Back to Basics:
A Savings Approach to Homeownership

Homeownership is a core American value. It epitomizes the American Dream and the opportunity to build better lives for our children. Home equity, as a financial asset, can be a springboard to the acquisition of other important assets like a college education, a small business, and a secure retirement. As the foreclosure crisis continues to illustrate, risky strategies for stimulating homeownership through excessive debt acquisition have jeopardized the financial security of millions of Americans.

Many Americans believed or were told that easy credit and no downpayment mortgages were their path to the American Dream. Now a new path is needed. Americans would be wise to return to the one that successfully paved the way to the American Dream for decades: traditional mortgage financing methods that require downpayments. A policy that emphasizes saving that leads to a substantial downpayment can create a pool of financially prepared buyers who will be able to obtain more manageable and less risky mortgages.

The Aspen Institute Initiative on Financial Security (Aspen IFS) proposes transforming U.S. housing policy through a dedicated downpayment savings vehicle with government incentives available to low- and middle-income Americans. In its report, *Savings for Life,* Aspen IFS recommends Home Accounts as a way to prepare more Americans to become homeowners.[1] Home Accounts are a pragmatic way to give low- and middle-income Americans a safer and more secure path to homeownership.

"The present housing debacle should teach home buyers, lenders, brokers and government some simple lessons that will ensure stability in the future. Home purchases should involve an honest-to-God down payment of at least 10% and monthly payments that can be comfortably handled by the borrower's income."
- Warren Buffett

Home Accounts would put homeownership safely within the reach of low- and middle-income Americans by leveraging their willingness to sacrifice and save in the pursuit of long-term financial security. Making the savings side of the homeownership equation more robust is a smart use of public dollars to create a pipeline of financially prepared homebuyers. Financial institutions would have a ready pool of active savers who would become mainstream, not sub-prime, mortgage clients, and low- to moderate-income Americans could buy a home with less debt and less risk of foreclosure. Home Accounts would build on families' commitments to provide better lives for future generations by making both their home ownership goal and the American Dream again a reality.

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The Savings Side of the Ledger

A housing policy linked to downpayments is based on the positive results of experiments with Individual Development Accounts (IDAs). IDAs are subsidized savings accounts targeted to the poor, with matching contributions rather than tax breaks as the incentive to save. The American Dream Demonstration was the first systematic experiment of IDAs. This demonstration project found that low-income families do save at a higher rate when offered matching contributions. Overall, among program participants who had an average household income of under $18,000, the homeownership rate increased by 14 percent compared to nonparticipants of the same income range. [2] Both the matched contribution and the ease of contributing acted as strong incentives to save.

The American Dream Demonstration provides support for an incentive savings approach to homeownership for low- and middle-income Americans. A 2005 study by H&R Block confirms the value of savings incentives for these income groups. In an experiment with 15,000 low- and middle-income customers, customers were randomly offered a 20% match, a 50% match, or no match at all on deposits into an IRA account. The study found that individuals were over five times more likely to contribute to an account when a 50% match was offered than when there was no match.[3] Home Accounts take the successful IDA experiments one significant step forward by delivering matching contributions directly into a savings account.

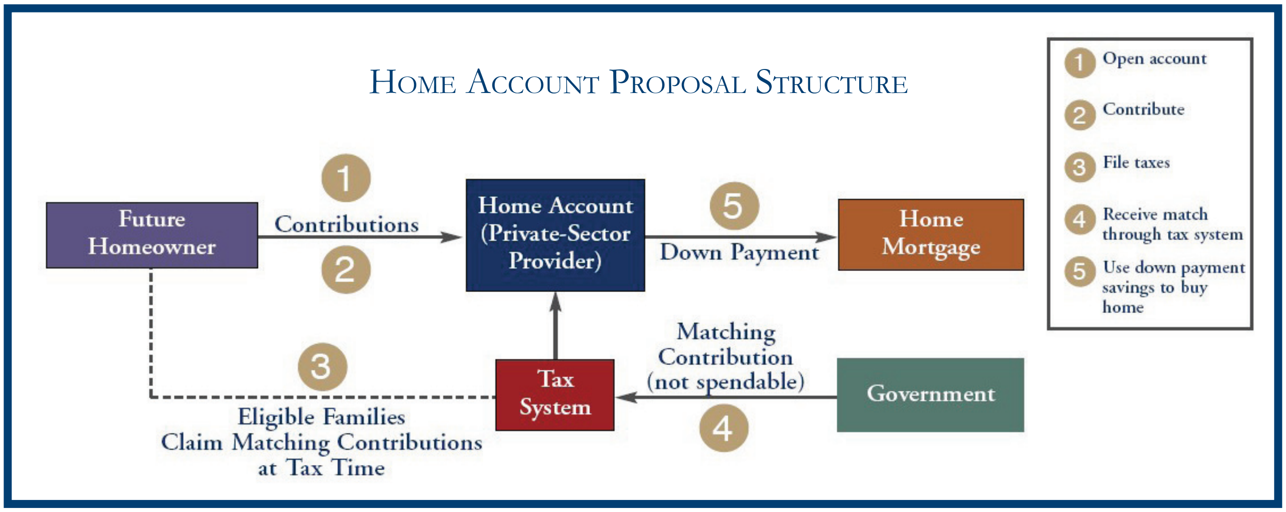
Home Accounts: The Better Way Forward

Aspen IFS Home Accounts are innovative savings accounts designed to help more Americans save for a downpayment. By offering a modest government matching incentive of $5,000, Home Accounts would encourage millions of low- and middle-income Americans to accumulate assets for a downpayment on a first home. Home Accounts would also have a simplified structure that keeps ease of participation in mind.

Home Accounts would have these features:

- Savers with incomes under $50,000 ($100,000 for a married couple) would get a 50 percent federal match on their contributions, up to a lifetime cumulative cap of $5,000.
- The matching contributions would be delivered through the tax system and directly deposited into accounts.
- Account assets could only be withdrawn for downpayment and closing costs when buying a home. Penalties would apply for withdrawals used for any other purposes.
- Home Accounts could be converted into retirement accounts without penalty.
- Home Accounts would be FDIC-insured and the interest rate paid on the accounts would vary by the participating bank or other financial institution.

As part of its original research and analysis, Aspen IFS built a financial model projecting savings and home purchases of prospective homebuyers, as well as the market size and government costs for an entire market of downpayment savers. Based on conservative assumptions regarding the number of people who would participate as well as the accumulated savings by prospective homebuyers, the model shows that Home Accounts would create at least four million new homeowners over ten years. These modest savings accounts would leverage $64 billion in mortgages after five years and $457 billion after ten years at a cumulative government cost of $28 billion over a ten-year period.[4]



Home Accounts: Benefits and Costs

While Home Accounts may be modest in size ($15,000 with the full match), they could provide significant assistance toward homeownership. Take, for instance, a newly-married couple who planned to buy a house. If each opens up a Home Account and each qualifies for the full match, together they would have $20,000 of their own savings, $10,000 from matching contributions, plus interest. With a total of over $30,000, the couple would be able to make a 20% or more downpayment on a house in a market like that of St. Louis, Pittsburgh, San Antonio, Atlanta, or Phoenix, where the median price of a single-family home is currently less than $150,000.[5]

The Aspen IFS model projects that in the first five years of the program, 4.5 million Home Accounts would be created and those accounts are conservatively projected to create a market of $35 billion in assets and leverage over $60 billion in new mortgages during that time. The annual costs to the federal government for Home Accounts are expected to range between $2 billion and $4 billion, with an expected five-year cost of $10 billion. While these are not trivial numbers, they are relatively small compared to the cost of the federal government's current housing policies. For example, in 2010, the Joint Committee on Taxation estimated that housing tax benefits for individuals would cost the federal government over $850 billion in the five years from 2009 to 2013.[6] The majority of these special tax benefits represent homeownership subsidies for middle- and upper-income Americans.

Home Accounts in Action

For a better understanding of how Home Accounts could facilitate savings for a down payment and result in home ownership, it is useful to consider an individual case:

Home Accounts in the Real World

Mary is single, 29-years old, and lives in Jackson, Iowa. She earns about $28,000 a year (in today's dollars) as a receptionist at a doctor's office, and would like to buy her own home. She opens up a Home Account and contributes $2,000 each year for five years and earns a $1,000 match from the federal government each year, too. After five years, Mary has over $16,000 in her account – the result of her savings, her interest, and $5,000 of government matching money, which she tapped each year at tax time. She uses her entire account to make a down payment and pay closing costs on a house costing $110,000. Mary gets a 30-year fixed-rate mortgage of 4.8 percent, which gives her monthly mortgage payments of $504 – even lower than what she had been paying in rent. She now has home equity valued at $14,000 in her home.[7]

This example illustrates the potential impact of Home Accounts at the individual level. For lower-income, working Americans, these matched savings accounts could make a significant difference in their ability to achieve their home ownership goals with just modest savings over time. And bringing more to the table in the form of a downpayment will protect consumers from risky loans and potential default.

Putting Homeownership Back Within Reach

Home Accounts could put homeownership within reach of millions of Americans. Creating a large, future pool of financially prepared homebuyers would be a good investment of federal resources both for families and the housing industry. Home Accounts encourage smart savings behavior. By placing the focus on the downpayment of a home, and by rewarding the savings aspect of homeownership rather than solely the spending aspect, Home Accounts promote consumer-friendly, sustainable mortgages and long-term financial security.

Home Accounts are not a fix for the current crisis. They do, however, point to a way forward—a path to a more cautious and sensible approach to increase homeownership among low- and middle-income Americans. Bolstering the savings side of the home financing equation is critical, but low- and middle-income households will need help to build downpayments. That help should be provided through direct government investment in saving for homeownership, rather than just more tax breaks. Through a dedicated savings vehicle with federal matching contributions like Home Accounts, the positive benefits of homeownership can become and remain a reality for millions of low- and middle-income Americans.

Endnotes

1 The Initiative on Financial Security, The Aspen Institute. (2007). *Savings for life: A pathway to financial security for all Americans*. Washington, DC. Available at http://www.aspeninstitute.org/sites/default/files/content/docs/initiative%20on%20financial%20security/Savings_for_Life.pdf

2 Schreiner, M., Clancy, M., & Sherraden, M. (2002). Saving performance in the American Dream Demonstration: A national demonstration of individual development accounts. St. Louis: Washington University. Retrieved from http://gwbweb.wustl.edu/csd/Publications/2002/ADDreport2002.pdf.

3 Duflo, E., Gale, W., Liebman, J., Orszag, P., & Saez, E. (2005) Savings incentives for low- and middle-income families: Evidence from a field experiment with H&R Block. *The Retirement Security Project Policy Brief, 5*. Retrieved from http://www.rand.org/labor/aging/rsi/rsi_papers/2006_gale2.pdf.

4 Home Account model simulations assumed a nominal return of 5% on all account deposits, with an assumed 2% inflation rate. The Initiative on Financial Security, The Aspen Institute. (2007). *Savings for life: A pathway to financial security for all Americans*. Washington, DC. Available at http://www.aspeninstitute.org/sites/default/files/content/docs/initiative%20on%20financial%20security/Savings_for_Life.pdf

5 National Association of Realtors. (2010, May). May Metro Area Existing Single-Family Home Sales and Prices. Retrieved July 8, 2010, from http://www.realtor.org/wps/wcm/connect/b4ae808042ef4c038d10bdd4db880d7c/EHS_RELEASE_201005_rev.xls?MOD=AJPERES&CACHEID=b4ae808042ef4c038d10bdd4db880d7c

6 Joint Committee on Taxation. (2010, January). Estimates of Federal Tax Expenditures for Fiscal Years 2009-2013. [Prepared for the House Committee on Ways and Means and the Senate Committee on Fianance] (p. 34). Washington: U.S. Government Printing Office. Retrieved July 11, 2010, from http://www.jct.gov/publications.html?func=startdown&id=3642

7 Mortgage rate of 4.8% on 30-year fixed rate mortgage is reflective of average rate provided by Charles Schwab Bank as of July 2010. Charles Schwab Bank. (2010, July). Today's Mortgage Rates. Retrieved July 11, 2010, from http://www.schwab.com/public/schwab/banking_lending/mortgages/todays_rates?cmsid=P-2266141&lvl1=banking_lending&lvl2=mortgages The projected $14,000 in home equity assumes $2000 in closing costs.

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