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Now is the time to bring back the 3 percent down-payment mortgage

By Rohit Gupta and Adolfo Marzol

Much attention has been directed at Federal Housing Finance Administration (FHFA) Director Watt's recent announcement that FHFA and the GSEs are working on guidelines to expand access to 3 percent low down payment mortgages. The reaction has been somewhat surprising.

At a time when policymakers are looking to reduce the government's role in housing finance while also improving access to affordable homeownership, prudently underwritten 3 percent loans would help accomplish these goals in a sensible and responsible manner, with clear benefits for consumers and taxpayers.

First, such a move would help reduce taxpayer exposure. The GSEs require the use of private mortgage insurance (MI) for these loans, providing substantial first-loss protection for taxpayers in the form of private capital. A 3 percent down payment GSE loan with MI would reduce taxpayer exposure by giving borrowers an alternative to FHA and other government programs, where taxpayers are responsible for 100 percent of losses. Through the use of MI, a prudently underwritten 3 percent down payment loan with standard coverage actually reduces taxpayer exposure significantly more than a comparable GSE loan with a 20 percent down payment without MI.

WIDER AVAILABILITY OF A 3 PERCENT DOWN PAYMENT OPTION WOULD HELP INCREASE AFFORDABLE OPTIONS FOR CREDITWORTHY BORROWERS

Second, responsibly underwritten 3 percent down payment loans with MI, which have been readily available to creditworthy borrowers in this market segment for many years, have a strong track record of good performance–comparable in fact to 5 percent down payment loans. According to the Urban Institute, data on default rates for loans with a down payment between 3-5 percent was similar to the default rate for loans with a slightly larger down payment of between 5-10 percent.

Third, rather than a return to subprime lending standards, responsible 3 percent down payment loans would have high standards, because the regulatory and underwriting landscape has changed dramatically since the crisis. Fully documented low down payment loans were not the cause of the mortgage crisis, and Dodd-Frank requirements have removed the products that were. The return of 3 percent low down payment loans would have to be consistent with new Qualified Mortgage standards' emphasis on responsible lending, and be fully documented.

Finally, wider availability of a 3 percent down payment option would help increase affordable options for creditworthy borrowers. Coming up with the required down payment can be one of the biggest hurdles to homeownership. For example, it could take about 20 years for the average firefighter or schoolteacher to save a typical 20 percent down payment. Right now, many low down payment borrowers are left with no other option but loans with FHA or other government insurance. Borrowers would also benefit greatly from an opportunity to purchase while 30-year fixed rates are near historic lows.

Providing qualified buyers greater access to responsibly underwritten 3% low down payment loans is yet another example of how policymakers can help make mortgage credit prudently available to more borrowers while protecting taxpayers through the use of greater private capital. Now is the right time to act.

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