HELP
Home Essentials Loan Program

CONCEPT DOCUMENT

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IDEAS • INNOVATION • IMPLEMENTATION

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THE OPPORTUNITY

Estimating the true cost of home ownership can be difficult, especially for first time homebuyers. And while those ongoing costs can be a challenge to manage, it is typically the expenses incurred shortly after the home purchase that pose the largest obstacle. Even if buying a newly constructed home, the borrower may still need to purchase new appliances, furniture, a fence, etc. If the home is older, the buyer may find themselves in a position of having to complete a number of repairs or renovations.

If a borrower makes a significant down payment, the lender might offer them a home equity line of credit (HELOC), which can then be used to absorb these additional expenses. Generally, the maximum combined loan to value (CLTV) on a HELOC is between 80% and 95%. However, considering that the median amount financed for a first time homebuyer is 98%, a HELOC is clearly not an option (MarketWatch.com, March 9, 2008 "100% More Difficult"). Therefore, when considering how to pay for any required repairs, upgrades, etc., a first time homebuyer has two primary options: tap their savings or use consumer credit.

Assuming the borrower has little in cash reserves, or is simply reluctant to deplete their savings after making such a large purchase, the remaining option is consumer credit. For good or bad, there is no lack of availability when it comes to consumer credit for home-related purchases (e.g. appliances, home repairs, etc.). However, availability does not translate into affordability. For example, the Home Depot Consumer Credit Card starts at 17.99% APR, and the Sears Card, offered through CitiBank, is advertised at 25.24% APR. While both of these programs offer teaser rates or other short-term incentives, the repayment terms can be overly burdensome (pay in full quickly or face high interest rates). Conversely, if the borrower chooses to make just the minimum payment amount each month, this debt can extend out for years, costing the borrower thousands in interest.

THE SOLUTION

During the mortgage closing process, a credit union could offer homebuyers an affordable unsecured line of credit of either $5,000 or $10,000—depending on credit quality and income—to be used for household purchases and repairs (called the Home Essentials Loan Program or "HELP"). After 90 days, the HELP line of credit is suspended and the current balance is amortized over a five-year term. The interest rate and payment amount are fixed and there is no pre-payment penalty. The HELP interest rate, maximum loan amount, and underwriting criteria would be set by each participating credit union. Ideally, the credit union would also issue a plastic card tied to the account that expires after 90 days. Not only does this improve convenience, by doing this, the credit union could also restrict purchases to certain merchant categories and generate interchange income.

The repayment term is what differentiates the HELP from a standard credit card or line of credit. The borrower benefits from the easy to access line of credit during their time of need, but is then required to make a fixed payment amount until the debt is repaid in full. On a credit card, the borrower could simply make the minimum payment each month, which is generally a percentage of the balance rather than a fixed amount. The discipline of having a fixed payment amount versus being allowed to make just the minimum payment benefits the borrower greatly in terms interest saved. The following example illustrates this:

> *Assuming an 8.99% APR and a $5,000 advance, the monthly HELP payment would be approximately $100 (about $20 per $1,000 borrowed). If the borrower advances the full $5,000, they would pay about $1,200 in interest and be debt-free in five years. However, if the borrower were allowed to make a minimum monthly payment based on 2 percent of the balance—the standard requirement for most credit card issuers—the borrower would pay about $2,200 in interest and would carry a balance for about 15 years. The disciplined approach saves the borrower $1,000.*

The second and more impactful difference is the lower, fixed interest rate when tied with a disciplined repayment approach:

> *Using the lowest Home Depot Consumer Credit Card interest rate of 17.99%, and a 2% minimum monthly payment, the borrower would pay approximately $12,800 in interest and it would take 35 years to repay the obligation.*

HELP achieves the ideal mix of credit availability, affordability, and repayment discipline.

As previously mentioned, it is recommended credit unions issue a branded card that is tied to the HELP line of credit. This essentially makes the account a credit card and would therefore need to comply with all applicable laws and regulations. If the credit union offers a design-a-card program (customizable plastic), the credit union could also add a picture of the borrower's new home on the card:

The credit union could also pre-arrange discounts or rebates with local merchants, helping the borrower to save even more money when using the HELP. This could include local landscapers, appliance centers, contractors, etc. A list of these services, along with the amount of the pre-arranged discount or rebate, could be included in the card mailer and on the credit union's website.

TARGET MARKET

The primary target market is first time homebuyers, between the ages of 24 to 34, with good credit. This target market is the most likely to need additional household items (e.g. furnishings). According to the National Association of REALTORS, these consumers have a median income of about $60,000, which easily supports a small line of credit.

A secondary target market is repeat homebuyers, who also made a small down payment, and need capital in order to repair or make small upgrades to their new home.

CONSUMER BENEFITS

- Convenient, immediate access to credit.
- Affordable, fixed monthly payment amount.
- Low, fixed interest rate.
- One lender for every need.
- The disciplined repayment approach reduces borrower anxiety around acquiring new credit.

CREDIT UNION BENEFITS

- Loan growth.
- Increased interest income.
- Deeper member relationship.
- Simple to launch, as the program can be integrated into the existing mortgage loan process.
- The general concept is easily adaptable to other member life events (e.g. honeymoon, small start-up business, vacation, etc.).

PILOT RESULTS

To test whether first time homebuyers need access to additional capital, Unitus Community Credit Union in Portland, Oregon, plans to launch a beta version of HELP in early October 2011. The Credit Union will offer the program to new borrowers, as well as to borrowers who closed a mortgage loan within the last ninety days. The Credit Union will look to see if there is interest in the product, and if so, what the utilization rate is between disbursement and conversion.

To accommodate the unique nature of the program, Unitus had its legal counsel develop an addendum to its standard loan agreement and disclosure. Unitus also confirmed the loan account could function as designed in its core system (including the automation of conversion).

OPERATIONAL AND OTHER CONSIDERATIONS

Launching a basic line of credit is relatively simple. However, a credit union considering the HELP will need to confirm whether its core system will allow for conversion once the line of credit expires (move from open-end to a closed-end), and whether that process can be automated.

With the unique structure of the HELP, credit unions will want to engage legal counsel in order to ensure compliance with all applicable laws and regulations pertaining to consumer credit, and specifically credit cards, should the credit union tie the account to a piece of plastic.

This product should be sold at the time of mortgage origination. The product could also be touted as a standard feature on all purchase-money loans.

FINANCIAL PRO-FORMA

Assumptions for a Mid-Sized Credit Union		
Line of Credit (LOC) Limit:	Minimum: $5,000	Maximum: $10,000
Average Number of Loans Originated:	Monthly: 20	Annually: 240
Average LOC Limit Amounts: **(50% qualify for $5K, 50% qualify for $10K)**	Monthly: $150,000	Annualized: $1,800,000

Average Outstanding Balances Year 1: **(50% of LOC limit amount; 50% of full year balances)**	$325,000
Average Interest Rate per Loan:	8.99%

Projected Income & Expenses - Program		
Interest Income on Year 1 Average balances:	**$38,140**	
Loan-Related Expenses:		
Cost of Funds:	$3,380	Estimated COF at 1.04%
Projected Charge-offs:	$10,660	Unsecured loan experience 3.28%
Subtotal Loan-related Expenses:	**$14,040**	
Servicing Expenses:		
Origination costs	$7,200	One hour at $30/hour for 240 loans
Annual Servicing costs	$3,600	One hour per year at $30/hour (120)
General Overhead costs	$3,600	$30 per serviced loan per year (120)
Subtotal Servicing Expenses:	**$14,400**	
Total Loan-Related and Servicing Expenses:	**$28,440**	
Year One Net Profit:	**$6,700**	
Rate of Return on Average Outstanding Balances:	**2.06%**	

Net Profit per Loan Basis	
Year 1 Interest Income	$318.00
Cost of Funds	$ 28.17
Loan Losses	$ 88.83
Servicing & Other Expenses	$ 90.00
Net Profit First Year	**$110.83**

RESOURCES

N/A

GETTING STARTED

1. Determine your account pricing.
2. Determine your underwriting criteria.
3. Validate that your core system can handle account conversion and add new loan type, as needed.
4. Update or revise the loan agreement and disclosure, if applicable.
5. Create marketing materials.
6. Train staff.
7. Contact Filene for additional information about HELP at innovation@filene.org