

# FHLBI Insider

## FHLBI programs can help lenders target first-time homebuyers with portfolio products

*An optimist sees an opportunity in every calamity; a pessimist sees a calamity in every opportunity. — Winston Churchill*

The “American Dream” is alive and well. Home ownership is at all-time highs of 69% nationally and 74% in the Midwest. No other industrialized nation has a higher rate of home ownership.

Figures from the 2000 census indicate that 84% of those with above median income already own their home. This contrasts with only half (53%) of those below the median. If ownership rates are to increase further, growth must come from lower income brackets. The current environment of rising interest rates and real estate appreciation present a challenge to housing affordability and further expanding home ownership.

This *Insider* was written by James B. Eibel, CFA, vice president and marketing representative. Back issues of the *Insider* are available at [www.fhlbi.com](http://www.fhlbi.com).

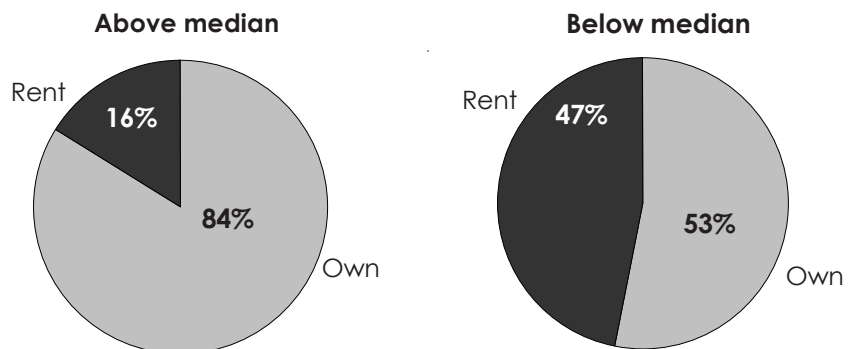
With pressure on housing affordability, the manufactured housing sector could play an important role in assisting first-time homebuyers. Unlike its cousin modular housing, manufactured housing is built entirely at the factory to HUD standards and installed on site. Factory, scale, and on-site efficiencies have enabled new manufactured housing to maintain a better than 50% cost advantage over site-built construction (Exhibit 2).

Given the cost advantage, it is no surprise that over 70% of the growth of the nation’s affordable housing stock and 13% of housing starts came from the manufactured

housing sector during 2004. Since Michigan and Indiana are the top two manufactured housing states in the Midwest, these figures are higher in the FHLBI district.

While manufactured housing may present growth and opportunity, caution is in order. The sector has experienced turmoil in recent years. Aggressive lending by finance companies has resulted in high default rates, a closing of capital markets to new securitizations, and wider spreads-to-treasury. Other than Fannie Mae and Freddie Mac’s limited and restrictive programs, portfolio lending represented the only option to penetrate the manufactured housing market

**Exhibit 1. Home Ownership by Income**



Source: 2000 Census, U.S. Department of Commerce



at year-end 2004.

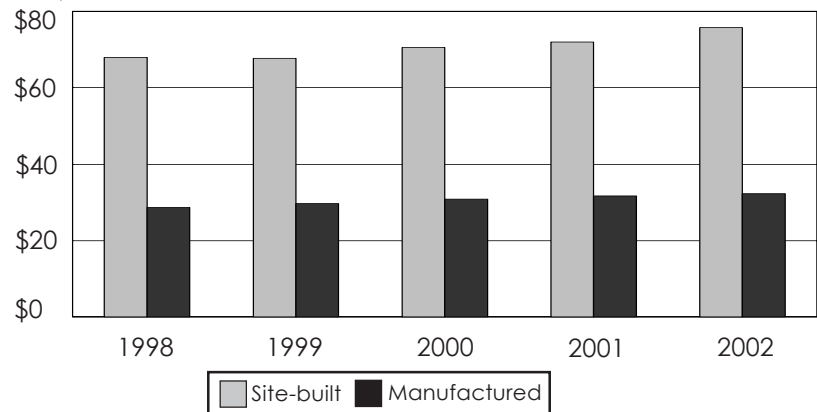
FHLBI members can use special products and programs to reduce risk and increase the return of portfolio mortgage strategies, including those involving manufactured and other affordable housing. By incorporating local knowledge to price and underwrite credit risk, community-based institutions can generate commercial loan-type profitability and further community reinvestment goals.

## Products and funding strategies

The FHLBI can help lenders manage liquidity, interest rate, and credit risk resulting from portfolio mortgage lending. Specifically, regular advances, the Community Investment Program (CIP), and Affordable Housing Programs (AHP) can be used to target manufactured and other affordable housing alternatives with portfolio products.

A primary benefit of FHLB membership is the ability to pledge relatively illiquid assets, such as non-conforming mortgages, as collateral for borrowings. Relatively illiquid real property manufactured housing loans can be pledged for FHLB advances as part of a diversified mortgage portfolio. This enables institutions to increase loan holdings and profit-

**Exhibit 2. Average Cost Per Square Foot (new)**



ability without increasing liquidity risk. It should be noted that high concentrations of manufactured housing collateral could result in a coverage ratio adjustment.

To reduce interest rate risk, many institutions only offer short-term ARMs for portfolio manufactured and affordable housing loans. Since lower income borrowers have the least flexibility to manage escalating mortgage payments, an ARM-only strategy exposes the institution to credit risk if rates increase. Fixed rate FHLB funding provides the means to offer highly desirable fixed-rate products while managing both interest rate and credit risk.

Lenders targeting low-to-moderate income housing (115% or below the area median family income) may use CIP funding to borrow 0.20%-0.30% below regular ad-

vance rates. Most manufactured housing and affordable housing loans qualify for specially-priced CIP funding. While income breaks vary by county and metropolitan statistical area, borrowers with family income below \$56,250 in Michigan or \$59,800 in Indiana would have qualified for CIP during late 2004.

Lenders targeting low-income housing (80% or below the area median family income) can use AHP, such as the Homeownership Opportunity Program (HOP) for closing cost and down payment assistance. HOP enables institutions to match the borrower's funds three-to-one, up to \$5,000. For most manufactured and affordable housing mortgages, this could increase borrower equity by 5%-10%, resulting in lower loan-to-value ratios and reduced credit exposure.

Both CIP and AHP funds are subject to availability and require submission of an application and documentation at the time of funding. If you would like more information on these programs, please contact Pat Gamble-Moore at (317) 465-0368.

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