Self-Help’s Community Advantage Program

A secondary market outlet that provides liquidity for community reinvestment lending has funded more than 50,000 mortgages made by 29 lenders in 48 states since 1998 without incurring widespread defaults.

Participants

- Self-Help Ventures Fund
- Ford Foundation
- Fannie Mae
- Mortgage Lenders
- UNC Center for Community Capital (Evaluator)

The Gap

Three stark facts motivated Self-Help’s commitment to providing mortgage loans to underserved households. First, the median household of color held around one tenth the net wealth of the median white household. Second, home equity was – and continues to be – the largest component of household wealth for families earning low or moderate incomes (LMI). And third, less than half of Hispanic and black households were homeowners in the mid-1990s, compared to around 70 percent of white households.

The homeownership gap translates into a gaping wealth disparity that far outstrips earning disparities in the United States. Self-Help recognized the role that disparate access to mortgage credit played in enabling lower-income and minority households to enter the ranks of home ownership and participate in the many social and economic benefits of home ownership.

In the mid-1990s, inflexible secondary market guidelines formed a key barrier to mortgage lending to underserved households. Through Community Reinvestment Act activities, banks were finding sustainable ways to finance affordable mortgages for more LMI and minority borrowers and communities, but they were often blocked from selling these loans in the secondary market and faced limits on the amount of such loans they could hold in portfolio. Self-Help recognized that facilitating the sale of such loans to Fannie Mae would open a major pipeline of affordable capital to communities that had long been left dry.

By the early 2000s, however, another wave of financing – subprime lending – was overtaking bank CRA and the affordable housing lending of government-sponsored enterprises in this segment and would ultimately grow into a tsunami. During these years, the lenders participating in CAP used this program to offer a standard prime-priced affordable fixed-rate mortgage alternative to the high-cost, high-fee, risky subprime products.

Closing the Gap

Self-Help Credit Union was founded in 1984 to address the credit needs of minority, rural, women-headed and lower-income households who were underserved by traditional lenders. Among its activities, Self-Help has directly financed $336 million in direct home lending to over 4,500 homeowners since its creation. Over the years, the good performance of the mortgages extended by the credit union convinced the organization that low-resource households could successfully obtain and sustain homeownership.

This lesson was also being demonstrated by North Carolina banks through the 1980s and 1990s, as they sought to meet CRA requirements by making mortgage loans in low- and moderate-income communities and to low- and moderate-income households. However, because the loans often did not conform to traditional underwriting standards (those established by Fannie Mae and Freddie Mac), they could not be sold on the secondary market. Though the programs performed well, even large commercial banks were constrained by the illiquidity of their growing portfolios of community mortgages.

The makings of a solution arose in 1994 when Self-Help purchased a portfolio of “non-conforming” loans from Wachovia, thus freeing capital for Wachovia to continue lending to more low- and moderate-income borrowers.
Building on this model, the Community Advantage Program (CAP) emerged four years later with a $50 million grant from the Ford Foundation to establish a loan loss reserve fund. With this fund in place, Fannie Mae agreed to purchase mortgages with Self-Help’s recourse (a form of guaranty provided by the seller of the loans, in this case, Self-Help). The program launched in fall of 1998 with four lending partners.

Self-Help has since worked with almost 30 lenders across the country to finance $4.74 billion in mortgages to nearly 52,000 homeowners across the country.

Another important by-product of the CAP program is in-depth knowledge about the benefits, risks and opportunities of mortgage lending to low-income and low-asset families. The portfolio of CAP loans, along with detailed annual surveys of borrowers, has provided the basis for a wealth of research from the UNC Center for Community Capital.

The CAP Model

Self-Help provides credit enhancement and acts as a financial intermediary between lenders and investors. Mortgage lenders originate mortgages to low- and moderate-income borrowers using their own customized guidelines (approved by Self-Help). Self-Help then purchases approved loans from these lenders and then sells or securitizes them with Fannie Mae.

Importantly, Self-Help retains the credit risk of the mortgages. If a borrower defaults, Fannie Mae can seek recourse and compensation, which highlights the importance of the loss reserve fund established with the help of the Ford Foundation. Fannie Mae can then either hold the mortgages in portfolio or pool the loans into mortgage-backed securities and sell them to investors, who can be confident of the credit quality of the investment.

Who CAP Targets

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Products

As noted, CAP borrowers would likely be disqualified from prime mortgages by high debt-to-income ratios and low credit scores. Further, they often can only afford low down payments on a mortgage. Over 69% of CAP homeowners had loan-to-value (LTV) ratios in excess of 95% at origination. Conventionally, such borrowers would typically only qualify for subprime mortgages with high interest rates and other high risk features like prepayment penalties and interest-only or negative amortization schedules. Nevertheless, Self-Help mostly offers very traditional mortgage products.
The CAP portfolio is predominately thirty-year, fixed-rate mortgages, retail originated, for the purpose of purchasing a home. The cost of a typical CAP mortgage is comparable to the cost of a prime fixed-rate mortgage originated in the same period. No mortgage insurance or junior liens are needed. Participating lenders set their own guidelines (subject to Self-Help and Fannie Mae approval) to meet the needs of their markets and the risk management requirements of their organizations.

Performance

The use of proven, safe products has resulted in strong performance through the foreclosure crisis. Of CAP borrowers, two-thirds have never missed a payment and just 4.8% have resulted in a foreclosure sale.

In general, the serious delinquency rate is more similar to conventional prime mortgages than subprime mortgages, despite borrower profiles more similar to the later.

In fact, Center for Community Capital research found that subprime loans were three to five times more likely to default than loans to comparable borrowers originated under the Community Advantage Program.\textsuperscript{vii}

Implications for the Future

The CAP experience clearly shows that home lending to lower income, low down payment borrowers can be good and sustainable business, even in challenging economic times. The elements of success include offering traditional, prime-market-priced, fixed-rate, 30-year mortgages without hidden fees and penalties. They also include prudently underwriting borrowers for ability to repay and documenting income and assets and credit histories.

For the most part, the programs used by lenders in the CAP program were encouraged by CRA and Affordable Housing objectives. Both explicitly call for lenders to apply safety and soundness considerations while at the same time finding ways to lend more flexibly. The results show that lenders can do both at the same time.

Significantly, the Self-Help pilot demonstrated how to bring a successful program to scale, efficiently, by using mainstream market participants. In particular, it underscored the critical importance of the secondary market in making affordable financing available to more families. If it had used the Ford grant to make direct mortgages, it might have served about 600 families. By instead offering a credit enhancement to encourage Fannie Mae to buy and securitize mortgages made by lenders around the country, it has helped nearly 50,000 families obtain financing.