



The Down Payment Report

News and Data on Residential Down Payments

November 2019

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DPA Cause and Effect

The rising level of defaults in the FHA portfolio is a cause for concern, but some of the proposed solutions could do more harm than good. Assuming that down payment assistance (DPA) from state and local housing agencies—or down payment assistance generally—inherently contributes to defaults is a good example.

As researcher Michael Stegman asserts in his new paper by the Center for Household Financial Stability at the Federal Reserve Bank of St. Louis, borrowers who do not have access to help from family and friends are more likely to make use of government-sponsored assistance. These borrowers tend to be lower income and African American.

However, aiming to manage mortgage defaults by limiting borrowers using down payment assistance or government-sponsored down payment assistance would deny mortgages to qualified borrowers with better credit than many who rely on gifts.

Rather than making homeownership even more difficult than it already is for borrowers who qualify for help from housing finance agencies, wouldn't it be a better idea to use tools that we know will reduce defaults, such as requiring homeownership education or raising FHA's credit standards?

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THE DPR INTERVIEW

Low Down Payments and Default Risk

A regular feature of the Down Payment Report, the DPR Interview showcases national leaders in homeownership assistance and low down payment programs.



Michael Stegman, Senior Research Fellow, Federal Reserve Bank of St. Louis

Michael Stegman is a senior research fellow in the Center for Household Financial Stability at the Federal Reserve Bank of St. Louis where he conducts research on the impact of homeownership on the balance sheets of low-income households. He also holds senior fellow positions at the Milken Institute Center for Financial Markets, and the Center for Community Capital at the University of North Carolina where he focuses on housing finance reform and affordable housing. He co-authored [“A Cautionary Tale of How the Presence and Type of Down Payment Assistance Affects the Performance of Affordable Mortgage Loans.”](#)

Q. Can you summarize your findings?

FHA purchase borrowers with down payment assistance have an earlier default rate than those without down payment assistance. We don't know what lies behind this since we haven't really been focusing on the credit attributes of the borrower. It may well be that those who have down payment assistance do have a higher credit risk, and it's not caused by the down payment assistance. There may be other factors, and as long as those borrowers meet the minimum lending threshold for FHA's scorecard.

In our paper, we look at default risk in the same population with and without down payment assistance. We try to isolate credit characteristics of the borrower, the local economy, the nature of the collateral of the house, the loan characteristics such as interest rate, LTV, and so on, and then determine whether or not the addition of down payment assistance is an incremental default risk. What we find in our analysis that when we control for all of those other borrower characteristics, lateral and market characteristics, down payment assistance is not an incremental default risk beyond the level of risk caused by other factors. That's the big question -- Does down payment assistance, all other things being equal, heighten default?

Q. How does race figure into your findings?

We really did not set out to look at the relationship of ethnicity to this question. Our objective was to answer the broader question of whether down payment assistance is incremental default risk, and our answer to that is no.

Then as we looked at sources of down payments, including down payment assistance programs, family and friends, government programs, and secondary financing, we found that there were differential utilization rates of those different sources by race and ethnicity.

(continued)

(DPR Interview continued)

A very, very important finding is that African American borrowers in our study are less likely to get help from family and friends. They are more likely to get it from government programs. So if you are thinking about going back to FHA, where they say that the highest elevated early default rates were among those who obtain down payment assistance, government programs have the highest rate of government default among all the different sources. So they may target that source of down payment assistance for either tighter imitations or by making assistance more expensive for borrowers. What we are saying is that that kind of market intervention will raise the cost of those loans, and that would have the greatest impact on African American borrowers.

If you look at FHA's housing finance reform plan that came out in September, they hone in on this issue. They say that given the higher early payment default rates and serious delinquency rates associated with government down payment assistance loans, FHA will evaluate whether its current premium structure is commensurate with the risk that the taxpayers are taking on.

What we are saying is that if they find that a significant number of FHA borrowers with government down payment assistance pose a greater early default risk than those without government assistance, it may not be the down payment assistance that's causing that elevated risk. That's the point I want to drive home.

Q. What additional research do you recommend on this issue?

We would love to see panel studies of FHA and GSE data that could replicate this pretty unique dataset. The reality is with a lot of housing finance agencies, homebuyer education with down payment assistance has become a huge part of their business model. There's a dearth of hard statistical model of the effects of loan performance on down payment assistance.

We didn't know what our findings would be, but we hoped that they would generate interest in replicating what we found with different data sets. I would love to see more data on down payment assistance through housing finance agencies.

Down Payment Assistance

Fed Study Finds HFA Down Payment Assistance Doesn't Inherently Increase Default Risk

In its [Housing Finance Reform](#) plan issued in September, HUD expressed significant concern over the increasing share of first-time homebuyers relying on DPA to finance their purchases and announced that “FHA will evaluate whether its current premium structure for these loans is commensurate with the risk taxpayers are taking on. It also is important that any DPA provided with respect to FHA loans complies with all legal requirements.”

However, HUD's analysis fails to take into account other risk factors unrelated to down payment assistance, such as the borrower's demographic attributes, including credit score, which could lead to poorly designed and racially punitive corrective action.

A new paper, “A Cautionary Tale of How the Presence and Type of Down Payment Assistance Affects the Performance of Affordable Mortgage Loans,” published by the St. Louis Federal Reserve found that down payment assistance, including down payment assistance from a government agency such as a state or municipal housing finance agency or community organization, does not inherently increase the risk of default. The study, conducted by Michael A. Stegman, Sarah F. Riley, and Roberto G. Quercia, was also shared by [the Harvard Joint Center for Housing Studies](#). (See *DPR Interview on page 2 with Michael Stegman*)

The researchers used data from a large sample of low- and middle-income borrowers whose mortgages were originated between 2000 and 2003 and tracked them over ten years. Because the use of various forms of DPA varies across racial groups, and the relationship of DPA to mortgage performance may vary by race, racial controls were included in the study. Other factors controlling for in the study were housing turnover and median year of construction in the census tract where the CAP house is located, but these additional measures do not account for the relationship between grant assistance and prepayment risk.

Though delinquency rates for FHA purchase loans with down payment assistance are generally higher than for loans without DPA, especially when the down payment assistance comes from governmental entities and non-profits rather than gifts from family or friends, the differences in default rates disappear when controls for ethnicity and race are introduced.

The study found that:

- Blacks are significantly less likely than whites to have received assistance from family or friends, but significantly more likely than whites to have received assistance via a second mortgage, or to have received a government or community grant;
- In contrast to what is found by simple descriptive analysis, the receipt of DPA is not significantly associated with default risk; and
- Grant assistance from a government or community organization has a marginally significant association with default risk, but this effect disappears when racial controls are incorporated in the model.

“Our multivariate analysis indicates that the receipt of DPA is not significantly associated with default risk. In particular, while grant assistance from a government or community organization is marginally significant as a predictor of default risk in one of our model specifications, this effect disappears altogether when racial controls are incorporated in the model. Thus, the receipt of DPA appears to be unrelated to default risk,” the authors of the study concluded.

Apple Pledges \$1 Billion to Help Bay Area First-time Buyers

As part of a \$2.5 billion plan to help address the housing availability and affordability crisis in California, [Apple](#) announced November 4 that it will contribute \$1 billion to provide down payment assistance to Bay Area first-time buyers.

Soaring housing costs and a crisis in affordable housing has motivated nearly 30,000 people to leave San Francisco between April and June of this year and homeownership in the Bay Area is at a seven-year low.

Apple said it will work with the State of California's first-time homebuyer fund to provide homebuyers with financing and down payment assistance. Apple and the state will explore strategies to increase access to first-time homeownership opportunities for essential service personnel, school employees and veterans.

[CalHEA](#), the state's housing finance agency, helped more than 11,000 low- and moderate-income residents buy their first homes in the 2018-2019 fiscal year, the most ever in the agency's 44-year history.

Down Payment Trends

Median Down Payments Fell in 2018-2019

Median down payments for both first-time buyers and all buyers fell one percentage point in the 2019 edition of the National Association of REALTORS' annual [Profile of Home Buyers and Sellers](#).

For first-time buyers, the median down payment fell from 7 percent in the 2018 Profile to 6 percent in 2019. The lowest median down payment for first-time buyers in recent years was 2 percent in 2005 and 2006. First-time buyers were 33 percent of all buyers, the same share as in the 2018 Profile.

For all buyers, the median down payment fell to 12 percent from 13 percent in 2018. The lowest median down payment by all buyers was 8 percent in 2007 and 2008.

For 60 percent of buyers, the source of their down payments came from their savings. Thirty-eight percent of all buyers used the proceeds from the sale of a primary residence, which was the next most commonly reported way of securing a down payment.

"Lower down payments among home buyers are another result of rising home prices as buyers find it difficult to save for a down payment. Seventeen percent of all buyers and 25 percent of first-time buyers used an FHA loan to purchase, likely taking advantage of low down payment programs," NAR said.

First-time Homebuyers

Number of First-Time Homebuyers Expected to Rise

A new [TransUnion analysis](#) projects at least 8.3 million first-time homebuyers will enter the mortgage market between 2020 and 2022. That number could climb to as high as 9.2 million if economic growth exceeds expectations. Both growth projections mark a significant acceleration from the 7.6 million first-time homebuyers added in the last three-year period (2016-2018).

The analysis was released by TransUnion's [mortgage business unit](#) at the Mortgage Bankers Association Annual Convention & Expo. The findings come at a time when overall homeownership growth has been muted. As of Q2 2019, 68.3 million consumers carried a mortgage balance, on par with the 68.2 million observed one year earlier in Q2 2018. The totals remain significantly lower than a decade ago, when 73.1 million consumers carried a mortgage balance in Q2 2010.

"While we've recently seen a boom in refi activity, actual homeownership rates are down. Challenges have included high home prices, sluggish wage growth and limited housing inventory," said Joe Mellman, senior vice president and mortgage business leader at TransUnion. "But we may be starting to see daylight as slowing home price appreciation, low unemployment, increased wage growth and low interest rates are helping affordability. As a result, we are optimistic that first-time homebuyers will contribute more to homeownership than at any time since the start of the Great Recession."

Number of First-Time Homebuyer Originations Expected to Rise in Next Three Years

Three-Year Date Range	2020-2022*	2016-2018**	2013-2015	2010-2012	2007-2009
Millions of First-Time Homebuyers (Originations)	8.31 to 9.20	7.64	6.67	6.32	6.75

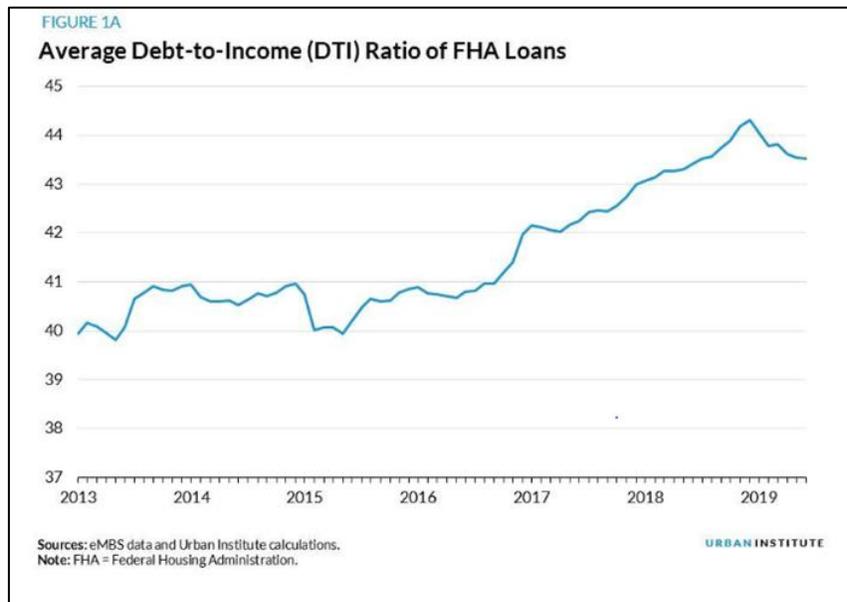
**Projection. **Note that we do not include 2019 as the year has not yet completed. Projection for 2019 is 2.7 million.*

FHA

Urban Institute: Raising FICO Scores is a Better Way to Reduce FHA Defaults

Noting that the average debt-to-income (DTI) ratio for FHA-insured loans has been consistently increasing for six years, FHA has signaled that it may tighten credit. However, a [recent Urban Institute analysis](#) found that DTI ratios are much less significant predictors of loan performance than FICO scores and that many high-DTI loans have strong FICO scores.

According to the FHA's quarterly report for its fiscal second quarter (which covers Jan. 1, 2019 through March 31, 2019), the average credit score for an FHA borrower fell to 665 in the second quarter. That's the lowest level since 2008 and is "well below" the FHA lending peak credit score of 703, which happened in 2011.



The analysis shows that higher-DTI loans do not always have higher serious delinquency rates. For example, 5.6 percent of loans with DTI ratios ranging from 0 to 35 percent have been seriously delinquent at 60 months of age, compared with 7.6 percent of loans with DTI ratios of 35 to 45.

But for loans with DTI ratios greater than 50, some 6.9 percent had delinquency rates over 90 percent. That's lower than those with DTI ratios of 35 to 45. For FICO scores, the percentage with delinquency rates over 90 percent ranged from 3.3 percent for loans with FICO scores greater than 780 to 12 percent for loans with FICO scores less than 620, or a factor of 3.5 percent.

"There is no question that higher-DTI loans, all else being constant, default at higher rates than low-DTI loans. However, even in the FHA market, the relationship is weak. FICO scores are much stronger predictors of default than DTI ratios," the study concluded.

No relief in sight on MIP

HUD has no plans to lower its mortgage insurance premiums (MIP) this year, Secretary Ben Carson told [HousingWire](#) in an interview following his speech at the Mortgage Bankers Association annual meeting in mid-October.

The Mutual Mortgage Insurance Fund (MMIF), which now has surplus of 2 percent, should be much stronger than it has been in recent years before the agency makes any changes to FHA mortgage insurance rules, he said.

“You know, there was a time the MMIF was like 6 percent,” Carson said. “That gives you a lot of flexibility. When it comes to experimenting with things, maybe looking at alternative credit sources, there are a lot of things you can do when you’re up at 6 percent that you can’t do when you’re at 2 percent.”

Last February, the [National Association of Mortgage Brokers](#) called on FHA Commissioner Brian Montgomery to consider changing the Mortgage Insurance Premium (MIP) structure in order to make the FHA mortgage more competitive with other loan products.

“We are concerned that FHA is only attracting the lowest credit score and highest debt-to-income borrowers which ultimately puts the Mutual Mortgage Insurance Fund at a greater risk for loss,” said NAMB President Richard M. Bettencourt.

FHA New Home Sale Loans Rose in Q3

Mortgages backed by the FHA made up 16.3 percent (27,000) of total sales of new homes in the third quarter, 2.5 percentage points higher than Q3 2018. The FHA share has averaged 17.9 percent since the end of the Great Recession, according to an analysis of the most recent quarterly sales by the [National Association of Home Builders](#).

Conventional loans accounted for 69.9 percent of new home sales in the third quarter of 2019, a 2.7 percentage point increase from Q2 2019. After 10 quarters above 70 percent, the percentage of new home sales financed with conventional mortgages has been below 70 percent each of the last three quarters.

VA Home Loans

VA Refunds \$400 Million to Veteran Homeowners

Veterans Affairs officials have paid out more than \$400 million in refunds of home loan funding fees in the wake of an inspector general's report that tens of thousands of veterans were improperly tagged with extra costs when applying for the loans, according to [Military Times](#).

Department officials said they reviewed 130,000 cases over the summer to look for errors, which mostly involved simple clerical mistakes or disability ratings changes after veterans settled on their loans.

Under existing rules, veterans and service members must pay a VA funding fee when they apply for a VA home loan, with costs between 0.5 percent and 3.3 percent of total money lent. The money is designed to defray some administration costs for the department, but disabled veterans are exempt from the fee.

VA Fees Will Rise in 2020; No More Loan Limits

Veterans and military service members will have more borrowing power but will pay slightly higher fees when they use VA home loans next year. The changes are part of the Blue Water Navy Vietnam Veterans Act of 2019, signed into law in June and effective Jan. 1, 2020.

The new law eliminates VA loan limits and increases the VA funding fee. It also provides disability benefits to certain Vietnam War veterans and their children.

Currently, VA loan limits are the same as those set by the Federal Housing Finance Agency on conforming loans. The limit in 2019 is \$484,350 in a typical U.S. county and higher in high-cost counties.

The fee for first-use, zero-down loans will be 2.3 percent of the loan amount in 2020, up from 2.15 percent for regular military in 2019. The fee for subsequent use loans will be 3.6 percent of the loan amount, up from the current 3.3 percent. These fees will stay in place for two years, return to current levels from 2022 to October 2029 and drop further after that. (Source: [NerdWallet](#))

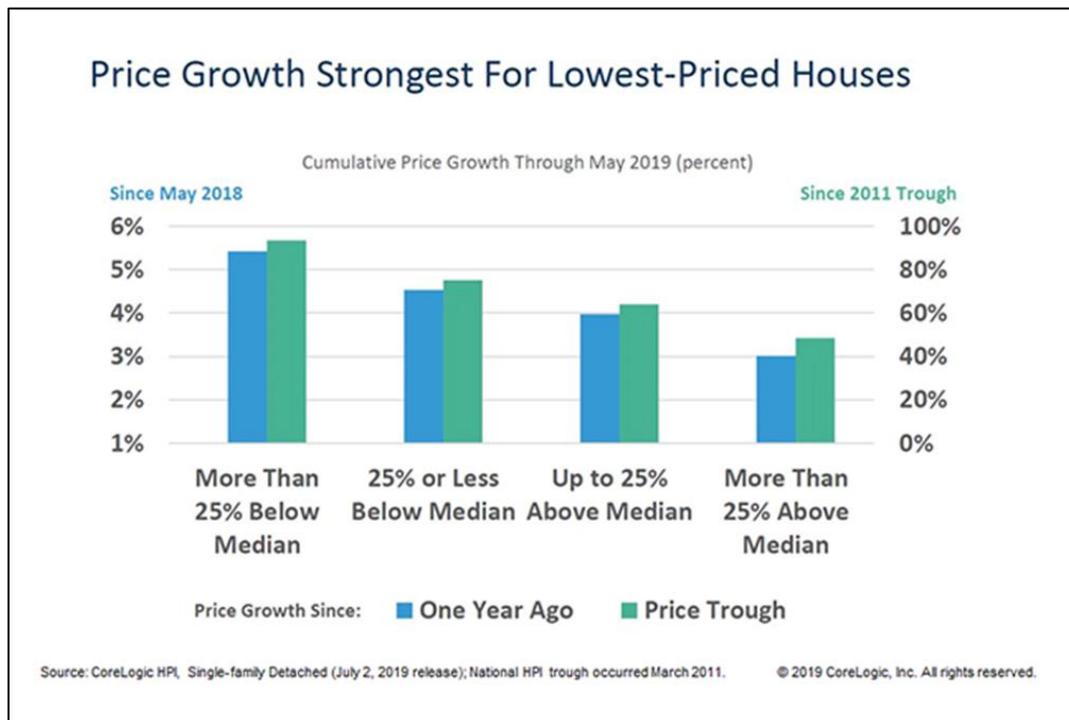
Affordable Housing

Lower Priced Homes Appreciate Much Faster

While home prices have been steadily rising for many years, [CoreLogic Chief Economist Frank Nothaft](#) recently noted that lower-priced homes are appreciating much faster than more expensive ones. Since May 2018, prices of homes more than 25 percent above the median have risen 3 percent, while homes in the lowest tier, those more than 25 percent below the median, have risen almost 5.5 percent.

Nothaft said demand from investors as well as from first-time buyers was driving up prices for less-expensive homes. Many would-be homebuyers are scrambling to find homes within their price range and increased activity of investors, who typically prefer to buy lower-priced homes as investments, has exacerbated the issue. The investor share of entry-level home purchases has sharply risen over the past two decades, going from 10.7 percent between 1999 and 2003 to almost double at 19.2 percent in 2015-2019.

"New construction, while picking up gradually over the last few years, is still well below what it was prior to the housing boom," Nothaft noted. The current inventory for homes is tightest in the lowest price tiers, particularly in those between 50 and 100 percent of the median home price. He said home builders are showing a preference to build expensive homes over affordable homes. In fact, only about 2 percent of entry-level homes are new sales, compared to 12 percent of premium homes, less than half of what it was two decades ago.



Source: [CoreLogic](#)

Down Payment Data

September Loan Data: Millennial Buyers

September	Millennials
Median loan size	\$205,806
FICO	729
LTV	85
DTI	24/36
Market Shares	CON 74%, FHA 22%, VA 2%

Source: [Ellie Mae Millennial Tracker](#)

Comparison of First-time and Repeat Buyers

Characteristics	GSEs		FHA		GSEs and FHA	
	First-time	Repeat	First-time	Repeat	First-time	Repeat
Loan Amount (\$)	246,983	275,276	219,328	240,111	236,375	270,412
Credit Score	743	757	669	673	714	745
LTV (%)	88	80	96	94	91	82
DTI (%)	35	36	43	44	38	37
Loan Rate (%)	4.11	4.01	4.25	4.12	4.16	4.03

Sources: eMBS and Urban Institute.

Note: Based on owner-occupied purchase mortgages originated in July 2019.

Source: [Urban Insitute October Chartbook](#)

September Purchase Loans

September	LTV	DTI	FICO	RATE
All loans	77	24/37	737	3.9
Conventional	80	24/36	754	3.96
FHA	95	20/44	675	3.96
VA	98	25/42	703	3.65
Millennials	85	24/36	729	4.05

Sources: [Ellie Mae Origination Reports and Millennial Tracker](#)

Key Facts

Data Highlights from this Issue

- A new paper released by Harvard Joint Center for Housing Studies found that neither down payment assistance from government agencies and non-profits nor down payment assistance increases default risk.
- Raising credit score standards rather than lowering DTIs is a better way to reduce FHA defaults, according to an Urban Institute study.
- National median down payments paid by first-time buyers (6 percent) and all buyers (12 percent) fell by one percentage point this year.
- Despite competition from conventional lenders, HUD does not plan to lower the mortgage insurance premium this year.
- Transunion forecasts a significant increase in first-time buyers from 2020 to 2024.
- Lower-priced homes continue to appreciate faster than more expensive ones, putting pressure on housing affordability.
- The Veterans Administration is refunding \$400 million in overpayments for funding fees made by veteran homebuyers.
- Next year and thereafter, VA loans will have no loan limits.

About the Down Payment Report

A regular service of Down Payment Resource, The Down Payment Report collects, archives and distributes the latest news, research and trends in residential down payments, including down payment assistance programs, low down payment options, mortgage insurance and homeownership education. The Down Payment Report is researched and written by [Steve Cook of Communications Consulting](#). Contact him at scook@commsonconsulting.com.

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