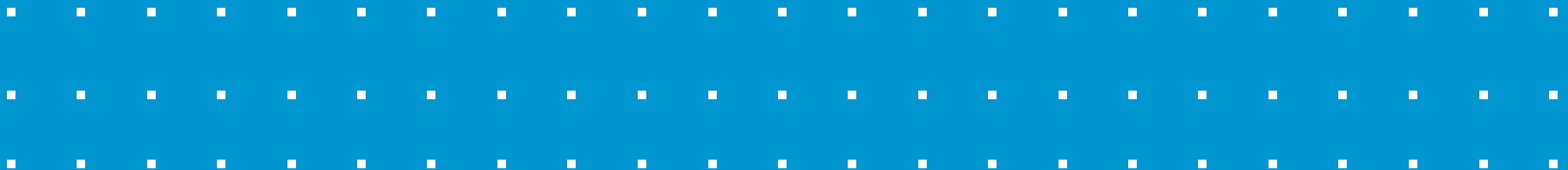




Cash Out Refinances: A Double-Edged Sword

Laurie Goodman
Co-Director, Housing Finance Policy Center
Urban Institute

NHC Webinar
May 14, 2019

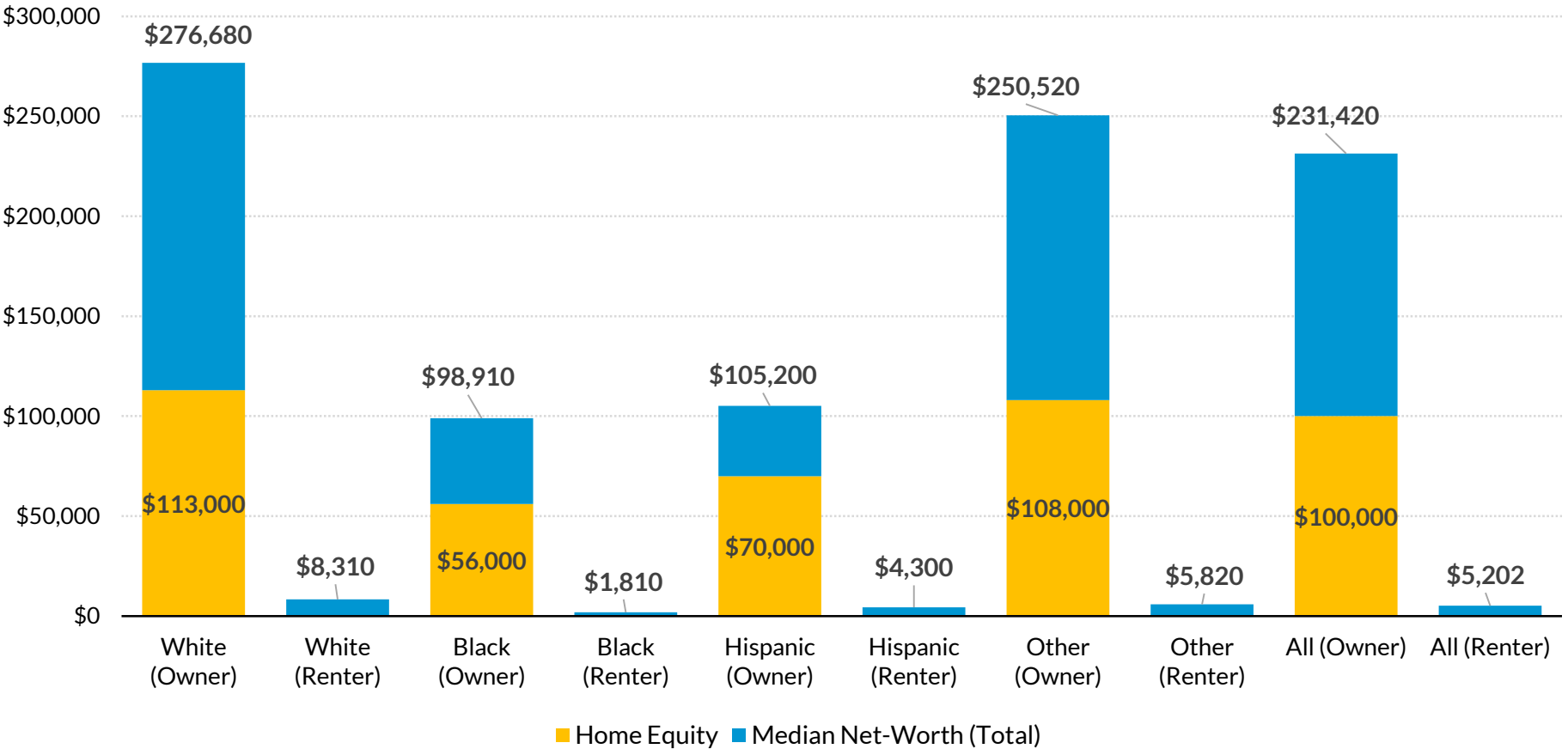


The Need for Cash-out Refis

Homeownership has historically been the best way to build wealth

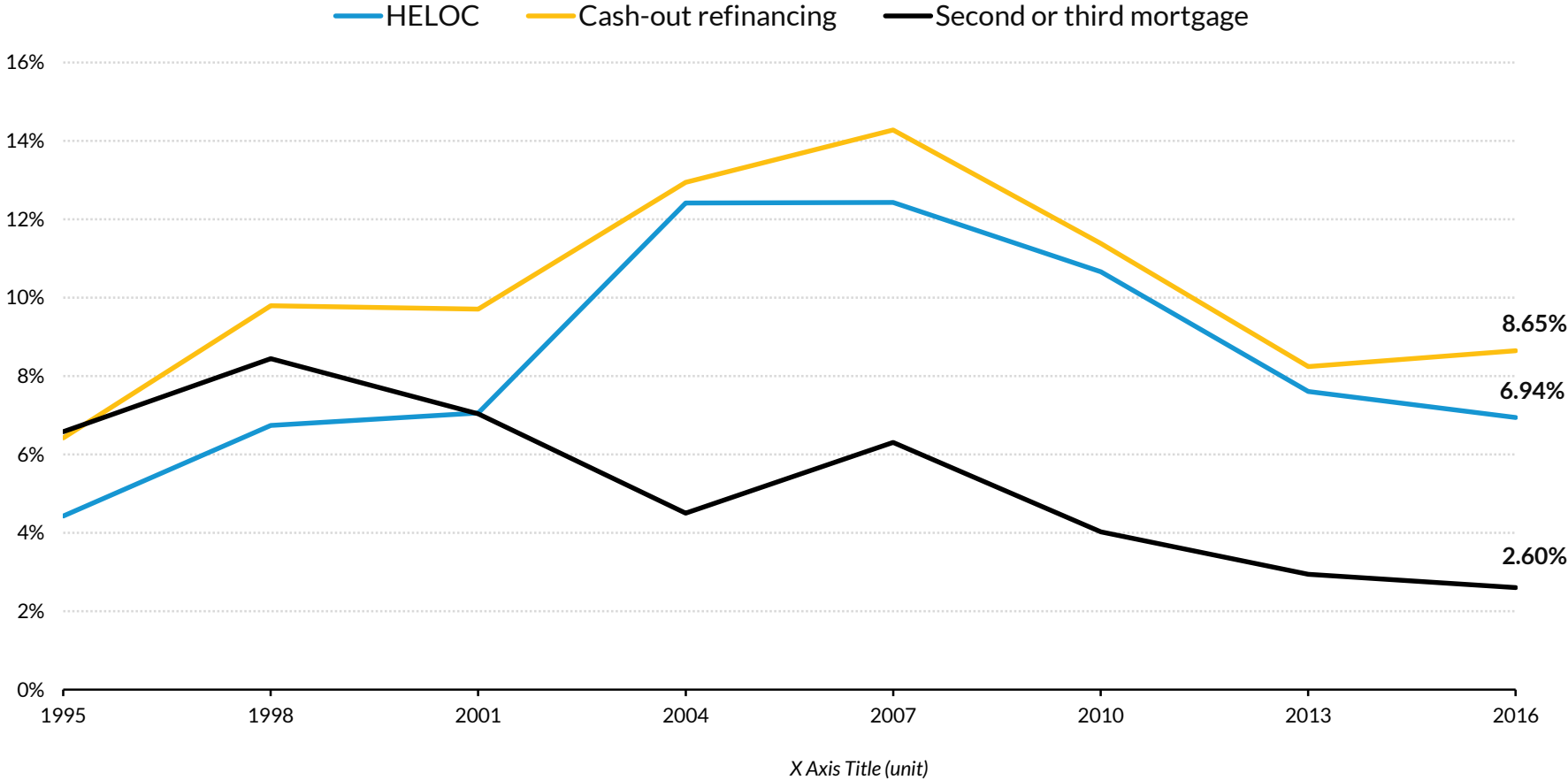
Homeowner Versus Renter Net-Worth (Median Dollars)

2016 Dollars



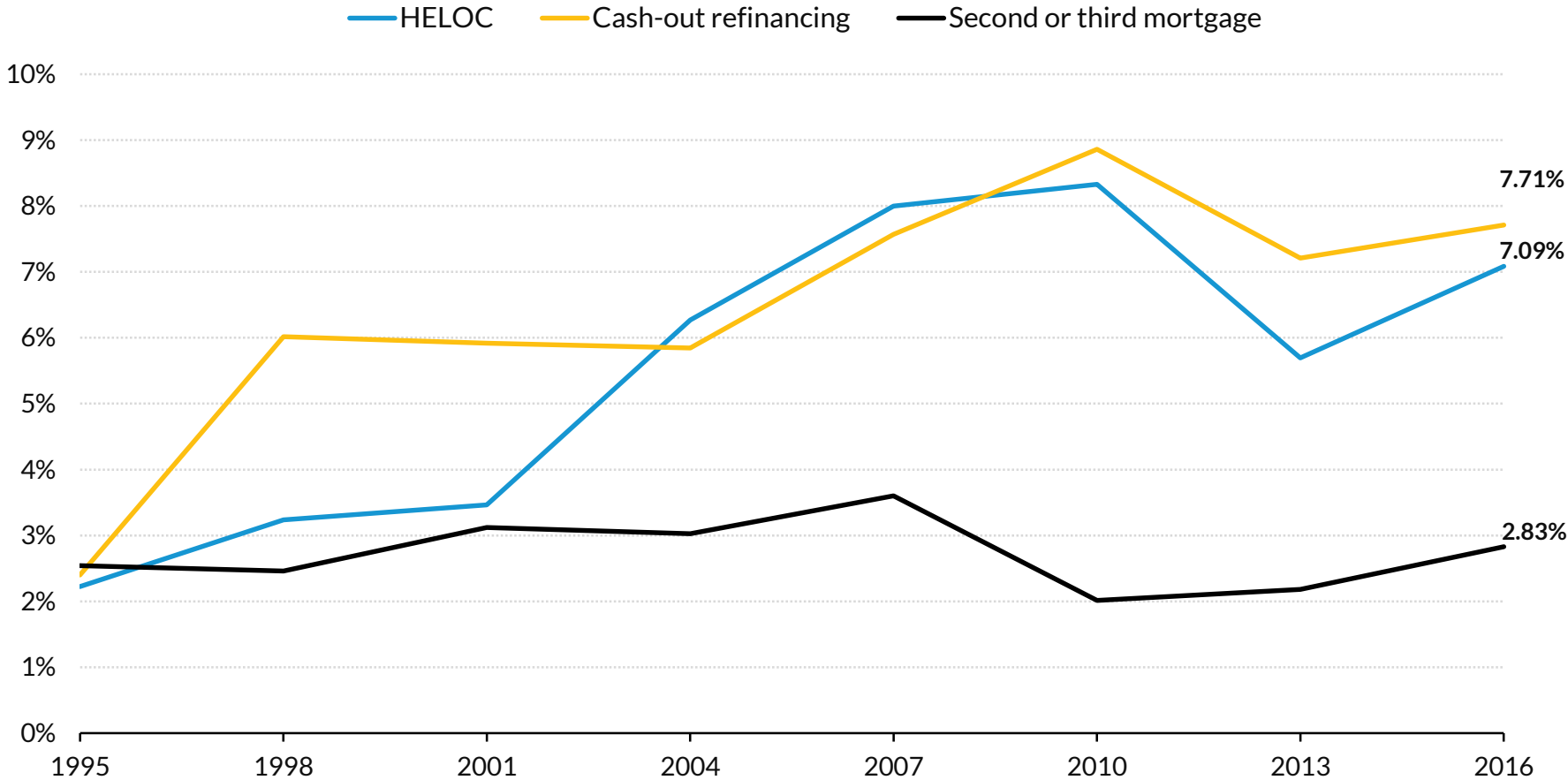
Sources: Urban tabulations of Federal Reserve Board, 2016 Survey of Consumer Finances.

Share of Homeowners with an Active Home Equity Product (all ages)



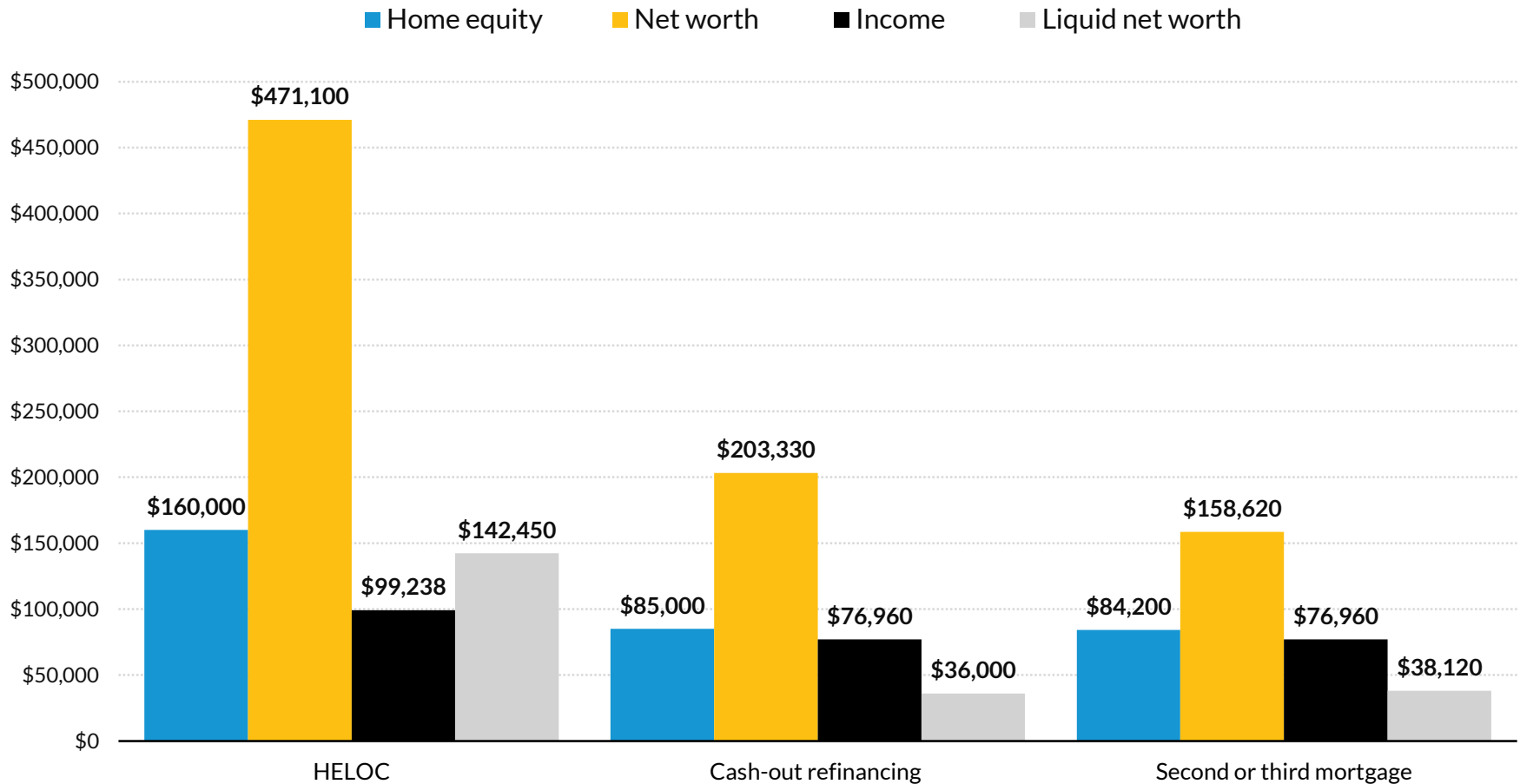
Sources: Urban Institute calculations based on the 2016 Survey of Consumer Finances. See Jesse Bricker et al., Changes in US Family Finances from 2013 to 2016: Evidence from the Survey of Consumer Finances (Washington, DC: Board of Governors of the Federal Reserve System, 2017).

Share of Homeowners Ages 65 and Older with an Active Home Equity Product



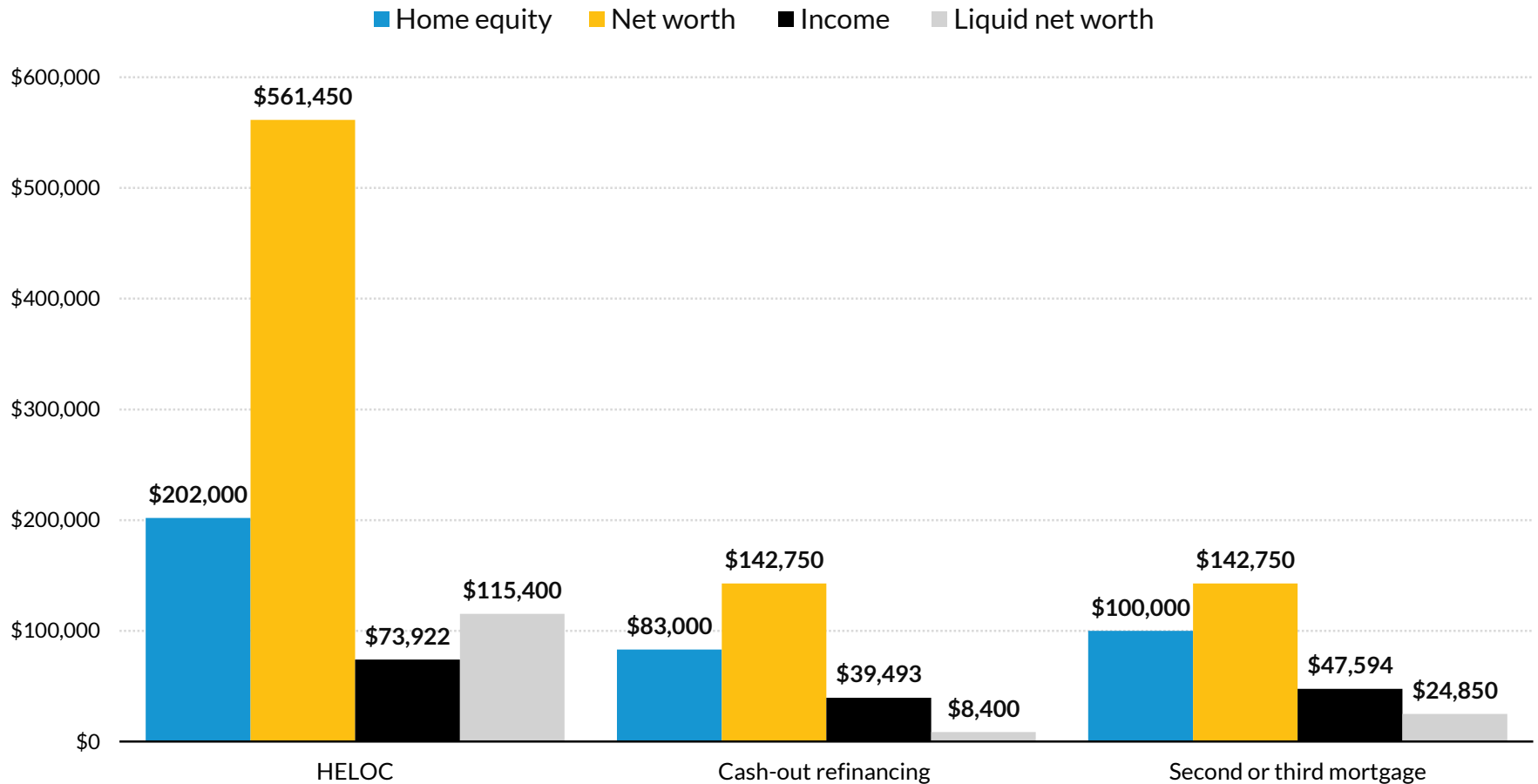
Sources: Urban Institute calculations based on the 2016 Survey of Consumer Finances. See Jesse Bricker et al., Changes in US Family Finances from 2013 to 2016: Evidence from the Survey of Consumer Finances (Washington, DC: Board of Governors of the Federal Reserve System, 2017).

2016 Wealth Measures for Households, by Extraction Channel (all ages)



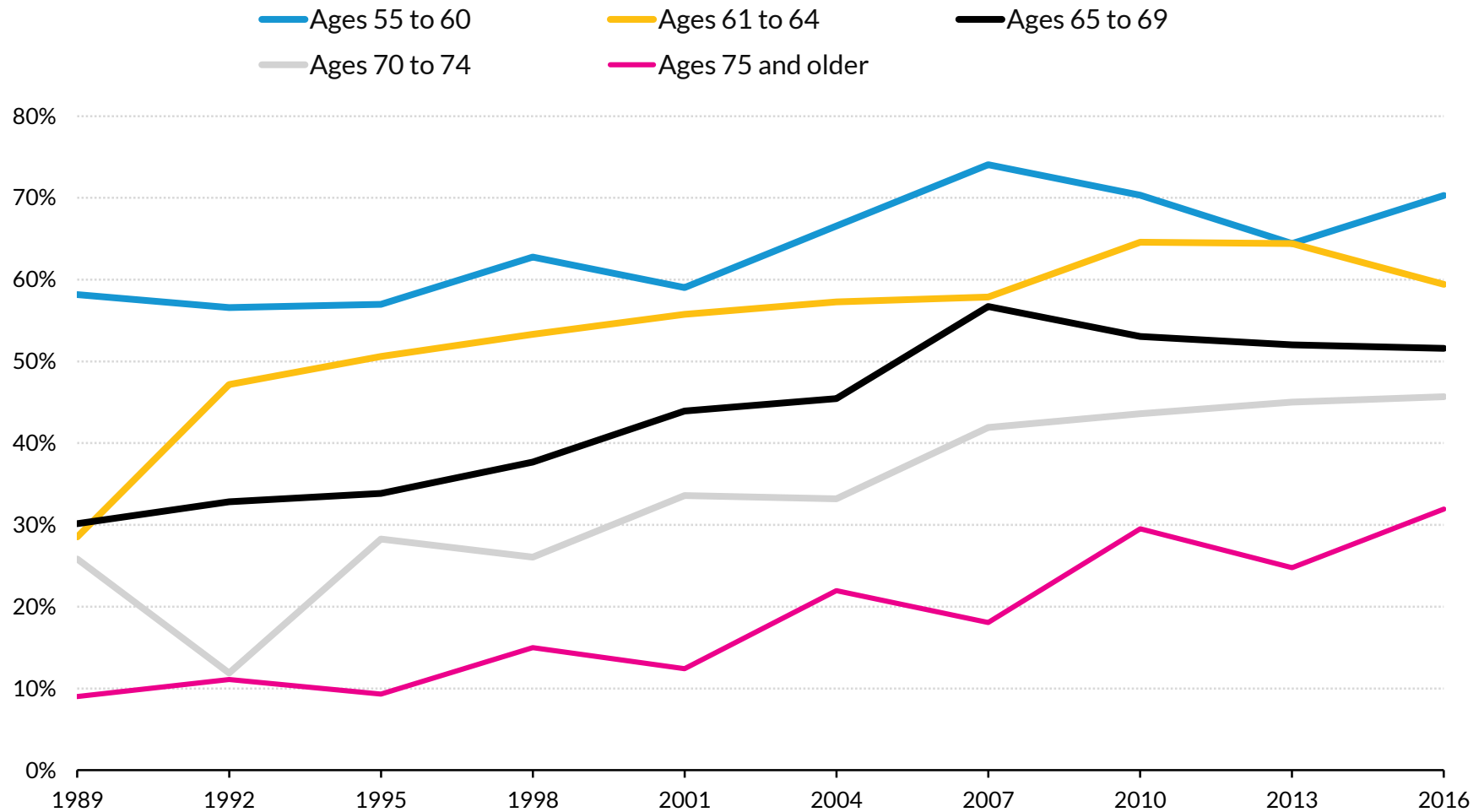
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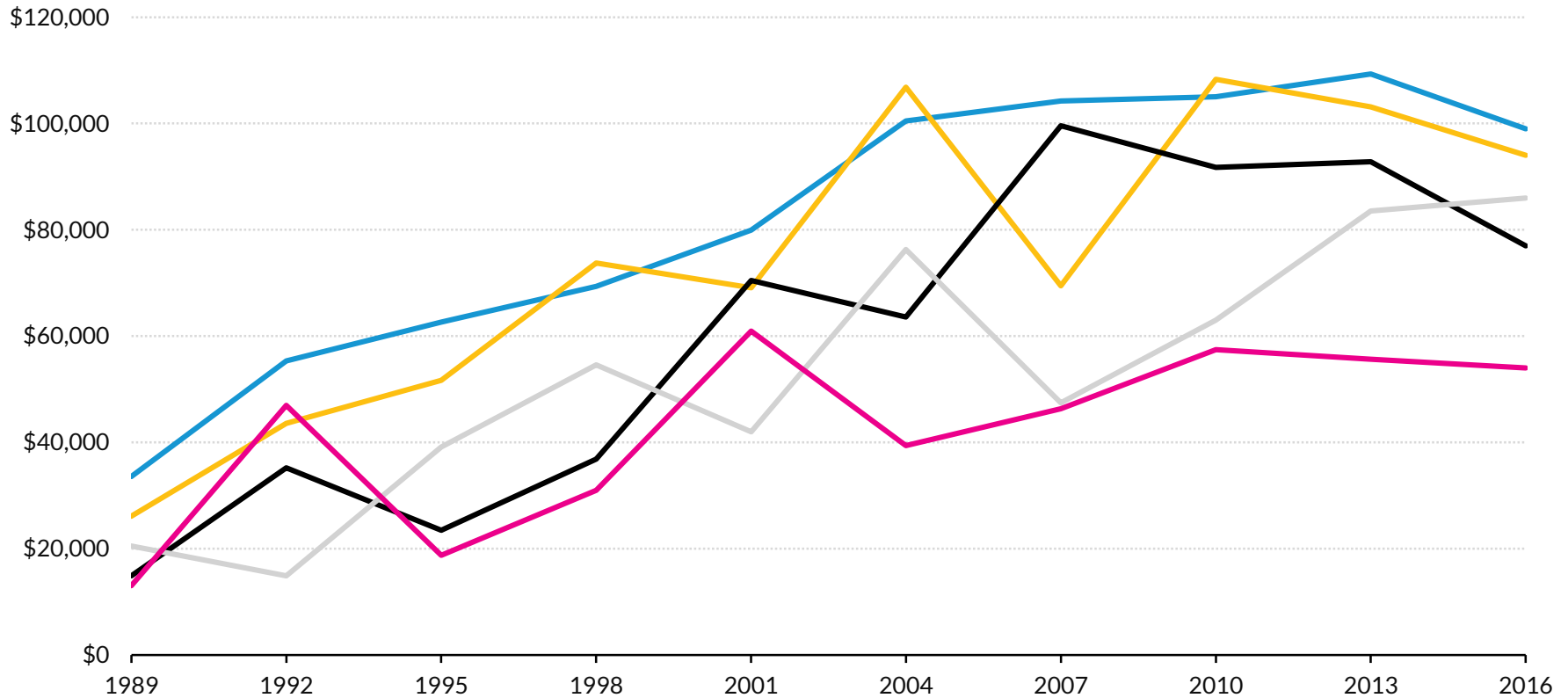
Share of Elderly Homeowners with a Mortgage



Sources: Urban Institute calculations based on the 2016 Survey of Consumer Finances. See Jesse Bricker et al., Changes in US Family Finances from 2013 to 2016: Evidence from the Survey of Consumer Finances (Washington, DC: Board of Governors of the Federal Reserve System, 2017).

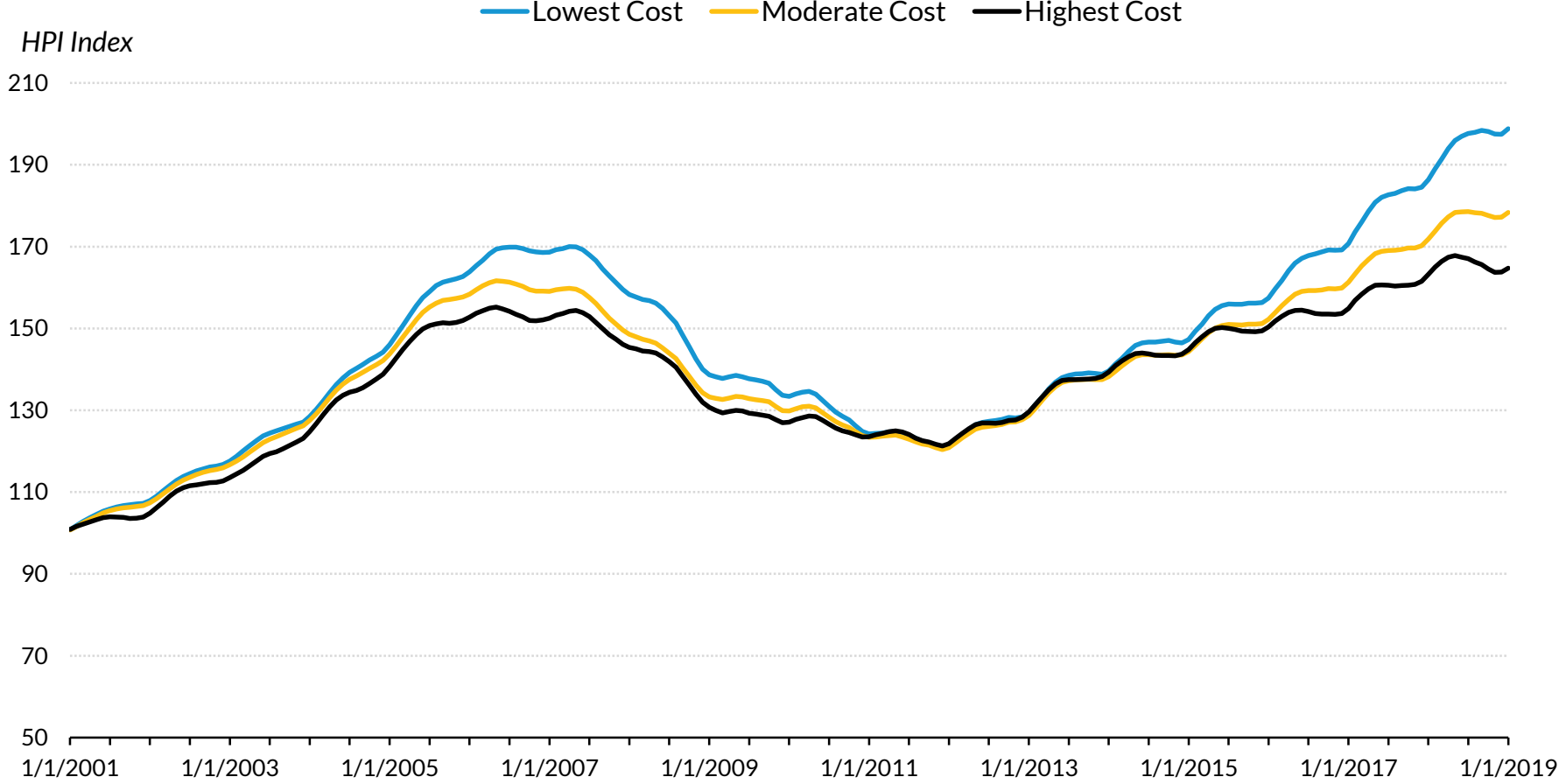
Median Mortgage Amount for Elderly Homeowners with a Mortgage

— Ages 55 to 60 — Ages 61 to 64 — Ages 65 to 69
— Ages 70 to 74 — Ages 75 and older



Sources: Urban Institute calculations based on the 2016 Survey of Consumer Finances. See Jesse Bricker et al., Changes in US Family Finances from 2013 to 2016: Evidence from the Survey of Consumer Finances (Washington, DC: Board of Governors of the Federal Reserve System, 2017).

Home Price Indices, by Price Tier



Source: Black Knight

Cash-out Refi Performance

Loan Characteristics

	Interest Rate			UPB			LTV		
	Purchase	Rate refi	Cash-out refi	Purchase	Rate refi	Cash-out refi	Purchase	Rate refi	Cash-out refi
2002	6.65	6.46	6.55	151,636	158,885	159,064	80.34	70.66	67.86
2006	6.44	6.44	6.47	186,449	189,917	193,124	76.62	70.54	65.98
2007	6.38	6.40	6.42	195,014	201,543	195,899	78.46	72.01	67.33
2012	3.87	3.81	3.91	220,364	274,573	219,958	80.12	67.94	63.79
All (1999-2016)	5.69	5.47	5.76	188,992	208,529	187,876	79.74	69.70	66.21

	FICO			Owner-occupied (%)			DTI		
	Purchase	Rate refi	Cash-out refi	Purchase	Rate refi	Cash-out refi	Purchase	Rate refi	Cash-out refi
2002	722	722	714	88.4%	93.8%	92.2%	34.80	31.83	33.98
2006	735	717	707	85.4%	92.0%	92.7%	37.60	37.42	38.25
2007	736	718	708	83.7%	89.5%	90.0%	37.66	37.74	38.85
2012	764	773	761	81.4%	91.0%	89.3%	32.78	30.51	32.49
All (1999-2016)	741	740	725	86.0%	92.5%	91.3%	34.95	32.33	35.15

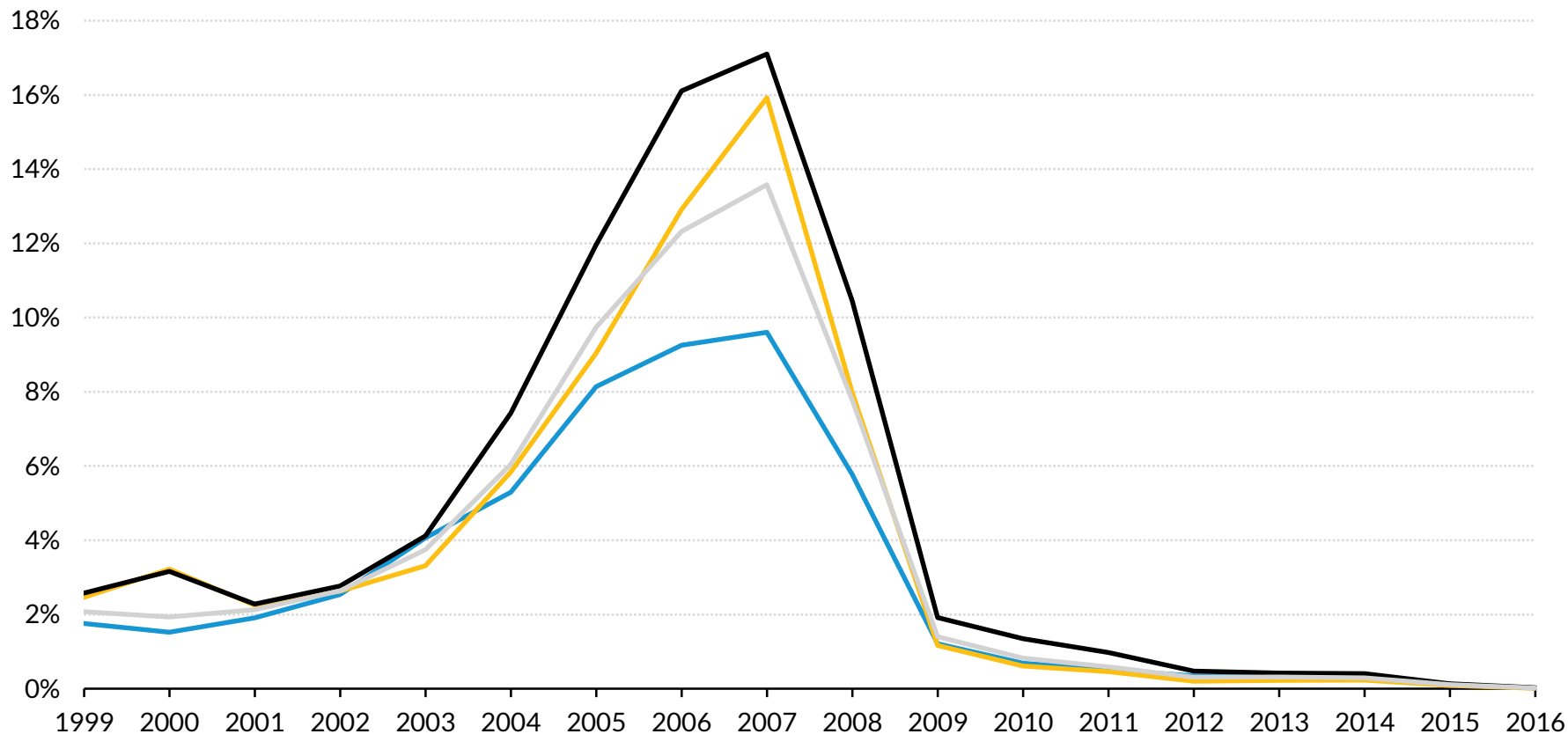
Sources: Data from Fannie Mae and Freddie Mac loan level credit databases, which are used to support credit risk transfer transactions. Data comprised only of full documentation, fully amortizing fixed rate mortgages.

Loan Characteristics Summary

- Rate refinances have much less risky characteristics than purchase loans: they have lower LTVs, similar FICO scores, lower DTI ratios and a higher owner occupied percentage.
- Cash-out refis have similar risk characteristics than purchase loans: They have lower LTVs and a higher owner occupied percentage than their purchase counterparts, but also lower FICO scores and similar DTI ratios.

Cash Out Refis have higher default rates than purchase loans or rate/term Refis

— Purchase — Rate Refi — Cash-out Refi — All



Source: Data from Fannie Mae and Freddie Mac loan level credit databases, which are used to support credit risk transfer transactions. Data comprised only of full documentation, fully amortizing fixed rate mortgages.

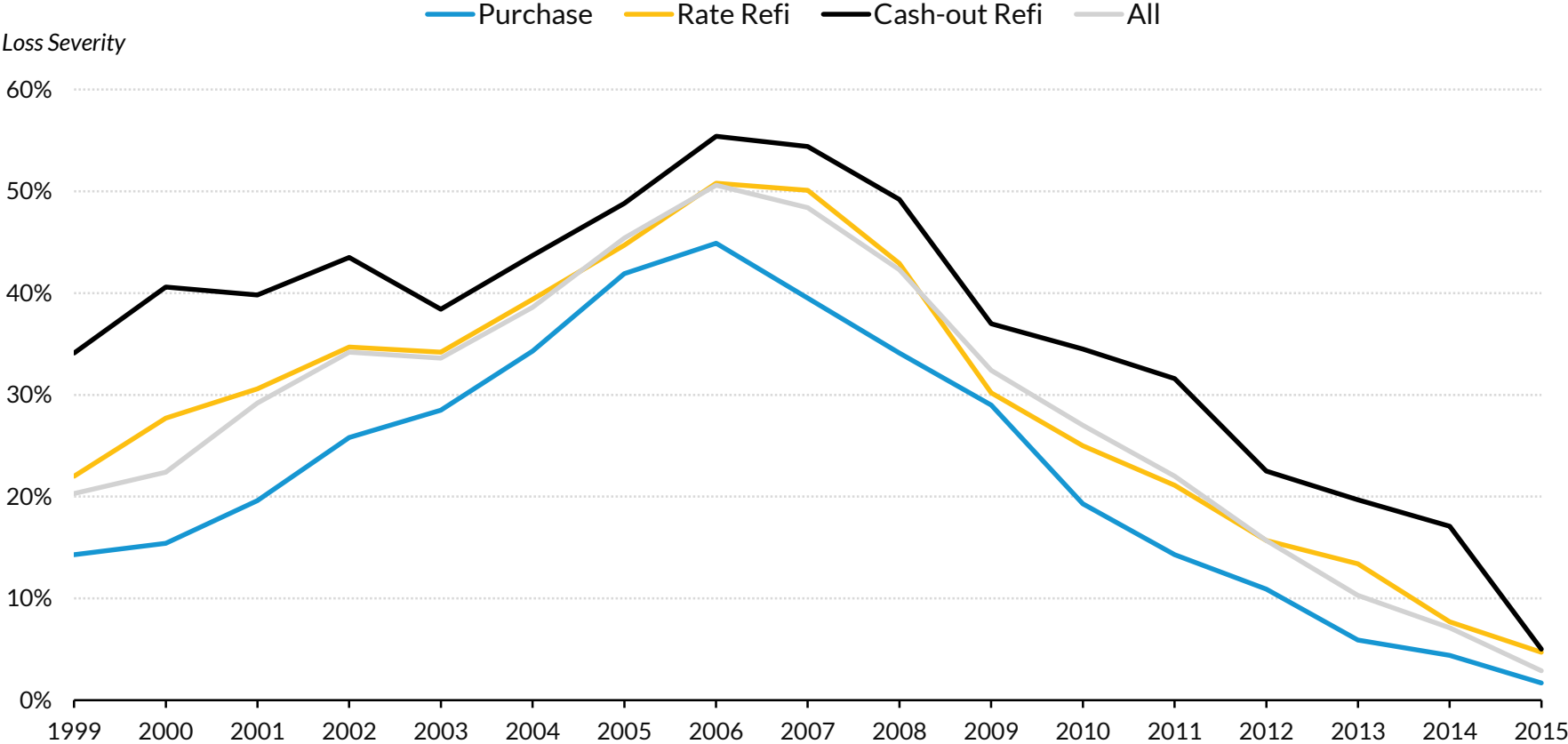
Cash Out Refis have higher default rates, even controlling for characteristics

D180 Rates by LTV and FICO Categories (<=700 FICO)

Origination Year	<u>Purchase</u>					<u>Rate Refi</u>					<u>Cash-out Refi</u>				
	≤70	70-80	80-90	>90	All	≤70	70-80	80-90	>90	All	≤70	70-80	80-90	>90	All
2002	3%	3%	6%	7%	5%	3%	5%	9%	11%	6%	4%	5%	8%	11%	5%
2006	9%	16%	22%	26%	18%	15%	22%	24%	27%	21%	19%	27%	27%	39%	23%
2007	9%	15%	22%	28%	19%	17%	25%	30%	34%	25%	21%	27%	33%	35%	25%
2012	1%	1%	2%	2%	2%	1%	1%	1%	2%	1%	2%	2%	3%	.	2%

Source: Urban Institute calculations from Fannie Mae and Freddie Mac Single Family Loan Level Dataset.

Cash Out Refis have higher loss severities than purchase loans or rate/terms Refis



Source: Urban Institute calculations from Fannie Mae and Freddie Mac Single Family Loan Level Dataset.

Cash Out Refis have higher losses than purchase loans or rate/term refis

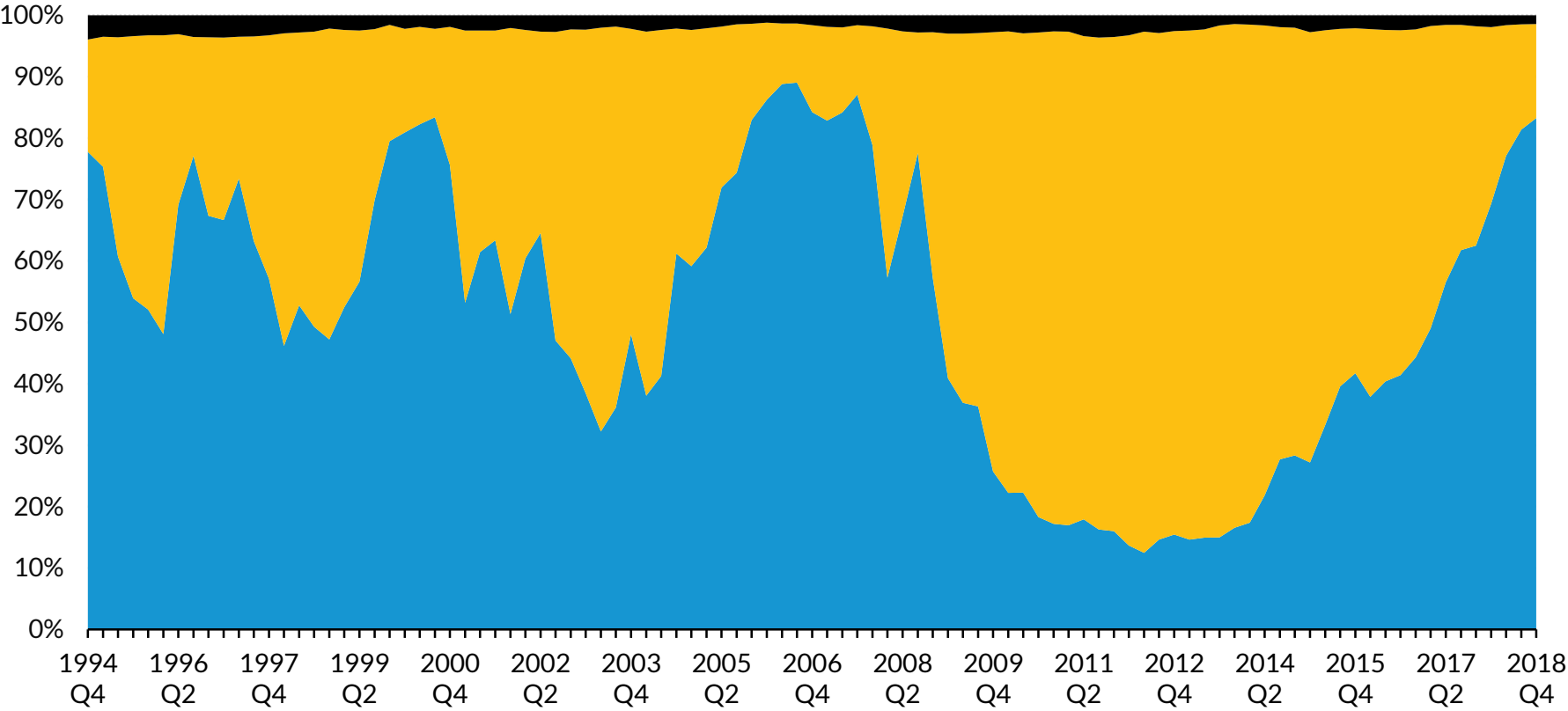
Origination year	Purchase	Rate refi	Cash-out refi	All
2002	0.42%	0.61%	0.76%	0.59%
2006	3.18%	4.60%	5.99%	4.43%
2007	2.78%	5.58%	6.02%	4.50%
2012	0.02%	0.02%	0.05%	0.02%
All (1999-2016)	0.72%	0.83%	1.74%	1.02%

Source: Urban Institute calculations from Fannie Mae and Freddie Mac Single Family Loan Level Dataset.

Cash-out Refis, should we worry?

Loan Amount After Refinancing

■ At least 5% higher loan amount ■ No change in loan amount ■ Lower loan amount



Sources: Freddie Mac and Urban Institute.
Note: Estimates include conventional mortgages only.

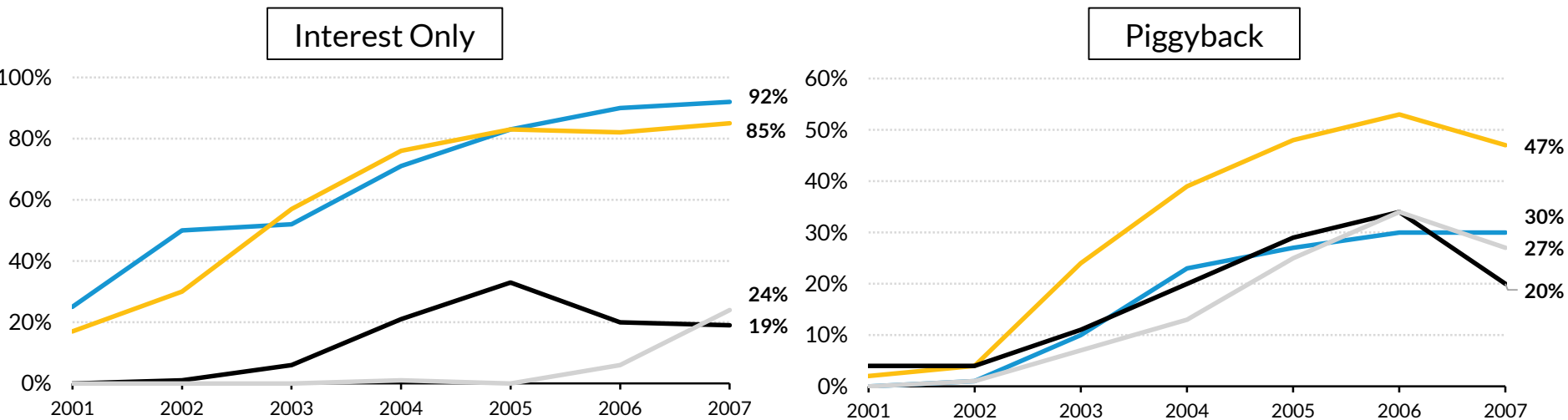
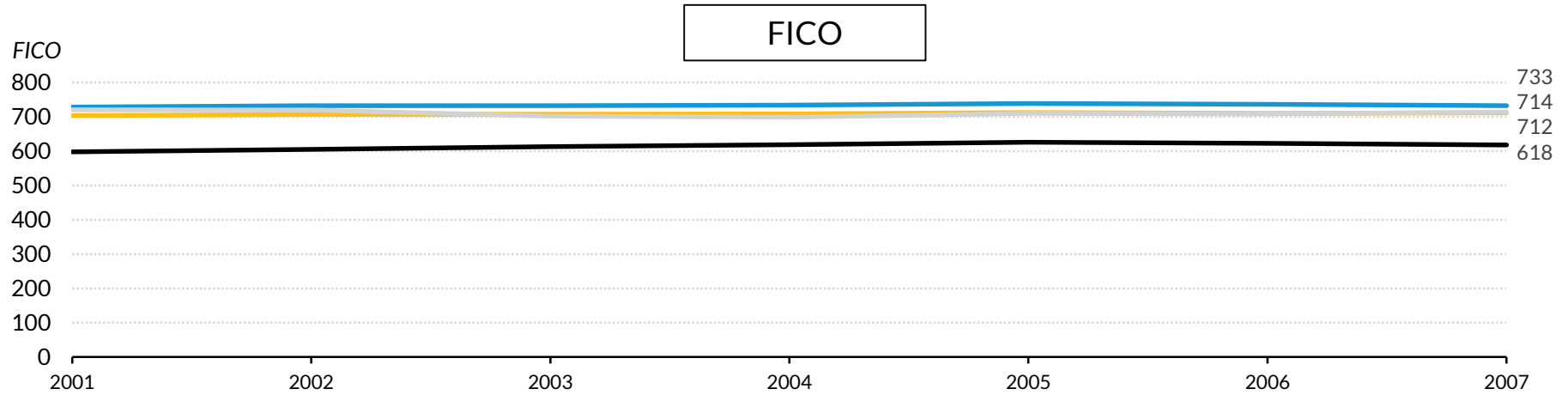
Cash-out Refi Volume



Sources: Freddie Mac and Urban Institute.
Note: Estimates include conventional mortgages only.

Collateral Characteristics for ARMs: FICO unchanged, huge increase in non-traditional products

Prime ARMs Alt-A ARMs Subprime ARMs Option ARMs



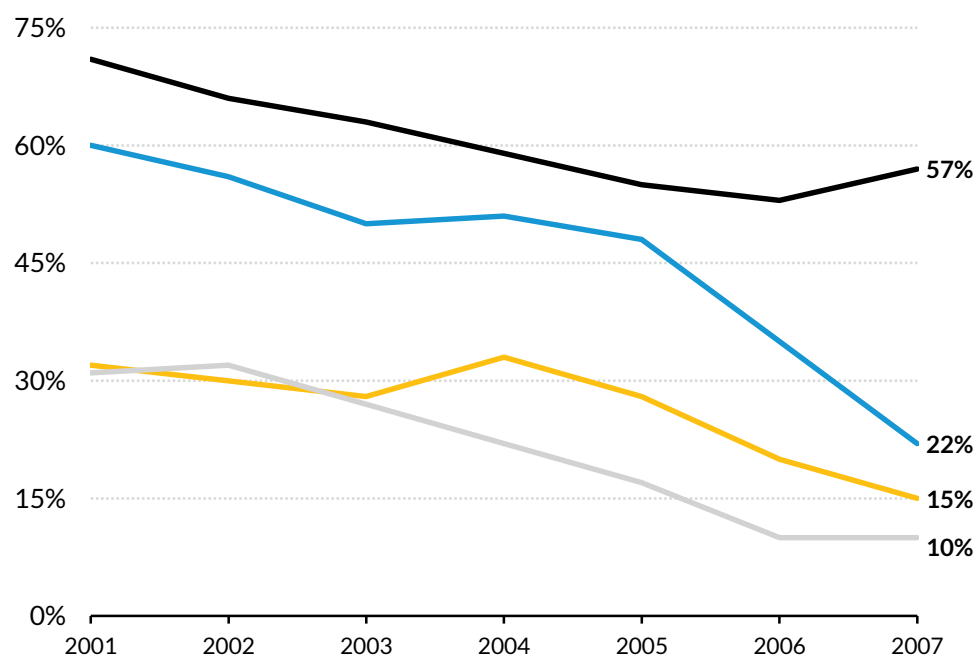
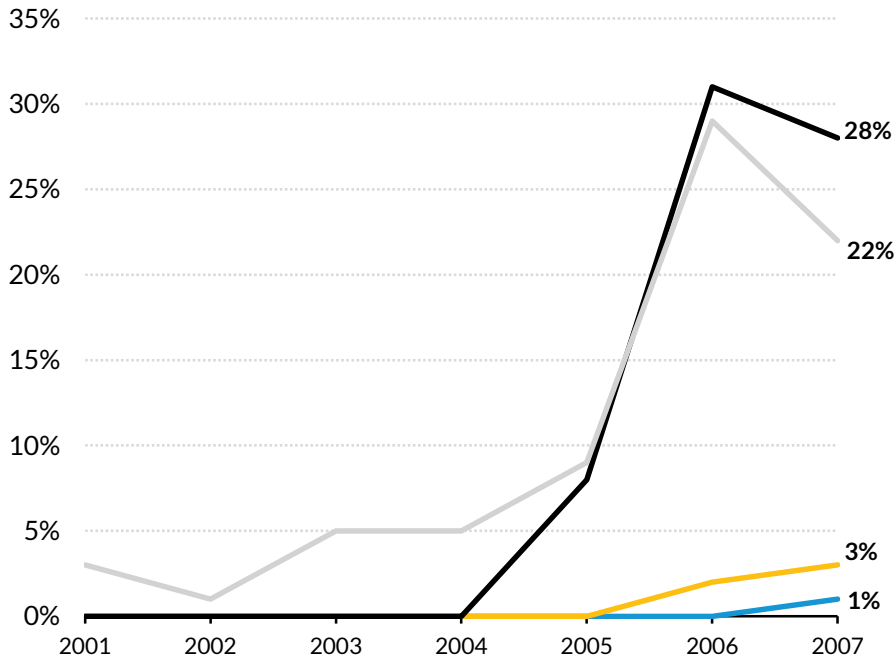
Source: Subprime Mortgage Credit Derivatives, Goodman et al, 2008. p19-21

Collateral Characteristics for ARMs (Cont.)

Prime ARMs Alt-A ARMs Subprime ARMs Option ARMs

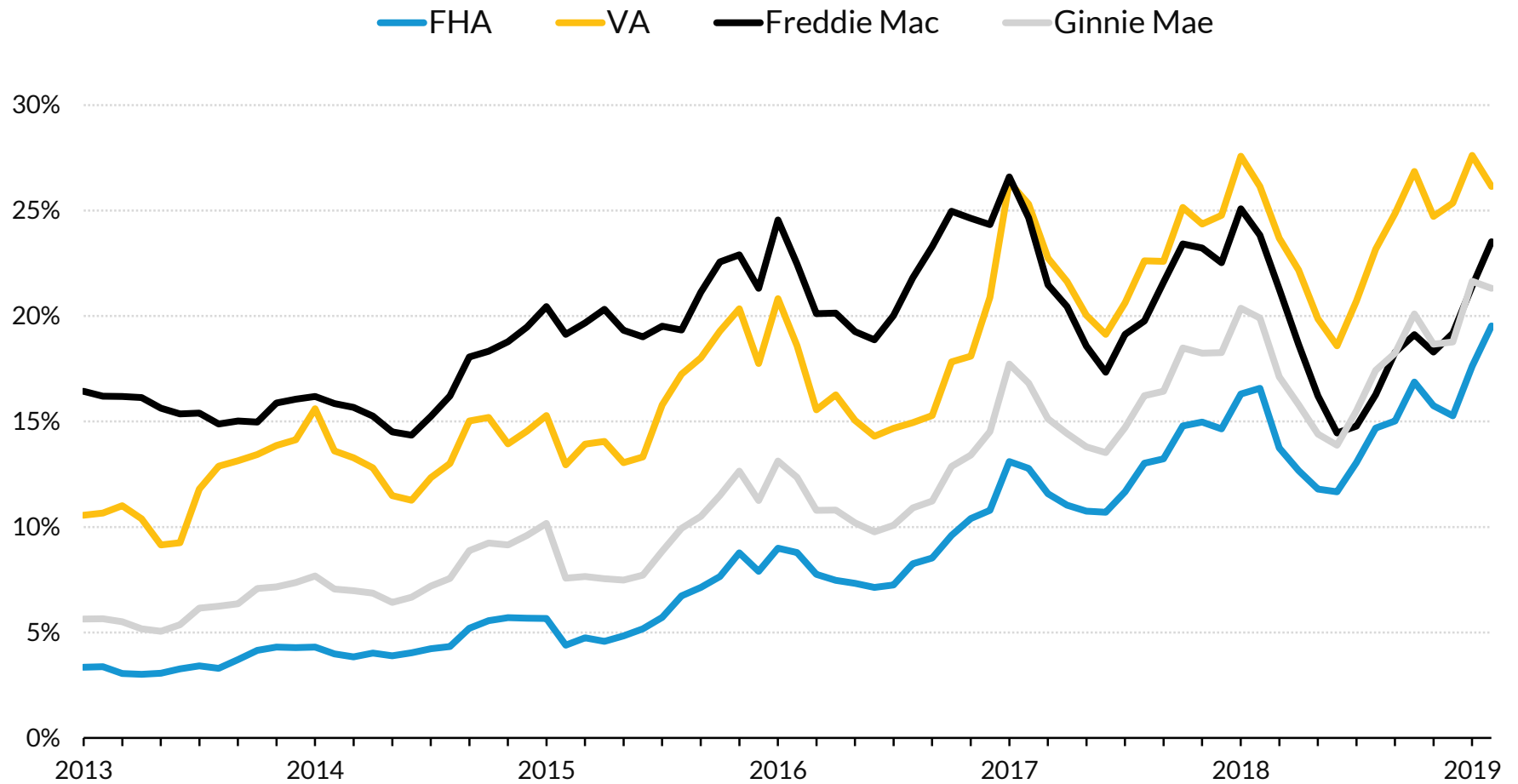
40 year

Full Doc



Source: Subprime Mortgage Credit Derivatives, Goodman et al, 2008. p19-21

Cash-out Refi Share of All Originations

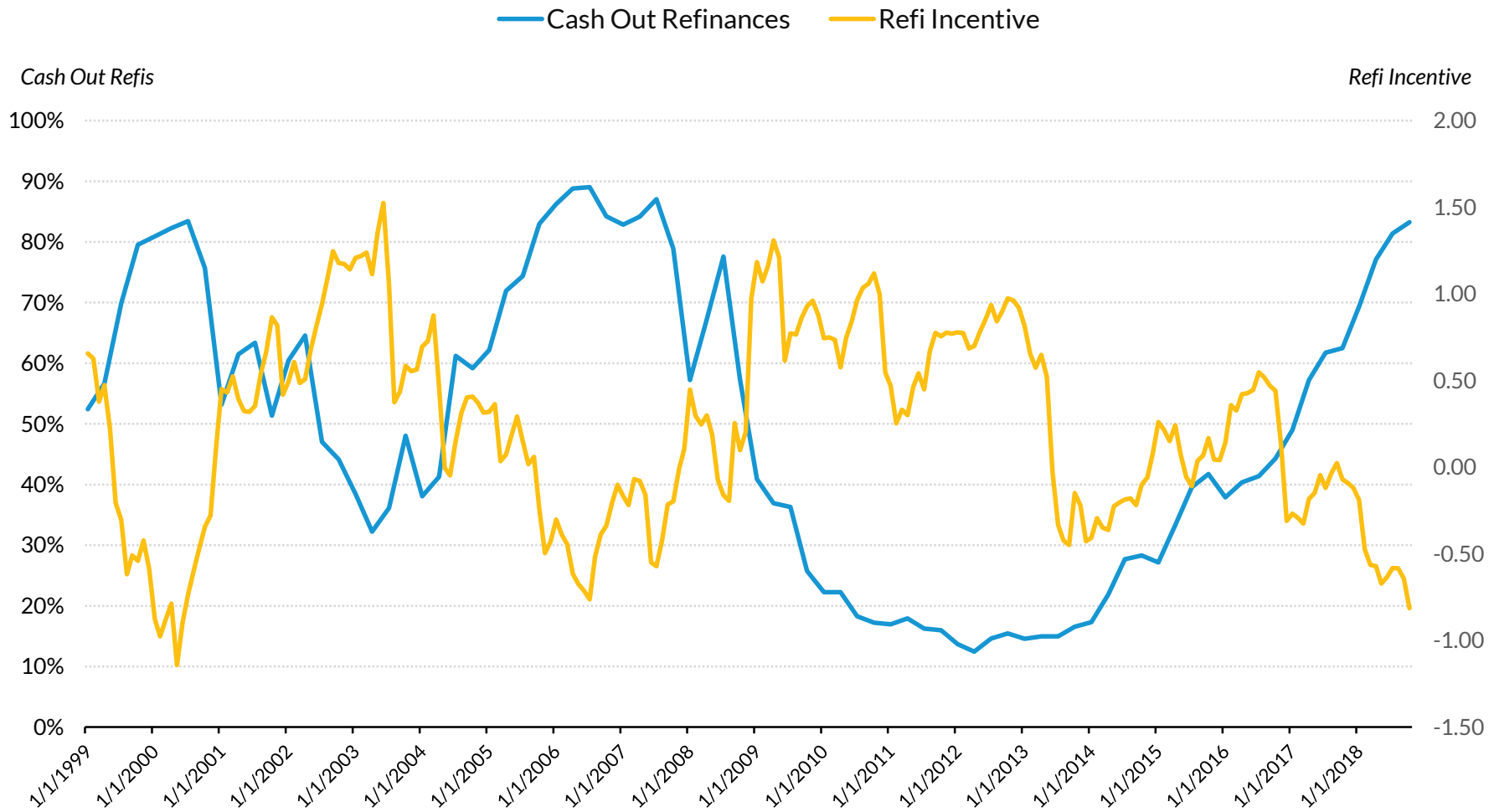


Sources: eMBS and Urban Institute.

Note: Cash-out refinance data not available for Fannie Mae.

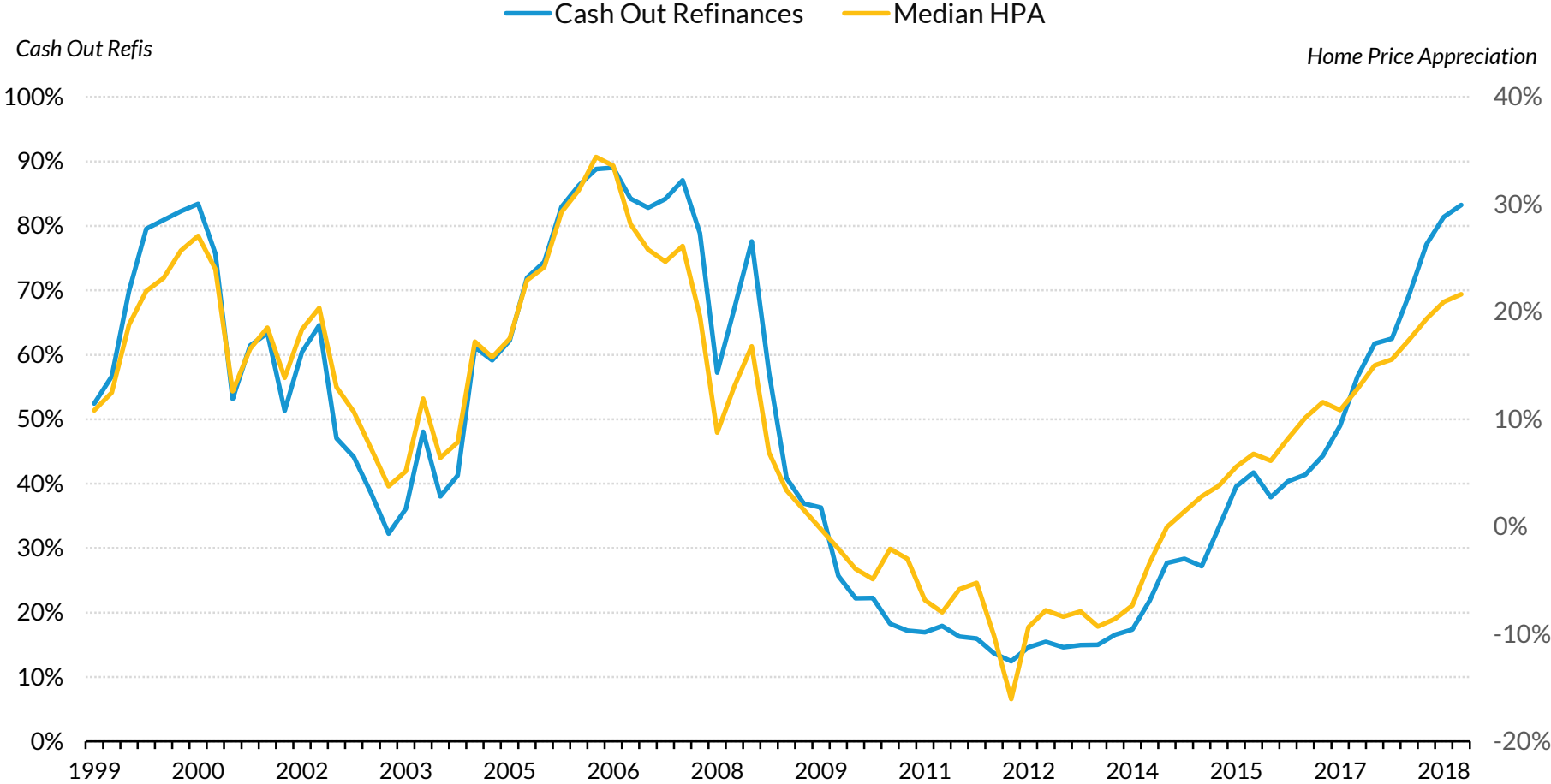
Data as of February 2019.

Cash out refinances dominate when the refi incentive is low



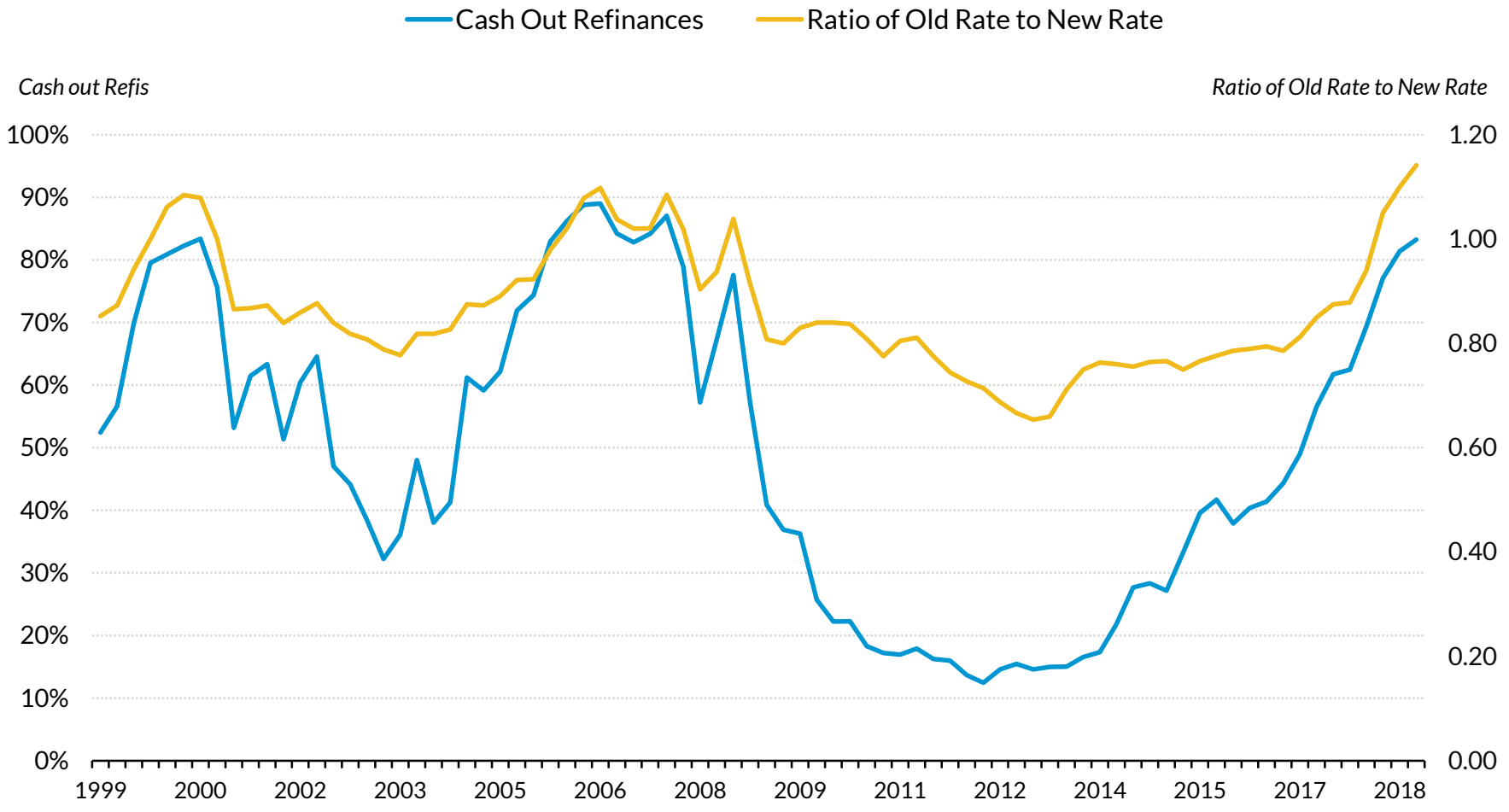
Sources: Freddie Mac

Cash out refinances dominate when there is a considerable amount of home price appreciation



Sources: Freddie Mac

When cash out refinances dominate, there is little interest rate savings on the refi



Sources: Freddie Mac

Maximum LTVs on Cash-Out Refis

FHA: 85%

- 600 credit score or higher (varies by lender)
- Must be an owner-occupied property
- No more than one late payment in past 12 months
- Existing mortgage must be at least six months old
- Debt-to-income (DTI) ratio below 41 percent
- Non-occupant co-borrowers may not be added

Fannie Mae/Freddie Mac: 80% on 1-unit owner occupied;

75% on 2-4 unit owner occupied

75% on 1-unit second homes or investment properties

70% on 2-4 unit investment properties

- Must have owned the property at least 6 months prior to the cash out refi
- Must otherwise qualify through DU or LP

Research from the Federal Reserve Bank of Dallas

Paper: *Do Restrictions on Home Equity Extraction Contribute to Lower Mortgage Default? Evidence from a Policy Discontinuity at the Texas Border.*

Author: Anil Kumar

Date: January, 2017

Conclusions:

- Texas is the only state that explicitly limits borrowing against home equity. A 1997 constitutional amendment limited home equity loans and cash-out refinancing, by restricting overall borrowing against home equity to 80% or less of home value.
- These rules lowered the probability of default on prime mortgage by 1.5% overall from 2007-2011.
- The effect on non-prime mortgages were even greater, on the order of 4-5 percent.
- Looking at discontinuities at the Texas border, he finds that default rates on mortgages with a short distance of the border are 20% lower on the Texas side.

Conclusion

- There are very legitimate reasons to allow borrowers to do cash out refis
- Cash-out refis perform much worse than other refis.
- We are not concerned about this at the present time: cash-out refis constitute a lot of the refis, the amount of equity extraction is very low.
- Freddie, Fannie and FHA all strictly limit the maximum LTV on cash out refis

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The screenshot displays the Housing Finance Policy Center website. At the top, the navigation bar includes links for About, Staff, Publications, Projects, Events, Urban Wire Posts, In the News, and a More dropdown menu. A blue button in the top right corner says "SUPPORT URBAN INSTITUTE". The main content area features a large line chart with multiple data series in blue and yellow, showing fluctuations over time. Below the chart is a navigation arrow with a central dot. To the right of the chart, the text reads "Housing Finance at a Glance: March" and "The most recent edition of At A Glance, the Housing Finance Policy Center's reference guide for mortgage and housing market data." Below this is a "LATEST WORK" section with three featured items: 1. "WORKING PAPER :: HOUSING AND HOUSING FINANCE" titled "What Fueled the Financial Crisis?" by Laurie Goodman and Jun Zhu, dated April 4, 2018, with an aerial view of a residential neighborhood. 2. "URBAN WIRE POST :: HOUSING AND HOUSING FINANCE" titled "Where can renters afford to buy homes?" by Laurie Goodman and Jun Zhu, dated March 20, 2018, with a photo of a person walking in a hallway. 3. "RESEARCH REPORT :: HOUSING AND HOUSING FINANCE" titled "Housing Affordability: Local and National Perspectives" by Laurie Goodman, Wei Li, and Jun Zhu, dated March 20, 2018, with a photo of a modern house.