Joint Hearing of the Assembly Committee on Housing and Community Development and the Assembly Committee on Banking and Finance

"First-Time Homebuyers: Housing Policies for New Realities"
Wednesday, March 25, 2015
9:30am-12pm
State Capitol, Room 126

Introduction & Background

In early 2007 it became clear that the U.S. housing market was in deep trouble as several major mortgage lenders filed for bankruptcy, others teetered on the brink of collapse, and market liquidity vanished. The pain of the foreclosure crisis was widely shared by homeowners, the financial markets, investors, and others. Foreclosures blighted neighborhoods, put financial pressure on families, and drove down local real estate values. Consumers, made more cautious by a crippled housing market, spent less freely, curbing the economy's growth.

Has the pendulum swung too far?

When evaluating the current difficulties in the housing market it is important to note the effect of the subprime mortgage crisis that coincided, some say triggered, the Great Recession. The years leading up to the 2007 crash saw unprecedented housing price appreciation, market liquidity, and access to easy credit. In the sixteen years prior to the collapse, 1990 to 2006, the Mortgage Backed Securities (MBS) market grew by seven fold to its height of two trillion dollars through a combination of Government-Sponsored Enterprises (GSEs) and private label MBS issuance. Subprime mortgages with creative rates and terms were over 20% of the first-time buyer market. Access to mortgage credit was easy and a popular saying from the era was "If they can fog a mirror they can get a loan." Everyone, from government, buyers, sellers, brokers, lenders, and everyone else in the mortgage market all assumed that housing prices would rise forever and that young people buying homes were not just buying property, but were purchasing their own ATM machine. It was not uncommon for borrowers in their early twenties, yet to finish college or start a career, to buy homes with no money down and little to no established credit. The financial cultural narrative of the early to mid-2000's was to buy the house now and worry about the finances later. Like all parties that last too long and end abruptly, the participants were left stunned and full of regret.

The collapse of the housing market and the recession that followed dried up much of the mortgage market except what was supported by the GSEs. Due to market dynamics and efforts to provide greater oversight and reform of the mortgage market the credit pendulum has swung in the opposite direction. Underwriting standards are more restrictive, credit scores actually matter and regulators are regulating. These things alone should not lock-out buyers from the market, but it may take some time to bring lending standards to a neutral position that allow first- time buyers access while also managing risk. However, it is important that first-time homeownership not be measured against the excesses of the housing bubble which created artificial levels of homeownership. Perhaps the most difficult job of policy makers and private markets will be to determine what makes a healthy market for homeownership.

In 2015 California can still feel the ramifications of the housing crisis. Overall homeownership rates have declined. According to the recent U.S Census, California's homeownership rate dropped quickly in the fourth quarter (Q4) of 2014, falling over a percentage point to 53.2%. This is down from 54.6% one year earlier. The homeownership rate has plummeted from its 60.7% peak in 2006 to its present level. Hispanic and African American families have seen an alarming decline as well in the last several years, from 47% in 2005 to 42% in 2013 for Hispanics and 40% to 33% for African Americans.

The evident lack of first-time homebuyers is slowing the housing recovery process. It seems millennials in California are currently staying out of the housing market. According to Veros Real Estate Solutions, (who provide tools for comprehensive property valuation and risk assessment to mortgage lenders, servicers, rating agencies and the investment community) the percentage of first-time homebuyers has dropped to 33% down significantly from the long-term national average of 40% (dating back to 1981), a 27 year low. In addition, the lack of first-time homebuyers impacts the rental housing market as well by creating greater competition for a finite number of rental units. About 45% of all California households –5.6 million households -- are renters. A number of factors contributing to the decrease of homeownership, including student debt, affordability, lack of interest, and convenience of living with parents.

The average millennial is about 24 years old and makes only about $35,000 a year. In addition, millennials are technologically savvy, dependent on their smart phones and social media. Millennials not purchasing homes creates a stagnant housing market which then impacts financial institutions (mortgage lenders), communities, and families. According to the California Association of Realtors, a study found that 45% of college-educated millennials have moved back in with their parents because they can't find a job or the one they have doesn't cover student loan payments and a place to live. The biggest factor contributing to this problem is most likely student

debt. According to Jonas Moe, vice president of product strategy at Ellie Mae, "For the first time, our accrued student debt is higher than our credit card debt."

Another issue for millennials is that their credit history is unestablished but college has left them with an extreme amount of debt. A huge number of millennials also do not earn enough income to be able to afford a home in California. According to the recent report released by the Legislative Analyst's Office, titled "California's High Housing Costs: Causes and Consequences," an average California home costs $440,000, about two-and-a-half times the average national home price ($180,000) and California's average monthly rent is about $1,240, 50% higher than the rest of the country ($840 per month.)

The California Association Realtors released a survey based on millennials in October, 2014 which found:

- Of the millennial renters, the majority (67%) rent because they can't afford to purchase a home.

- Like any other home buying segments, millennials are concerned about high home prices and affordability, with nearly half (45%) citing those as their biggest concern about homeownership.

- One in two millennial renters has student debt, but most don't feel it is preventing them from qualifying for a mortgage. Additionally, more than four in 10 (43%) don't have debt that would prevent them from buying a home.

- Even though many millennials saw their parents struggle through the recession, more than half (59%) said the housing crisis didn't affect their attitude toward homeownership being a good investment.

- Despite the stereotypes that these young adults mostly seek urban living with a high walkability factor, millennials said they prefer single-family homes on large lots in the suburbs, with two out of three (67%) indicating they plan to purchase a single-family detached home, while only 12% said they plan to purchase a townhome or condominium.

- While they aspire toward homeownership, the majority was uncertain or doubtful they could obtain a mortgage now, with 45% saying they were not sure, and 33 % saying they would not be able to obtain a mortgage now.

Who is your Typical Millennial?

- Nearly 3/10 of millennials have a college degree.

- One quarter of millennials are students and only 1/3rd millennials have full time jobs.
- Majority rent (41%) or lives with their parents (36%), only 1/5 are home owners.

Renters

- Two-fifths of millennials are currently renting.
- Majority rent instead of buying because they cannot afford to buy, but most expect to buy a home in the same county or same neighborhood within 5 years.
- Contrary to common belief, detached single-family homes and big lots of land are the preferences of prospective buyers.
- The majority of millennials value home ownership, giving an average importance rating of home ownership of 7.1 on a scale of 1-10.

Buyers

- One-fifth of millennials are homeowners. Twenty-eight percent of those homeowners inherited their properties. Nearly 9/10 are first-time buyers.
- Affordability is the main reason for buying a home. Most millennial homeowners did not buy a home sooner due to a lack of urgency.
- They are optimistic about future home prices, with 59% expecting prices will be higher in a year and 63% think prices will go up in 5 years.

Financing

- The majority of millennial home buyers obtained financing. Of the 17% who paid cash, most of those funds came from personal savings.
- The average down payment for those who obtained financing was 26%.
- More than half found it easy to acquire financing, with an average difficulty rating of 4.4 on a 10 point scale (10 = extremely difficult).

Buyer/Agent Relationship

- Millennial homeowners preferred communicating with their agent through email and telephone and those expectations were met, for the most part. Agents also met expectations on response time, with most responding to their clients within the time frame the client expected.
- Buyers were mostly satisfied with the home buying process and with their agent because the agent worked hard and negotiated a good deal.
- Millennial buyers found that they needed the most assistance from agents in finding the right home and negotiating the purchase price. Many felt they

received a positive value from hiring an agent and would work with that agent again.

State Action for First-Time Homebuyers

The state invests in multiple programs for first-time homebuyers. Listed below are a few of the state agencies that administer these programs.

The California Housing Finance Agency (CalHFA)

Established in 1975, CalHFA was chartered as the state's affordable housing bank to make low-interest rate loans through the sale of tax-exempt bonds. CalHFA is a self-supporting state agency, and its bonds are repaid by revenues generated through mortgage loans. It provides funding for both single family homeownership and multifamily rental properties.

As part of its single family homeownership profile, CalHFA provides low interest rate mortgages to low and moderate income homebuyers, as well as downpayment and closing costs assistance. Eligibility requirements, such as income limits, vary depending on the program. For the purpose of first-time homebuyer assistance, a "first-time homebuyer" is defined as someone who has not owned and occupied their own home in the last three years. Programs such as the California Homebuyers Downpayment Assistance Program (CHDAP) help first-time homebuyers achieve homeownership by providing "silent" second-mortgage loans to reduce the principal and interest payments on a first mortgage. The CHDAP provides a deferred-payment junior loan – up to 3% of the purchase price, or appraised value, whichever is less, to be used for their down payment and/or closing costs. This program may be combined with a CalHFA or non-CalHFA, first mortgage loan. Buyers generally access these loan funds through their lender.

Another program offered by CalHFA, the Mortgage Credit Certificate (MCC) program, is also geared towards first-time homebuyers. The MCC Tax Credit is a federal credit which can reduce potential federal income tax liability, creating additional net spendable income which borrowers may use toward their monthly mortgage payment. This MCC Tax Credit program may enable first-time homebuyers to convert a portion of their annual mortgage interest into a direct dollar for dollar tax credit on their U.S. individual income tax returns. Exceptions to the first-time homebuyer requirement are 1) the home is located in a federally designated targeted area or 2) the homeowner is a qualified veteran pursuant to the Heroes Earning Assistance and Relief Tax Act of 2008.

Department of Housing and Community Development (HCD)

The role of HCD, according to its mission statement, is to "[p]rovide leadership, policies and programs to preserve and expand safe and affordable housing opportunities and promote strong communities for all Californians." HCD is involved in numerous housing programs and policies throughout California, and administers more than 20 programs that award loans and grants for the construction, acquisition, rehabilitation and preservation of affordable rental and ownership housing, homeless shelters and transitional housing, public facilities and infrastructure, and the development of jobs for lower income workers. Generally, these loans and grants are made to local public agencies, nonprofit and for-profit housing developers, and service providers. In many cases these agencies then provide funds to individual users.

For example, as part of Proposition 46, the CalHOME Program provided funds for homeownership programs to assist low- and very low-income households become or remain homeowners. Funds were allocated in either grants to programs that assist individuals or loans that assist multiunit homeownership projects. Grant funds were used for first-time homebuyer downpayment assistance, home rehabilitation, homebuyer counseling, home acquisition and rehabilitation, or self-help mortgage assistance programs, or for technical assistance for self-help and shared housing homeownership. Loan funds were used for purchase of real property, site development, predevelopment, and construction period expenses incurred on homeownership development projects, and permanent financing for mutual housing or cooperative developments.

Franchise Tax Board (FTB): New Home/First-Time Homebuyer tax credit program

Homeownership is a public goal under the existing tax structure, and the state New Home/First-Time Homebuyer tax credits reflected this goal. In 2009, the Legislature passed and the Governor signed SBX2 15 (Ashburn, Chapter 11, Statutes of 2009), which authorized a $10,000 tax credit (or 5 percent of the purchase price if that amount is lower) for taxpayers purchasing qualified homes after March 1, 2009 and before March 1, 2010. The legislation allocated $100 million in credits for previously unoccupied homes that serve as the taxpayer's principle residence. The FTB allocated all of the available credits by July 2, 2009, on a first-come, first-serve basis.

In 2010, AB 183 (Caballero/Ashburn, Chapter 12, Statutes of 2010) reauthorized this tax credit to provide an additional $100 million in credits for taxpayers purchasing previously unoccupied homes between May 1, 2010 and December 31, 2010, or any taxpayer who purchases a qualified home on and after December 31, 2010, and before August 1, 2011, pursuant to an enforceable contract executed on or

before December 31, 2010. An additional $100 million in credits were also authorized for first-time homebuyers purchasing existing homes in the same time frames. The FTB fully allocated the $100 million allotted for the First-Time Homebuyer credit, and allocated $94 million for the New Home credit.

Federal Action for First-Time Homebuyers

Fannie Mae and Freddie Mac/Government Sponsored Enterprise (GSEs)

In October of 2014, the GSEs announced that they will allow loan-to-value (LTV) ratios as high as 97%. This is an effort to make more homeownership more accessible since a down payment may be the biggest hurdle for a potential buyer. This change means buyers can put down just 3% instead of the previous 5% down payment requirement that was in place for conforming mortgage loans. Investment properties and second homes are not eligible.

Eligibility requirements for Fannie Mae's 97 % LTV Offering:

- At least one borrower must be a first-time homeowner (no ownership interest in last 3 years)
- Available on one-unit principal residences only
- Maximum loan-to-value ratio 97%
- No income limit requirements for standard purchases
- Reserves may be gifted
- Only fixed-rate loans with terms up to 30 years are eligible
- No high-balance loans or adjustable-rate mortgages
- Manufactured housing not permitted
- Mortgage insurance is required
- Minimum 620 FICO score
- Pre-purchase home buyer counseling is not required
- Must be underwritten through DU
- Available now

Eligibility requirements for Freddie Mac's Home Possible Advantage

- Available for low- and moderate-income borrowers
- Both first-time buyers and other borrowers with limited down payment savings can qualify
- First-time home buyers must participate in homeowner education program
- Maximum loan-to-value ratio 97%
- Loan options include 15, 20, and 30-year fixed mortgages
- Can be used to purchase a single-unit, primary residence
- Minimum 620 FICO score

- Manufactured housing not permitted
- Income limits vary by area (no limit in underserved areas)
- Lender-paid mortgage insurance permitted
- No reserves required
- Available March 23rd, 2015

U.S Housing and Urban Development (HUD)

In early January, 2015, HUD announced the Federal Housing Administration (FHA) will reduce the annual premiums new borrowers pay by 0.5 percentage point from 1.35% to 0.85%. This change is projected to save more than two million FHA homeowners an average of $900 annually and spur 250,000 new homebuyers to purchase their first home over the next three years.

During the housing crisis FHA increased its premium prices to stabilize the health of its Mutual Mortgage Insurance Fund. The reduction announced is an effort to expand access to mortgage credit for families and is expected to lower the cost of housing for the approximately 800,000 households who use FHA annually. The new annual premiums took effect in late January.

FHA Loans

An FHA loan is a mortgage loan that is insured by the FHA. Essentially, the federal government insures loans for FHA-approved lenders in order to reduce their risk of loss if a borrower defaults on their mortgage payments.

The FHA program was created in response to the rash of foreclosures and defaults that happened in the 1930s; to provide mortgage lenders with adequate insurance; and to help stimulate the housing market by making loans accessible and affordable. FHA loans are very popular, especially with first-time home buyers.

Eligibility requirements for a FHA loan.

- Must have a steady employment history or worked for the same employer for the past two years.
- Must have a valid Social Security number, lawful residency in the U.S. and be of legal age to sign a mortgage in the state purchasing.
- Must make a minimum down payment of 3.5%. The money can be gifted by a family member.
- New FHA loans are only available for primary residence occupancy.
- Must have a property appraisal from a FHA-approved appraiser.
- The front-end ratio (mortgage payment plus HOA fees, property taxes, mortgage insurance, home insurance) needs to be less than 31% of gross income, typically.

Buyers may be able to get approved with as high a percentage as 46.99%. The lender will be required to provide justification as to why the lender believes the mortgage presents an acceptable risk. The lender must include any compensating factors used for loan approval.

- The back-end ratio (mortgage plus all your monthly debt, i.e., credit card payment, car payment, student loans, etc.) needs to be less than 43% of your gross income, typically. Buyers may be able to get approved with as high a percentage as 56.99%. The lender will be required to provide justification as to why they believe the mortgage presents an acceptable risk. The lender must include any compensating factors used for loan approval.
- Minimum credit score of 580 for maximum financing with a minimum down payment of 3.5%.
- Minimum credit score of 500-579 for maximum LTV of 90% with a minimum down payment of 10%. FHA-qualified lenders will use a case-by-case basis to determine an applicants' credit worthiness.
- Typically the buyer must be two years out of bankruptcy and have re-established good credit. Exceptions can be made if the buyer is out of bankruptcy for more than one year if there were extenuating circumstances beyond the control that caused the bankruptcy.
- Typically the buyer must be three years out of foreclosure and have re-established good credit. Exceptions can be made if there were extenuating circumstances and credits improved.
- There are maximum mortgage limits for FHA loans that vary by state and county. In certain counties, you may be able to get financing for a loan size up to $729,750 with a 3.5% down payment. Conventional financing for loans that can be bought by Fannie Mae or Freddie Mac are currently at $625,000.

Veteran Affairs (VA) Loans

Designed to help active duty military and veterans qualify for homeownership, VA Home Loans are guaranteed by the U.S. Department of Veteran Affairs and feature easy home financing options. Because VA loans are government insured, they offer veterans and military personnel lower interest rates and better terms than conventional mortgages. With a government insured VA mortgage, veterans and military personnel may secure a home purchase loan with no down payment and no monthly mortgage insurance premiums. VA Home Loans are popular for first-time mortgages and for buyers with less-than-perfect credit.

Benefits to a VA Home Loan include:

- No down payment required
- Negotiable interest rates
- Adjustable & fixed rate mortgage options
- No monthly mortgage insurance premiums

- No prepayment penalty
- VA assistance to borrowers due to financial difficulty
- Ability to finance the VA funding fee
- Reduced funding fees with a down payment of at least 5% and exemption for veterans receiving VA compensation

Alternative Homeownership Models

There are a variety of alternative homeownership models in California. Some of these methods involve nontraditional ownership models, while others involve nontraditional methods of financing. Below are just a few examples.

Community Land Trusts (CLT)

The CLT model is a mechanism for maintaining and expanding the stock of affordable housing. CLTs, which are community-based and governed by a non-profit board, retain ownership of the land and transfer ownership of the improvements to rental housing developers or income-eligible homebuyers. In the homeownership context, homeowners own the structure but not the underlying land, which they lease via a long-term ground lease. This model promotes affordable homeownership by reducing the cost of the home and ensuring long-term affordability through land covenants.

Lease-to-Own

In lease-to-own real property transactions, the potential homeowner initially lives in the property as a renter, and pays towards purchasing the property within a specific period of time. While lease-to-own contracts vary, they can be used as a mechanism to assist first-time homebuyers. For example, Visionary Home Builders in Stockton, a non-profit lender and developer, offers a lease-to-own program for eligible applicants that do not currently own a home and with an income that does not exceed 80% of the local AMI. As part of the contract, participants develop a plan that allows them to live in their future home for three to five years as they repair their credit, save for a down payment, and plan a household budget that will help sustain long-term homeownership. At the end of the program, participants should be in the financial position to purchase the home. Achieving and promoting financial stability is a central component of the program, and participants are required to participate in extensive financial education.

Community Lending

Community lending involves working with homebuyers who have limited access to down payment funds and who can only afford properties with deed restrictions not found in a traditional real estate transaction. Many mission-based community lending institutions are 501(c)(3) non-profits, while others are for-profit. These

lenders often work with multiple layers of financing and have expertise in deed restrictions that help maintain long-term affordability. In addition to financing, these organizations may provide other community-based services, such as financial counseling and foreclosure prevention.

Conclusion

While some remain pessimistic as to what the future holds in the homeownership realm, many remain optimistic. As home values continue to rise after the housing bust, it is timely to identify programs available to first-time homebuyers and explore the shifting economic realities of becoming a homeowner. Only then can we explore possible solutions to sustainably increase our record low homeownership rate.