point in the life cycle drives the ability to buy a home, to get an education, to start a business – all springboards to financial security and upward mobility.

⁷ Lisa Mensah, Pamela Perun, Elena Chávez and Joseph Valenti, “Savings for Life: A Pathway to Financial Security for All Americans,” Initiative on Financial Security, The Aspen Institute, 2007.

Greater personal saving is not a panacea for all problems, of course, either for individuals or for the economy. It certainly won't solve the immediate problems with the subprime lending crisis and rampant predatory lending practices, especially among low-income and minority communities. But it is clear that helping more Americans save, invest and own must be a major element of any serious effort to build greater household and national prosperity.

That is why Aspen IFS spent over two years bringing together policy experts who had new ideas for savings vehicles and the private firms that must ultimately offer and administer these products. Our work together is summarized in our report, *Savings for Life: A Pathway to Financial Security for All Americans*. Based on several principles that include simplicity, the need for a government match, and private sector delivery, we developed a package of four complementary savings vehicles (including Home Accounts) to significantly improve the savings options for all Americans. After careful scrutiny and analysis, we put forth the following proposals in *Savings for Life*:

- **Child Accounts** to build savings from the beginning of life. All children born in the United States would receive a beginning endowment provided by the government to open an investment account and matching funds on their own savings until age 18. Based on the United Kingdom's Child Trust Fund, this market-based, retail-sold account product would give every child a financial jump start and help build financial literacy.
- **Home Accounts** to be used for a down payment on a home (as discussed in detail above).
- **America's IRA**—standardized, simple Individual Retirement Accounts with a one-time incentive for opening the account as well as government matching funds for low- and moderate-income Americans who do not have access to retirement plans where they work. America's IRA would be similar to existing IRA products and would use existing distribution channels. .
- **Security "Plus" Annuities**—basic life annuities to provide an additional layer of lifetime, guaranteed income as a complement to Social Security. It would partner the familiar and universal Social Security program with the private market. And it would provide many of the 80 million soon-to- retire baby boomers with a simple, low-cost annuity product, provided as part of monthly Social Security benefits, that protects them from outliving their savings.

Conclusion

The current subprime lending crisis has put millions of home owners at risk, and it will require a combination of efforts and expertise from private industry, the federal government and community-based organizations to address the problem, protect families and put our economy back on track. At Aspen IFS, we believe these remedies must be immediate and swift in order to protect the millions of families at risk of foreclosure.

While these efforts are underway, however, we must not lose sight of what home ownership symbolizes for so many families. It is possible for all Americans to strive toward this important, potentially wealth-building goal. Although the current crisis underscores the difficult challenge of promoting home ownership for everyone, we cannot ignore the significant racial gap in current home ownership rates or simply accept the status quo. A truly sustainable solution will require significant political will to push new policies forward. And it will build on families' commitments to provide better lives for future generations and on their willingness to sacrifice for long-term financial security. Proposals like Home Accounts will help make the home ownership goal a reality for these families and put the American Dream back within reach.