

Improving Home Affordability through Low Interest Rates

How Much Would Homeowners in Low-Income Areas Save?

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Programs to improve financial literacy and financial outcomes focus on how best to establish and maintain good credit. With good credit and information, families can borrow at market interest rates and make purchases of homes and cars more affordable. Potential impacts on housing affordability are especially significant. A high credit score enabling a family to borrow at 5 percent instead of 9 percent on a mortgage of \$100,000 lowers total mortgage payments by nearly \$270 per month. The lower interest rates also reduce monthly interest payments, allowing families to accumulate home equity more quickly and increase potential wealth. Even if the family used the mortgage reduction for consumption, the equity gain resulting from the lower interest rate would have reached about \$8,000 in 10 years.

How do these figures compare with what families in low-income neighborhoods would actually save? Cross-sectional data from the Making Connections initiative, sponsored by the Annie E. Casey Foundation, yield recent estimates for homeowners in selected neighborhoods in six cities (Denver, Des Moines, Indianapolis, Providence, San Antonio, and White Center in King County, Washington). This note draws on the 2008/09 survey in five cities and a 2010 survey in Providence. In all six cities only a minority of families owned homes, with the homeownership rate varying from 24 percent in Providence to 48 percent in Des Moines. Owner-occupied dwellings made up about one in three households in the other cities. Using survey data on monthly mortgage payments (which we interpret to include property taxes and insurance) as well as the size of the mortgages, we calculate what savings in mortgage payments would accrue to families were they able to borrow at a 5 percent interest rate (table 1).

Overall, families would save about \$276 per month in mortgage payments, an amount strikingly similar to the example noted above. While the gains extend to all groups, the largest benefits would flow to homeowners in White Center (Seattle area), Providence, and San

Antonio. The monthly gains as a percentage of current mortgage payments vary widely, from 18 percent in Denver to 47 percent in San Antonio. Ethnic and racial differences in dollar savings are substantial, with U.S.-born Hispanics and Hispanic immigrants benefitting most. However, the dollar gains depend in part on the size of the mortgage. When considered as a percentage of the mortgage payment, the savings are similar across ethnic and racial categories, ranging from 23 to 32 percent. Some owners who have held their mortgages for more than 10 years may find their monthly principal repayments are higher with their existing mortgages than with a new 30-year, 5 percent mortgage. But, the data show that gains in refinancing are as high for long-duration owners (10 or more years) as for owners who bought their property more recently.

These results demonstrate the importance of helping families build good credit, of improving financial literacy to ensure that families have better information about mortgage pricing and how to shop for good mortgages, and of making sure that our credit scoring system works for low-income families. Doing so could help homeowners in low-income neighborhoods save about 1 in 4 dollars they spend on mortgage payments, while speeding up their accumulation of home equity and potential wealth.

TABLE 1. Monthly Mortgage Payments and Projected Savings from Moving to a 5 Percent, 30-Year Mortgage

	Mortgage payment	Projected mortgage payment	Monthly savings	Savings as % of actual mortgage
All sites, subgroups	\$1,085	\$809	\$276	25.4
City				
Denver	\$1,310	\$1,075	\$235	17.9
Des Moines	\$663	\$426	\$237	35.8
Indianapolis	\$606	\$385	\$221	36.5
Providence	\$1,324	\$1,018	\$307	23.2
San Antonio	\$652	\$343	\$309	47.4
White Center	\$1,618	\$1,262	\$356	22.0

Source: Tabulations from the Making Connections 2010 Providence and 2008/09 Cross-Site Surveys, Annie E. Casey Foundation.

Note: We assume actual and projected payments contain property taxes and insurance premiums.

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Given the chance, many low-income families can acquire assets and become more financially secure. Conservatives and liberals increasingly agree that government's role in this transition requires going beyond traditional antipoverty programs to encourage savings, homeownership, private pensions, and microenterprise. The Urban Institute's *Opportunity and Ownership Project* policy fact series presents some of our findings, analyses, and recommendations. The authors are grateful to the Annie E. Casey Foundation and the Ford Foundation for funding the policy facts.

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