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A Message from Ted Rood:

""Less sophisticated" may explain home buyer confusion when it comes to mortgages. Makes originators' jobs even more critical!"

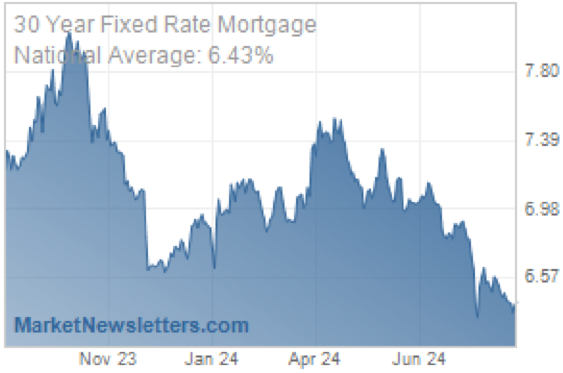
First-time Buyers are Younger, Less Sophisticated, Poorer - but Not Riskier

A working paper just released by the Federal Housing Finance Agency (FHFA) attempts to determine the reasons why mortgages given to **first-time homebuyers** perform more poorly than those given to repeat buyers. *The Marginal Effect of First-Time Homebuyer Status on Mortgage Default and Prepayment* was written by Saty Patrabansh of FHFA's Office of Policy Analysis and Research.

Given that homeownership is generally considered a societal benefit and that many government policies focus on incentivizing first-time buyers the author says it is important to understand whether first-time buyers as a group are likely to default at higher rates than repeat buyers both in order to anticipate that an increase in the rate of first-time homeownership could lead to increased foreclosures and negatively affect communities and because, if they do not default at higher rates it is important they **not be treated as more risky** buyers.

Earlier studies that touched on various aspects of first time homeownership and loan performance have generally used data from **FHA** guaranteed loans and were not designed specifically to study first-time buyers. The FHFA study developed a modeling approach specifically to discuss first-time buyer loan performance based on data on **Fannie Mae and Freddie Mac** (the GSEs) originated mortgages. The study sought answers to two questions: (1) do first-time homebuyer mortgages perform worse than those of repeat homebuyers? And (2) do any differences persist when borrower, loan, and property characteristics known at the time of origination are held constant?

National Average Mortgage Rates

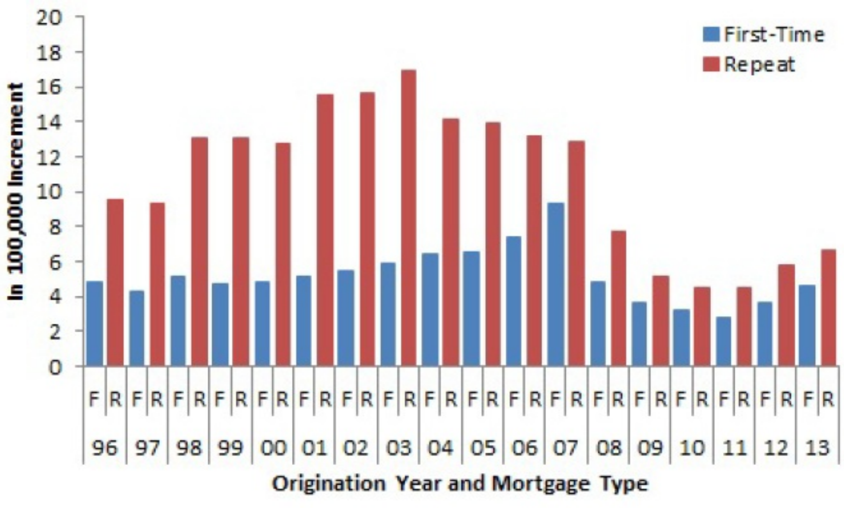


	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	6.43%	+0.02	0.00
15 Yr. Fixed	5.95%	0.00	0.00
30 Yr. FHA	5.82%	+0.02	0.00
30 Yr. Jumbo	6.62%	0.00	0.00
5/1 ARM	6.28%	-0.01	0.00
Freddie Mac			
30 Yr. Fixed	6.35%	-0.51	0.00
15 Yr. Fixed	5.51%	-0.65	0.00
Mortgage Bankers Assoc.			
30 Yr. Fixed	6.44%	-0.06	0.54
15 Yr. Fixed	5.88%	-0.16	0.68
30 Yr. FHA	6.36%	-0.06	0.85
30 Yr. Jumbo	6.75%	+0.07	0.39
5/1 ARM	5.98%	-0.27	0.65

Rates as of: 8/30

Recent Housing Data

		Value	Change
Mortgage Apps	Aug 28	226.9	+0.49%
Building Permits	Mar	1.46M	-3.95%
Housing Starts	Mar	1.32M	-13.15%
New Home Sales	Mar	693K	+4.68%
Pending Home Sales	Feb	75.6	+1.75%
Existing Home Sales	Feb	3.97M	-0.75%



		Value	Change
Builder Confidence	Mar	51	+6.25%

Differences in overall loan performance between first-time and repeat homebuyers could be driven by differences in borrower, loan or property factors. Each of these can be refined into sub-factors. Borrower factors can be further classified as sophistication, endurance, and intentions. A sophisticated or experienced borrower may find ways to keep mortgages current when faced with trigger events such as going "underwater" on a loan while a less sophisticated buyer make lack that ability. Likewise an experienced borrower may have a **greater tendency to default strategically** when events appear to warrant it. To the extent first-time buyers are less experienced or sophisticated than repeat buyers they can be expected to default at a higher rate and prepay at a lower rate.

Borrower financial endurance can determine the borrowers' capacity to withstand a trigger event such as by refinancing. Borrower intentions may determine if homeowners default strategically without a trigger event or fail to refinance even with the capacity to do so.

Loan factors can further classified as those of the product or the institution, **Subprime and non-traditional** products could default at a higher rate; mortgages with prepayment penalties are less likely to be refinanced. Loan institutions such as guarantors and services affect performance by their programs and policies.

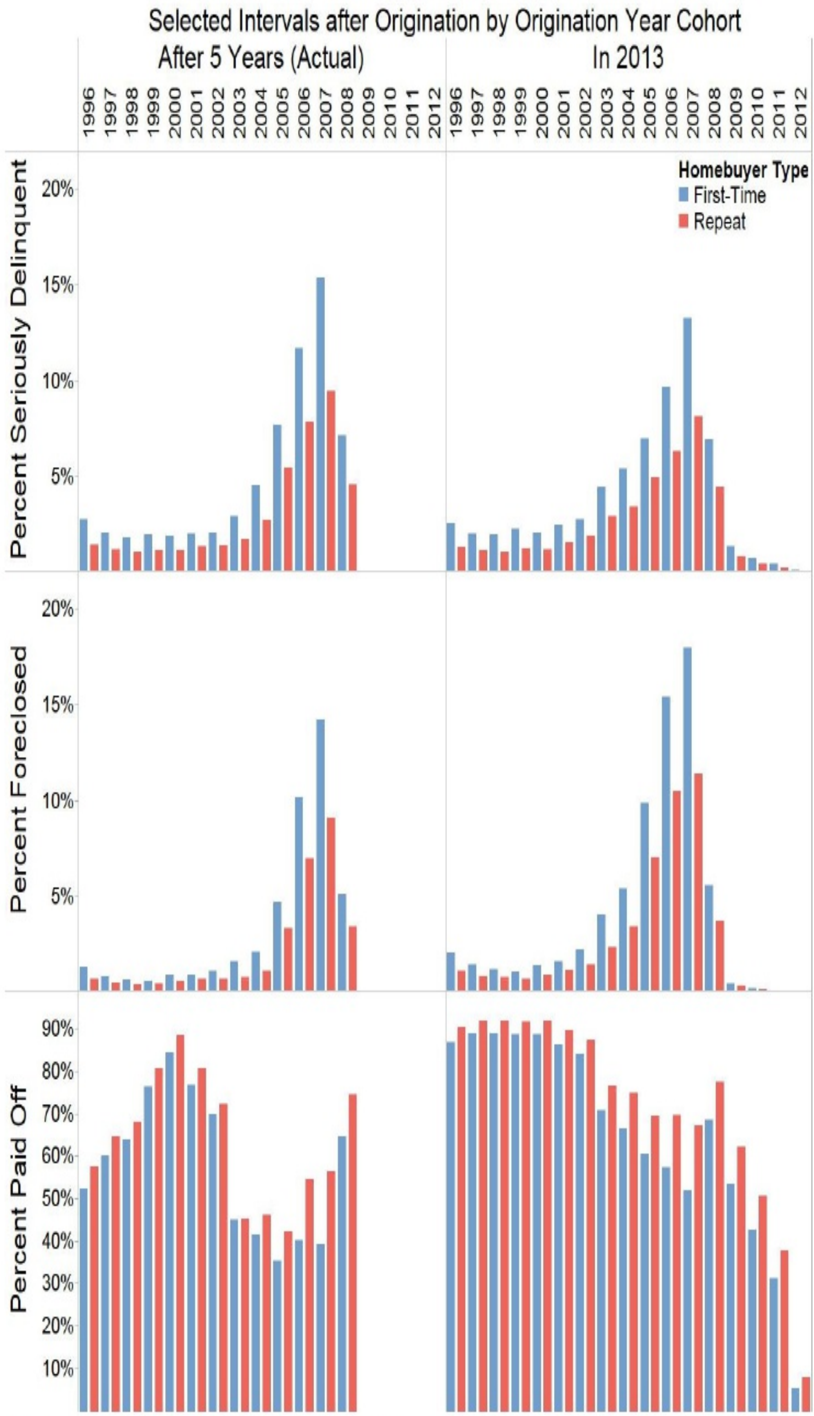
Property characteristics can have sub-factors such as property quality (properties in poorer condition can tax borrower financial strength) and property location (economic conditions may affect one location more than others.) To the extent that first-time homebuyers chose certain loan products, property quality, or location to a greater degree than repeat buyers may impact their loan performance as a group.

First-time homebuyers are younger as a group than repeat homebuyers and the difference in median age between the two groups **steadily increased** from 6 years in 1996 to 10 years in 2012. First-timers are more likely to borrower as individuals, perhaps because they are unmarried, and earn a median monthly income that was lower by about $700 compared to repeat buyers in 1996 and by around $2,000 less in 2012. Their median credit scores and the loan-to-value (LTV) ratios of their loans were lower as well. Their payment to income ratios averaged 2 to 4 points higher than repeat buyers but their debt-to-income (DTI) ratios were comparable.

First-time homebuyer properties were worth a median value of **$22,000 less** in 1996 and over $50,000 less in 2012 than repeat buyer properties and are more likely to be condos or in Planned Unit Developments. The difference in their median loan size ranged from about $11,000 in 1996 to $30,000 in 2012 and had higher note rates by 6 to 16 basis points.

The study characterizes loans as **performing** if no more than two consecutive payments have been missed; as seriously delinquent after missing three payments even if ultimately brought current, as foreclosed, or as paid off.

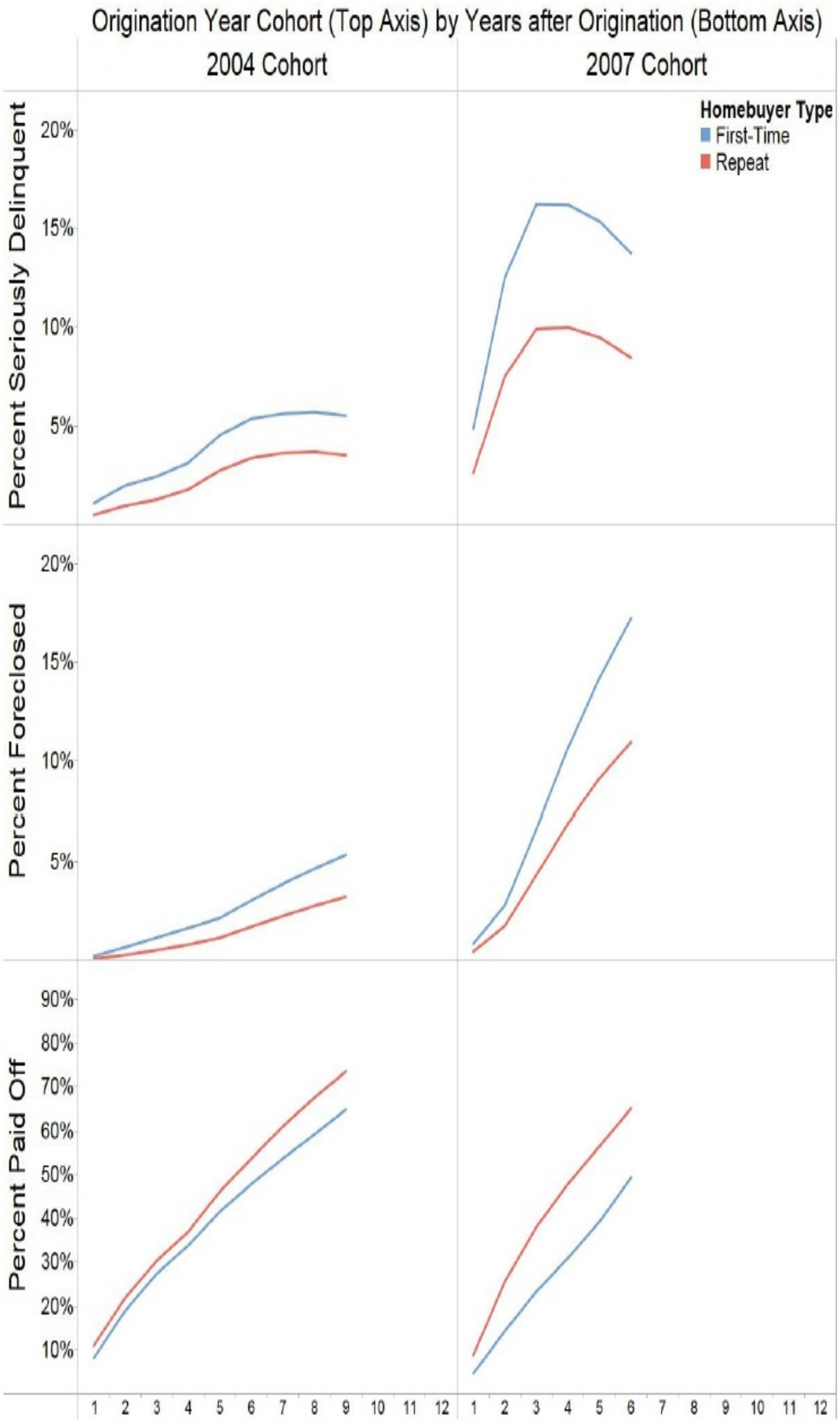
The study used these definitions to separately analyze loans to first-time and repeat buyers for every loan origination year from 1996 to 2012. The performing rate could not increase over time as loans that cured were still counted as non-performing. The seriously delinquent and foreclosed rates could change as loans moved from the former to the latter.



Source: FHFA data of Fannie Mae and Freddie Mac purchase-money mortgages for single-family owner-occupied homes.

Note: The scale for the top two horizontal panels is five times that of the bottom panel.

Figure 3: Enterprise First-Time and Repeat Homebuyer Loan Performance



For loans originated from 1996 through 2002 serious delinquency and foreclosure rates were low and within a tight band of 1 to 2 percent for both first-time and repeat buyer mortgages. For origination cohorts 2003 to 2008 both delinquency and foreclosure rates were higher, the **highest** being the loans originated in 2007.

By 2013 **13.3 percent** of first-time mortgages and 8.2 percent of repeat mortgages originated in 2007 were seriously delinquent and 18.0 percent and 11.4 percent respectively had been foreclosed. For loans originated from 2009 to 2012 both seriously delinquent and foreclosure rates to date were back again to 1 percent or less.

Regardless of the point in time, the serious delinquency and foreclosure rates of first-time homebuyer mortgages of any origination cohort were **higher** than those of repeat homebuyer mortgages for the same cohort, on average by 1.1 percentage points.

The differences between first-time and repeat homebuyer mortgages were somewhat larger in terms of the serious delinquency rate (an average of 1.3 percentage points) than the foreclosure rate (an average of 0.9 percentage points) and larger for the 2003-2008 originations (up to 6.6 percentage points higher) than earlier or later originations. Clearly, as shown by the height difference of the blue and red bars in the top and middle panels of Figure 2, first-time homebuyer mortgages were **seriously delinquent** or foreclosed at a higher rate than repeat homebuyer mortgages.

Mortgage pay-off is generally more volatile because it depends on the extent to which borrowers refinance their mortgages or purchase new homes, which in turn depends greatly on how mortgage interest rates and housing markets change over time. In percentage point terms, the pay-off rate (the share of loans that had paid off) of first-time homebuyer mortgages was on average 5.6 percentage points lower than that of repeat homebuyer mortgages.

While there were differences between origination cohorts, the difference in performance of first-time and repeat homebuyer mortgages was evident for every cohort, whether cohorts were analyzed at distinct intervals (figure 2) or over time (Figure 3). First-time homebuyer mortgages have performed worse than repeat homebuyer mortgages in all time periods analyzed.

After determining the **actual differences** in performance of the two homebuyer groups the author created models to account for the differences between them. While first-time homebuyer mortgages acquired by the GSEs generally performed worse than repeat homebuyer mortgages, the difference is due to the distributional make-up of the two groups. First-time buyers are inherently different, with lower credit scores, income, and equity in their homes and are therefore less likely to withstand financial stress or take advantage of financial help in the marketplace than are repeat homebuyers. These are borrower, loan, and property characteristics that can be determined at the time of loan origination and once they are accounted for in an econometric model there appears to be virtually no difference between the average buyers in each group in their risk of default.

Therefore, as long as the borrower, property, and loan characteristics known at the time of origination are able to determine ability to repay and risk is priced accordingly there **should not be a concern** that the average first-time homebuyer mortgages are inherently any riskier. As a result, any policies targeted to mitigate mortgage default risk are equally likely to be effective for first-time and repeat homebuyers.

There does appear, however, to an inherent difference in prepayment probabilities between the two groups. First-time homebuyers are less likely to prepay a mortgage even after accounting for the distributional make-up of the two groups at loan origination. The result that first-time homebuyers refinance at a lower rate than repeat homebuyers, once it is also corroborated by a competing risk default-prepayment model, could also have policy implications for targeting refinance programs.

Responsive service, experienced expertise

I've dedicated my 22 year mortgage career to client education, superior service, and honest answers. The lending landscape has changed dramatically the past few years, and continues to do so. My job is to ensure client partners' loans close quickly, without surprises, and I take that responsibility very seriously. Referrals are a responsibility I appreciate; they're a measure of trust, and that trust must be earned every day, on every referral.

Ted Rood