“Save at Home”: Building Emergency Savings One Mortgage Payment at a Time

Concept Summary, Prepared for the Emergency Savings Project Salon

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Mortgage reserve accounts (MRAs) combine mortgage financing for low and moderate income (LMI) first- time homebuyers with a mechanism to build accessible emergency savings, thereby buffering income and expense shocks within the first few years after home purchase. Most LMI households enter homeownership with little equity or residual savings--on average only $2,000 of liquid assets-- including cash on hand, savings and checking amounts. While homeowners are building equity through their monthly mortgage payments, the equity accumulated in the first few years is not accessible for consumption until the loan balance falls below a leverage-able threshold. Financial shocks and unexpected expenses within the first few years of homeownership can put LMI homeowners at risk of losing their homes through foreclosure. The key feature of the MRA models proposed here is the post-purchase emergency savings mechanism, integrated with the monthly mortgage payment. From a behavioral perspective, the MRAs proposed here also target specific consumer vulnerabilities through automation, incentives and monitoring. First-time homebuyer programs administered by State Housing Finance Agencies provide a scalable delivery channel because of their structured, repeated interactions with LMI homebuyers before and after purchase.

Behavioral Mechanisms:

- **Automation.** Similar to an escrow account for property taxes and homeowner’s insurance, a reserve account linked to the monthly mortgage payment is established at the time of closing. The total monthly mortgage payment includes a specified amount to be deposited into the reserve account, in addition to the portion of the payment paid to principal, taxes and insurance. Funds accumulated in the reserve account can be constrained to cover housing related expenses within the first few years after purchase, through restrictions, penalties or incentives.
- **Incentives.** Affordable mortgage programs could include the MRA in their underwriting process, thereby creating an incentive to participate. To the extent that the MRA reduces the default risk to the lender, the MRA can serve as a “compensating factor” for underwriting approval (allowing otherwise riskier borrowers to quality for financing). Third-party funded initial or ongoing deposits into the MRA (similar to downpayment assistance) can also serve as incentives.
- **External Monitoring**. Regular communications with participants can be easily integrated into the MRA model, through monthly mortgage statements, text messages and/or phone calls. Missed mortgage payments and/or associated deposits into the reserve account can trigger early intervention from a financial coach or counselor by phone, email or mail.

Implementation:

Rather than requiring a new structure for implementation, MRAs can be readily incorporated into existing first time homebuyer programs, such as those administered through state Housing Finance Agencies (HFAs). State HFAs have an established, sustainable infrastructure in place to provide affordable mortgages to LMI households, serving an average of 100,000 first time homebuyers nationwide each year. Each state tailors its first time homeownership program to meet the needs of underserved populations in the state, which helps ensure that diverse population groups have access to the product. A successful pilot study recently conducted by the researchers with the Ohio Housing Finance Agency demonstrates the potential to combine the HFA financing structure with interventions for LMI homebuyers before and after purchase. Rather than a one-size-fits all model, MRAs can be tailored to fit within the context of the HFA, thereby minimizing administrative costs and regulatory burden. We present four sample models based on variations in the entity collecting, holding and controlling the MRA payments. The lowest cost, most scalable model allows the servicer to establish and collect the MRA payments, but provides the borrower with control over the funds accumulated in the account.