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# Reinventing Homeownership: A Compendium of Concepts to Consider

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# About Us

*Progress is the constant replacing of the best there is with something still better!*

— ***Edward A. Filene***

The Filene Research Institute provides credit unions with research, future-focused thinking, and practical innovations to enable them to prosper today while preparing for tomorrow's opportunities.

The name of the Institute honors Edward A. Filene, founder of the Filene's Department Store chain, who is considered the father of the United States credit union system.

Since the Filene Research Institute's inception in 1989, this 501(c)(3) not-for-profit institute has collaborated with over 100 academic institutions and credit union system partners to publish hundreds of research studies. The entire research and innovation library is available online at filene.org.

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by David Reiss, JD,
*Professor*

The issues that we struggle with today are as important as those we struggled with during the Great Depression: What should housing policy look like, and what decisions should be made in the next five years or so to bring us from crisis to stability? In all likelihood, our answers to these questions will define the housing market for generations. To help answer these questions, the Filene Research Institute has produced this policy brief on reinventing homeownership.

This brief presents a compendium of innovative mortgage products that all challenge the dominant mortgage product of the 20th century: the high-down-payment, 30-year amortization, fixed interest rate mortgage (the FRM). These innovative products do not, however, go to the other extreme like the infamous subprime and Alt-A mortgages of the early 21st century. Rather, they take into account demographic trends, changes in the workplace, and existing barriers to homeownership to structure new products for contemporary households.

These innovative products take on the big questions in residential mortgage finance: What is the future of the FRM? What is the fate of the low-down-payment mortgage? And what does homeownership mean today?

## The FRM

The FRM will survive one way or another as we adopt a plan of reform for the housing finance market. But the knee-jerk support of that mortgage product is questionable. The average American household lives in the same home for only seven years. That implies that most Americans, or a very large swath of Americans, could do better with a shorter term fixed interest rate, which would result in lower monthly interest payments. This is not to say that adjustable rate mortgages (ARMs) are the answer to everybody's housing situation, but it calls for innovation in the context of the FRM.

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This brief presents some interesting alternatives to the FRM, products like the gently adjustable rate mortgage. We applaud such innovations and would even push for more, such as longer (10- or 15-year) fixed periods for interest rates for ARMs as they might cover most households, given how long they typically stay in their homes; interest rates that are based on rolling averages that slow the rate of change of

the interest rate; longer adjustment periods so the interest rate does not change every year but instead maybe every three or five years; and lower caps on annual interest rate increases, perhaps limiting them to 1% instead of the more typical 2%. All of these suggestions could reduce "payment shock," when a household is used to making a monthly mortgage payment of a certain size and suddenly has a much bigger bill. Payment shock is really what people are afraid of, and there are tools other than the FRM to respond to that legitimate concern.

The good thing about all of these suggestions is that they would also allow lenders to move away from the 30-year fixed mortgage, which exposes lenders to severe interest rate risk because their business model is based on borrowing short (from depositors and in the commercial paper market) and lending long (to residential borrowers).

## The High Down Payment

From an underwriting perspective, the hallowed 20% down payment is clearly desirable as defaults for such mortgages are exceedingly low. From an opportunity perspective of increasing homeownership, especially with first-time homeowners, it is an overwhelming burden. This is why the federal government has implemented a variety of low (e.g., 3%) down payment mortgage programs, particularly through the Federal Housing Administration. Many of these programs have had very high default rates, which have led to calls to abolish them. The problem with such an approach, of course, is that returning to a high down payment requirement would keep a large group of potential first-time homeowners from taking the plunge. There is evidence, however, that there is a down payment sweet spot of about 5% at which default rates are within an acceptable range. This brief proposes additional alternatives that avoid the Scylla and Charybdis of high and low down payment products. The NOW Mortgage and the Step It Down Mortgage both address the need for flexibility with down payment sizes, but also acknowledge the power of owners' equity to curb defaults and foreclosures.

From an underwriting perspective, the hallowed 20% down payment is clearly desirable as defaults for such mortgages are exceedingly low.

## Homeownership Today

The role of homeownership in American society had not been meaningfully considered until the subprime crisis. It should have been. Peter Wallison, co-director of the American Enterprise Institute's program on financial policy studies and member of the Financial

Crisis Inquiry Commission, challenges the notion that we can create a system that takes only reasonable risks while increasing homeownership. This view is controversial and has to be addressed before we can move forward with any reform program for the housing finance market. This brief provides some clear thinking on the other side of this issue. It argues that well-structured mortgage products can build sustainable homeownership for a broad swath of Americans.[1]

As the homeownership rate slips further and further from a bubble high of 69%, we must decide what we want our housing finance system to accomplish.

As the homeownership rate slips further and further from a bubble high of 69%, we must decide what we want our housing finance system to accomplish. In the next few years, we will make decisions that set up our housing finance system for a long time to come. With this policy brief, Filene is helping to ensure that we make good decisions.

# Executive Summary and Commentary

by Denise Gabel,
*Chief Finance and Strategy Officer*

"Millions of Americans have lost their homes since the start of the Great Recession. By the middle of 2010, 4.6% of U.S. home mortgages were in foreclosure, three times the rate seen at the height of the Great Depression."[2]

Take a moment and let that sink in. It's clear that a perfect storm of economic events has left homeowners and prospective homebuyers in a mess, not to mention the devastating aftereffects on investors and financial institutions.

The fallout comprises more questions than answers about what this all means for the next generation. The challenge is clear: How can the country's home loan financing system rebuild itself in a manner that creates a win-win-win for borrowers, lenders, and investors? How can credit unions take the lead in building this new future—helping people get into homes they can afford, helping them make appropriate payments, reducing defaults, stabilizing families, and creating financially sound futures of promise?

The Filene Research Institute, your industry think-and-do tank, has tackled the mortgage issue from both the research and innovation sides of the coin for several years. Our mission is to discover how credit unions can shape the future of the mortgage industry by:

- Increasing their mortgage loan portfolios with high-quality assets.
- Providing innovative solutions to consumers for reaching their dreams of homeownership.

Related research briefs from Filene researchers include:

- *Fannie Mae and Freddie Mac: Implications for Credit Unions*, David Reiss, Professor, Brooklyn Law School, February 13, 2011.
- *Reimagining the Dream: The Future of Home Ownership*, Denise Gabel, Chief Innovation Officer, Filene Research Institute, and Robert Manning, Research Professor, Rochester Institute of Technology, November 2, 2009.
- *Mortgage Borrower Risk Profiles, Delinquencies, and Interest Rates in 2005–2008*, Mark Meyer, CEO, Filene Research Institute, and Luis Dopico, Macrometrix, April 13, 2009.
- *Keeping People in Their Homes: Policy Recommendations for the Foreclosure Crisis*, Robert Manning, Research Professor, Rochester Institute of Technology, February 11, 2009.
- *Cool Solutions: First-Time Home "Y'ers,"* Tammi Feltham, PhD, Associate Professor, Faculty of Human Ecology at the University of Manitoba, October 10, 2006.

Given this solid foundation, we are excited about the many recent initiatives that are propelling this issue and its solutions forward. In this brief, we examine the social impact of homeownership and provide a brief glimpse at the Canadian mortgage market. Then, we move on to look at thought-provoking ideas from Credit Union National Association (CUNA) leaders, new concepts from $i^3$ teams, and breakout methodologies from young innovators. We are confident that the seeds of a new homeownership financing model have been sown here, and there are rewards for credit unions that are willing to try something new. The potential benefits are enormous for consumers, communities, credit unions, and cooperative systems as a whole. Let's see what credit unions can do to start putting people in homes again.

Publications are available at no charge to Filene members or for a fee to nonmembers at filene.org.

## Denise Gabel

As Chief Finance and Strategy Officer of the Filene Research Institute, Denise is responsible for identifying trends and opportunities outside the credit union system. Through her high-energy style and a natural ability to coax people and ideas forward, she brings new business models, people, and opportunities together.

Denise's career is littered with both left and right brain assignments. Prior to joining Filene, Denise served as a Vice President—Strategic Direction for Spokane Teachers Credit Union. In her first assignment at Filene, she served as the Chief Innovation Officer where she led the prestigious $i^3$ group. She is a summa cum laude graduate of Eastern Washington University, and a member of the Berkeley Innovation Forum at the University of California, Berkeley Haas School of Business. Denise also graduated from Harvard Business School's Women's Leadership Forum.

When she's speaking and traveling, she's mentoring and connecting, constantly looking at trends and exploring new strategies to help leaders get off the cul-de-sac to see what's going on out on the autobahn. She challenges the notion of life balance—arguing that one can have it all. A big part of her all is her husband, Dennis, who is her biggest champion.

## David Reiss

David Reiss, JD, is a professor of law at Brooklyn Law School in New York. He concentrates on real estate finance and community development. His article "Subprime Standardization: How Rating Agencies Allow Predatory Lending to Flourish in the Secondary Mortgage Market" in the *Florida State University Law Review* was chosen as the best article on a topic dealing with consumer financial services law by the American College of Consumer Financial Services Lawyers in 2006. His other publications address topics such as the secondary mortgage market, predatory lending, and housing policy. His views on a variety of real estate and land use issues have appeared in print media around the country as well as in a variety of online sources.

Before joining Brooklyn Law School, Reiss was a visiting clinical associate professor at the Seton Hall Law School Center for Social Justice. Previously, he was an associate in the New York office of Paul, Weiss, Rifkind, Wharton & Garrison in its real estate department and an associate in the San Francisco office of Morrison & Foerster in its land use and environmental law group. He also served

as a law clerk to Judge Timothy Lewis of the U.S. Court of Appeals for the Third Circuit. Prior to attending law school, he worked for a not-for-profit that helps people with psychiatric disabilities make the transition from shelters and hospitals to independent living. He holds a JD from New York University and a BA from Williams College.

## Homeownership Matters

Homeownership has a bigger context than just the romantic notion of the American dream. There is specific, concrete evidence that homeownership impacts the fabric of society at every crucial juncture. *Social Benefits of Homeownership and Stable Housing*,[3] an August 2010 report by the National Realtors Association, examines the importance of the housing sector on the economy and the long-term social and financial benefits to an individual homeowner. The report draws from many sources to conclude that homeownership yields:

There is specific, concrete evidence that homeownership impacts the fabric of society at every crucial juncture.

- **Stable neighborhoods.** Homeowners move far less frequently than renters and become integrated into the same neighborhood and community for a longer time.
- **A positive impact on teens.** Teens are more likely to stay in school if they are raised by homeowning parents compared to those in households where the parents rent. Also, daughters of homeowners have a lower rate of teenage pregnancies than daughters of renters.
- **Academic achievement.** Reading and math performance of children ages 3 to12 is higher and is positively impacted by homeownership factors, including environment, neighborhood quality, and residential stability.
- **Happiness and good health.** The notion that homeowners are happier and healthier is supported by a variety of surveys that measure factors such as self-esteem, life satisfaction, and both physical and emotional health.
- **Less crime.** Homeowners are less likely to be crime victims, and the stable neighborhoods created by homeownerships are further deterrents.

Later, we look at some exciting ideas that can position credit unions to put more people in homes, further nurturing the social fabric of the communities they serve.

## The Canadian Dream

While many Canadians may share the so-called American dream, there are substantive differences between the two countries' mortgage environments. According to a report by the Center for American Progress, "The most important difference between the U.S. and Canadian mortgage markets is in their relative exposure to unregulated lending channels and products—and it is this difference that

best explains why Canada avoided the credit crisis that plagued the United States."[4]

While both markets were built on a foundation of government-backed mortgage programs (the United States has Fannie Mae and Freddie Mac, while Canada has the Canada Mortgage and Housing Corporation), in the 2000s the U.S. market was flooded with riskier options offered by unregulated nonbank lenders that were packaged and sold as mortgage-backed securities. Only 29% of Canada's mortgages are securitized compared to 60% in the United States.[5] Other important differences:

- Canadian mortgages are more likely to be insured.
- Canadian mortgages are more often held on the balance sheet of the originating lender, with payments made by auto debit.
- Canadian mortgage holders have more equity in their homes.
- While Canadian mortgages may amortize over 25 years or longer (similar to U.S. mortgages), their fixed rates typically roll over somewhere between six months and five years.
- The Canadian mortgage market is much smaller ($1 trillion vs. $14 trillion in the United States), which limits exposure.[6]

## Adjusting for Mutual Benefit

Bill Hampel, senior vice president of research and policy analysis and chief economist for CUNA, has been investigating and writing about a product called the partially adjustable rate mortgage (PARM).[7] At Filene, this product is referred to as Bill's GARM, or gently adjustable rate mortgage. It features an initial fixed rate of one to three years, and then experiences incremental adjustments based on its index. Bill's GARM just may be the perfect solution for credit unions that want to create member-friendly and asset/liability-friendly first mortgages they could safely hold on their balance sheets.

According to Hampel, despite current economic conditions, credit unions originated a record $94 billion in first mortgages in 2009. But they also sold off a record $51 billion instead of holding the loans in their portfolios. It's too bad that at a time when credit unions are deposit-rich, they are not offsetting their liabilities with these prime assets. But there is too much risk to the credit union from the 30-year fixed rate mortgage.

Conversely, traditional ARM products shift too much risk to borrowers, making them unattractive. The beauty of Bill's GARM is that it provides an acceptable risk to both borrowers and the credit union, making the product a mutually beneficial option. Here's how the unique rate structure works, according to Hampel:

"The loan could be originated with an initial fixed-rate period of one to three years, and then adjusted only at a fraction of any change in the index. Many credit unions' average cost of funds adjusts at about 40% of changes in the one-year Treasury rate. So why not create a loan with a rate that changes by 40% of the change in the index? If the index rises 1%, the rate rises 40 basis points. At a 40% adjustment, it takes a 2.5% increase in the Treasury rate to generate a 1% increase in the loan rate, thus controlling payment shock."[8]

Learn more about PARMs in Bill's article "Time to Rethink Mortgages," attached as Appendix A. www.creditunionmagazine.com/articles/print/36311

## Idea Engineering

In October 2011, mortgages were on the agenda at a Filene assembly called big.bright.minds. During the presentation "Fannie Mae and Freddie Mac: Implications for Credit Unions," a lively discussion occurred between Canadian and U.S. credit union representatives trying to understand each other's situations and roles in the current mortgage crisis. At the same time, Bill's GARM was brought to Filene's attention. The convergence of ideas and passionate dialogue led Filene to assemble a workgroup of current and former $i^3$ members and other invested parties to explore solutions that would benefit credit unions.

Soon, these creative minds were brainstorming via conference calls and eventually held an in-person meeting to explore solutions for credit unions and their members. They tapped into Innovation Engineering tools (see innovationengineering.info) to develop ideas, then sifted and winnowed to land on six top prospects.

Filene then engaged with design thinking firm e10 (see e10inc.com) to conduct a qualitative evaluation to identify the top two or three ideas with the greatest potential for successful commercialization. The process considered factors such as:

- Propensity for homeownership.
- Likely target market segment.
- Potential market demand.
- Level of uniqueness or innovation.
- Potential barriers to success.
- Variations to the concept.

An eye-opening aspect of this process was a focus group that comprised noncredit union participants providing unbiased opinions of the ideas from both a consumer and a profitability viewpoint.

*Figure 1: Rating Snapshot*

| Rating | Idea | Commercialization Rating | Market Demand Rating | Innovation Rating |
|---|---|---|---|---|
| **1** | WorkPerks | 6 | 7.83 | 6.83 |
| **2** | NOW Mortgage | 3 | 7.00 | 6.00 |
| **3** | Step It Down Mortgage | 4 | 5.17 | 5.17 |
| **4** | Pass It On | 2 | 3.33 | 5.50 |
| **5** | 20/20 Mortgage | 2 | 2.00 | 3.83 |
| **6** | Personal Mortgage Guide | 0 | 2.20 | 2.83 |

Review the complete e10 report and description of ratings in Appendix 2.

The six ideas are profiled below, from highest to lowest potential.

## WorkPerks

**Potential: EXCELLENT**

Realizing that the down payment is the biggest barrier to homeownership was a big aha! moment for the workgroup. If consumers don't have sufficient funds, the process of securing a mortgage of any kind, regardless of its structure or features, is a nonstarter. It's no surprise, then, that WorkPerks was developed and easily secured the highest viability ratings.

WorkPerks is targeted toward first-time homebuyers who are shy on the amount of equity they need to qualify for a mortgage. The concept connects workers with their employers to expand on their employee benefits. It is common to encourage employees to save for retirement through employer-sponsored plans, but not all employees are ready to save for retirement when they haven't achieved more basic financial goals, like owning a home. WorkPerks functions like a retirement savings plan, only it allows employees to contribute a percentage of their income into a savings account for a down payment on a home. Employers may offer a matched contribution. At a simple level, an employer plan would be packaged and administered by a credit union using existing savings and Automated Clearing House (ACH) products. At a more sophisticated level, legislative action

"WorkPerks connects to what credit unions do at their roots by tapping into a solid niche: [select employee group] relationships with employers and their employees. This free employee benefit bundles the concept of saving for a down payment with the total member relationship."

*—Lisa Palma, COO, Blackhawk Community Credit Union ($340 million, Janesville, WI), and Filene workgroup project manager*

would be taken to allow before-tax contributions to savings accounts for down payments for a home and tax breaks would be given to employers that offer the program. The main benefit is to give consumers a method to acquire a down payment for a home and develop the habits to save regularly for future financial goals.

## NOW Mortgage

**Potential: GOOD**

NOW Mortgage provides financing for the down payment, along with the mortgage, at a blended interest rate that factors in both components. The mortgage would reprice once the down payment is paid off. Payments would be structured so 20% equity is built up within five years, or more quickly, based on the member's goal. The solution may be appropriate for first-time homebuyers with strong credit and other application factors, but who lack a sufficient down payment. Here are two options for structuring this product:

- Option #1 requires 10% down but pays the next 10% over 5 years, leaving 80% on a 25-year amortization. It puts members in a strong position of equity quickly.
- Option #2 requires 10% down (90% loan-to-value (LTV) ratio, no private mortgage insurance). The rate starts out at 2% above an 80% LTV loan rate but when payments are made on time, the rate drops by 0.50% for the first four years as a reward.

## Step It Down Mortgage

**Potential: GOOD**

An inverse to the NOW Mortgage, Step It Down Mortgage and its increasing payments might be referred to as a diminishing payment mortgage. The theory is that first-time homebuyers with poor credit have something to prove and need to start off with aggressive payments to build equity and forced savings to reduce the default risk. Their monthly payment starts higher than with a traditional mortgage and includes mandatory deposits to a frozen savings account. Once the loan has performed for a predetermined time and the savings account has reached a targeted amount, the credit union would be satisfied that its risk is mitigated and can ease up on the restrictions. At this point the consumer should have an improved credit score, increased equity in the home, and a solid cushion of savings. The required savings deposits will terminate, effectively reducing the monthly payment, and control of the savings will revert to the borrower.

## 20/20 Mortgage

**Potential: AVERAGE**

The 20/20 Mortgage is structured with a monthly payment set to 20% of the consumer's income so that it is always affordable. It is based on the premise that a first-time homebuyer is in the beginning stages of earnings potential and assumes increased payments over the life of the loan with a payment amount floor set at origination. The term is amortized based on payment and income projections. The 20/20 Mortgage works in tandem with a household budget plan that helps borrowers live within their means in other major categories such as car payment, savings, and disposable income. One operational consideration is the annual income reviews at the time of income tax filing and annual payment adjustments. First-time homebuyers concerned with the long-term affordability of mortgage payments and borrowers wanting to live within a structured budget should find this option appealing.

## Pass It On

**Potential: AVERAGE**

To understand Pass It On, think savings bonds or educational savings plans but for future homeowners. This investment product or insurance policy would be offered to parents and would mature into a down payment for their adult children. In the same way that parents and grandparents start savings for college at a child's birth, Pass It On takes advantage of the time value of money with regular incremental deposits into an investment (such as a bond ladder) or insurance vehicle (such as an annuity) tied to market rates.

## Personal Mortgage Guide

**Potential: LOW**

The Personal Mortgage Guide puts consumers in control of their loan application. This web-based application guides applicants to different product options based on the information they provide. Offerings can be customized by the credit union to include mortgages for first-time homebuyers, refinances, reverse mortgages for retirees, and borrowers with inadequate down payments and/or low credit scores. A personalized analysis lets the potential borrowers evaluate the options that might best suit their needs, arming them with valuable information to leverage in discussions with their lender. Tech-savvy consumers may have experience working with similar web programs for auto purchasing.


## Another Barrier Buster

While the Filene workgroup ideation process was well under way, a 2011 innovation tournament held with Filene's young adult community Crash Network (now called The Cooperative Trust) also tackled the mortgage issue. Participants in the contest were asked how credit unions might increase the availability of affordable homeownership in North America.

It is interesting to note that the winning idea, honeycomb (originally titled CU Homebuyer), took on the barrier of saving for a down payment, as did top workgroup idea WorkPerks. Clearly, saving for a down payment is hard, but honeycomb makes it easier for credit union members. This savings match program pays out when the member gets a mortgage and includes a vital social networking component called the "hive" that makes it all work.

For a detailed look at how the innovation tournament was structured and how honeycomb evolved from a germ of an idea to a full-fledged solution, see Appendix C.

For more information or to contact Filene with your interest, visit filene.org/blog/post/announcing-honeycomb.


## CU-Homewise

An early foray into home solutions by a Filene i³ led to the development of the Responsible Rent Loan, which has since evolved to CU-Homewise. This program connects investment property owners with qualified tenants, adding stability to that niche of the housing

BIRTH OF THE COOPERATIVE TRUST

The Cooperative Trust, Filene's young adult community, got its grassroots start as the Crash Network, a group of young credit union leaders who initially came together to "crash" the CUNA Governmental Affairs Conference in Washington, DC in 2010 and in subsequent years (see crashthegac.com).


The goal is to create a network of the passionate, next generation of credit union voices, while connecting to the leadership and traditions of the past. This community supports socially responsible finance and wants a seat at the table in shaping the future of business, credit unions, and cooperatives.

market. CU-Homewise consists of testing several markets with simultaneous tenant screening services, using credit scores and the Responsible Debt Relief (RDR) algorithm to better identify the risk factors with that tenant.

CU-Homewise is a win-win-win product that:

- Helps **credit unions** grow their investment property portfolio without having to discount the rate or fees. Credit unions further benefit by establishing relationships with qualified tenants that hopefully will lead to mortgages, investments, or other profitable credit union services in the future.
- Paves the way for **investors** to become an investment property owner with lower risk because the payment deferments reduce the possibility of default and the tenant screening service increases the probability that investors will attract good, paying tenants.
- Allows **members/tenants** to differentiate themselves based on noncredit-based factors with the use of a screening system, making it easier to secure acceptable housing.

North Country Federal Credit Union ($350 million, South Burlington, VT) and West Community Credit Union ($137 million, O'Fallon, MO) have piloted CU-Homewise. These two early testers had expertise in investment property lending and also needed new loan volume. Unfortunately, during the pilot CU-Homewise did not gain significant market traction, and its further development is on hold. If any credit union interest materializes, the next steps would be to fine-tune the product details and develop a marketing toolkit and staff training plan. Establishing a prototype website that could connect credit union property investors with responsible renters is another key step.

## Insert [your idea] Here

Oftentimes one of the biggest challenges in problem solving is not coming up with ideas, it's settling on the idea that is best for you that then leads to a successful implementation. Some credit unions will welcome ideas that are already teed up and just need a project champion and some T.L.C. to bring them to fruition. Building on an existing concept can be an easy and efficient way to get a new idea to market quickly. If you are in this camp, we encourage you to adopt any of the ideas in this brief, modify as needed, implement and experiment, and let us know how they are working.

Others may want to forge their own trail and create something on their own. In the innovation

To register, visit filene.org/home/events for a schedule of Innovation Engineering workshops or contact innovation@filene.org for more information.

and implementation process, never underestimate the power that you can generate with a sense of ownership. Credit unions are encouraged to enrich their creative process by taking advantage of tried-and-true design thinking methodologies and relevant tools. To that end, Filene has partnered with Doug Hall (inventor and founder of Eureka! Ranch) to bring his Innovation Engineering Management System to credit unions via workshops scheduled throughout the United States and Canada.

Meet Doug Hall as our feature on "Lunch with Ed": filene.org/blog/post/innovation-engineering.

Regardless of your approach to innovation, the key is to keep innovating, particularly in the crucial arena of mortgages and homeownership. Communities and consumers need a beacon of hope in achieving their American—or Canadian—dream.

*Figure 2: Doug Hall's Innovation Engineering Card*

CONCEPT PITCH SHEET

| | |
|---|---|
| **To:** (Specific Customer) | House-hunters |
| **Subject:** (News Headline) | Homeownership rises 20%. |
| **Are you frustrated with...** (Problem this innovation is addressing) | |
| Being told "no" by the Banks for your home loan | |
| **Introducing...** (Name: Suggestive of Benefit) | |
| Your Idea | |
| **The first...** (type of Product, Service, System) | |
| Homeownership program that is affordable | |

A sample snapshot of a concept pitch sheet from Innovation Engineering.

## Time to Rethink Mortgages

**CUs originated, and sold, record volumes of first mortgages in 2009.**

***By Bill Hampel***

*Credit Union Magazine- August 02, 2010*

Credit union earnings have been pummeled during the past two years by high loan losses, low yields on investments, share insurance premiums, and write-downs of capital deposits in corporate credit unions.

The one potential bright spot is that the yield curve—the difference between shorter- and longer-term interest rates—is unusually steep. As a result, the spread between what credit unions charge on loans and pay on savings should also be high, boosting net income.

With a weak economy, however, savings growth is strong while loan demand is almost nonexistent. All that cheap money languishes in even cheaper investments, rather than contributing to the bottom line through higher-yielding loans.

Despite the weak economy, credit unions originated a record volume of first mortgages in 2009: $94 billion. It's a shame they couldn't hold more of these loans. Instead, credit unions sold $51 billion, also a record. Credit unions could have taken a big step to even the imbalance between loan and savings growth last year by holding more mortgages in portfolio.

The reason for the increased loan sales was, of course, good asset-liability management (ALM). With very low interest rates, adding substantial amounts of fixed-rate mortgages to a balance sheet is financial suicide. And, with interest rates low, consumers are unwilling to take on the substantial risk of adjustable-rate mortgages (ARMs)—that is, most versions of ARMs currently available.

Today's standard mortgage products weren't designed with the needs of depository institutions in mind. Instead, they were tailored to the investors who buy mortgage-backed securities. Thirty-year, fixed-rate mortgages are attractive to borrowers and some investors. But credit unions, relying on mostly short-term funding from members, can hold them only in moderation. ARMs are great from an ALM point of view, but can be very scary to borrowers.

What if credit unions created their own first mortgages, specifically designed to be both member- and ALM-friendly, so that they could be safely held in portfolio? State Employees' Credit Union, Raleigh, N.C., has a successful product that fits this description. It's a two-year ARM with a 1% cap. It takes six years for the loan rate to increase by 3%, and then only if interest rates increase that much and stay up.

Another approach: Create a "partially adjustable-rate mortgage" or PARM. The loan could be originated with an initial fixed-rate period of one to three years, and then adjusted only at a fraction of any change in the index.

Many credit unions' average cost of funds adjusts at about 40% of changes in the one-year Treasury rate. So why not create a loan with a rate that changes by 40% of the change in the index? If the index rises 1%, the rate rises 40 basis points. At a 40% adjustment, it takes a 2.5% increase in the Treasury rate to generate a 1% increase in the loan rate, thus controlling payment shock.

The problem with standard ARMs is they put all the risk on borrowers, while providing more interest-rate protection than credit unions really need. Not surprisingly, they're not very attractive to borrowers unless interest rates are very high.

A PARM would split the risk between the borrowing member and the credit union. As long as the initial rate is sufficiently below the 30-year fixed rate, a PARM could be quite attractive to the borrower while safe for the lender.

If loans don't have to be sold for ALM reasons, the remaining issue would be liquidity. Adjusting rates would give significant control over volume. Adding PARMs to a product mix could give both members and credit unions a useful new tool.

*BILL HAMPEL is senior vice president of research and policy analysis/chief economist for the Credit Union National Association.*

e10 BUSINESS STRATEGY + DESIGN

# Exploration and Evaluation of Mortgage Concepts

Final Report and Recommendations

**CONFIDENTIAL**

Prepared for the Filene Research Institute

12/30/11

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## Introduction

e10 conducted a focus group to explore and evaluate seven (7) new mortgage product concepts developed by a Filene innovation team. Six (6) Subject Matter Experts ("participants") were hand selected to participate in the discussion. Participants were chosen for their depth and breadth of experience in the home mortgage and real estate markets and shared valuable perspectives as each concept was discussed and evaluated. Discussions were moderated to ensure all aspect of the concepts were explored and perspectives uncovered.

Mortgage concepts evaluated:

- Work Perks: Employee Down Payment Benefit
- NOW Mortgage
- Step It Down Mortgage
- Personal Mortgage Search: Self Directed Loan Analyzer
- Home Trak: Homeowner Repair & Care Budget Plan
- 20/20 Mortgage
- Pass It On: Down Payment Investment/Insurance

The primary objective of the focus group was to identify and hone the top 2-3 concepts that offer the greatest potential for successful commercialization. The research began with an explanation and visualization of each concept and proceeded with a moderated discussion on the following topics:

- Propensity for homeownership
- Likely target market segment
- Potential market demand
- Level of uniqueness or innovation
- Potential barriers to success
- Variations to the concept

While the research was purely qualitative, participants were also asked to independently rate the concepts based on potential market demand, innovation level, and the likelihood of commercialization success.

## Executive Summary

Overall, the participants were very responsive and offered a lively and honest discussion. While several have had credit union experience, their perspectives were mainly from a broader financial industry viewpoint. Participants were concerned with how a financial institution might find the concepts attractive financially (i.e. profitability) and how prospective homeowners (not member-owners) would respond to the concept. The broader perspectives, however, brought the depth and volume of mortgage experience necessary to truly evaluate and expand upon the concepts.

Of the seven concepts, **Work Perks** holds the most potential if an employer matching or percent contribution program is instituted. The Work Perks product could also provide a very unique offering in the market and would likely encourage homeownership among first home buyers, second home buyers and potentially current homeowners who need mortgage assistance. While participants commented on how this product would add significant value to employer benefit packages, further research would be necessary to explore employers' interest level in a Work Perks program. Without a matching or percent contribution fund, this concept has little to offer in terms of unique benefits to a prospective homeowner.

The **NOW Mortgage** concept also offers solid commercialization potential, yet only among strong borrowers in very specific financial situations. Participants agreed that this is not a product for the average homeowner, as the monthly payments would be unrealistically high. A good prospective homeowner for the NOW Mortgage may be someone who has very little savings, yet is soon to be earning a significant monthly income. Excellent candidates might be recent law or medical school graduates, homeowners who need a bridge loan to buy a new home while their current home is still on the market, or equity challenged homeowners. At a slightly higher interest rate, the NOW Mortgage may appeal to credit unions and still offer strong borrowers a unique and attractive mortgage product.

The **Step It Down Mortgage** offers good potential to increase homeownership among credit challenged consumers. Participants suggested that the product be positioned as refundable mortgage insurance, which would be a unique offering in the market. With reasonable rates, this product could be a highly attractive alternative to sub-prime lending programs for credit risky buyers. The product concept could also be extended to credit cards, car and other short term loans. A real downside to this concept is that savings contributions may not be enough to offset

the risk, so solid underwriting would be key in further development of the product. A higher interest rate may be required to make the Step It Down Mortgage attractive to credit unions.

Concepts with mixed reviews include, **Pass It On** and the **20/20 Mortgage**. While Pass It On was seen as fairly unique in the market - especially if it includes a tax incentive - most participants agreed that there would be limited market demand. Wealthy parents who already have a college fund set up for their children may be a likely target, yet a niche segment. The 20/20 Mortgage is also very unique in the market (there is no other mortgage that regulates payments according to income each year), however market demand may be limited to fiscally conservative consumers who desire external help in managing their budget. Of all of the concepts, the 20/20 Mortgage posed the most barriers to success including, complicated loan administration, overbearing control on consumers, and unpredictable consumer incomes.

**Home Trak** and the **Personal Mortgage Search** appear to offer the least potential for commercialization success. These two concepts are not as unique in the market and are not as likely to increase the propensity for homeownership. While participants were in favor of the Home Trak concept as an educational tool, some felt it may actually discourage homeownership as total costs are revealed. Participants also agreed that an incentive would be needed to encourage homeowners to open a repair/maintenance savings account.

As for the Personal Mortgage Search, participants' comments may have been biased due to their line of work. While they were in favor of a tool that could be used by a loan officer, they voiced numerous red flags for a consumer-based tool. Concerns were expressed that prospective borrowers would be unable to provide extensive, accurate and valid information without a loan officer's assistance. However, a highly robust Personal Mortgage Search for loan officers to use on site could automate a very time-intensive evaluation process. While this concept may not encourage homeownership, it could be used as an interest generating tool and could potentially improve and distinguish a financial institution's level of customer service.

## Recommendations

1. **Work Perks** has definite merit as a new mortgage product. We recommend further evaluating this concept with potential employers to determine the level of interest in matching funds (or contributing a percentage) - and the importance of pretax benefits. The concept could be explored beyond mortgages, to cars or college funds, and could be offered as part of a larger SEG or business development package of benefits for credit union membership. Research would also be required to assess the viability of forming a new pretax benefit from the federal government. This concept is very likely a win-win for consumers and credit unions, if employers are on board.

2. The **NOW Mortgage** concept should also be pursued to the next level. We recommend panel testing a prototype using financial rates that are attractive to both credit unions and the identified market segments. Potentially test the concept with credit unions that serve health care and law industries, for example Florida Hospital Credit Union, Baylor Healthcare Credit Union, United Healthcare Credit Union and the Legal Community Credit Union.

3. The **Step It Down Mortgage** offers potential, yet needs to be further explored from a financial risk perspective. We recommend developing several financial models of the concept along with various consumer debt scenarios to further determine the level of risk this mortgage product may carry. To bring this concept forward, it is critical to determine the amount of savings required by these credit risky borrowers and the underwriting required.

4. The loan officer's version of the **Personal Mortgage Search** may also offer commercialization potential. We recommend conducting a thorough competitive search for similar tools and extensively map the loan officer's decision-making process in order to further understand the scope and technology development requirements of this concept.

## Work Perks

Discussion Summary

**Encourages Homeownership**

The Work Perks product would definitely encourage homeownership if the employer matched the funds. Much like a matching 401K, this product would be a strong component of a benefits package for companies looking for talent. The Work Perks product could also encourage executives to purchase a second home and could assist homeowners who are underwater in their current mortgage.

**Potential Barriers to Success**

- Employer participation is critical to the success of this product.
- Potential of loans with bad credit risk as consumers get into a home they can't afford.
- FHA may not approve.
- Access to funds - would there be a penalty for other uses?
- Potential questions of fairness for those who choose to rent.

**Market Uniqueness**

This is a unique product. Gift down payments from employers are unusual and have only been offered on a case by case basis. Corporate relocation plans offer employee benefits, but not matching funds.

**Variations**

Pull in the community businesses and organizations to help match funds, encouraging homeowners to buy in the local community. Another variation is to offer credit union loan benefits for financing the mortgage with the credit union, like reducing the loan rate for participating employers, or reducing the origination fee.

**Target Market**

This has a broad potential target market. New homeowners, those looking for a second home and current homeowners who need assistance in equity recovery. Large size employers would be a good target to adopt matching funds.

**Ratings**

On a scale of 1-10 (where 10 is highest), the Work Perks product was given an average rating of 7.83 for market demand and 6.83 for the level of innovation. It received all 6 votes for having the potential for commercialization success.

## NOW Mortgage

Discussion Summary

**Encourages Homeownership**

Participants felt that the NOW Mortgage would offer strong borrowers in specific situations (see target market below) an attractive financing option and help them get into a home faster. The NOW Mortgage is favorable to the "now" consumer mentality.

**Potential Barriers to Success**

- If rates are at market value, credit unions would be giving away margin. A higher rate would still be attractive to consumers, yet make this product more attractive for credit unions.
- Monthly payments would be too high for the average buyer, which limits the target market.

**Market Uniqueness**

This product is unique in that it reduces the risk for financial institutions.

**Variations**

Potential variations include lowering the monthly payment and adding a 5 year balloon and tying balance targets to LTV vs. time.

**Target Market**

The NOW Mortgage is perfect for recent graduates who will be quickly earning a significant salary such as, doctors or lawyers (perhaps this product would be of value to credit unions who serve these types of members). Their lack of current savings and potential for a steep rise in earnings makes them an excellent candidate for the mortgage product. The NOW Mortgage could also serve consumers who are established in their career, but have recently lost equity in their current home, and/or consumers who need a bridge loan to purchase a new home while theirs is on the market.

**Ratings**

On a scale of 1-10 (where 10 is highest), the NOW Mortgage was given an average rating of 7.0 for market demand and 6.0 for the level of innovation. It received 3 votes for having the potential for commercialization success.

## Step It Down

Discussion Summary

**Encourages Homeownership**

The Step It Down mortgage has real merit and the opportunity to increase homeownership with credit challenged consumers. Participants saw this product as an improvement to sub prime lending programs, especially if the mortgage reflects a reasonable rate, and helps consumers buy and save at the same time. Participants noted that a more positive and appropriate name for this concept is “Build It Up” Mortgage.

**Potential Barriers to Success**

- Will credit unions want these (risky) loans on their books? Could the savings account be enough to really cover the risk? Solid underwriting will need to be explored.
- The product doesn’t solve the real issue with credit challenged consumers. They usually have multiple credit cards of high interest debt.
- What happens with delinquent loans? Rules must to be set for when the savings is utilized.

**Market Uniqueness**

Participants equated this product to mortgage insurance, but with a unique twist in that consumers get their payments back. Participants suggested this product is positioned as refundable mortgage insurance.

**Variations**

This concept could be extended to other financial products such as credit cards and car loans. Participants suggested to set the rate slightly above market and then lower the rate if a down payment is provided or solid payment history is achieved. Another suggestion is to offer consumers the option to use their savings account to pay down the mortgage, or another debt that would improve their credit rating.

**Target Market**

A good fit with consumers who are a credit risk, such as those whom have recently foreclosed, as it offers a more attractive financial option. Not a product for first time homebuyers.

**Ratings**

On a scale of 1-10 (where 10 is highest), the Step It Down Mortgage was given an average rating of 5.17 for market demand and 5.17 for the level of innovation. It received 4 votes for having the potential for commercialization success.

## Personal Mortgage Search

Discussion Summary

**Encourages Homeownership**

Participants thought the Personal Mortgage Search would be valuable if it really worked in extracting reliable data. The product runs the risk of giving consumers false hope, as results could be unrealistic, and therefore, may not encourage homeownership.

**Potential Barriers to Success**

- The tool relies on the client to give accurate input in order to provide valid output and hence may lead to a significant potential for fraud.
- Human interaction is missing, which is critical to capturing the real picture.
- It would require endless disclaimers throughout the process.
- Participants felt it is not realistic to expect a consumer to answer the questions with the required depth and accuracy, and it would be a very tedious process for consumers. It's much better to have a conversation.

**Market Uniqueness**

The Personal Mortgage Search is essentially what loan officers do today with their clients (an in-depth decision tree analysis). Currently there is no tool on the market that has this proposed level of robust detail. There are numerous mortgage calculators and financial modeling tools available that provide base level advice (for example, Wells Fargo has an assessment tool for loan officers, but may not be as sophisticated).

**Variations**

Participants agreed that the Personal Mortgage Search would be better served as a loan officer's tool and could serve as lead generation tool. It could also be a great add-on for tax estimator tools (ex: Turbo Tax).

**Target Market**

The Personal Mortgage Search could benefit consumers who don't want to interact with a loan officer and just need a simple mortgage.

**Ratings**

On a scale of 1-10 (where 10 is highest), the Personal Mortgage Search was given an average rating of 2.2 for market demand and 2.83 for the level of innovation. It received 0 votes for having the potential for commercialization success.

## Home Trak

Discussion Summary

**Encourages Homeownership**

Participants were in favor of this web-based tool to help homeowners understand the total costs involved in homeownership as a stand-alone product, yet felt the product may actually discourage homeownership if tied to a mortgage (it may encourage renting). It may also reduce the loan qualification level if a savings account was required.

**Potential Barriers to Success**

- There would need to be an incentive for consumers to open a savings account specifically for home maintenance and repair.
- A savings account ear-marked for home maintenance and repair limits financial flexibility.
- Home exterior maintenance and repair costs are significant. Would the savings be enough?
- Scares away potential buyers.

**Market Uniqueness**

Participants stated that there are already many online calculators to estimate the total cost of homeownership and numerous utility or appliance protection policies (these may be more basic than the Home Trak tool). Exterior home coverage programs are unique (unless the homeowner is part of an association).

**Variations**

Participants suggested offering an incentive, such as a higher interest rate, to open the savings account, or offering a low-interest home equity loan to pay for the anticipated expenses. Encourage an initial capital investment when opening the savings account as this would allow the savings to grow faster and be more likely to cover expensive exterior costs. The product could also be tied in to the home appliance warranty or insurance coverage programs.

**Target Market**

This product would be good for parents helping their kids with the true cost of homeownership.

**Ratings**

On a scale of 1-10 (where 10 is highest), the Home Trak product was given an average rating of 2.33 for market demand and 3.5 for the level of innovation. It received 0 votes for having the potential for commercialization success.

## 20/20 Mortgage

Discussion Summary

**Encourages Homeownership**

Participants agreed that the 20/20 Mortgage likely would not encourage homeownership as most homeowners are already above a 20% level (especially first time buyers).

**Potential Barriers to Success**

- This product is too complicated and confusing to most consumers. It would need to be positioned positively.
- Holding an annual review may be challenging to administer, unless it was an automated process.
- Basing the 20% off of last year's income works only in stable earning situations. A large commission check and loss of a job the next year would place homeowners in a difficult financial position.
- Feels controlling and intrusive (i.e. big brother).
- Would be challenging for financial institution to value the loan as the payments fluctuate from year to year.
- As incomes grow, many homeowners would rather have cash or use their income for savings instead of paying a higher mortgage payment.

**Market Uniqueness**

There is no other mortgage today that regulates the payment according to income each year.

**Variations**

A simplified version of the loan would make it more easily understood by consumers and administered by financial institutions.

**Target Market**

For the fiscally conservative who needs help managing their budget.

**Ratings**

On a scale of 1-10 (where 10 is highest), the 20/20 Mortgage was given an average rating of 2.0 for market demand and 3.83 for the level of innovation. It received 2 votes for having the potential for commercialization success.

## Pass It On

Discussion Summary

**Encourages Homeownership**

The Pass It On product would encourage homeownership, yet the market might be very limited. Comments were made relative to parents' ability to save for college, let alone a future first home for their children. The feasibility of this product is also dependent on offering tax incentives.

**Potential Barriers to Success**

- Would need to offer tax benefits (like a 529 or an education IRA for housing).
- Limits financial flexibility of parents and goes against general financial advising principals.
- Some parents may feel that their children should earn their downpayment for a home.
- May impact child's eligibility for financial aid for college.
- Child/homeowner may not be a good credit risk (even though they have the downpayment).
- Would need rules for withdrawals and account control.

**Market Uniqueness**

This would be a very unique product if tax incentives were offered.

**Variations**

Explore possible financial models that work similar to life insurance policies.

**Target Market**

Wealthy parents who already have a college fund set up for their children.

**Ratings**

On a scale of 1-10 (where 10 is highest), the Pass It On product was given an average rating of 3.33 for market demand and 5.5 for the level of innovation. It received 2 votes for having the potential for commercialization success.

## Market Demand

Please rate the following concepts based on the potential of **homeowner demand** ("10" for the greatest potential demand; "1" for the least potential demand).

| Mortgage Concept | Total | Average | Rating (1-10) |
|---|---|---|---|
| Work Perks | 47 | 7.83 | 10;10;10;5;6;6 |
| NOW Mortgage | 42 | 7 | 6;7;5;10,10;4 |
| Step It Down Mortgage | 31 | 5.17 | 8;6;3;7;4;3 |
| Personal Mortgage Search | 13 | 2.12 | 3;1;3;1,2;3 |
| Home Trak | 14 | 2.33 | 1;5;3;3;1;1 |
| 20/20 Mortgage | 12 | 2 | 6;2;1;1;1;1 |
| Pass It On | 20 | 3.33 | 1;1;8;2,2;6 |

## Innovation

Please rate the following concepts based on their **innovation or uniqueness in the market** ("10" for the most innovative; "1" for the least innovative).

| Mortgage Concept | Total | Average | Rating (1-10) |
|---|---|---|---|
| Work Perks | 41 | 6.83 | 10;10;5;5,4;7 |
| NOW Mortgage | 36 | 6 | 3;6;5;9;8;5 |
| Step It Down Mortgage | 31 | 5.17 | 3;7;5;6;5;5 |
| Personal Mortgage Search | 17 | 2.83 | 6;2;2;1;4;2 |
| Home Trak | 21 | 3.5 | 3;6;7;1;2;2 |
| 20/20 Mortgage | 23 | 3.83 | 3;5;8;1;3;3 |
| Pass It On | 33 | 5.5 | 6;8;7;1;4;7 |

## Commercialization Success

Circle up to 3 mortgage concepts that may offer the greatest likelihood of successful commercialization.

| Mortgage Concept | Total Votes |
|---|---|
| Work Perks | 6 |
| NOW Mortgage | 3 |
| Step It Down Mortgage | 4 |
| Personal Mortgage Search | 0 |
| Home Trak | 0 |
| 20/20 Mortgage | 2 |
| Pass It On | 2 |

## Participant Biographies

**STEPHEN SPEARS**
**Market President, Fee Based Businesses**
**Klein Bank**
Minneapolis
Stephen brings an extremely broad base of expertise in mortgage and banking ranging from his leadership role as Managing Director of GMAC ResCap to being a principal in Mortgage Capital Parnters. He offers a critical mortgage industry perspective built over 20+ years of experience including 2 years with TruStone Financial Federal Credit Union.

**JODY KERN**
**Private Mortgage Banker**
**Wells Fargo Home Mortgage**
Minneapolis
Jody has over 15 years of experience in banking & mortgages covering mortgage sales and operations, marketing, project management, finance and leadership development experience. Her current direct responsibilities include business development and profitability, customer service, referral partnerships, credit quality and professional development of staff. In addition, Jody spent the first four years of her professional career in member services and loan operations at a billion dollar west coast credit union.

**BUDD BATTERSON**
**Principal, Triad Development**
**Principal, Linnese Devlelopment**
**Real Estate Sales at Edina Realty**
Minneapolis
Budd is a savvy professional with a 25+ year career in all facets of real estate from construction & property development to successful real estate sales to industry leadership. He has his fingers on the pulse of the consumer side of the real estate and mortgage markets. Budd will bring a valuable unique perspective to reviewing our products from the market demand perspective. Recognized for his leadership in the industry, he has been active with the Minneapolis Area Association of Realtors and was recently recognized as 2011 Minnesota REALTOR of the Year.

**DOUG NESBIT**
**Principal, Blue Rocket Marketing (strategic consulting)**
**Chief Marketing Officer, CMG Mortgage, Inc.**
Danville, CA
Doug brings a comprehensive package of mortgage expertise; in depth experience in the consumer mortgage products plus an innovative vision to change the whole mortgage market's thinking. He has incorporated products from abroad to tailor them to the US market. He co-developed and rolled out the innovative "Homeowner accelerator product". Doug has spent over 25 years working with consumer products, including financial services and mortgages.

**NOBU HATA**
**Realtor**
**Member, Northstar MLS Advisory Committee**
**Founding Member, Minneapolis Area Assoc of Realtors YPN**
Minneapolis
Nobu is a founding member of the Minneapolis Area Realtors Association Young Professionals (YoPro). He is passionate about helping families buy homes and looking for innovative, new alternative home financing for today's complicated economic times. His marketing background in consumer insight research has given Nobu a unique appreciation and understanding of all facets of homeownership. A native of Alaska, Nobu grew up with a credit union and believes in the power of the credit union philosophy.

**STEVE MORRIS**
**Branch Manager**
**Wintrust Mortgage**
Minneapolis
Steve developed his multi-faceted experience having worked in a variety of roles in the mortgage world during his 15-year career including processing, underwriting, originating and closing. Steve prides himself on educating clients about the various details of the mortgage process, as well as creating customized and comprehensive financing options and solutions for clients. Steve has earned numerous awards and recognition, most recently named one of the Twin Cities Super Mortgage Professionals.

**LISA PALMA**
**Sr VP, COO**
**Blackhawk Community Credit Union**
**Janesville, WI**

A seventeen-year veteran in the credit union industry, Lisa offers a wealth of knowledge in many areas, including member services, sales management, technology, branch management, call center support and marketing. Lisa's creative vision has led to numerous successful initiatives including an innovative new member-friendly branch design format featuring living room atmosphere with fireside learning library, member engagement pods and children's education & computer station. She is one of the brightest young executives in the credit union arena and was appointed to a two-year term on the industry's prestigious Filene Research Institute's i3 Innovation Program.

## Concept Briefs

**A. WorkPerks -- Employee Down Payment Benefit** – This product offers down payment savings options and perhaps an employer match as an employee benefit. Wellness benefits are popular with employers, so this idea expands on the concept of financial wellness. It is common to encourage employees to save for retirement through employer-sponsored plans, but not all employees are ready to save for retirement when they haven't achieved more basic financial goals, like owning a home. This benefit works like retirement savings, only it allows employees to contribute a percentage of their income into a savings account for a down payment for a home. Employers can offer a matched a contribution. At a simple level, an employer plan would be packaged and administered by a credit union using existing savings and ACH products. At a more sophisticated level, legislative action would be taken to allow before-tax contributions to savings accounts for down payments for a home and tax breaks would be given to employers that offer the program. The main benefit is to give consumers a method to acquire a down payment for a home and develop the habits to save regularly for their next financial goals (perhaps retirement).

Target Market: First time homebuyers without a down payment

**B. Home Trak Repair & Care Budget Plan**– This is a web-based program that helps consumers budget for the true cost of homeowners by figuring the ongoing costs and timelines for replacement and maintenance of a home's major expenses: roof, furnaces, kitchen appliances, etc. The homeowners would enter the age or scan the bar codes of appliances and all major home components. The program analyzes the date and prepares a custom timeline and cost chart for these expenses over a the life of the home. The homeowner would establish a voluntary forced savings acct – adding a specific dollar amount to their monthly mortgage payment. This extra HomeTrak money is automatically diverted to a savings account to finance care & maintenance of the home. The main benefit is to help consumers understand the true costs and help them budget for these costs over time. It also helps build a stronger financial position for the homeowner throughout the mortgage.

**C. 20/20 Mortgage** – This is a mortgage product with a payment structured to always be 20% of the consumer's income, so that it is always affordable. It is based off of the premise that a first-time homebuyer is in the beginning stages of earning potential and assumes increased payments over the life of the loan with a payment amount floor set at origination based upon

present employment. This mortgage works in conjunction with a budget plan for the borrower to live by for all of their expenses (i.e. car payment %, savings %, disposable income %). From a logistic standpoint, this mortgage requires annual income reviews at the time of income tax filing and annual payment adjustments. The term is amortized based upon payment and income projections. The main benefit is to help consumers live within a budget, so that they can achieve their financial goals and be able to afford their home.

Target Market: First time homebuyers concerned with long-term affordability of mortgage payments, borrowers wanting to live within a structured budget

**D. Step it Down Mortgage -- Diminishing Payment Mortgage** – This mortgage product has a payment that starts out higher and includes mandatory deposits to a frozen savings account (earning dividends) in order to reduce the risk of default for the credit union and lower the consumer's payments later in the loan. Once the loan has performed for a pre-determined amount of time (disclosed and set at origination) and the savings account has reached a pre-determined percentage of the mortgage, the consumer will prove that their credit risk has been mitigated. So, the consumer will be rewarded. The first reward is that the mortgage payment will be reduced because the savings deposits will stop. The consumer will continue to make timely mortgage payments at the new amount for a predetermined amount of time (disclosed and set at origination). The second reward is that the savings balance will be allocated to future mortgage payments to further reduce the monthly payment amount or the savings account will be released to the member. The main benefit is to help consumers with credit problems own a home and fix their credit.

Target Market: First time homebuyers with credit risk issues

**E. NOW Mortgage** – This product would provide financing for the down payment, along with the mortgage. It has a blended rate that accounts for the down payment and the mortgage. The mortgage would re-price once the down payment is paid off. Payments are structured to set the member up to pay the mortgage down to 80% LTV in 5 years. It could be set up for faster repayment based upon the member's goal. Their payment decreases over time, gets consumers into a home quickly (or NOW). The main benefit is to help consumers get into a house and positions them to be in a strong financial position throughout the mortgage.

Target Market: First time homebuyers without a down payment, borrowers with strong credit

TWIST #1 on Now Mortgage – requires 10% down, but pays
the next 10% over 5 years, leaving 80% on a 25-year

amortization, puts members in a strong position of equity quickly

TWIST#2 on Now Mortgage – requires 10% down (90% loan to value, no MI). Rate starts out at 2% above an 80% LTV loan rate but when payments are made on time, rate drops by 50 bp for the first 4 years as a reward.

F. **Personal Mortgage Guide -- Self Directed Loan App** This web-based personalized analysis would be tied to the application process. A user-friendly custom application would direct consumers to different product options based on information supplied in their application. It would offer members more information and more control of the mortgage process…choices and options versus just being directed to one specific product by a mortgage loan officer. It could offer consumers more information or advice on qualification issues that arise in the application process such as credit/FICO scores, income, etc. It would also allow for customization by individual credit unions.

Twist – In Branch Tool Box approach -- would create the loan application process for credit union employees to ask the appropriate questions and offer personalized solutions at origination. A package of assorted products to fit specific member need …first time homebuyers, refinances, retirees/reverse mortgages, low down payment available, bad credit score, etc. This combines the innovative solutions with a high-touch personal interaction.

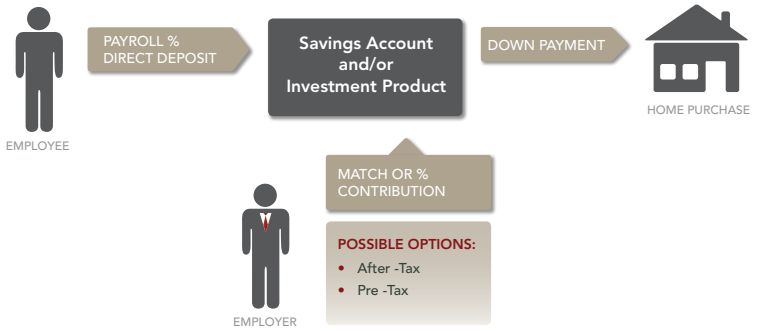
Target Market: First time homebuyers, technically savvy consumers, any homebuyer, consumers wanting a personalized mortgage

**G. Pass It On --- Down Payment Investment/Insurance** – This investment product or insurance policy would be offered to parents and would mature into a down payment for their adult children. In the same way that parents and grandparents are saving for college expenses, this product begins when the child is young, requires regular incremental deposits into an investment or insurance vehicle tied to market rates and matures into dedicated money for a down payment for a home.

Target Market: Parents wanting to pass on the value of homeownership to their children

CONCEPT I

## Work Perks: Employee Down Payment Benefit




**TARGET MARKET:**
Home buyers needing help with down payment.

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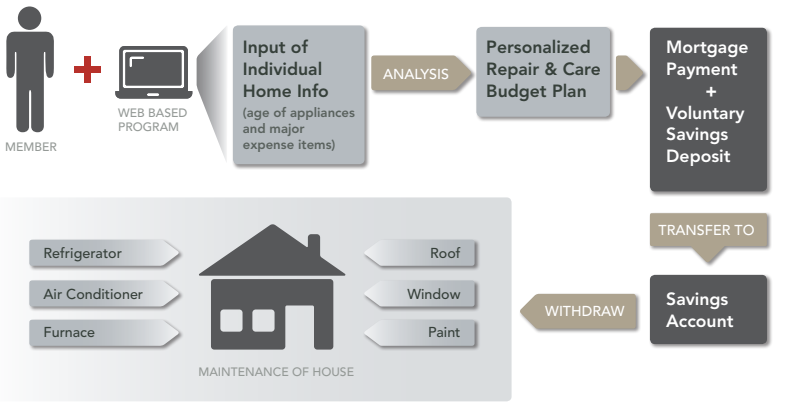
CONCEPT II

## Home Trak: Homeowner Repair & Care Budget Plan




**TARGET MARKET:**
First time home buyers, technically savvy consumers, any home buyers, consumers wanting to budget for the true cost of homeownership.

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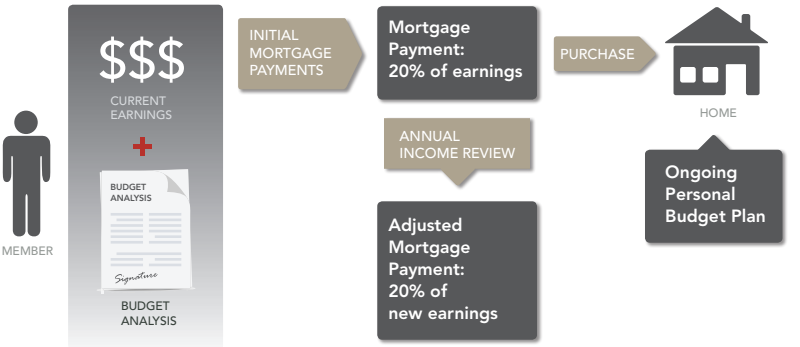
CONCEPT III

## 20/20 Mortgage




**TARGET MARKET:**

First time home buyers concerned with long-term affordability of mortgage payments, borrowers wanting to live within a structured budget.

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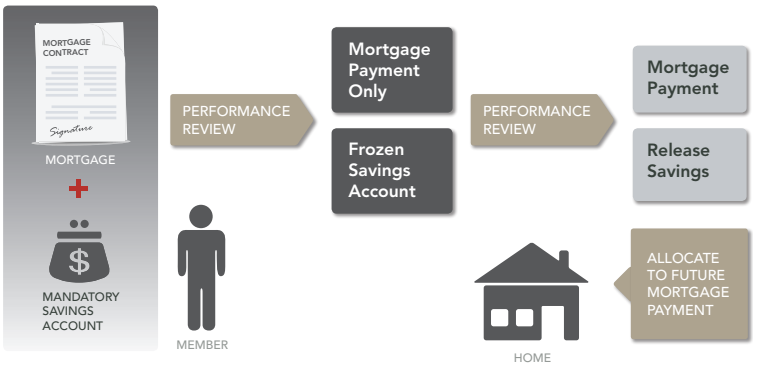
CONCEPT IV

## "Step It Down" Mortgage




**TARGET MARKET:**

Home buyers with credit risk issues.

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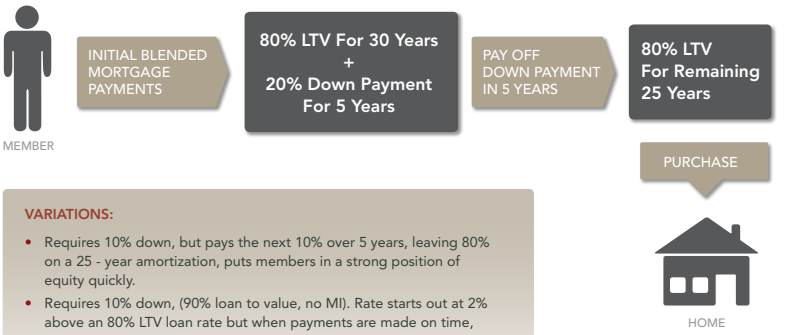
CONCEPT V

## Now Mortgage




**VARIATIONS:**

- Requires 10% down, but pays the next 10% over 5 years, leaving 80% on a 25 - year amortization, puts members in a strong position of equity quickly.
- Requires 10% down, (90% loan to value, no MI). Rate starts out at 2% above an 80% LTV loan rate but when payments are made on time, rate drops by 50 bp for the first 4 years as a reward.

**TARGET MARKET:**

First time home buyers without a down payment, borrowers with strong credit.

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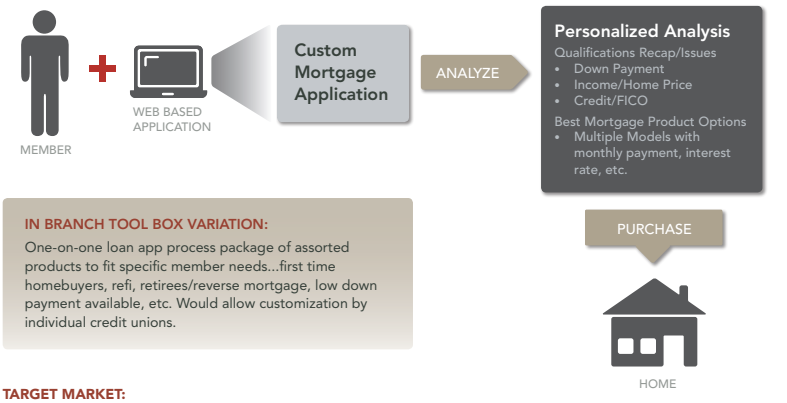
CONCEPT VI

## Personal Mortgage Search: Self Directed Loan Analyzer




**IN BRANCH TOOL BOX VARIATION:**

One-on-one loan app process package of assorted products to fit specific member needs...first time homebuyers, refi, retirees/reverse mortgage, low down payment available, etc. Would allow customization by individual credit unions.

**TARGET MARKET:**

First time home buyers, technically savvy consumers, any home buyers, consumers wanting a personalized mortage.

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CONCEPT VII

## Pass It On: Down Payment Investment/Insurance


**TARGET MARKET:**

Parents wanting to pass on the value of homeownership to their children.

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## Discussion Guide

**I. Introduction (5 min)**

Thank you for coming and for your willingness to participate in tonight's discussion. Our purpose is to explore and validate seven new mortgage concepts that were developed by a Filene innovation team. Each one of you has been selected based on your area and depth of expertise in the mortgage or real estate markets. We are asking you to help us further explore these seven concepts, offer insights on potential market interest, and assist in selecting the concepts that have the greatest opportunity for marketization.

As we're discussing the concepts, I want you to feel free to agree or disagree with one another, play devil's advocate and offer new twists to the concepts. As we explore together, perhaps a completely new concept will surface. Lastly, we are audio taping the discussion so we are sure to capture tonight's dialogue.

Let's start by introducing ourselves.
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• Filene (Lisa)
• Subject Matter Experts (name, company and expertise)

**II. Assessment of each Concept (15 min each)**

• Describe the concept and answer any questions

• Does this concept increase the likelihood of homeownership? Why or why not?

• What are some potential barriers to the success of this mortgage product?

• What aspect of this concept is most unique or innovative?

• How might you make this an even better idea? (i.e. variations)

**III. Evaluation between Concepts (10 min)**

• How might you rate each concept in terms of prospective homeowner demand?

• How might you rate each concept in terms of innovation or uniqueness?

• Overall, which of these seven concepts offers the greatest potential for commercialization?

**IV. Thank participants. Provide payments.**

# Appendix C: Collider Tournament

A 2011 innovation tournament led by the Crash Network (now called The Cooperative Trust) posed the question: How might credit unions increase the availability of affordable homeownership in North America? Entries rolled in from across Canada and the U.S. and into a three-round process that winnowed through the best of the best and resulted in one named winner.

Robert Christiansen of Servus Credit Union ($11.2 billion, Alberta, BC) was crowned the champion with his CU Homebuyer idea, which is now called honeycomb.

| Tournament Structure | Anatomy of the Winning Idea |
|---|---|
| **Round 1: Think It**<br>Nineteen concepts were evaluated in the elevator pitch round. Contestants submitted concise statements that communicated<br>1) Generally what the idea is;<br>2) What problem it fixes;<br>3) Who should care; and<br>4) Why they should care. | **Round 1: The Pitch**<br>The CU Homebuyer pitch explained in short and sweet terms how a different approach to down payment assistance (in the arena of matched savings) for first-time homebuyers, could not only empower the member's ability to buy, but build a short term deposit boost and still build for the future of conventional mortgage lending. |
| **Round 2: Develop It**<br>Ten contestants submitted concept documents for consideration. These expanded on the original brief statement in a format of less than two pages. | **Round 2: The Concept Document**<br>Robert shared sample numbers, and detailed a few of the expectations such as required in-branch visits (for members' deposits), as well as the consequence of members not using the matched savings for a home purchase. |
| **Round 3: Build It**<br>Four contestants built out prototypes, or working models, to show how their idea might come to life. | **Round 3: The Prototype**<br>Feedback from the field was a vital component in this round. Robert was able to not only identify but confirm ballpark amounts of matched savings, both from senior executives within the credit union, as well as young people (as potential buyers). Samples of marketing pieces, forms, and banking systems to be used were the final elements that drew this idea closer to reality. |

For more insight on innovation tournaments, see the Filene publication *BUILD: A Guide to Developing a Portfolio of Ideas and Experiments*. Members can download a free copy at filene.org.

# Endnotes

1. David Reiss' ideas are also featured in "Reforming the Residential Mortgage-Backed Securities Market," *Hamline Law Review*, forthcoming 2012, ssrn.com/abstract=2035021.
2. Roberto G. Quercia, Allison Freeman, and Janneke Ratcliffe, *Regaining the Dream: How to Renew the Promise of Homeownership for America's Working Families* (Washington, DC: Brookings Institution Press, 2011), www.ccc.unc.edu/RegainingTheDream.php.
3. National Association of Realtors, *Social Benefits of Homeownership and Stable Housing* (August 2010), www.realtor.org/Research.nsf/files/05%20Social%20Benefits%20of%20Stable%20Housing.pdf/$FILE/05%20Social%20Benefits%20of%20Stable%20Housing.pdf.
4. David Min, *True North: The Facts About the Canadian Mortgage Banking System* (Washington, DC: Center for American Progress, August 2010), www.americanprogress.org/issues/2010/08/true_north.html.
5. John Kiff, "Canadian Residential Mortgage Markets: Boring But Effective?" IMF Working Paper WP/09/130 (Washington, DC: International Monetary Fund, June 2009), www.imf.org/external/pubs/ft/wp/2009/wp09130.pdf.
6. Min, *True North*.
7. Bill Hampel, "Time to Rethink Mortgages," *Credit Union Magazine*, May 2010, www.creditunionmagazine.com/articles/36311-time-to-rethink-mortgages.
8. Ibid.

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