Working Together Mortgage

CONCEPT DOCUMENT

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IDEAS · INNOVATION · IMPLEMENTATION

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THE OPPORTUNITY

With record low lending rates and an abundance of homes available for sale, young consumers have an optimal opportunity to purchase their first home. Home values in many parts of the United States have either plateaued or in many states, have declined. Regulatory changes have led to tighter lending guidelines, yet many financial institutions are aggressively seeking ways in which to stimulate borrowing. The lack of ability to produce the normal 20% required down payment to purchase a home causes frustration to otherwise qualified borrowers.

In the February 6, 2012 edition of *Fortune* magazine, Janice Revell addressed the issue of young consumers being unable to purchase a home. She wrote, "One in three first-time buyers received either a gift or loan from their families to help buy a home in 2011, according to the National Association of Realtors."

The Working Together Mortgage addresses this issue and allows the young consumer to work together with their parents in order to make the seemingly unrealistic dream of purchasing a home a reality.

THE SOLUTION

The Working Together Mortgage is a mortgage product that helps the first time home buyer obtain an 80/20 mortgage without having to have 20% cash for the down payment. It utilizes the equity from a relative's home (most likely a parent) pledged as part of the down payment. By avoiding the requirement for Private Mortgage Insurance (PMI), the borrower saves money and also may save on the monthly payment since the loan's interest rate is based on an 80% LTV. The parent benefits because they can assist with the down payment without having to borrow or pull cash to put down on the mortgage, they can continue to focus their cash toward their retirement or other goals.

The equity pledge would be released in 10 years or earlier depending on the appreciation rate of the borrowed property. If the parents decide to sell their property during this time they could do so and the equivalent cash for the pledged amount would be used in place of the equity pledge so that the loan against the borrowed property is reduced to an 80% Loan to Value.

TARGET MARKET

The primary target market is first time home buyers with a relative (primarily a parent) that has equity in an existing home and is willing to pledge that equity as collateral for the first time home buyer. The first time home buyer will need to have good credit and adequate cash flow to fully service the mortgage loan.

According to a Federal Reserve study sent to Congress in January, 2012, first time home buyers tend to be younger (less than 34 years old), have newer credit profiles, lower-than-average credit scores and fewer economic resources to make a large down payment. According to the National Association of Realtors, people between the age of 25 and 34 made up 27 percent of all home buyers in 2011, the lowest in the last decade and compared to 33 percent in 2001. The ailing economy and very tight lending conditions in the mortgage markets has led to a decline in mortgage borrowing by potential first time home buyers.

This product solution is intended to stimulate home ownership among a segment of the population that may not have the resources to qualify for a traditional mortgage loan. Yet the strong underwriting criteria and contribution of equity by a relative (parent) mitigates potential risk of default.

CONSUMER BENEFITS

- Enables consumers to purchase a home easier.

- Gives consumers an additional trusted funding resource to purchase a home.
- Helps the consumer with the down payment on a home and avoid the costs of Private Mortgage Insurance and obtain a lower interest rate.

CREDIT UNION BENEFITS

- Enables credit unions the chance to reach a younger demographic.
- Allows credit unions to establish a relationship with a member's entire household.
- By adding more mortgages to its portfolio, a credit union can earn additional income.
- Program is fairly easily to implement, with minimal additional documentation needed to what the credit union already uses for a traditional mortgage.

PILOT RESULTS

A survey was conducted using members at Veridian Credit Union, Directions Credit Union, and Sandia Labs Federal Credit Union. 3,306 members gave feedback on the Working Together Mortgage concept. When asked the likelihood to consider buying a home with a relative offering the use of the equity in their home, 56.7% of respondents said they were either likely or very likely to take advantage of this opportunity.

Directions Credit Union in Toledo, Ohio has implemented this program at their institution. However, no Working Together Mortgages have been disbursed at the time of publication.

OPERATIONAL AND OTHER CONSIDERATIONS

The Working Together Mortgage is underwritten using the same standards the credit union uses for standard mortgages. The same documentation can be used for this mortgage with two additional documents – a Signature Authorization form allowing the credit union to discuss all aspects of the mortgage with involved parties including any parties involved in securing the mortgage. This is done to allow the credit union to be able to share with the party pledging their property for the down payment information regarding late payment or missed payments on the mortgage. The other document is a Consent to Mortgage which is the document used to pledge the equity for the down payment.

Other considerations when doing a Working Together Mortgage. There are two:

- Mortgages – one for the borrower and one for the pledged property
- Proofs of Insurance –one for the borrower and one for the pledged property
- Flood Insurance Certificates – one for the borrower and one for the pledged property
- Appraisals – one for the borrowed property and one for the pledged property

In addition, there are the following documents:

- Lien search for the pledged property.
- Title insurance for the borrowed property.
- Right to Rescind document signed by the borrower and one signed by the person pledging equity.

Mortgage originators or staff would want to present this mortgage concept to both the borrower and the party providing the equity pledge to make sure they both understand their roles in the mortgage and the costs and savings resulting from the Working Together Mortgage.

Any state, city, or country documents necessary for a mortgage would also be applicable with the Working Together Mortgage concept.

FINANCIAL PRO-FORMA/ROI

Please see Attachment A.

RESOURCES

Please see Attachment B for an example of the financial aspects of the Working Together Mortgage.

GETTING STARTED

Contact us if interested at innovation@filene.org.

FINANCIAL PRO-FORMA/ROI

Assumptions for a Mid-Sized Credit Union		
Median home purchase price for first time home buyer[1]:	$150,000	
80% Loan to Value on Borrower's home + 20% Loan to Value on parent's home	$150,000	
Average Number of Loans Originated with Parental Assistance that wouldn't have been originated otherwise:	Monthly: 2	Annually: 24
Average Outstanding Balances Year 1: **($300k X 12 months X 50% of full year)**	$1,800,000	
Average Interest Rate per Loan:	3.875%	

Projected Income & Expenses – Program		
Interest Income on Year 1 Average balances:	**$69,180**	
Loan-Related Expenses:		
Cost of Funds:	$15,480	Estimated COF at .86%
Projected Charge-offs:	$ 4,500	Estimated at .25%
Subtotal Loan-related Expenses:	**$19,980**	
Servicing Expenses:		
Origination costs	$1,440	Two hours at $30/hour for 24 loans
Annual Servicing costs	$ 720	One hour per year at $30/hour (24)
General Overhead costs	$ 720	$30 per serviced loan per year (24)
Subtotal Servicing Expenses:	**$2,880**	
Program Start-up Expenses:		
Attorney's fees for extra disclosures	$ 450	3 hours at $150 an hour
Extra title company expenses for two mortgages	$3,000	$125.00 for 24 loans
Staff Training & Administration expenses	$2,000	5 hours @ average hourly rate of $40 for 10 people
Subtotal Extra Expenses:	**$5,450**	
Total Loan, Servicing & Program Expenses:	**$28,310**	
Year One Net Profit:	**$40,869**	
Rate of Return on Average Outstanding Balances:	**2.27%**	

Net Profit per Loan Basis	
Year 1 Interest Income	$ 5,765.00
Cost of Funds	$ 1,290.00
Loan Losses	$ 375.00
Servicing & Other Expenses	$ 347.00
Net Profit First Year	**$3,753.00**

1 Median home price for first time homebuyers according to 2005 American Housing Survey.
2 Proforma assumes borrower pays for all other closing costs (title, appraisal, credit reports, etc.)

Working Together Mortgage – Attachment B – Example of the Financial Aspects:

Purchase Price	$177,100
Borrower's Cash Down	$ 5,000
Parent Equity Pledge	$ 30,420 (Child puts in $5000;parents pledge makes up difference to reach 20% down payment)
Amount Loan Payments Based on	$172,100

Borrower's Cost and Savings:

Monthly Savings from no PMI	$ 75.21 (this is money that could be used toward student loans, other debt, or beginning retirement savings for borrower)
Savings over 1st 10 years of loan	$ 9,025.20

Costs for Working Together Mortgage:

Borrower Closing Costs	$ 2,600 (this is estimated at 1.5% of cost of mortgage)
Costs for Pledge Property	$ 700 (appraisal, lien search, flood certificate, record mortgage)
Total Costs	$ 3,300

Total Net Benefit of Working Together Mortgage For Borrower	$ 5,725.20
Monthly Savings to Parent If would have borrowed Against Equity for cash down	$ 254.04
If invest monthly savings at 4.25% For 10 years (period of equity Pledge) parent would save toward Retirement (this is based on Investment into a 10 year Fixed rate annuity)*	$ 30,549.13
Total savings of Working Together Mortgage	$ 36,274.33

The equity pledge would be released within 10 years if no appreciation on the borrower home. It could be released sooner if the borrower's home appreciates to a point at which the LTV is 80%. In the above example this would be when the Mortgage amount remaining reaches $141,680.

**Note – the annuity investment rate is quoted from Directions Credit Union Investment Advisor.*