



The Wealth Building Home Loansm : A straight, broad highway to building wealth for middle and working class families

The revolutionary Wealth Building Home Loansm, developed by AEI's Edward Pinto and Stephen Oliner, is a new home loan that is less risky than the popular 30-year loans, allows the homeowner to quickly build equity, and encourages buying the right-sized house, all while providing the opportunity to build wealth and save money on loan interest: You own your home free and clear in just 15 years.

What is the Wealth Building Home Loansm?

The Wealth Building Home Loan (WBHLsm) provides low-income borrowers a straight, broad highway to building wealth based on a 15-year, fully amortizing, fixed-rate loan. It has a much lower foreclosure risk because of faster amortization and common-sense underwriting. Its monthly payment is almost as low as 30-year, fixed-rate loan while providing the buyer with more than 90 percent of the buying power. It requires little or no down payment and has a broad credit box, meaning sustainable lending for a wide range of prospective homebuyers.

A homeowner with a WBHL will build wealth through faster accumulation of equity—a function of how the mortgage payment is split between principal and interest payments. In the first three years of a WBHL, 77 percent of monthly mortgage payments pay off principal, creating huge amounts of equity, while in a 30-year loan, 68 percent goes to pay interest. With the WBHL you own your home free and clear in 15 years, and in year 16, you have free cash flow for life-cycle needs such as your children's education.

How does the WBHL work?

The WBHL delivers more than 90 percent of the buying power of a 30-year FHA loan because of the combined effect of four factors:

- The conventional 15-year loan rate is 0.75 percent below FHA 30-year rate.
- The annual credit risk expense is lower.
- The strong savings component safely allows for a slightly higher housing debt-to-income ratio.
- A maximum LTV (loan-to-value ratio) of 100 percent allows for repurposing the 5 percent in down payment funds for a 1.25 percent permanent rate buydown.



The initial rollout of the WBHL for low-income buyers is being undertaken by the Neighborhood Assistance Corporation of America (NACA) and Bank of America this month and will be implemented throughout NACA's 37 offices over the next few months. Other WBHL pilots are expected to follow, including ones for middle-income homebuyers.

Why the WBHL?

For more than 50 years, US housing policy has relied on ever-looser underwriting standards in an attempt to lift the homeownership rate, particularly for low- and moderate-income homebuyers as an attempt to build wealth for these households. But the effort to advance the homeownership rate has failed miserably. While the homeownership rate expanded from 43.6 percent in 1940 to 61.9 percent in 1960, it has been largely stagnant since and is now declining from the current 64.7 percent.

A 2013 paper by Herbert et al. of the Harvard Joint Center for Housing Studies sums up this view:

"In many respects, the notion that owning a home is an effective means of accumulating wealth among low-income and minority households has been the keystone underlying efforts to support homeownership in recent decades."

This policy has not proven to be a reliable and consistent wealth-building tool because homes generally, and any one home in particular, are a highly volatile asset (particularly, lower-priced homes), especially when combined with risky loan terms and the slow amortization of a 30-year loan. The WBHL provides both a safer loan and a pathway to wealth building since the monthly payment primarily goes to pay principal rather than interest. Middle-income WBHL pilots are being explored, and additional low-income WBHL pilots are also being discussed, which are expected to provide about the same purchasing power as a 30-year FHA loan.