

# Now's The Time



How the Housing Crisis Has  
Created An Unprecedented  
Opportunity for Working  
Families to Achieve Financial  
Security

A Study by Homewise, Inc.

Santa Fe, New Mexico

With the Support of

The McCune Charitable Foundation

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**homewise**<sup>®</sup>

*your partner in homeownership*

*The mission of Homewise is to help working New Mexicans become successful homeowners in order to achieve financial security, strengthen families and increase the economic and social vitality of our communities.*

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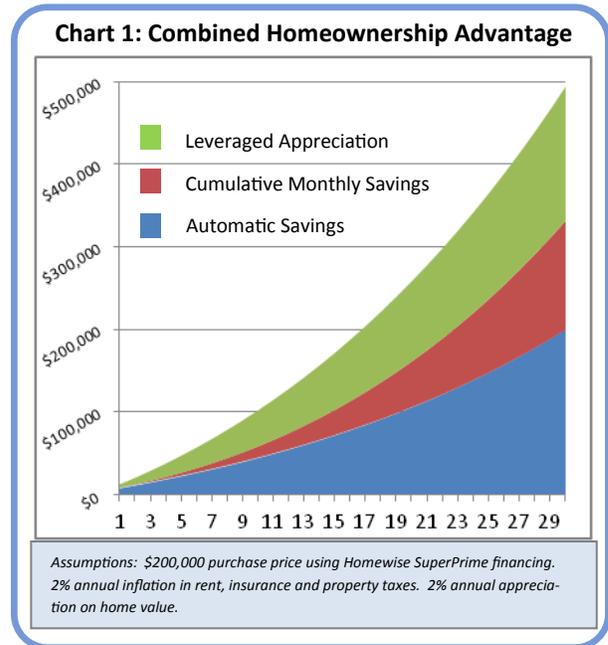
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*Executive Summary*

Fueled by the greatly expanded use of subprime loans, housing prices experienced an extraordinary boom in the past several years, only to be followed by a historic and painful bust. The tumult that has caused prices to drop has also eroded confidence in homeownership, leading many to question whether the average family should buy a home, can buy a home, or even wants to buy a home.

But these unprecedented market conditions, combined with the enduring wealth-building benefits of homeownership, have created an extraordinary opportunity for families to build long term financial security through smart home purchase. Homeownership's financial benefits build on each other to give ownership a significant advantage over renting. Homeowners stabilize their household budgets by locking in their housing payments (typically the biggest monthly expense). They generate automatic savings through equity building, and they create wealth through leveraged appreciation. The typical owner who purchases a \$200,000 home in today's market will amass a homeownership advantage of nearly half a million dollars over 30 years compared to renting.



Today, many more families are able to secure these benefits after being locked out of the market for years, thanks to increased affordability. Home prices have dropped significantly from their peak and interest rates are at a historic low. The result is that the income needed to purchase the median priced home has dropped 39% nationally since the peak, with even greater decreases in some areas of the country. With lower incomes required, more households can afford to buy -- 22.5 million *more* households in the United States compared to 2006. While tightened credit standards (a reaction to the disastrous use of subprime loans) may temper that affordability, hundreds of organizations like Homewise continue to prepare homebuyers to meet mortgage qualification standards and secure effective, responsible financing in order to become strong, successful owners.

The unprecedented opportunity for families to secure their financial futures through homeownership is fleeting and will diminish as interest rates rise and existing inventory is absorbed. With such a moment at hand, we should be hearing calls for a renewed commitment to homeownership. But instead, the confusion has taken its toll on policy makers and the media, who are moving away from policies that support home purchase and casting doubt on the working family's ability to achieve homeownership. In order to take advantage of the present opportunity, it is essential for homeownership organizations to renew their commitment to helping working families purchase their first home prudently, with sound underwriting standards that rewards healthy financial behaviors. The current opportunity will not be with us forever; now is the time to work harder than ever to seize it .

Volatile. Tumultuous. Unpredictable. Turbulent. There is no shortage of dark adjectives to describe the economic conditions of the past several years. Fueled by a greatly expanded use of subprime loans, housing prices experienced an extraordinary boom only to be followed by a historic and painful bust. Graphs showing this trend read more like schematics for a hair-raising roller coaster than an economic analysis. That economic roller coaster has caused many, even longstanding advocates of homeownership, to ask some basic questions: Is homeownership a smart financial choice? Are people able to buy? And even if people can buy, do they want to buy? Such questions are the natural result of a financial collapse that caused economic panic and unprecedented changes in financial and home purchase markets. As we emerge from the crash, the panic has given way to lingering confusion about the appropriateness of homeownership for the average American family. Consider how the national narrative surrounding homeownership has changed in the past few years. As home prices continued up, headlines exalted the housing boom and analysts assured us this was not a bubble ready to burst. Time magazine explained “Why we’re going gaga for real estate” in its Home Sweet Home article.



Just a few years later, the headlines were very different, with calls away from homeownership. The analysts talked of renting with the same passion and certainty they once had for homeownership. In their book *This Time Is Different: Eight Centuries of Financial Folly*, economists Carmen M. Reinhart and Kenneth S. Rogoff noted the same startling shift in the narrative, writing “When the ‘subprime financial crisis’... began to unfold in the summer of 2007, a cursory reading of the global financial press would have led one to conclude that the world economy was moving through dark and uncharted waters. Indeed, after events took a decided turn for the worse in the early fall of 2008, much of the commentary took on an apocalyptic tone usually reserved for a threat that could potentially end civilization...” And after explaining why Americans are gaga for real estate, *Time* magazine shifted to try to instead explain “Why owning a home may no longer make economic sense.”



Sometimes the herd runs one way, and sometimes it runs the other.

That herd instinct to retreat from homeownership after a bust in the market is not a surprising one given the fear and panic prompted by “apocalyptic” headlines. However, considering the current market conditions, the better approach is to pull away from the stampede and pause to consider the implications for homeownership as a tool of long term financial security. A historic combination of low prices and interest rates, combined with the enduring benefits of homeownership, has created an unprecedented opportunity for families to obtain long term financial security through smart homeownership. Yet, despite the historic affordability, unnecessary barriers are keeping many buyers from capturing this moment and securing their financial futures. The opportunity is too great for the herd’s fears to stand in the way. Now is the time to recommit to homeownership for working families.

**Is Homeownership a Smart Financial Choice?**

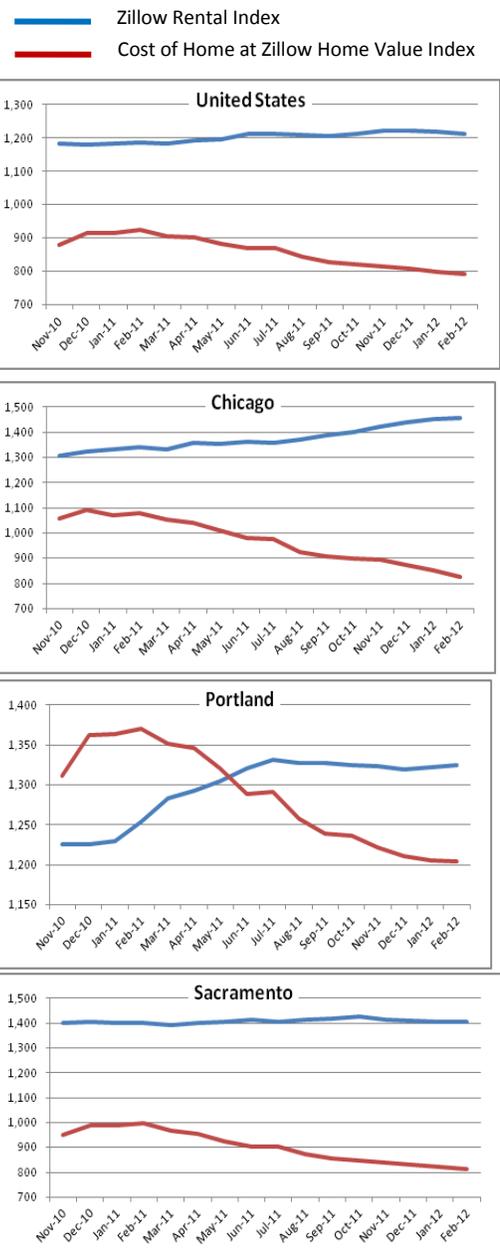
Housing is a basic human need and, for the typical family, it is the largest portion of the monthly budget. Most households consider two basic options for their housing: rent or own. Compared to renting, homeownership offers significant benefits as a tool for promoting long term financial security. The homeownership advantages include stable housing payments, wealth creation through equity building, and the power of leveraged appreciation.

**Stable Housing Payments**

For most families, the cost of housing is the single biggest expense in the monthly budget. Homeowners enjoy the advantage of stability in their housing payment throughout their tenure in a home. There are no other line items in the family budget that can be locked into place for 30 years or more. Food, health care, utilities, gas, clothing, entertainment and other expenses are all subject to continued inflation. For owners, the only portions of the housing payment subject to increase are taxes and insurance. The principal and interest payment, by far the largest portion of the housing payment, remains steady. In contrast, rent is unpredictable and is subject not only to inflation, but also to market fluctuation caused by shifts in supply and demand. Homeowners are shielded from volatility in the housing markets when planning their monthly household budgets. They lock in the housing payment when they purchase and their payment remains steady even as prices rise and fall around them. In contrast, renters cannot lock in their housing payment and are subject to unpredictable rises.

While many focus solely on the appreciation benefits of homeownership, this stability benefit is equally important to a family's long term financial success. Locking in their biggest monthly expense gives the household the predictability to plan ahead financially and contribute to other long term financial goals. And over the years as incomes grow and the housing payment remains steady, that additional margin can be dedicated to other uses, including saving for college, retirement, and emergency reserves, instead of paying higher rents.

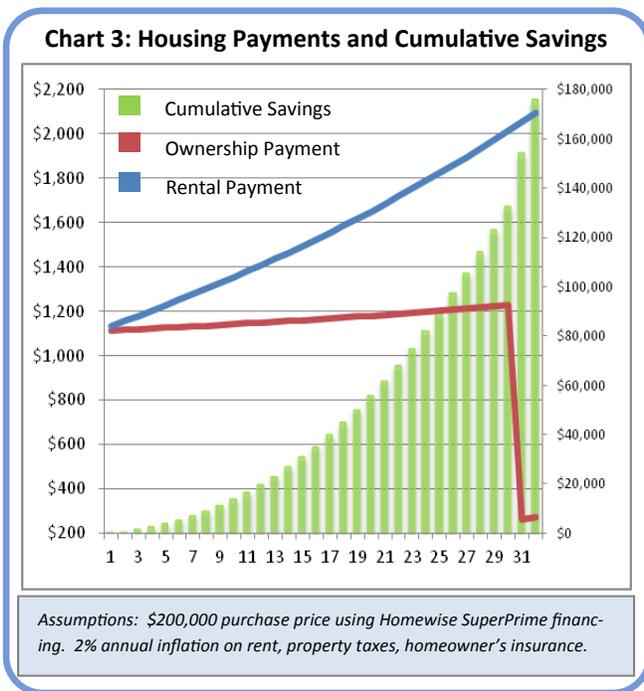
**Chart 2: Cost of Rent is High and Rising**



Sources: Zillow Inc, Real Estate Market Report, February 2012, Primary Mortgage Market Survey

As home sale volume has decreased, demand for rental units has increased and rental rates have increased commensurately. In its February 2012 Real Estate Market Report, the real estate research firm Zillow Inc.<sup>1</sup> reported that “national rents have increased 2% annually while national home values have depreciated 4.5% over the same period of time.” While markets vary, the trend of rising rental rates is widespread. The report continues, “The Zillow Rent Index shows year-over-year gains for nearly 68% of the metropolitan areas covered by the ZRI. By contrast, only 8% of the metro areas covered by the [Zillow Home Values Index] experienced annual home value increases.” Using Zillow’s data and historic interest rates, the graphs in Chart 2 compare the cost to rent and own in four geographies (which will be revisited throughout this paper), United States; Chicago, Illinois; Portland, Oregon; and Sacramento, California. In all four areas, the current median rent is *higher* than the monthly cost of owning a home priced at the Zillow Median Home Value.

The ability to lock in a low housing cost is the first of many ownership advantages and that advantage grows over time. As the cost of renting increases and the cost of owning remains stable, the owner begins to accumulate significant savings over the years. Chart 3 demonstrates this effect, comparing



the monthly costs for the buyer of a \$200,000 home (using Homewise SuperPrime financing<sup>2</sup>), and the renter in a similar home. As inflation impacts the renter’s monthly costs, the monthly ownership advantage grows each year and accumulates. Assuming that the renter’s and owner’s monthly payments start out equal, and assuming a modest 2% inflation each year, the total housing payment for a renter increases 22% in just 10 years. By comparison, the owner’s housing payment increases only 4% in 10 years because the inflation only impacts taxes and insurance. This advantage continues to increase as rental inflation builds on itself. In the 31<sup>st</sup> year, just in time for retirement, the owner has paid off his loan and his monthly housing payment plummets to just the taxes and insurance. Meanwhile, the renter’s payment has

increased 85%. Over the years, this savings adds up significantly. In year 30, the cumulative savings of the owner compared to the renter is just over \$130,000 and grows even faster once the owner’s mortgage is fully amortized. In just the next two years, the cumulative savings increases by about

<sup>1</sup>The Zillow Home Value Index is the median estimated valuation. The Zillow Rent Index is the median estimated monthly rental price. Both measures include all single-family residences, condominiums, cooperatives, and, for rentals only, apartments regardless of whether they sold or were listed for rent within a given period.

<sup>2</sup> Homewise SuperPrime financing combines a 30 year fixed rate first mortgage at 80% loan to value with a second mortgage provided by Homewise. Current first mortgage rate is assumed at 4%, the rate on the second is 5.5% and down payment and closing costs are assumed at 2.5% each.

\$45,000 to reach a total of about \$175,000.

The assumption that the monthly costs for renters and owners are equal in the first year may strike some as incorrect. In fact, most people assume that buying a home will result in an increased monthly housing payment, according to Fannie Mae's National Housing Survey. This increase, however, is also a function of the renter moving *up* to a better home. With today's combination of low prices and low interest rates, the cost of buying can actually be lower than renting the equivalent home. Analysis by the Wall Street Journal in November 2011 compared the costs of rental to ownership in 27 major metropolitan areas and also found that the cost of ownership was *lower* than renting in 12 cities, including Chicago and Sacramento, confirming the Zillow data shown in Chart 2. Given the variations in local markets, the assumption of equal starting costs for the owner and renter is not only reasonable, it is also helpful in demonstrating the inherent characteristics of ownership and rental, applicable to an array of markets and conditions.

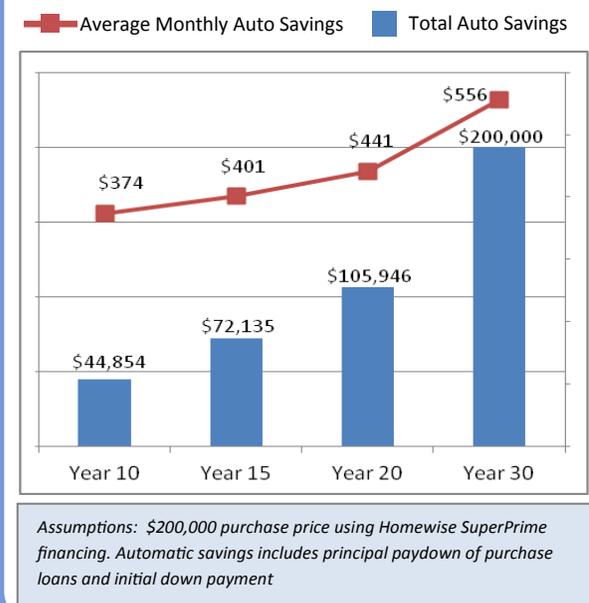
**Wealth Building**

By itself, the stability benefit of homeownership is enough to give it a compelling advantage compared to renting. But the stability advantage is just one benefit of ownership. Homeownership serves a dual purpose: it provides the basic human need of safe and decent housing, and it serves as an investment vehicle to help families build wealth.

The first way homeownership builds wealth is as a savings tool. Part of each monthly mortgage payment is essentially being paid back to the owner in the form of principal paydown. In essence, this serves as an automatic savings plan for the owner, increasing the owner's net assets each month as he pays down his loan. It is as if the owner has set up an automatic plan that transfers funds each month into a savings account (with the added benefit that this savings account also provides him shelter). The value of this savings plan grows over time as the portion of the payment that is credited toward principal each month increases. In contrast, the amount of a rent payment directed toward the renter's net assets is steady. It is, and always will be, zero.

Chart 4, based on a typical \$200,000 home purchased in today's market, shows how an owner's equity increases over the years as the loan balance is paid down. This benefit is *solely* the result of paying down the principal and doesn't factor in any appreciation in the home's value. By year 10, the cumulative value of the automatic savings is almost \$45,000. That would be the same as the owner transferring \$374 to a savings account every month for 10 years. The value of the savings plan grows as the entire loan

**Chart 4: Automatic Savings Effect of Homeownership**

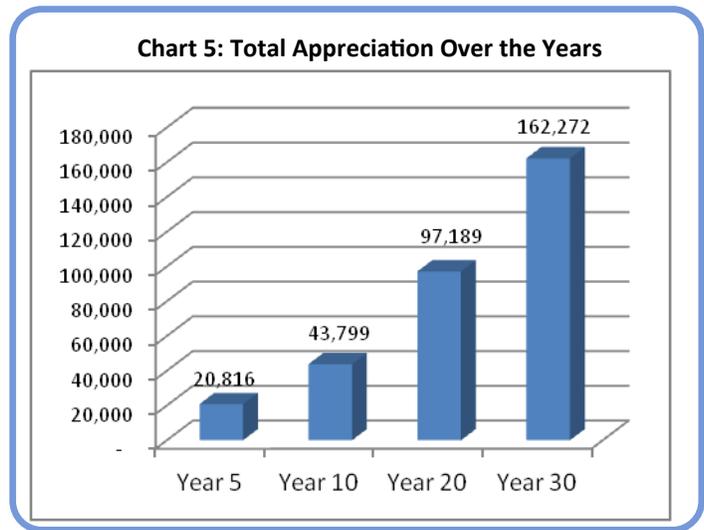


amount is paid down and the owner has accumulated \$200,000 of savings.

By contrast, a renter does not enjoy the benefit of this built in, automatic savings plan since no part of his housing payment goes toward his net assets (though it does go toward his landlord's net assets). Any automatic monthly savings the renter wants to set aside will have to be *in addition to* his housing payment, adding cost to the monthly budget and requiring impressive financial discipline. And remember, the renter's monthly housing expense is subject to volatility and increase. As housing costs grow, setting aside savings each month would become more challenging. By contrast, the owner's savings is built in to his principal and interest payment, which is locked in for 30 years. His house is the piggy bank where he can live.

**Appreciation and Leverage**

The principal paydown effect of homeownership is like automatically transferring funds into a savings account each month. However, any good savings account provides interest on those deposits. So too does homeownership, in the form of appreciation. Even modest appreciation in the home's value has a powerful cumulative effect on the homeowner's wealth. For an owner who purchases a \$200,000 home and enjoys 2% annual price growth, appreciation will total over \$20,000 in just 5 years, and will grow to more than \$162,000 over 30 years. The benefit of this appreciation is *on top of* the automatic savings effect described above. Even with the volatility the market has experienced in the past few years, it is still realistic to project appreciation. Since 1991, the median home price in the United States has increased 62%, which equates to annual appreciation of 2.44% when we factor in the power of compounding interest<sup>3</sup>. The three cities have also seen average yearly appreciation in the past 20 years even though we have endured the steepest drop in prices in recent history (Chicago: 1.88%, Portland 4.73% and Sacramento 1.05%). Even with the recent drop in the market, today's prices show the annual growth that allows a homeowner to build wealth with the power of leverage and compound appreciation.



A savvy investor may find a projection of 2% annual appreciation to be low at first glance, and may even think that homeownership compares badly to other investment options. But that first glance misses one of the most powerful wealth building features of homeownership: leverage. Homeownership provides appreciation on the *entire value* of the home even though the homeowner has put up only a portion of that value in cash. This leverage amplifies the return on the homeowner's initial investment so that the overall return on investment is much higher than the simple annual rate.

<sup>3</sup>Readers checking our math may question the annual appreciation rate of 2.44% since 62% divided by 20 years is 3.1%. However, this calculation returns the simple interest rate. We assume compounding interest in home values. Factoring in the compounding effect, we find the annual appreciation rate between 1991 and 2011 is the equivalent of 2.44%.

For example, say a person has \$10,000 cash to invest. If he puts that in an investment vehicle that earns 10% annual appreciation (a great rate of return!), he would earn \$1,000 appreciation in that first year:

$$\$10,000 \times 0.10 = \$1,000$$

Now, say that person uses his \$10,000 to buy a house, putting his cash toward down payment and closing costs in order to purchase a \$200,000 home. Even if he gets a much lower annual appreciation rate of 2%, his actual appreciation is *four times higher* because of the power of leverage:

$$\$200,000 \times 0.02 = \$4,000$$

Typically, only professional or institutional investors can take advantage of the power of leverage to increase their rate of return. Homeownership is likely the only vehicle that allows the individual to achieve this kind of investment leverage (and he achieves it while also meeting the basic human need of housing). In contrast, the renter has to address the needs of housing and financial planning separately, making room in his monthly budget for both his rent and a regular contribution to an alternate investment vehicle. He also has to display impressive financial discipline, making those regular deposits month after month, even while his rent is subject to increase.

How much would that regular contribution have to be for a renter to catch up to the homeowner using the alternate savings vehicle? If we continue to assume the generous 10% annual appreciation for the alternate investment (such as the stock market) and the modest 2% appreciation on homeownership, we can determine the amount the renter would have to set aside each month to catch up to the owner. The renter's required monthly contribution decreases slightly each year since, in this scenario, we are assuming a very generous and steady 10% return for the stock market and a conservative 2% appreciation on home prices. However, even with the 10% return, the renter has to set aside a significant amount of funds each month to catch up to the homeowner:

**Chart 6: Amount the Renter Must Invest Each Month to Keep Pace with Homeowner's Wealth**

Year	Net Value of Investment	Owner's Monthly Required Payment	Renter's Monthly Required Payment
5	\$ 43,633	Housing Payment Only	Rent + \$351 per month
15	\$141,309	Housing Payment Only	Rent + \$233 per month
30	\$362,272	Housing Payment Only	Rent + \$73 per month

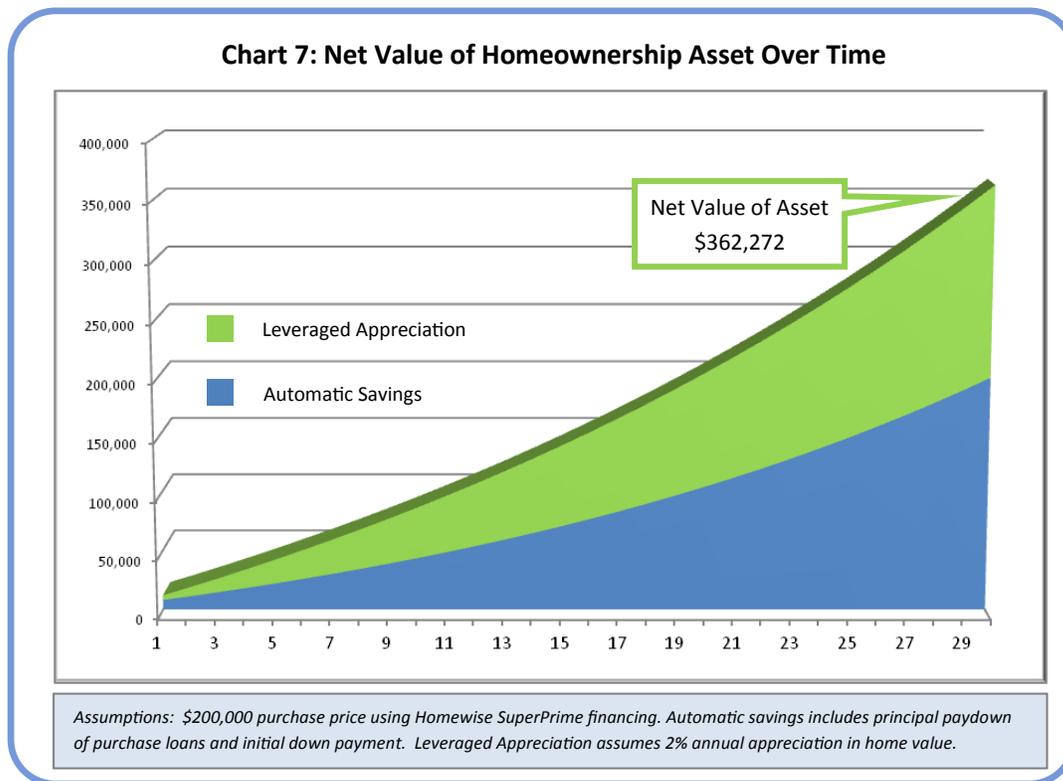
*Assumptions: Initial investment of \$10,000. 2% annual appreciation on home value. 10% annual return on stock market investment.*

As the chart shows, the renter who wants to reach the same net assets in 15 years as the homeowner needs to pay his rent *plus* an additional \$235 per month, year after year. The homeowner simply has

to make his mortgage payment. And, with home prices and interest rates so low in today's market, it is reasonable to assume that a homeowner will have the same, or even lower starting monthly payment than the comparable renter. Consider what a household could do with an additional \$235 in their monthly budget! The homeowner could use that additional money to invest further in a retirement account or their children's college fund and build even more wealth and long term security. They could set it aside in an accessible rainy day fund to protect themselves from unpredictable life challenges like sickness or job loss. And just as importantly, they could have a little more fun – perhaps work in a few more vacations – without sacrificing long term financial security.

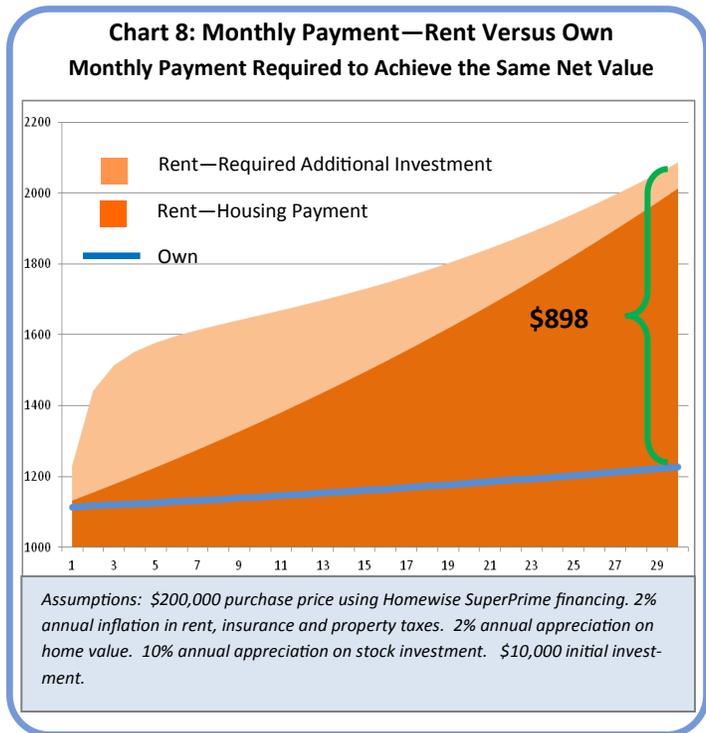
**Combined Power of Wealth Building**

The table showing the amount the renter must set aside to keep pace with ownership starts to convey the true power of homeownership as a tool for building wealth because it combines the power of the automatic savings, appreciation and leverage factors that are built into homeownership. Chart 7 below demonstrates how those factors layer to build wealth over time.

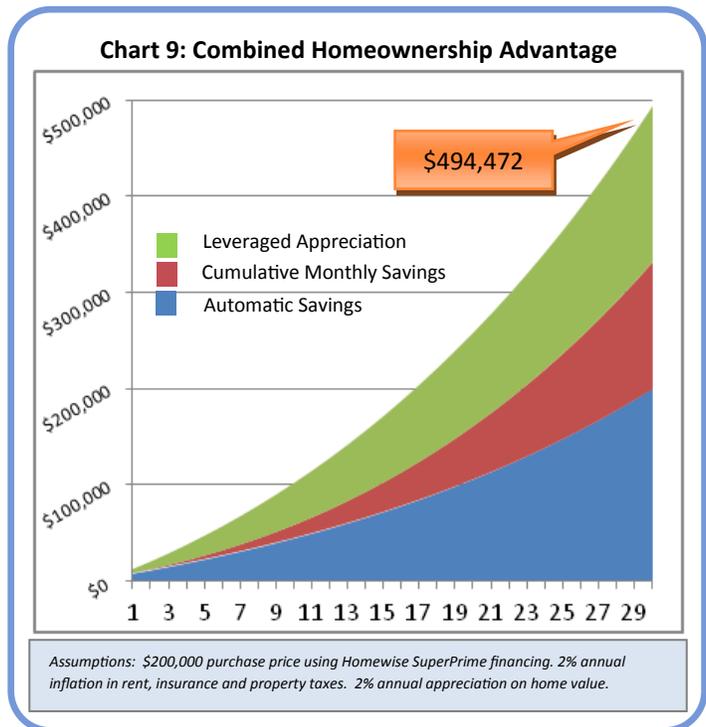


Starting from an initial cash investment of \$10,000 used for the down payment and closing costs, our homeowner has built a net wealth of over \$360,000 just by making his monthly housing payment. Again, this assumes a modest 2% annual appreciation which is a reasonable estimate when we look at past performance.

When we combine these layers of financial benefits, we see how the homeownership advantage grows over the years. The chart below shows the total monthly housing cost the renter would incur to achieve the same net value as the homeowner. The renter's monthly payment includes both his rent, which is increasing due to inflation each year, and the amount he needs to invest in the stock market to match the owner's wealth. The owner's monthly payment includes just his housing payment, only impacted by the inflation on taxes and insurance. Chart 8 again assumes the modest 2% homeownership appreciation compared to an aggressive 10% annual stock market growth and demonstrates how much more the renter will pay each month just to keep pace with the homeowner. Over 30 years, the homeowner's housing payment increases just 10%, while his initial cash investment grows into a net wealth of over \$360,000. In contrast, the renter's monthly payment must be \$898 more than the homeowner's if he is to keep up on his rent and amass \$360,000 in his investment fund.

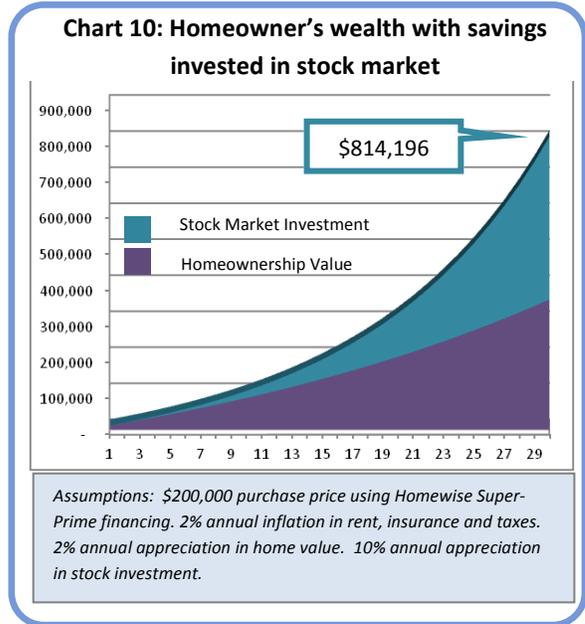


That monthly homeownership advantage accumulates over the years to support the owner's long term financial security. Chart 9 demonstrates the combination of the accumulated savings compared to renting, the automatic savings achieved through principal paydown, and the leveraged appreciation gained on the home. Over 30 years, the homeownership advantage grows to almost half a million dollars. This example is based on the assumption that the owner's and renter's monthly costs start at the same value. As we've seen, owning is less expensive than renting in many markets. Factoring in those savings would increase that ownership advantage *even more* as savings accumulate each year.



**Supporting Additional Investment**

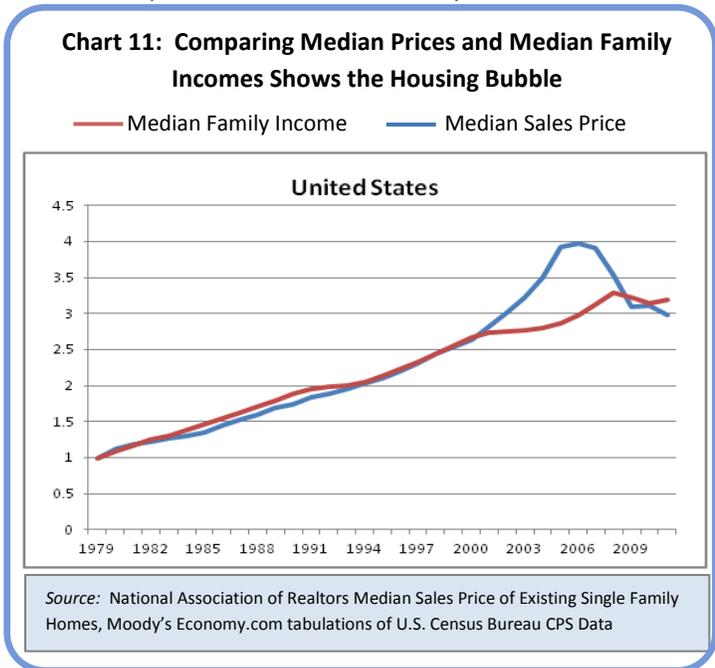
The monthly and cumulative ownership advantage is compelling. But even though homeownership is a strong investment tool, few would advise a homeowner not to also save additional funds through other vehicles, such as the stock market. The first benefit of homeownership discussed above – payment stability - provides a continued advantage toward this goal as well. Because the homeowner has locked in his largest monthly expense, he has more discretionary income over the years to invest. How much additional wealth could the homeowner build just by investing the amount he saves compared to the renter? With the same 10% return we assumed for the renter, the homeowner builds additional wealth of almost \$450,000 on top of the net value of his home asset for a total net wealth of over \$800,000. By contrast, the renter paying *the same* combination of housing and investment payment each month would only build about \$360,000 over the 30-year period.



**Volatility and Risk**

A discussion of whether homeownership is a good choice for the typical American household must also consider the risk of home purchase. Falling home prices remind potential buyers that there is risk in homeownership and the market is volatile. When prices are at their low, buyer confidence also tends to be at a low, as potential buyers see the impact of market volatility.

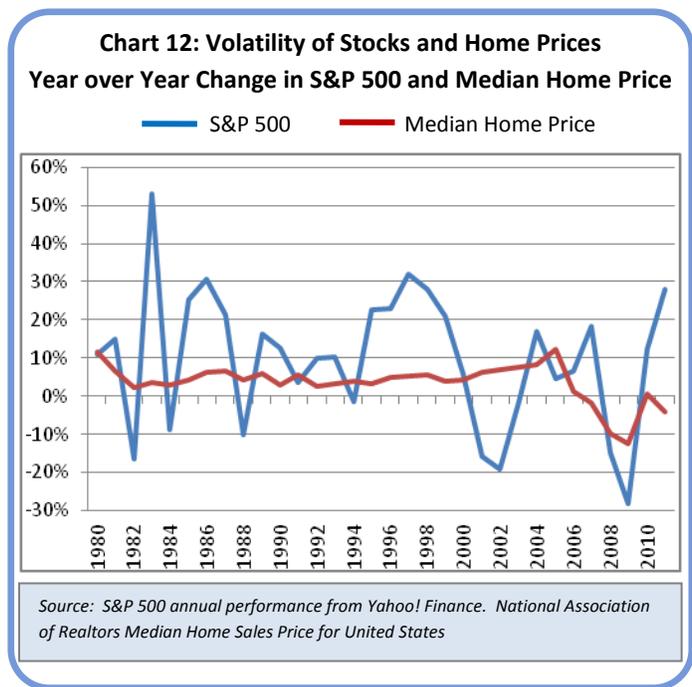
Homeownership serves the dual purpose of housing and investment, and like other investments there is risk along with the reward. Timing of a home purchase matters and the last few years have been unusually volatile. As shown in Chart 11 home prices since 1979 have generally kept pace with incomes (See Appendix 1 for the graphs in all four geographies). Starting in about 2000, home prices dramatically outpaced incomes until the peak in 2006, creating the distinct bubble on the graph and showing how unusual the recent boom was. Since that peak, prices have returned to follow the historically expected trend line of



incomes, thereby correcting for that unsustainable boom. For owners who bought, or obtained home equity loans, during that bubble, the impact of the resulting bust was financially negative. But prudent investors should look *forward* as they make investment decisions and the analysis of home prices and data supports the conclusion that home prices have returned to their historical trend line, tracking incomes in a generally upward long-term direction.

Home purchase as an investment undoubtedly includes risk, as do all investment vehicles. Reviewing the year over year change in home prices and the same change in the S&P 500 gives us a good comparison of the relative volatility of these investment vehicles. As Chart 12 demonstrates, the S&P 500 has experienced far more dramatic year to year changes since 1979 than housing prices.

In both investments, the timing of the purchase and the resale matter. Just as there is a natural tendency for people to pull their money out of stocks every time the market crashes, so too is there an understandable instinct to fear homeownership after such a historic drop in prices. But in both cases, the successful investor will fight that instinct to flee, knowing that the bottom of the market creates the best opportunity to buy low. And in both cases, investors are better insulated from short term volatility if they take a long term approach. Other investment vehicles carry less risk than home purchase or stocks, but their return is commensurately lower. Since these investments don't offer the power of leverage that homeownership does, the wealth-building gap between these investments and homeownership would be even greater than the gap illustrated previously with the stock market investments.



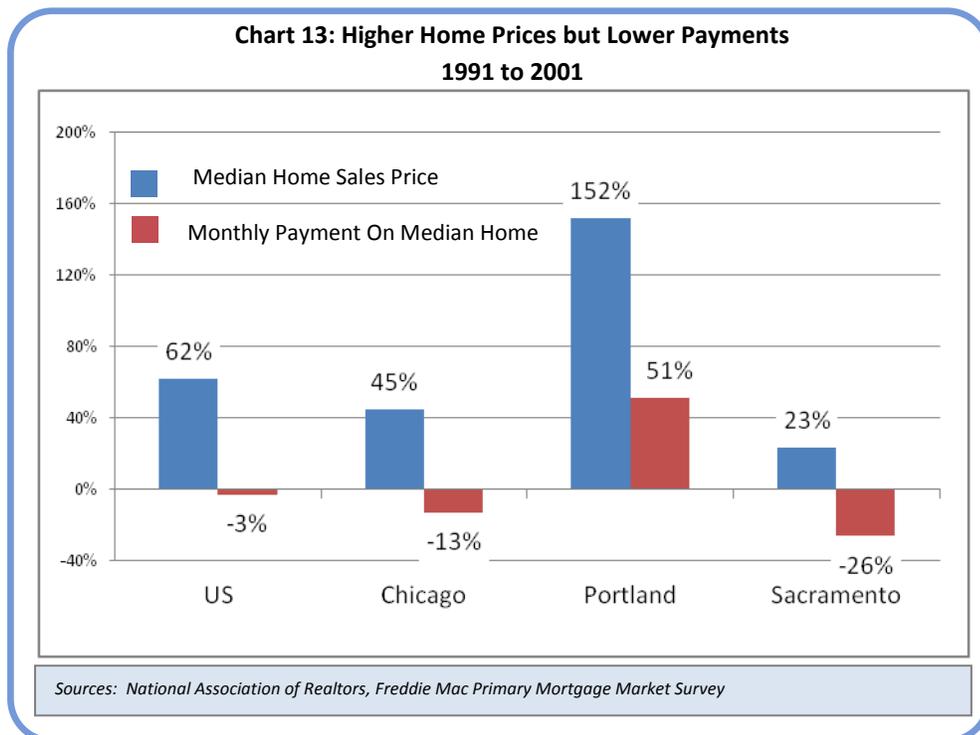
Buying a home at the low point in the market helps insulate the homeowner from future risk and volatility. As an example, consider the Sacramento market, which has been more volatile than the national market. Sacramento has experienced more pronounced booms and busts in its housing market, with the previous low point coming in 1997. A homebuyer who purchased in 1997 would have paid \$116,100 for the median priced home. In 2011, after a drop in prices that matched the Great Depression, the median home was priced at \$167,100, a total increase of 44%. A homeowner who had to sell at the bottom of the current bust would have been protected from loss *if he bought low to begin with*. This historical reminder reinforces the opportunity presented by the current market to buy low, locking in not only low prices, but also historically low interest rates, that will help shield him from future volatility.

*Are People Able to Buy In Today's Tight Credit Conditions?*

Even with the benefits of homeownership so strong, another nagging question remains: *can* people buy? In the wake of the subprime loan fueled foreclosure crisis, lending standards have tightened and mortgage financing is more difficult to obtain. This reaction is not altogether unreasonable though reflects a measure of over-correction. There can be little argument that certain loan products – stated income loans, interest only loans, negatively amortizing loans, and their many variants – were unwise and should not have been used in the traditional home purchase marketplace. The instinct to tighten standards is therefore reasonable, if a little overdue. The national discussion of lending challenges is having its impact on both renters and owners. In Fannie Mae's National Housing Survey 3<sup>rd</sup> Quarter 2011, 75% of renters felt it would be difficult for them to qualify for a mortgage today. In addition, 75% of all respondents said they think it will be harder for their children or the next generation to buy a home than it is today. But to borrow a phrase from Mark Twain, reports of homeownership's death have been greatly exaggerated. Today, low prices and interests rates have opened homeownership to millions of households that have been previously locked out. And with the right strategy, challenges to obtaining credit can be overcome.

**Increased Affordability**

The current market's combination of low prices and interest rates is unprecedented, making homeownership affordable and attainable for households that had been previously locked out. With the goal of buying low in mind, today's market presents the best opportunity in decades to purchase a home. Not only have prices dropped significantly since the subprime-fueled peak, but the monthly cost has dropped even more dramatically. In fact, the national median home price *increased* 62% from 1991 to 2011, but the monthly payment *decreased* 3%.



This counter-intuitive drop in payments is a function of the dramatic drop in interest rates. In the last 30 years, the interest rate on a 30-year conventional mortgage has fallen over 78%, and this decrease in rates is the primary factor creating the unprecedented affordability for today's home buyer. The low interest rates are the result of decisions by the Federal Reserve to keep the federal funds rate (the rate banks charge one another on overnight loans) low in an effort to stimulate the economy. The federal funds rate influences the rate on consumer loans, including mortgage rates. In December 2011, the Federal Reserve announced that it would keep the federal funds rate at a target range of 0% – 0.25% in an effort to encourage continued economic growth. At the current range of 0% -0.25%, the federal funds rate cannot be lowered any further. As the economy improves, threats of inflation will rise, and the Federal Reserve will be expected to raise rates. Home prices are likely to rise as the economy improves as well. While the combination of historically low prices and interest rates is a temporary one, today's homebuyers will lock in the benefits for their entire tenure in the home.

**Chart 14: Interest Rates at Record Low**



Source: Freddie Mac Primary Mortgage Market Survey for 30-year fixed rate mortgage

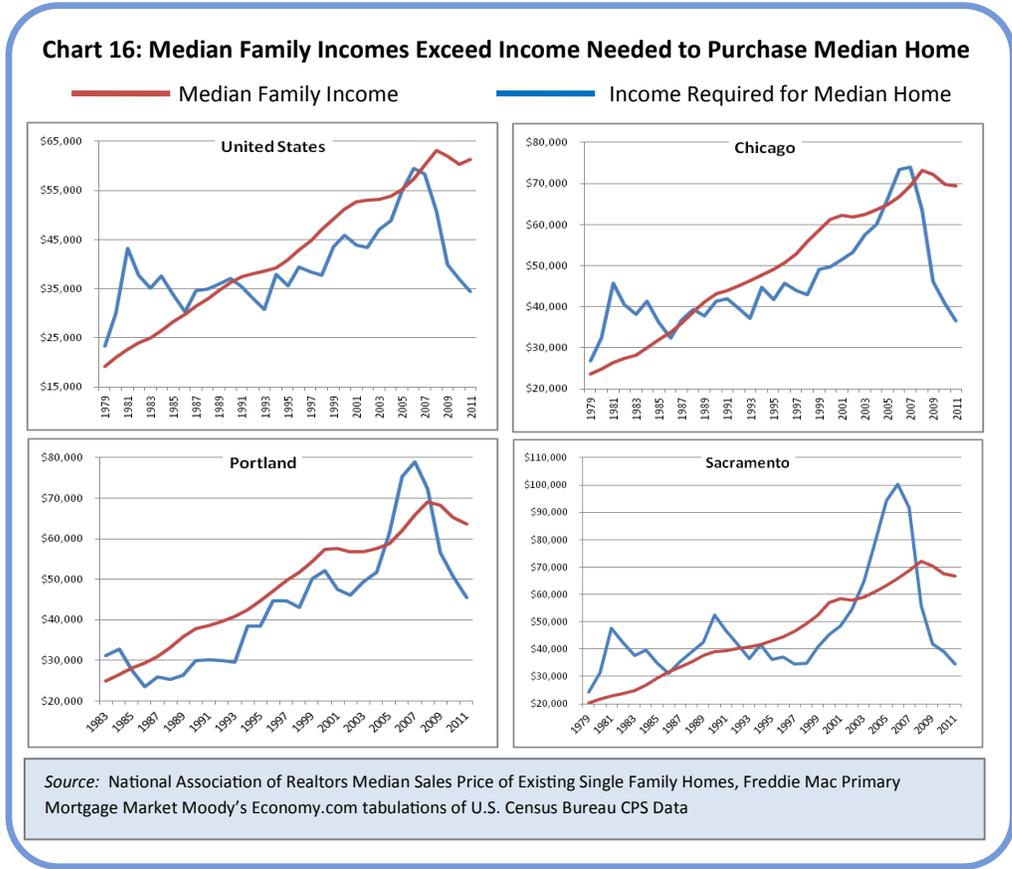
**More Households Can Buy**

Because the monthly cost of owning has dropped, the income needed to purchase a home has also fallen, allowing more households to enter the home purchase market. At the country's peak in home prices, a household would have needed a yearly income of almost \$60,000 to purchase the median priced home. Today, a household earning just under \$35,000 can purchase the median home, a drop of almost 50%. The change in other markets is more dramatic. In Sacramento, the required income peaked at over \$100,000 but today, a family earning under \$35,000 can buy the median home. In fact, because of the fall in prices and interest rates, the Median Family Income in the United States and in all three metro areas in this paper far exceed the required incomes to purchase the median priced home. In Sacramento, the Median Family Income is almost double the income needed to purchase the median priced home. As shown in Charts 15 and 16, the situation was reversed at the peak of housing prices. In all four geographies, the Median Family Income was insufficient to afford the median priced home using sensible, conventional financing. In Sacramento, the income needed to purchase the median priced home was over \$100,000 while the Median Family Income was just over \$65,000, a gap of over \$34,000.

**Chart 15: Income Needed to Purchase Median Home**

	U.S.	Chicago	Portland	Sacramento
<b>Peak</b>	\$59,486	\$73,994	\$78,970	\$100,394
<b>2011</b>	\$34,459	\$36,594	\$45,510	\$34,645

Source: National Association of Realtors Median Sales Price of Existing Single Family Homes, Freddie Mac Primary Mortgage Market Survey

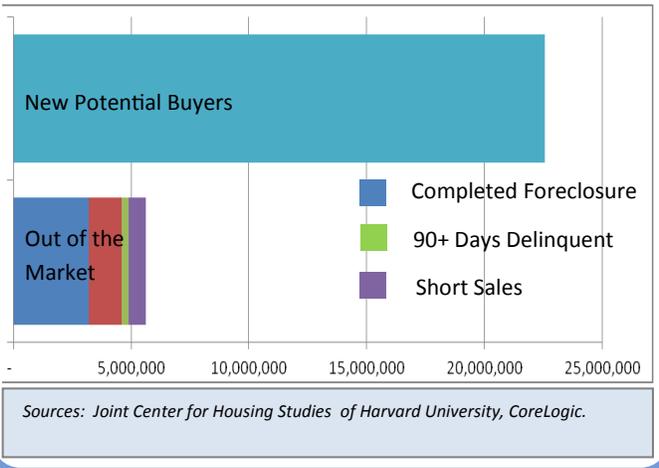


As Chart 16 shows, home purchase affordability has improved tremendously because of the drop in prices and record low interest rates. Still, many pessimistic analyses of the home purchase market point out that millions of homeowners have gone through foreclosure or some other form of default, and will therefore be unable to purchase for some years to come. Their “penalty window” may vary, depending on the type of default, the circumstances surrounding it, and the future underwriting standards of different lenders. These analysts argue that the home purchase market will be pulled down by these former homeowners for years to come and conclude that efforts to promote and support homeownership should shift focus to rental programs instead.

However, even with these families held out of the market, millions more families can enter the market for the first time in years, thanks to the improved affordability illustrated above. The addition of these new potential buyers compensates for the buyers who must sit on the sidelines while their financial profiles recover. In fact, the growth of households that can now afford homeownership significantly outnumbers the incidents of foreclosures and other defaults since 2008. Chart 17 shows this comparison. Combining all of the completed foreclosures, loans currently in foreclosure, loans that are 90 days or more delinquent and completed short sales since 2008, we can see that an estimated 5.6 million loans have resulted, or will soon result, in a default, according to data from CoreLogic. However, analysis by Harvard’s Joint Center for Housing Studies shows that over 70 million American

households earned enough income to support the purchase of the median priced home in 2010. By comparison, only 48 million households earned enough to support purchase in 2007. That is an increase of 47% and means another 22.5 million households can purchase today compared to 4 years ago. It is difficult to predict the total number of households who have suffered or will suffer some default event that will preclude them from home purchase in the next few years. However, even if the estimate above is doubled, the number of new potential homebuyers still far outweighs the number of defaulted owners. With affordability at its best and the market open to tens of millions of new possible buyers, the home purchase demand pool has the potential to be even stronger than it was when the country was gaga for real estate.

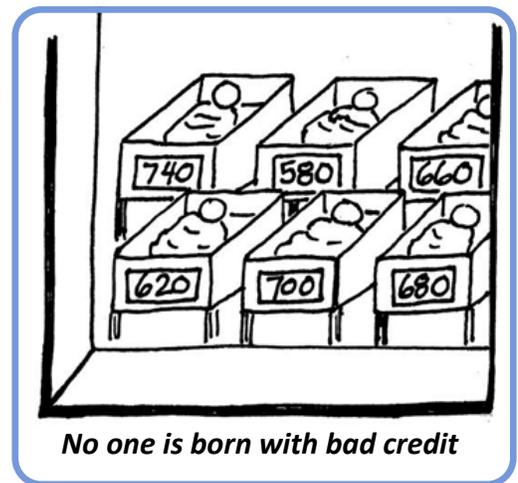
**Chart 17: Potential New Homebuyers Outnumber Defaults**



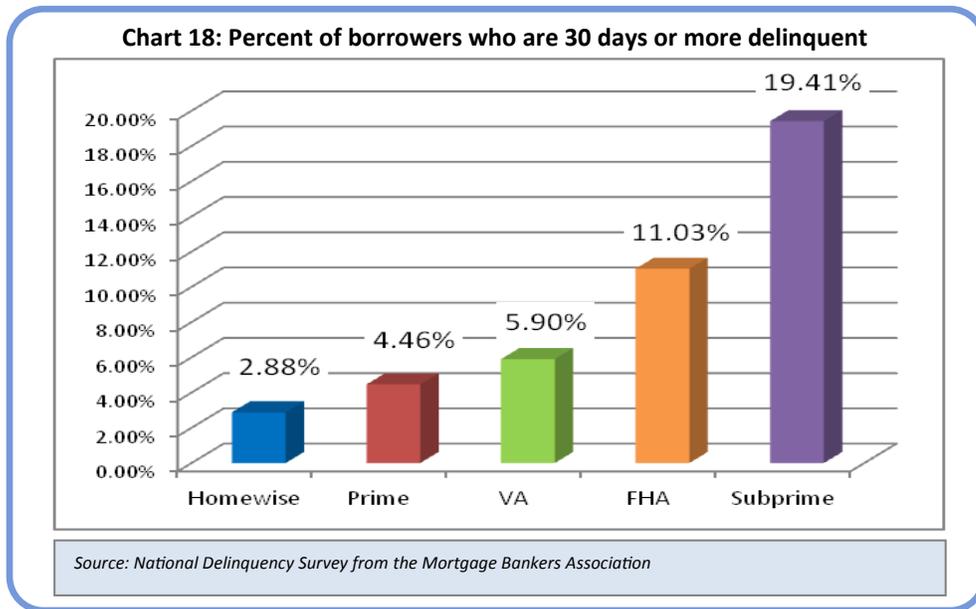
**Credit Obstacles**

Among the 70 million potential homebuyer households, there are undoubtedly potential buyers who do not meet mortgage qualification standards because of issues such as low credit score, high debt, or insufficient savings. Stricter lending standards have increased the number of households in this category, and this challenge is often cited as another reason to feel discouraged about homeownership's current prospects. Since 2006, the average FICO score for an FHA borrower has increased from 630 to 700. The reliance on government insured mortgages increased 559% from 2005 to 2010, an indication of stricter down payment requirements for conventional loans.

However, mortgage qualification challenges are not incurable conditions. No one is born with bad credit. It is a result of behavior, and behavior can change. There are hundreds of non-profit homeownership organizations, like Homewise and its colleague agencies in Sacramento, Portland and Chicago, that know how to help people improve their credit habits so they can qualify for a good, fixed-rate mortgage and become strong, successful homeowners. The experience of Homewise customers demonstrates how potential buyers can improve their credit profiles, especially when guided by trained home purchase advisors. Last year, Homewise buyers increased their credit scores an average of 59 points and decreased debt an average of \$48 per month. In addition, they increased savings an average of \$5,500.



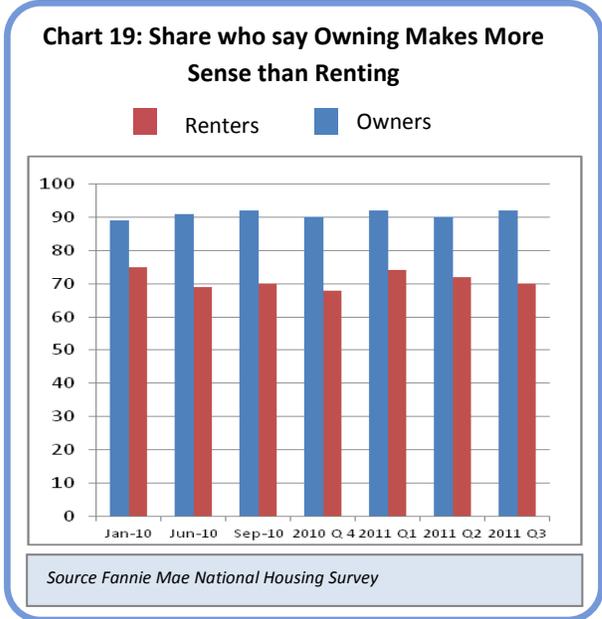
This concerted strategy to prepare clients for homeownership doesn't just help them qualify for a mortgage. It also helps them succeed as default-resistant homeowners. Homewise buyers, and buyers working with similar organizations, would be considered high-risk by many lending institutions. They often have lower incomes and they can rarely make a down payment near the 20% standard being required by conventional lenders. Yet, they succeed at a higher rate than borrowers in every other category, as demonstrated by their low delinquency rates. In the first quarter of 2012, the percentage of Homewise borrower's who were 30 days or more delinquent was more than 50% lower than the rate for conventional mortgages, considered the "safest" loan portfolios. And the delinquency rate for FHA loans, currently considered by many to be the only option for anyone with less than 20% down payment, is almost four times higher than Homewise's rate. With preparation and support, the millions of new potential homebuyers in today's market can take advantage of this historic affordability to lock in the financial benefits of homeownership.



### Do People Want to Buy?

So far in this analysis, we have demonstrated that homeownership is still a smart financial choice, and that millions of households are able to buy in today's market. But the housing market is fretting over another nagging thought: do people even want to buy? Given continuing unease about the housing market and economy, the public's feelings about homeownership are understandably mixed. According to Fannie Mae's National Housing Survey, a majority of respondents feel that homeownership will be harder to attain in the future. In 2010, with prices continuing their fall, the share of renters who said they intended to buy in the next three years dropped from 57% in 2003 to 39%.

However, despite the increased worries, homeownership is still viewed very favorably, and a majority of renters still aspire to be homeowners. In the recent Fannie Mae survey, 70% of renters say that owning makes more sense than renting. In addition, 80% of respondents said they would prefer to live in a neighborhood where most people are owners. Existing owners have maintained a positive outlook on ownership, despite the recent volatility. Even after the barrage of negative headlines over the last several years, 96% of owners responded that homeownership has been a positive experience for them and their families. Perhaps even more surprisingly, among those owners who are underwater in their homes, 93% still say ownership has been positive. More recent surveys show optimism toward homeownership may be building again. As reported in *National Mortgage Professional* magazine in May 2012, TD Bank found that 84% of respondents ages 18-34 intend to buy a home. A majority of all the respondents said that homeownership is a vital component defining the American dream. While people may doubt their own ability to achieve homeownership, their view that owning a home leads to a better quality of life, more security and financial benefits has endured.



### Now's The Time

The benefits of homeownership are not difficult to understand. When compared to renting, purchasing a home is a very smart financial choice. Owning a home stabilizes the family's biggest monthly expense, creates an automatic savings plan by paying down mortgage principal, and, even at low home appreciation rates, provides a very good return on investment. Homeownership is an incredibly powerful engine helping working people improve their long-term financial security, which is why homeownership has been one of the primary drivers in expanding America's middle class. It is also not hard to see how today homeownership is more accessible than it has been for decades, due to lower home prices and historically low mortgage interest rates.

So why are we not hearing more about the incredible opportunity for working families to take advantage of homeownership and help secure their long-term financial wellbeing? Instead of helping people better understand the potential benefits of purchasing a home in a favorable market, many media stories are questioning the viability of homeownership and trumpeting the benefits of renting, a focus that would have been a lot more appropriate during the housing boom when home prices were artificially pumped up by subprime mortgage lending and rampant speculation.

And while the millions of new households who can now afford to purchase a home could be a way to restore health to the housing market, policy makers are instead focusing on speculative housing

strategies that ignore this incredible pool of new potential buyers. With cruel irony, at just the moment when millions of working families can finally afford sensible homeownership, public policies and private practices are giving the significant competitive advantage to investors while creating barriers to the individual buyer. The investors know that today's market presents an exceptional opportunity to invest in homes and they are using billions of dollars to swallow up swaths of single family homes, turning them into rentals and further locking out the American working family. In its recent article "Meet Your Hedge Fund Landlord", *Mother Jones* magazine reported on several such investors, including Carrington Investment Partners which "formed a partnership with another hedge fund to buy nearly half a billion dollars worth of foreclosed single-family homes and convert them into rental properties." Carrington Investment Properties was founded by Bruce Rose, a former CitiGroup banker who brags that he "single-handedly invented subprime mortgage-backed securities."

*The New York Times* reported on the trend as well in its April 2, 2012 article "Investors are Looking to Buy Homes in the Thousands." The article describes Waypoint Real Estate Group, which has purchased 1,200 homes since 2008 to hold as rental properties, but plans to increase its purchases with another 10,000 to 15,000 homes by the end of next year, using hundreds of millions of private equity cash. (That equity investment even includes an investment from CalPERS, California's public employee pension system.) To handle such volume, the company created a software system to assess the amount it can pay for a property in about 30 minutes. The *New York Times* quotes a Waypoint manager as saying "We think this is a huge opportunity and we are going to treat it like a factory and create a production line to do this." The same investor capital that created and funded subprime loans is now being used to buy the damaged remnants of that subprime crisis, again turning neighborhoods and family homes into investor profit factories.

If their billions in cash weren't enough of an advantage, these investors also enjoy other competitive advantages when contending for homes in the available inventory. A host of factors combine to make home purchase more difficult for the individual buyer compared to the investor. The availability of conventional financing has decreased dramatically, with lenders increasing credit requirements, increasing down payment requirements and creating heightened scrutiny on property conditions. The Federal Housing Administration (FHA), which insures loans to further its stated mission of supporting homeownership, has enacted new restrictions on the use of time-tested mortgage assistance programs that have helped working families for decades. FHA has also increased its underwriting standards and property assessment practices, while also increasing its insurance premiums.

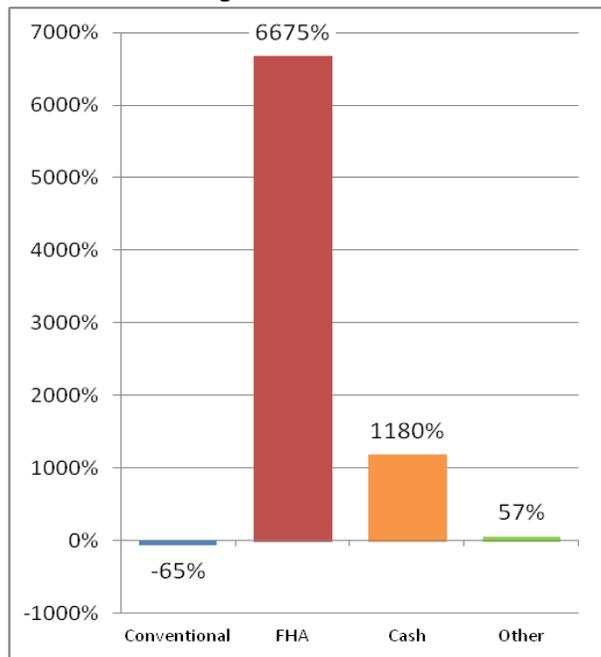
At the same time, the inventory in many markets continues to be dominated by REOs and short sales and typically, sellers of these distressed properties are unwilling or unable to make the kinds of repairs required to make the home suitable for an individual buyer. For example, FHA requires properties it insures to meet its Housing Quality Standards (HQS) before it will insure a loan against it. HQS standards are so detailed as to call out items such as a rip in the carpet or a crack in the walkway. At the same time, Fannie Mae, another institution originally created to encourage middle class homeownership, typically maintains a policy of selling its properties on an as-is basis, unwilling to

make even small repairs, such as repairing a rip in the carpet or a crack in the walkway. These two agencies, both of which are ultimately overseen by the U.S. Department of Housing and Urban Development (HUD), enforce short-sighted policies that make it difficult for the average buyer to achieve homeownership during this unprecedented window of opportunity.

Even without government policies working against them, the average buyer is at a disadvantage against the investor. Just as Waypoint has created its factory line to purchase, investors of all sizes can move quickly, offering to pay cash, close quickly, and take the property as-is. And in many cases, investors can afford to bid up the property, knowing that today's appraised values are likely to be deflated. They have the ability to pay above appraised value, knowing that they will still realize immediate positive cash flow from high rents, and enjoy additional profit at resale in five to seven years.

Individual buyers, on the other hand, must make offers contingent on their financing, which will require the seller to make repairs and the purchase price to be supported by an appraisal. And unlike cash buyers, individual homeowners can't offer a quick closing period. Instead, they must ask the seller for patience while their loan application is reviewed in an increasingly detailed and extended process. Chart 20 shows how the field of home purchase financing has changed to the detriment of the working family. Data from Sacramento Association of Realtors shows the percent of home purchase transactions financed with all cash increased 1,180% between April 2005 and April 2012, a product of increased investor activity. The share of transactions financed by an FHA loan increased an amazing 6,675% in the time period as conventional lenders decreased their volume and increased underwriting requirements.

**Chart 20: Home Purchase Financing in Sacramento Area  
Change from 2005 to 2012**



*Source: Sacramento Association of Realtors MLS Statistics, April 2012 and April 2005*

Even with such existing advantages, institutional investors stand to gain another advantage. In February 2012, the Federal Housing Finance Agency (the agency that oversees Fannie Mae and Freddie Mac and ultimately reports to HUD) announced a pilot project to sell pools of single family properties to large rental investors in several test markets, including Chicago. The program is designed for institutional investment groups like Waypoint and Carrington Investment Partners (to pre-qualify as bidders, companies must submit a 34 page application and have at least \$5 million in assets) and requires the buyers to hold the units as rentals for a minimum number of years. This program was designed following a request for information issued by FHFA, HUD, and the U.S. Department of the

Treasury to solicit ideas on how to dispose of large batches of properties in bulk sales. Individual homebuyers, and even organizations in the position to help families purchase their first home, are not eligible to take advantage of these bulk sales. The strategy is particularly galling to community advocates who watched subprime lenders reap billions in profits by exploiting vulnerable neighborhoods and are now watching those same neighborhoods again exploited by investors who have a competitive advantage because of federal policies, restrictive lending practices and sheer financial might. As Mother Jones wrote "...In home-sales markets that have hit bottom, big players like Carrington might bid prices beyond the reach of low-income buyers, denying locals the chance to benefit from the post-crash appreciation....Turning too many homes into rentals might even put a drag on the housing recovery. Numerous studies show that homeowners do more than renters to maintain and improve their properties and participate in neighborhood and civic groups."

In explaining the policy decision, FHFA and the investors that stand to benefit from these exclusionary bulk sales argue that it is beneficial overall to the housing market to have these foreclosed and vacant homes be sold and reoccupied. But this position is based on the misguided but pervasive assumption that there are too few individual buyers who want to, or can, qualify to buy a home. As the numbers show, the potential demand in the housing market has increased by millions of households, given the low prices and low interest rates that have created historic affordability. Facilitating the sale of homes to individual working families would also achieve the goal of re-occupying vacant properties, and it would allow those families to enjoy the benefits of appreciation while investing directly in their own neighborhoods. Despite that potential, no request for information has been issued to solicit ideas on how federal policy could best help the millions of Americans take advantage of the current opportunity after years of being locked out.

These federal agencies could have solicited responses to the question: "What are strategies to help remove the barriers to homeownership so American households can take advantage of today's exceptional affordability?" Instead federal housing policy has left behind its historic commitment to helping the middle class access homeownership in favor of another round of investor speculation in the housing market.

### *How Do We Seize this Opportunity?*

Were federal agencies to issue such a request for information, how would we in the homeownership community respond? While it may be easy to take shots at federal agencies and Wall Street-backed investors (they do make themselves easy targets), the homeownership community has to some extent shown its own lackluster response to this golden opportunity. The chaos and economic damage of the market has taken its toll on the community's confidence in its mission and strategies to achieve that mission. How many homeownership organizations have started to drift from that core homeownership mission to pursue other strategies based on their fear that no one will buy a home these days?

The community of homeownership non-profit organizations and their funders should resist the herd-induced panic and instead recognize its own ability to help our clients and communities overcome

today's market challenges. There are organizations across America, like Homewise, that have prepared solid, successful homebuyers for years, using time tested practices. We should learn from the best practices of these organizations to develop and implement a homebuyer preparation system that adapts to today's challenges and opportunities, creating new homeowners in a way that propels them on a path to long-term financial security. This homebuyer preparation system should avoid past lending practices that adjusted underwriting standards to poor buyer credit histories and instead help buyers improve financial habits in order to qualify for a good mortgage. The organizations who have been successful in creating new homebuyers have built their strategy around two key tactics: buyer preparation and home purchase finance. The two work hand-in-hand, with buyer preparation creating new mortgage-ready clients, and home purchase financing rewarding hard work and incenting prudent financial behaviors.

### ***Buyer Preparation***

Earlier in this paper, we mentioned some of the barriers to homeownership: credit history, lack of savings, and excessive debt. Homewise and its colleague organizations work with buyers to help them overcome these barriers. With the right guidance, potential homebuyers can change their financial profiles in order to qualify for a high-quality mortgage. That guidance trains buyers to understand the credit scores, savings and debt standards they have to meet in order to qualify for a mortgage and helps them create a specific and achievable plan to reach those standards.

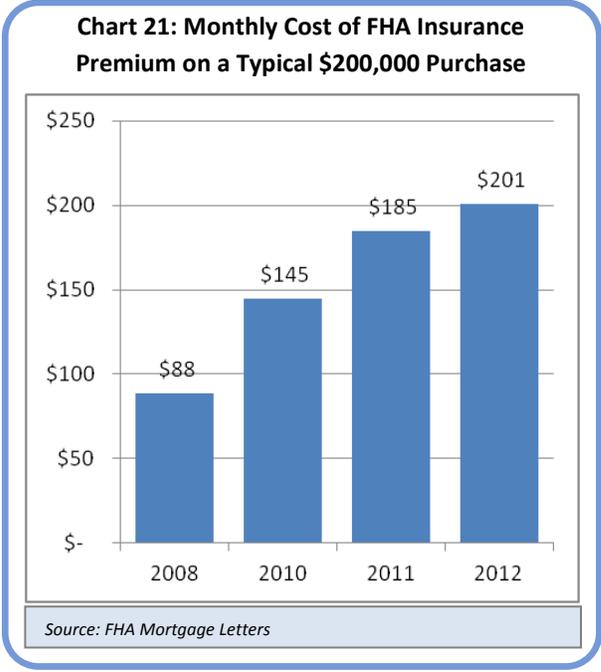
While there are many organizations that offer buyer preparation services, the current system is not coherent or comprehensive. The effectiveness of buyer preparation agencies varies widely, and the funding streams are sporadic, bureaucratic and, most distressing, not tied to actual outcomes. Could a collaborative effort by the best organizations in the industry improve on this buyer preparation system and create additional home purchase demand that could help turn around the housing market? We think the answer is yes.

### ***Financing***

After helping a buyer prepare for a mortgage, the next obstacle in today's market is the restriction on mortgage financing. As described above, credit standards have increased and both conventional lenders and FHA have created new barriers to financing. The main barrier for most families in securing stable, low cost financing is the down payment. Just as no one is born with bad credit, few of us are born with a ready down payment. Saving for a down payment has always been one of the daunting tasks associated with home purchase, but that task has become even more difficult as conventional lenders and FHA have placed barriers on the use of programs that help buyers meet down payment requirements. These programs include grant programs and both deferred and amortized second mortgages to lower the loan-to-value ratio of the first mortgage.

To take full advantage of this opportune moment, American homebuyers need a system of home purchase financing that rewards good financial habits while helping them overcome the down payment barrier. Unfortunately, FHA is not that system, yet for most people with less than a 20%

down payment, it has become the only option. FHA's insurance system not only creates additional, unnecessary, obstacles to home purchase (such as its unreasonable HQS requirements and its short-sighted limitations on the use of secondary financing), but it also increases the cost of ownership substantially. In June, the pricing on FHA insurance will rise, with a 1.75% up front fee added to the mortgage, and an additional 1.25% annual fee added to the owner's monthly payment. The cost of that insurance on a typical \$200,000 home purchase adds about \$190 per month to the payment compared to Homewise SuperPrime financing. By simply adding more cost to the mortgage in order to account for a buyer's perceived risk, FHA follows the same failed strategy that high cost subprime loans used, and with similar results. As shown in Chart 18 previously, FHA's current delinquency rate is just over 11%, second only to delinquencies on subprime loans.



There is a viable alternative to the FHA financing option or conventional loans that require large down payments. Throughout this paper, we have used Homewise SuperPrime financing while calculating the cost of homeownership. This financing model uses an amortizing second mortgage originated by Homewise to help clients meet the loan-to-value ratio requirements of the market-rate first mortgage. That financing accomplishes two major objectives. First, it allows the buyer to purchase with a down payment smaller than what is typically required by conventional loans while eliminating the high cost of FHA mortgage insurance. Second, it creates a strong incentive for Homewise to do a good job in preparing the buyer for long term success. With its own capital invested in the home, and in second position, Homewise has "skin in the game" and stands to lose if the buyer loses. Homewise's low delinquency rate demonstrates the effectiveness of this financing strategy when combined with the right buyer preparation.

What would it take to make SuperPrime-style financing widely available to buyers who have prepared themselves for homeownership? Organizations across the country have the capacity to combine buyer preparation with community lending, as Homewise does. But just as there is no coherent strategy or system for preparing buyers, neither is there a coherent system to capitalize this kind of home purchase financing and reward strong, financially prepared homebuyers.

Given these barriers, how would the homeownership community respond to the hypothetical request for information we wish had been issued? We believe the response should be a collaboration of high-performing private, non-profit homeownership organizations, improving and expanding on the tools we know to be effective in order to prepare and finance homebuyers for long-term success.

***Recommitting to Homeownership***

A national strategy of developing homebuyers and providing them with effective financing would help working families take advantage of today's historic affordability, and would help communities rebuild from the subprime loan and foreclosure crisis. But the first step is for organizations, leaders and individuals to recognize the opportunity in today's market and recommit to homeownership as a cornerstone of financial security for America's working families. Non-profit organizations who themselves have been shaken by the tumult of the housing market crash and economic recession should resist the urge to simply follow the herd and instead consider the potential benefits of facilitating homeownership in their communities. While many would wish for our federal housing agencies to take the lead developing a coherent strategy (in keeping with their organizational missions), expecting wholesale change or bold leadership from these agencies is not realistic. History has shown us that these agencies are not readily adaptable or fleet of foot, and their current reaction to the problem only confirms this trend. We believe the task of developing an effective strategy to support home purchase will fall to the private non-profit organizations that have been helping homeowners for decades.

Today's unique home purchase market has created unprecedented opportunities in homeownership, and with it, some daunting challenges. But there have always been challenges to those organizations working to help families achieve homeownership: that's why such organizations exist. If it were easy — if it had ever been easy— none of our organizations would have been founded in the first place. The homeownership community has taken on many daunting challenges over the decades without losing sight of our founding missions, and we should rally again to take on this next challenge as well. The opportunity for working families to achieve financial security through homeownership is too great to ignore. Now is the time to work harder than ever to seize that opportunity.

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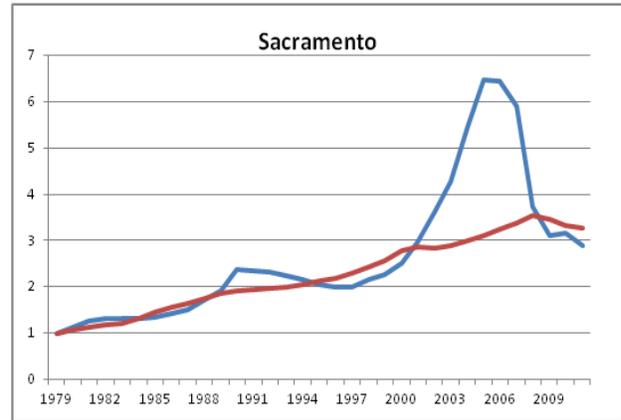
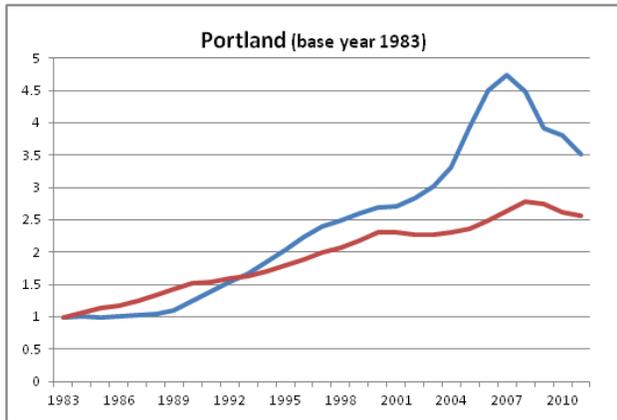
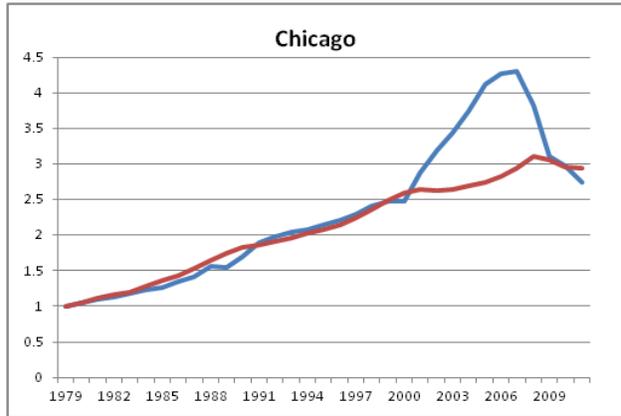
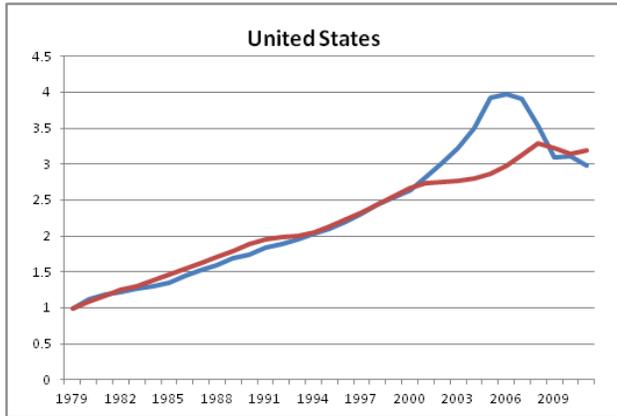
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### Appendix 1

#### Comparing Median Prices and Median Family Incomes Shows the Housing Bubble

Multiples of 1979 Values

— Median Sales Price      — Median Family Income



Source: National Association of Realtors Median Sales Price of Existing Single Family Homes, Moody's Economy.com tabulations of U.S. Census Bureau CPS Data