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A Message from Jeffrey Chalmers:

"Maybe a great saving option for today's eager Buyers."

Would "Student Loan Mortgages" Solve Homeownership Problems?

In June the National Association of Realtors® (NAR) released a "working paper" from the Rosen Consulting Group and the Fisher Center for Real Estate and Urban Economics, University of California, Berkeley, detailing **several barriers to homeownership**; affordability, post-foreclosure stress disorder, access to mortgages, and student loan debt, among others.

A **second** Rosen Group paper was released last week with suggestions for overcoming these barriers. We made passing reference to it while summarizing NAR's housing forecast for 2018. However, but some of the suggestions contained in *Improving Access to Affordable, Safe and Sustainable Homeownership*, especially those relating directly to affordability and mortgage access, are worth a closer look.

One key factor, relating to both affordability and access, is the difficulty households have **saving for a down payment**. Rents, which increased rapidly even during the recession, and the rising costs in other areas such as healthcare, child care, and transportation, have strained budgets, especially as incomes stagnated. The paper suggests this is likely to get worse, and will continue to prevent millions of eligible households from purchasing a home. They suggest, for starters, a down payment savings program.

Research from the 2017 Nobel laureate Richard Thaler on mental accounting concludes that individuals do not treat their money as one large fungible pool. As such, separating out savings into different accounts can encourage households to save for an explicit purpose; in this case to purchase a home.

The Rosen Groups sees a program, much like 401k or Individual Retirement Accounts that would allow households to save **specifically** for a down payment in a tax-deferred account. Under current rules, money can be withdrawn from the various retirement funds for a home purchase, but with restrictions, such as being permitted once in lifetime, limited in amount, structured as a short-term loan, or permitted only for a first-time home purchase.

National Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	7.09%	+0.07	0.00
15 Yr. Fixed	6.56%	+0.03	0.00
30 Yr. FHA	6.62%	+0.07	0.00
30 Yr. Jumbo	7.35%	+0.04	0.00
5/1 ARM	7.30%	+0.06	0.00
Freddie Mac			
30 Yr. Fixed	7.02%	-0.42	0.00
15 Yr. Fixed	6.28%	-0.48	0.00
Mortgage Bankers Assoc.			
30 Yr. Fixed	7.08%	-0.10	0.63
15 Yr. Fixed	6.61%	+0.01	0.65
30 Yr. FHA	6.89%	-0.03	0.94
30 Yr. Jumbo	7.22%	-0.09	0.58
5/1 ARM	6.56%	-0.04	0.66

Rates as of: 5/17

Recent Housing Data

		Value	Change
Mortgage Apps	May 15	198.1	+0.51%
Building Permits	Mar	1.46M	-3.95%
Housing Starts	Mar	1.32M	-13.15%
New Home Sales	Mar	693K	+4.68%
Pending Home Sales	Feb	75.6	+1.75%
Existing Home Sales	Feb	3.97M	-0.75%

		Value	Change
Builder Confidence	Mar	51	+6.25%

For a program to successfully promote homeownership, the authors say, the **withdrawal limitations** of a separate account parallel to the current retirement vehicles, would need to be significantly reformed. Withdrawals would be taxed, but not interest earnings. They do suggest, however, that a restriction to first-time buyers or returning homeowners should be retained.

Other programs could be coordinated with this effort such as government or local downpayment **assistance**. Employers might be encouraged to match employee contributions,

Another suggestion from the Rosen Group is **graduated payment** mortgages (GPM.) Many would-be homebuyers are in the early stages of their careers, not yet making much money but with the potential to do so. They may not currently be able to afford a mortgage and the current pace of price increases may put them into a situation of perpetually pursuing affordability

In its simplest form, the GPM is a fixed-rate mortgage where payments are slightly lower early in the loan, rising gradually as the loan ages, but on such a schedule to track expected household income and avoid payment shock.

GPMs are **not new**, the FHA offered various versions from 1974 to 2008, and are not the only mortgage product seeking to increase initial affordability. Adjustable-rate mortgages (ARMs), borrower buydowns, and government buydowns seek to do this, but with cost and risk implications the GPMs don't share. Some GPM drawbacks, such increased interest payments over the life of the loan and possibly some negative amortization issues, can be significantly mitigated, the paper says, by how such loans are structured such as by using a payment schedule with smaller increases over a shorter period.

Mortgage insurance is key to the availability of GPMs because they do carry higher default risk. Without it, lenders will tend to concentrate the loans among borrowers to appear to be the most upwardly mobile. those most likely to already qualify for a conventional mortgage. They may use a GPM simply to increase the amount of home they can purchase.

Another innovation is **shared equity** products. This is a homeownership model that allows a household to purchase a house by dividing the equity stake of the home among multiple parties. Several models exist today where households can purchase a home by partnering with an organization or investor. The partner provides a portion of the up-front money to buy, the homeowner shares a portion of the future capital gains when the property is sold. It has principally been non-profit organizations participating in these programs, but market-driven models are beginning to emerge. Shared equity arrangements have had low delinquency and foreclosure rates, and homeowners tend transition to another home at about the same rates as traditional buyers, using their share of sales proceeds to purchase their next home without assistance.

A related model involves buyers purchasing together, either occupying one single-family home or through an investor-like relationship. An example would be co-buying a home with parents or two siblings purchasing a home together.

Several proposals in the paper address the problem of **student loan deb**t, which several recent surveys have identified as delaying homeownership significantly. Perhaps the most immediate help could come through standardizing underwriting guidelines related to that debt. The authors cite income-based repayment (IBR) plans that can be beneficial in some cases but be difficult for other borrowers because lenders find it difficult to calculate debt-to-income ratios.

Providing simplified options for calculating monthly payments, taking into consideration any assistance borrowers may be getting in repaying the debt, and applying guidelines across all mortgage lenders could expand mortgage opportunities to more younger persons and avoid penalizing otherwise qualified borrowers with student debt.

The paper lays out several proposals for increasing usability and benefits from the current allowable student loan interest tax deductions. However, since the bill before Congress at this time would **severely limit** what already exists, we will leave these suggestions for another time.

Perhaps the **most innovative** of the homeownership proposals is for a **student debt mortgage**. As envisioned in the working paper, this would be a product that would consolidate existing student debt into a purchase money mortgage.

The new loan would carry a **slightly higher interest rate** than a traditional mortgage, but probably one lower than that of the student loan. This, combined with spreading the student loan balance over 30 years, would result in a single payment lower than the sum of two separate ones. This would free up cash to allocate to mortgage payments while reducing the debt-to-income ratio. There could also be tax benefits to rolling student loans into mortgages, especially for individuals in higher tax brackets. A mechanism akin to private mortgage insurance would be necessary for at least the uncollateralized (student loan) portion of the new mortgage.

With student debt delinquencies comparatively higher than other debt types, a consolidated mortgage would also likely reduce late payments and improve credit profiles, thereby enhancing the ability of potential homebuyers to qualify for larger mortgages and trade up over the longer term. The policy would be especially effective in supporting younger, first-time homebuyers most burdened by student loans. With the composition of high-debt borrowers shifting to those with less earning potential during the past several years, the policy would also help bring more lower-income buyers into the market.

While this new loan type could make homeownership accessible to a larger number of student debt holders, the authors point to some factors that could **deter** borrowing and **compromise** successful implementation. Federal student loans carry several protections and benefits that would be lost through consolidation. These include flexible payment plans based on income and the ability to defer payments if the borrower is out of work or returns to school. The 30-year lifespan of the mortgage, while partially offset by a lower rate, still increases the total interest paid on the debt.

If the Rosen Group is correct, such a loan is a **real possibility**. They see a lot of potential backers, the most likely being existing mortgage lenders but also recognize the need for a secondary market and probably for some government incentives and guarantees. The existing GSEs or a new agency, working independently or in partnership with a major student loan company, could serve as intermediaries to support a new market for the loans. The authors also see a growing number of fintech companies, some of which are already in the student loan refinancing and consolidation area, as another new source of originations. Some work in this area is already going on; they point to a new provision from Fannie Mae allowing borrowers with sufficient home equity to fold student loans into their home mortgages and another Fannie program, the Student Loan Payoff Refi, operated jointly with SoFi.