POLICY BRIEF

COMMUNITY ADVANTAGE PANEL STUDY

GOOD BUSINESS AND GOOD POLICY:
Finding the Right Ways to Serve the Affordable Mortgage Market

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Center *for* Community Capital
Research and analysis on the transformative power of capital

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The Center for Community Capital at the University of North Carolina at Chapel Hill is the leading center for research and policy analysis on the transformative power of capital on households and communities in the United States.

The Center's in-depth analysis help policymakers, advocates and the private sector find Sustainable ways to expand economic opportunity to more people, more effectively.

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Homeownership is a source of pride and a mark of achievement and satisfaction for many Americans—an important part of the "American Dream." Yet while policy makers and researchers have described ways in which homeownership improves financial and social opportunities, some studies suggest that these benefits are less attainable for households with lower-incomes. For the past several decades, advocates of homeownership have focused on extending homeownership opportunities to lower-income households, and the resulting availability of new mortgage products has created thousands of first time homeowners. Yet further research is necessary to determine the specific lending practices that can create the greatest possible benefits for both the mortgage industry and low- and moderate-income (LMI) homeowners. Such research is particularly important in light of the current mortgage foreclosure crisis, as millions of homeowners have lost or face the possibility of losing their homes due to unsustainable mortgages, and the mortgage industry is suffering as a result.

The Center for Community Capital at the University of North Carolina at Chapel Hill conducts research in order to find a key balance between good business and good policy for the affordable mortgage market. For the past 7 years, the Center has undertaken research on loans made to LMI borrowers through a groundbreaking partnership between Self--Help (a leading Community Development Financial Institution), the Ford Foundation, and Fannie Mae; this partnership is known as "The Community Advantage Program" (CAP). The program grew out of Self-Help's goal of creating a secondary market for affordable mortgage loans, and the Ford Foundation and Fannie Mae have provided the capital and capacity to make Self-Help's vision a reality.

Launched in 1998, CAP had two objectives: to help tens of thousands of low-income households build wealth through homeownership and to show that lending to low-income homeowners presents an acceptable level of risk. By 2003, the program exceeded its initial $2 billion goal, and the participating organizations decided to expand it indefinitely. The commitment of the Ford Foundation, Fannie Mae, and Self-Help presents an unparalleled investment in affordable mortgage lending that has generated substantial positive outcomes for nearly 47,000 homeowners nationwide.

CAP also provides a unique opportunity for evaluating the benefits and costs of affordable mortgage lending for both homeowners and mortgage practitioners. Analysis of CAP's success will enable the industry to determine the best affordable mortgage lending practices. In recognition of this opportunity, the Ford Foundation commissioned the Center for Community Capital to conduct a long-term evaluation of CAP. Two main goals guide this study: First, the Center is tracking data on the entire portfolio of 46,475 loans to evaluate the viability of the LMI market from a business standpoint. Second, the Center is analyzing the effects of homeownership on the households themselves; over a period of seven years, we are conducting in-depth interviews with a panel of homeowners and a comparison panel of renters, matched by location and income. Through analysis of this unique and extensive data set, the Center will provide crucial information about how best to serve the LMI market in a way that is both profitable from a business standpoint and beneficial to the homeowners themselves.

CCC's research aims to produce recommendations for policy and practice that are based on rigorous analysis of data, make good business sense, and enable LMI households to enjoy fully the benefits of homeownership.

Research Design

The Center for Community Capital tracks data on all CAP loans (currently 46,475) to understand the intricate relationship between loan product, borrower and property characteristics, and loan performance. Our database includes origination information and monthly payment records and is supplemented with credit data, updated property values, and census characteristics.

For a unique and in-depth look at homeownership among low- and moderate-income households, the Center also follows a panel of homeowners (initially 3,743[1]) over a seven year period following purchase of a home financed by a CAP loan. We conduct six annual interviews with this panel of CAP borrowers. For purposes of comparison, the Center also tracks a companion panel of renters (initially 1,531) over a similar time period. The renters panel allows us to isolate tenure effects and to closely examine the transition from rental to ownership. Our study's large number of participants and panel design offer a unique opportunity to explore both the performance of CAP loans and the financial and social impacts of homeownership on individual households.

The CAP study is innovative in several ways. First, we have access to a quantity of loan-level mortgage information that is rarely available. Second, ours is the first such dataset focusing specifically on low- and moderate-income homebuyers. In particular, the mortgages were all made as part of Community Reinvestment Act (CRA) or affordable programs, and we expect to generalize our findings to those lending practices. Third, the panel enables us to merge loan performance data with household characteristics, providing both an extensive data set and an in-depth understanding of important household variables. Fourth, our renters' panel serves not only as a comparison group but also as its own informative database. The renters' panel allows us to investigate which renters transition into homeownership, what events play a role in this transition, and how people experience this change. Finally, our surveys are extensive and consistent: each wave of surveys builds on the last, expanding knowledge gained from previous questions and continuing our longitudinal analysis.

What data are we gathering through our panel interviews? Through a series of 45 minute interviews conducted by phone or in-person, we inquire about homeowners' type of employment, family, income, and employment status. The table below shows the various survey modules and the schedule for their administration. In the baseline survey, we collected information about the home purchase experience, and we have followed up with questions about moving, refinancing, and repayment difficulties. In a series of waves, we have asked about money management, decisions to save, and the use of credit. In 2005, and again in 2008 (the most recently completed wave of survey data collection), we conducted in-depth reviews of household assets and liabilities. We also inquire about community participation, parenting, volunteering, and neighborhood satisfaction in order to gain a better understanding of the social impacts of homeownership. Overall, our surveys are providing useful information about what factors can enable homeowners and lenders to work together for their mutual benefit.

PANEL SURVEY MODULES	
All Waves	Demographics, Income, Employment, Intent to Own (renters only), Decision to move (movers only)
2003-only owners	Home purchase experience, Pre-purchase counseling
2004	Social Capital, Parenting
2005	Wealth & Assets, Savings, Intent to own (renters), New mortgages (move & refi only)
2006	Financial Literacy, Savings behavior, Energy Costs, Sense of Community
2007	Repeat 2004 modules, Medical costs, Credit scores
2008	Repeat 2005 modules
2009	Economic Challenges

[1] *As was expected and as is common in panel data collection, we have experienced some panel attrition, particularly among those respondents who are less educated, male, and Hispanic. We have employed retention efforts such as field tracing and incentives, but we do anticipate some attrition bias to persist in subsequent survey years. We are developing non-response and post-stratification weighting to minimize the impact of attrition bias.*

Research supported by the Ford Foundation

CAP and the Mortgage Market

The Center's evaluation of CAP is particularly important in light of trends in the mortgage market. In an industry once characterized as failing to serve lower-income and minority households and, more recently, as flooding that market with unaffordable and poorly designed products, CAP stands out as a success story. CAP has served lower-income borrowers using products that are profitable, effective, and beneficial to new LMI homeowners.

Historically, banks and secondary market investors have been reluctant to provide financing to higher-risk borrowers, and a large population of lower-income and minority households has lacked equal access to mortgage credit. The Community Reinvestment Act (CRA), passed by Congress in 1977, encouraged banks to accommodate a whole new tier of households previously not eligible for conventional, prime home loans. Lenders developed new, one-off mortgage products that allowed thousands of households to obtain mortgages (Quercia, McCarthy, Wachter 2003). However, these mortgages did not conform to the necessary requirements for sale to the government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac, and so they lacked a secondary market outlet. As a result, banks found themselves holding large portfolios of "non-conforming" CRA loans on their books, which often constrained them from being able to offer more of these affordable loans.

In the early 1990's, Self-Help began to recognize the limited options that originators faced in trying to provide affordable mortgages for lower-income households. Self-Help also knew from its own direct lending experience that loans to low-income households performed quite well. In 1994, Self-Help began to purchase non-conforming loans, creating a local secondary market for affordable loans in North Carolina. Yet though Self-Help's nonconforming loan portfolio revealed minimal losses, it lacked the long-term funds necessary to sustain this program on a national scale.

In 1992, Congress established affordable housing goals that required the GSEs to serve lower-income communities more actively (Fannie Mae 2005). In the late 1990s, Fannie Mae made a trillion dollar commitment to expanding lending services to underserved communities. In 1998, these developments brought Self-Help, Fannie Mae, and the Ford Foundation together to create CAP. A generous Ford Foundation grant provided risk capital, while Fannie Mae brought the capacity that allowed Self-Help to expand its impact.

Since the launch of CAP in 1998, mortgage lending guidelines among participants have grown more flexible, expanding possibilities for homeownership. (Quercia, McCarthy, Wachter 2003) Indeed, it would seem the industry has, in many ways, accepted Self-Help's proposition that flexibility in making loans to low-income and minority families is good business. Beginning in 2003 or 2004, however, another important trend emerged in the mortgage industry: the rapid expansion of the sub-prime mortgage market and, along with it, of "predatory lending." The phrase refers to mortgages made under exploitative terms, loans typically based on collateral rather than on the borrower's ability to repay. While innovative mortgage products increase access to credit for LMI borrowers, predatory lending can devastate families and communities and thus needs urgent attention from policy makers (Quercia, Stegman, & Davis, 2004).

CAP has helped thousands of low-to-middle income and minority households build wealth through ***sustainable*** *homeownership.*

In contrast, CAP models how mortgage lending can be extended to and benefit lower-income populations. Our research reveals that, among borrowers with similar credit characteristics, those with subprime loans are three to five times more likely to default than those with CRA-type loans provided through CAP. This finding emphasizes that mortgage features like adjustable interest rates, prepayment penalties, and broker originations are likely to lead borrowers into default, while LMI borrowers with safe products can sustain their mortgages.

During its first 8 years, only 2% of CAP loans were charged off. This period saw strong property appreciation, no doubt contributing to CAP's performance. However, it remains to be seen how these loans fare in the current soft real estate market. We have been collecting CAP data during a time of unprecedented housing appreciation followed by an abrupt and devastating downturn related to unsustainable lending practices. Housing prices and sales peaked in the first quarter of 2006 but have declined ever since. In 2007, mortgage delinquencies began a rapid upward climb, and since the start of 2007 the number of foreclosures has tripled (Center for Responsible Lending 2009). The Ford Foundation has extended CAP analysis in order to asses the impacts of the housing downturn on borrowers and gauge how CAP respondents are dealing with the economic crisis.

A Closer Look at Homeownership

Our study of CAP is helping to clarify the relationship between homeownership and various financial and social outcomes. Prior research has revealed both financial and social benefits to homeownership, and yet certain claims about these benefits remain hotly contested. This is particularly true in the case of LMI households. The financial benefits of owning a home are well known: homeownership has been shown to play a large role in wealth generation and accumulation, an especially significant factor for LMI households since a home might be their only source of wealth. The U.S. Department of Housing and Urban Development (2006) found that lower-income homeowners were as likely as other households to experience the financial gains of homeownership through house appreciation. In addition, research has revealed some of the social benefits of homeownership, such as positive impacts on children, higher satisfaction with one's home and neighborhood, and greater physical and psychological health (HUD 2006). HUD also showed that the children of LMI homeowners are more likely than children of LMI renters to experience social impacts such as greater educational benefits and employment success.

However, other studies have posited that the financial and social benefits of homeownership do not necessarily extend to households of all incomes. McCarthy, Van Zandt, and Rohe (2000; 2001) investigated the economic and social benefits of homeownership across varying income groups. They found that certain benefits are available to households of all incomes, while others, such as homeowner tax benefits, are denied to low-income households under the U.S. housing finance system. The authors conclude that further research needs to be conducted on the conditions under which housing is a good investment, and future research must place an emphasis on the sustainability of homeownership for LMI families.

The Center for Community Capital is addressing this need for further research on the benefits and risks of homeownership for LMI households. Three of our research categories focus specifically on analysis of issues related to potential benefits of homeownership; these issues include Home Equity, Wealth and Assets, Tenure and Mobility Choices, Financial Literacy, and Social Impacts.

The Center is using CAP data to explore the relationship between HOME EQUITY and household wealth. Analysis of CAP panel data has revealed that homes purchased with a CAP loan between 1999 and 2003 appreciated at an average annual rate of 2.3% between the time of purchase and January 2009, more than the Dow Jones Index and the prevailing average rate on a six-month CD. The initial investment by the median CAP panel borrower of $1,947 has grown to $19,681. Gains vary according to length of home tenure and geographic region, but for all borrowers, the median *annual* equity gain has been 39%. Even families with weak credit histories or who were new to the credit system have been able to build significant wealth through homeownership. In addition, families who fell behind in payments and came close to default generally accumulated enough equity for preventative servicing and creative approaches to help them retain their homes. The Center's research thus reveals that sustainable homeownership has proven a solid investment for this low- and moderate-income population.

We are also analyzing the effects of homeownership on the WEALTH AND ASSETS of LMI borrowers. Wealth data gathered in 2005 and 2008 reveals that the median net worth of CAP owners increased from $36,999 in 2005 to $53,983 in 2008. Home equity was a driving force behind this increase; between 2005 and 2008, owners' median home equity rose from $8,025 to $26, 223. Owners' liquid wealth grew from $3,426 in 2005 to $5,100 in 2008. Additionally, a greater percentage of

CAP owners are saving over time. In 2005, 43% of owners reported having saved in the 12 months preceding the survey, while by 2008 this increased to 54%.

However, because household wealth is generally a prerequisite for homeownership, lower-income households might not be able to access this opportunity to build wealth through equity. CAP is an effort to broaden access to homeownership as a means of wealth creation. Through its analysis of CAP data, the Center is helping to determine the exact relationship between homeownership and wealth by attention to several influential factors: the process by which renters become owners, the financial and social outcomes of the decision to move, the effect of homeownership on access to affordable credit, the impact of household debt on wealth and assets, and the intent of households to save and the process through which they do so.

Our research has revealed several trends related to how RENTERS BECOME OWNERS. Through 2008, 18% of our rental panel had transitioned to homeownership. Those renters with the strongest intentions to own were the most likely to purchase a home within a year, suggesting that strong intentions help renters achieve homeownership despite challenges. However, intentions to own were less associated with home purchases for minority renters, and lower-income renters and renters in areas with greater poverty or home appreciation rates were less likely to purchase homes. Thus, even for renters with intentions to own, financial and social forces pose challenging constraints.

In our analysis of DECISIONS TO MOVE, we found that low-income and minority households are less likely to move and more likely to purchase a new rather than lived-in home when they do move. Such results suggest that these households may exhibit stronger attachments to homeownership once it is achieved. Comparing these patterns of tenure and mobility among CAP borrowers to those of the larger population proves challenging. However, our analysis offers a more complex picture of LMI homeowners' experiences by separating tenure choice and mobility as two distinct decisions, rather than coupling the purchase of a new home and the return to renting as "the transition out of homeownership."

The deregulation of financial services has placed increased responsibility on consumers in terms of managing their personal finances. Consumers must enhance their FINANCIAL LITERACY in order to decide how much credit they can afford and to evaluate the terms of different mortgage products. The Center's interviews of CAP borrowers ask a series of questions related to financial literacy; these concern unsolicited offers to refinance mortgages, whether or not borrowers applied for loans from such lenders, and whether or not the offer was accepted. Such data allow us to identify suspected predatory lending and to determine the financial literacy of borrowers and the effects of financial literacy on mortgage loan delinquency and default.

A related issue is borrowers' use of MORTGAGE BROKERS to refinance. Given the central role that mortgage brokers played in the growth of the subprime industry, policy makers are increasingly attentive to the potential for steering by mortgage brokers. Our research suggests that borrowers who refinanced through mortgage brokers were more likely to report both that the refinance was solicited and that the terms changed at closing, as well as lower levels of overall satisfaction with the refinance.

Our research also aims to examine the SOCIAL IMPACTS of homeownership. Researchers have posited that a homeowner's longer tenure in a neighborhood and increased stake in a community's vitality affect neighborhood satisfaction, civic engagement, political participation, sense of community, collective efficacy, and parenting behavior. However, existing research fails to consider self-selectivity bias; it has been unclear whether homeownership increases social benefits or whether people in more satisfying social situations are more likely to purchase homes. Our evaluation of CAP accounts for selectivity bias and examines the processes by which social benefits accompany homeownership. We have found that homeowners in economically disadvantaged neighborhoods are more active in local politics than both renters in similar areas and homeowners in more affluent areas. Further, renters who become homeowners become more likely to join local civic groups. Homeowners also have wider social networks than renters, partially as a result of their increased involvement in civic groups. Finally, we have found that LMI homeowners are more likely than LMI renters to engage in positive parenting practices, experience neighborhood satisfaction, and have greater social capital.

Sustainable Industry Practices

The Center for Community Capital's evaluation of CAP has important implications not only for LMI homeowners or potential homeowners, but also for industry stakeholders. The Center intends to provide hard evidence to lenders, policy makers, and the secondary mortgage market that lower-income borrowers are indeed bankable and profitable. Our analysis of CAP data will offer industry practitioners an in-depth look at the various factors that influence loan performance in the affordable market. Several of our research topics address industry concerns, including Drivers of Default, Trigger Events, Prepayment, Home-ownership Education and Counseling, Loan Servicing, Loss Mitigation, Bankruptcy, and the Changing Role of Community Reinvestment Lending.

From the early stages of our research we have been analyzing DRIVERS OF DEFAULT. We have confirmed that origination credit score, current LTV, and mortgage interest rate relative to market rate are leading predictors of default for CAP borrowers. By introducing panel variables, we are able to identify the role of such factors as emergency assets, unemployment spells, and lack of health insurance. We have consistently found that race is not a significant variable.

Longitudinal panel data collection allows us to explore how certain TRIGGER EVENTS or dramatic changes such as divorce or separation, job loss, reduced income, and unexpected expenses affect the risk of default. We are using CAP data to analyze the impact of such events on loan performance. The Center has found that the experience of trigger events is not uncommon for CAP borrowers. We are developing an option-based model of mortgage delinquency that explores how changes in household characteristics impact the decision to stop payment or to prepay. We merge data on trigger events with loan performance data in order to compare prior repayment history to repayment history after a major event.

Our research adds to evidence that affordable mortgages (in the case of CAP, prime mortgages geared towards LMI households) have slower PREPAYMENT rates than other conventional mortgages. This is particularly true in times of interest rate volatility, when investors are most concerned with the probability of early payment. From an industry perspective, then, affordable mortgages are of value to investors in terms of their diminished prepayment risk. Moreover, we find several specific characteristics of affordable mortgages that affect prepayment speed, including equity, credit score, income and liquid assets, and racial and ethnic attributes of borrowers.

We are also filling gaps in research on preventive servicing and loss mitigation techniques, particularly in the context of sustaining homeownership among lower-income households. The last 15 years have seen a ten-fold increase in funding for HOMEOWNERSHIP EDUCATION AND COUNSELING, from $3.5 million in 1990 to $40 million in 2005 (Hornburg 2004). The Center's research expands the few recent studies on homeownership counseling by examining the effects of different counseling methods on loan performance, as well as the joint impact of pre- and post-purchase counseling. For example, we found that intensive, classroom based homeownership education and counseling programs were effective in improving homeowners' abilities to evaluate mortgage products and terms, as people in these programs were more responsive to the potential benefits and costs of prepayment. Further, new research suggests that pre-purchase homeownership counseling increases the extent to which participants search for and compare alternative mortgage products.

We have found that LOAN SERVICING methods can impact performance. Specifically, after we control for loan and borrower characteristics, the likelihood that a mildly-delinquent borrower will fall further behind varies significantly across servicers. Our findings suggest a need for policy makers to incorporate preventive servicing into affordable homeownership programs.

In examining serious delinquencies, we find that only 29% of CAP loans reaching 90-day delinquency end in foreclosure. In examining the factors and conditions that affect the outcomes of serious delinquencies, we find significant evidence that well-timed, situation-appropriate, intensive LOSS MITIGATION counseling increases the probability of curing a delinquency.

We are also assessing the impact of BANKRUPTCY on CAP homeowners and renters. We know when our respondents file for bankruptcy, and we are investigating whether or not filing for

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Chapter 13 bankruptcy helps prevent foreclosure. We are also exploring the effect of household and exogenous shocks that may precede bankruptcy, state-level effects of bankruptcy, and the impact of bankruptcy on credit scores.

Buttressing all of this research is the finding that loans originated through CAP often substitute for subprime originations. In documenting the CHANGING ROLE OF COMMUNITY REINVESTMENT LENDING, our research suggests that CAP loans have increasingly served as alternatives for subprime originations during the subprime industry's growth. For instance, our estimates imply that, for every 100 CAP loans originated between 2004 and 2006, roughly 67 fewer high-cost loans were originated.

In sum, the Center for Community Capital's research will offer new and crucial insights for mortgage industry stakeholders, including lenders, investors, servicers, and credit enhancers. The Center hopes to document for stakeholders the lending practices that can serve their own best interests while also sustaining and increasing beneficial homeownership opportunities for the LMI market. Our policy and practice recommendations will make good business sense for the mortgage industry. They will also meet the needs of LMI homeowners, who deserve the same benefits that sustainable homeownership offers families of higher incomes.

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