Regaining the Dream

Case Studies in Sustainable Low-Income Mortgage Lending

Massachusetts' SoftSecond® Loan Program

An alliance of organizations pools resources and risks to reduce down payment requirements for 15,000 low-income households to become homeowners

Participants

- Massachusetts Housing Partnership (MHP)
- Massachusetts Affordable Housing Alliance
- More than 40 commercial banks and credit unions
- Commonwealth of Massachusetts
- Massachusetts Bankers Association
- More than 50 homebuyer counseling agencies

The Gap

In 1989, research from the Federal Reserve Bank of Boston uncovered a pattern of racial bias in mortgage lending. The authors wrote, "The findings show that housing and mortgage credit markets are functioning in a way that hurts black neighborhoods in the city of Boston."[i] The study generated public outrage and led the Massachusetts Housing Partnership, the City of Boston, the Massachusetts Bankers Association, the Massachusetts Affordable Housing Alliance and other community advocates to form a coalition in search of innovative methods for expanding homeownership to underserved households.

Lack of assets for down payment and high house prices relative to income have long been recognized as the key barriers facing lower-income, lower-wealth families in attaining viable homeownership (Quercia, McCarthy and Wachter, 2003).[ii] The affordability gap in Boston, where the program was first conceived, has historically been among the worst in the nation with a current median house price that is more than five times area median income.

Closing the Gap

In 1990, the coalition introduced the "SoftSecond Loan Program," an innovative and efficient way to increase the purchasing power of lower-income Massachusetts households.

Massachusetts Housing Partnership (MHP), which manages the program, had been founded in 1985 and operated the Homeownership Opportunity Program, a conventional affordable housing program which used public funds to subsidize mortgage interest rates. The SoftSecond program, in which an average public investment of $5,000 leverages nearly $200,000 in private mortgage financing, enabled more efficient use of public funds. Over the past two decades, the SoftSecond program has financed $2.5 billion in mortgage lending through more than 40 participating banks and credit unions to help more than 15,000 families buy their first home.

The SoftSecond Model

Under the SoftSecond program, borrowers can receive financing for up to 97 percent of a home's purchase price in a two-part loan extended by one lender. The first part of the loan is a standard conventional first mortgage for up to 77 percent; the second part, the "SoftSecond" finances the remaining 20 percent. A down payment of 3 percent is required but only half of that must come directly from the borrower.

Not only does the program address the down payment gap, it also eases the debt-to-income burden. The first loan is 30-year, fixed-rate, fully amortizing and made at or below prime market rates. No points can be charged to the borrower and no loan-level price adjustments made based on risk-based pricing models common in the market.

The "SoftSecond" portion is also a fixed-rate loan and requires interest-only payments for the first 10 years, and then fully amortizes over the remaining 20 years.

Additionally, some low- income borrowers qualify for a subsidized rate on the "SoftSecond." In this case, the MHP provides an upfront payment[1] to the lender to make up the difference, and then adds a 0% interest rate, subordinate lien to the financing. The funds are required to be repaid upon sale, but the repayment obligation allows borrowers to retain at least 80% of any net appreciation after five years of ownership. Notably, a review of the SoftSecond program found no evidence that the subsidy increased the likelihood of default.[iii]

The SoftSecond Model

3%	Down Payment	Amount: 3%; minimum 1.5% borrower's own funds (minimum $1,500), remaining amount can be gift or grant
97%	1st mortgage	Amount: typically 77% of the purchase price Term: 30 years (Homeowner pays full P&I) Provider: participating lender Interest Rate: lender's 30-year, 2-point fixed rate with no points charged
	SoftSecond mortgage	Amount: 20% of purchase price or $20,000 (whichever is greater) Term: 30 year term; interest-only for first 10 years, amortizing over 20 years Provider: participating lender Interest Rate: same as the 1st mortgage (interest may be subsidized by public funds for the first 9 years)
	3rd mortgage (for borrowers receiving interest subsidy)	Amount: equal to the total public funds used to subsidize 2nd mortgage interest payments Term: 30 years – subsidy recapture provision triggered upon refinance or sale Provider: MHP Interest Rate: 0%

The borrower is expected to repay the subsidy upon refinance or sale.

Who takes the risk on the "SoftSecond" portion of the financing? MHP funds a loan loss reserve account that is pooled by lender and is available to pay any losses incurred by that lender on the second lien.

Who SoftSecond Targets

Since inception, the SoftSecond program has helped more than 15,000 borrowers in Massachusetts, which MHP estimates is 10 percent to 20 percent of eligible households statewide.

The SoftSecond program is designed to help lower-income first-time homeowners. The maximum eligible household income is 100 percent of area median income (AMI) and any household earning less than 80 percent of AMI is eligible for the interest rate subsidy. The program particularly targets borrowers earning 60 percent of AMI or less, who account for over half of borrowers served in FY2009 and FY2010. Total household income averaged $50,200 in 2011.

Historically, half the loans are to minority, first-time purchasers statewide, while in the Boston area that figure is two thirds.

Product

The loans must be 30-year fixed rate mortgages, and the SoftSecond portion has interest-only payments for

1 This payment is equal to the discounted value of the reduced interest payments the lender expects to receive.

the first 10 years, so the payments step up modestly over time depending on whether and how much subsidy was received, at a predetermined schedule.

In this manner, the SoftSecond program provides *real* affordability, in contrast to the illusion of affordability provided by disastrous, exploding payment adjustable-rate loans that were prevalent in the mid 2000s and wrecked financial havoc on so many households, communities and the economy as a whole. These exotic loans regularly featured an artificially low initial rate (at which the borrower would be qualified), and unpredictable future payments that could more than double even within the early years of the loan.

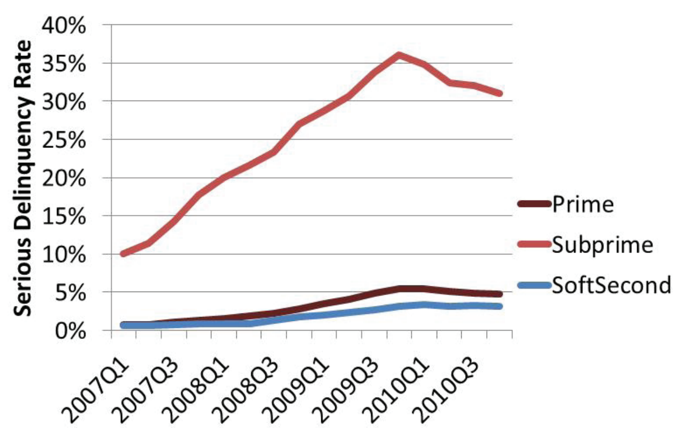
Loans made under the SoftSecond program are fully underwritten for ability to repay. Maximum allowable debt-to-income (DTI) ratios for single-family and condominiums are 36 percent on the front-end and 43 percent on the back-end. Generally, a minimum credit score of 660 is required. Furthermore, there is no potential for negative amortization. And the long horizon and modest payment adjustments allow the household to plan and benefit from normal income growth.

In order to qualify, applicants must complete a pre-purchase education class from one of 52 agencies approved by the Massachusetts Homeownership Collaborative. Classes take place over at least two days and include a minimum of eight hours of instruction.

Mortgage delinquency and default are kept low through additional, post-purchase counseling, known as HomeSafe, developed by the Massachusetts Affordable Housing Alliance. Each SoftSecond homeowner is required to attend a workshop within one year of closing for guidance on budgeting, maintenance, security, managing credit and avoiding delinquency. Graduates are then eligible for discounts on homeowners' insurance, appliances, and other purchases. In the event of delinquency, the MHP notifies one of a network of counseling agencies, who then proactively reaches out to contact the borrower to offer assistance.

Performance

Throughout the ongoing foreclosure crisis, the serious delinquency rate (90+ day delinquent or in foreclosure) of borrowers in the SoftSecond program have tracked not just below subprime loans, but consistently below the delinquency rate for even prime loans in Massachusetts. Analysis of the SoftSecond program from its inception to FY2010 found a cumulative default rate of just 3.4 percent. With lenders retaining some part of the credit risk, the cumulative loss rate was just 44 basis points, a substantial portion of which was covered by loan loss reserve funds.



Note: Massachusetts figures only
Source: Mortgage Bankers Association; Massachusetts Housing Partnership

Implications for the Future

This program offers many lessons to take forward:

- A relatively small amount of public subsidy has leveraged private dollars to finance affordable homeownership for 15,000 households.
- A strong network of public and private institutions has made the program what it is today. It is the result of a long history and evolution of efforts to put homeownership safely within reach of more qualified households through access to safe,

traditional mortgage products.

- The originating lenders have kept "skin the game" while working with the public sector to mitigate their risks. Loans are well underwritten, and borrowers are supported in their responsibilities as homeowners through both pre-and post purchase counseling.

While originally motivated to combat long-standing racial bias in access to home ownership finance, in recent years the program has also served to solve a new problem: neighborhood stabilization. In 2010, more than 40 percent of SoftSecond buyers purchased in cities hardest hit by foreclosures, playing an important role in the recovery of communities at a time when other sources of financing are pulling back.

The SoftSecond program is a primary mortgage market innovation. Today, its most significant challenge is the inability of lenders to sell mortgages on a flow basis to the secondary market. If this were possible, lenders would be able to originate SoftSecond loans with fewer, if any, internal volume restrictions. If the mortgage secondary market entities (Fannie Mae and Freddie Mac) can agree to systematically buy these loans, the program's reach and scale could be greatly expanded.

---

[i] Bradbury, Katharine L., Karl E. Case and Constance R. Dunham. "Geographic Patterns of Mortgage Lending in Boston, 1982-1987." *New England Economic Review*. (1989).

[ii] Quercia, Roberto G., George W. McCarthy and Susan M. Wachter, The Impacts of Affordable Lending Efforts on Homeownership Rates, Journal of Housing Economics, Volume 12 Issue 1, March 2003, pp 29-59.

[iii] Park, Kevin. "Determinants of Mortgage Default." Prepared for Massachusetts Housing Partnership. (2010).

[iv] Winn, Douglas. "Static Pool Analysis Report." Prepared by Willary Winn, LLC for Massachusetts Housing Partnership. (2009).

UNC
COLLEGE OF
ARTS & SCIENCES
CENTER *for* COMMUNITY CAPITAL

Regaining the Dream: Case Studies in Sustainable Low-Income Mortgage Lending is a project of the UNC Center for Community Capital, with Ford Foundation funding, to document successful home loan programs that expand homeownership opportunity to low- and moderate-income people.

The UNC Center for Community Capital 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 analyses help policymakers, advocates and the private sector find sustainable ways to expand economic opportunity to more people, more effectively. For more information, visit www.ccc.unc.edu.

UNC Center for Community Capital
1700 Martin Luther King Jr. Blvd, Suite 129
CB# 3452
Chapel Hill NC 27599-3452
Phone 919.843.2140
Toll Free 877.783.2359
communitycapital@unc.edu
www.ccc.unc.edu