Maximizing Impact: How a Simple Administrative Policy Shift Could Expand Access to Homeownership for Potential Buyers Repaying Student Loans Under the SAVE Program

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January 2024

Introduction

The Department of Education's newly launched income-driven repayment (IDR) program, "Saving on a Valuable Education (SAVE)," represents a significant step forward in improving the affordability of federal student loan repayments for millions of borrowers. SAVE accomplishes that goal by basing repayment on a realistic estimate of a borrower's discretionary income considering the borrower's family size and reducing the amount of income that applies to repayment by half. The plan also prevents unpaid interest from increasing a borrower's loan balance and ensures that any remaining balance is forgiven after a certain number of years. Based on these changes, researchers have found that the SAVE program will improve the financial security of millions of borrowers by requiring them to repay less of their student loan debt and achieve full federal student loan forgiveness faster.

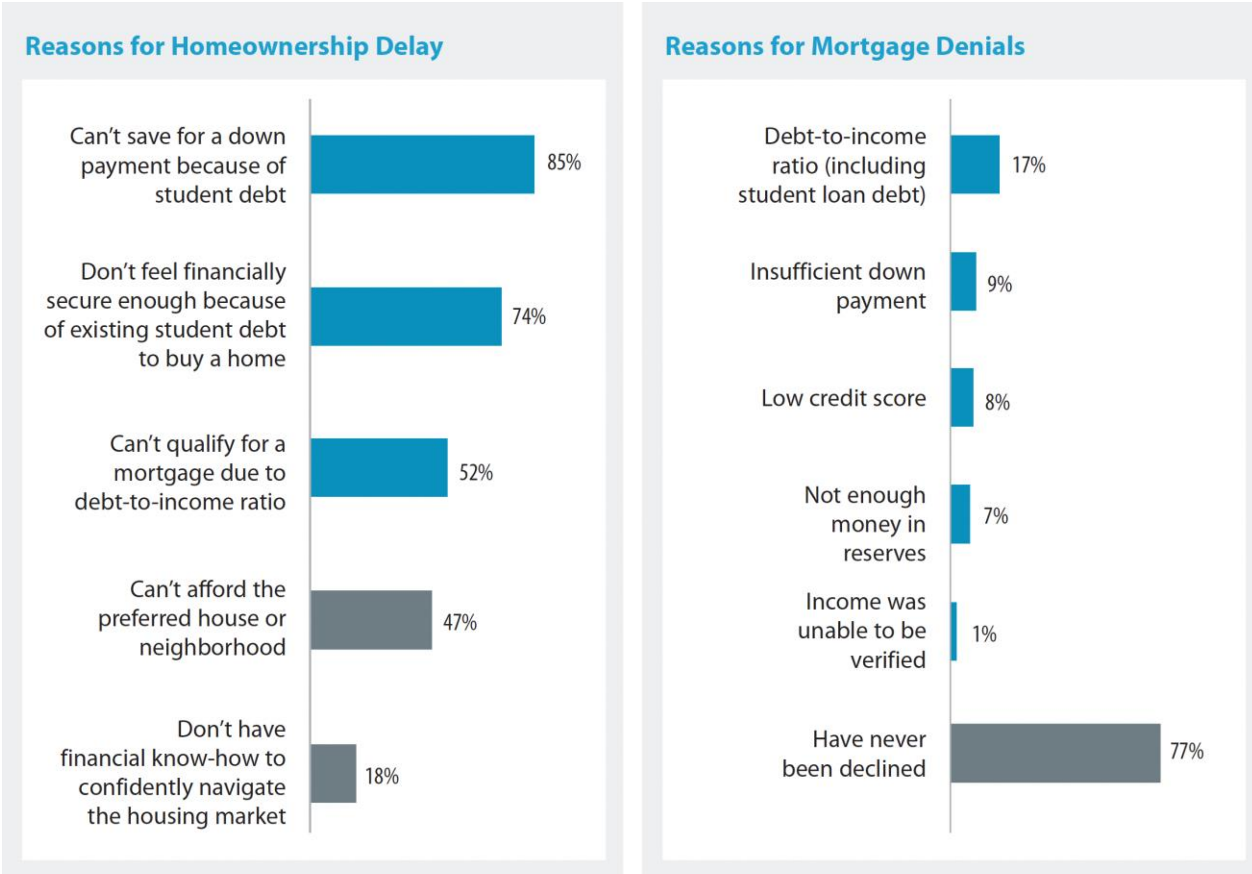
Yet, to date, little public analysis exists on how the program will impact other aspects of financial security for affected borrowers, such as their ability to access and sustain wealth-building financial products like business capital loans and mortgages. However, recently released research by the Center for Responsible Lending (CRL) seeks to answer that question, in part, by examining the SAVE program's impact on homeownership for federal student loan borrowers. The report, "Unveiling the Potential of Saving on a Valuable Education," finds that SAVE could expand access to mortgage credit for federal student loan borrowers in two important ways:

- First, by reducing monthly repayment amounts, the SAVE program could allow borrowers to increase savings for a mortgage down payment; and
- Second, the reduced monthly payment amount should create a corresponding reduction in a borrower's debt-to-income (DTI) ratio — a key calculation used in underwriting that determines whether an individual qualifies for a home loan.

Examining SAVE's Impact on Debt-to-Income Ratio Calculations in Mortgage Underwriting and the Treatment of $0 Repayments

The latter finding represents a significant opportunity to both quickly and responsibly expand access to mortgage credit for many potential homebuyers who are in student loan repayment. Among mortgage applicants, DTI remains the most common reason for loan denial.[1]

Figure 1: Impact of Debt-to-Income Ratio on Homeownership for Student Loan Borrowers [2]



Source: Student Loan Debt and Housing Report 2017, National Association of Realtors

The SAVE program's impact on expanding access to mortgage credit by reducing DTI ratios will be automatic for borrowers seeking to obtain a mortgage loan guaranteed by a federal agency. This change is possible due to existing provisions requiring lenders to use the actual student loan repayment amount as reflected in the borrower's credit report when calculating the debt-to-income ratio. Yet, there is one notable exception. For lower-income potential homebuyers, existing federally guaranteed or government-supported mortgage underwriting standards either do not permit lenders to use a $0 repayment or allow lenders to use their own discretion in deciding whether to calculate student loan repayments at $0, even if $0 is the actual repayment amount reported to credit bureaus under an income-driven repayment program.

Table 4: Treatment of IDR for zero-dollar payments by federal agencies in underwriting

Agencies	**Treatment of IDR**	**Annual Payments on a $25,000 loan**
Fannie Mae	Use monthly zero IDR payment	$0 per year
Freddie Mac **FHA** **USDA**	Does not accept zero-dollar repayments. Use 0.5 percent of the loan balance monthly (6% annually)	$1,500 per year
VA	Does not accept zero-dollar repayments. In the lender's discretion to: 1. Use the monthly IDR payment reported on credit report if that amount is more than zero, or 2. Five percent of the outstanding loan balance per year divided on a monthly basis, if the reported amount is zero or greater.	Non-zero, and up to $1,250 per year

Based on CRL's analysis,[3] the failure to allow or require $0 federal student loan repayments in current mortgage underwriting standards results in potential millennial borrowers having a 3.8 percent to 7.1 percent **higher** debt-to-income ratio than their actual DTI.[4] Given this, the failure to fully incorporate the benefits of the SAVE program for borrowers eligible for $0 repayments serves as a barrier to securing a federally guaranteed or federally supported mortgage for as many as 3.9 million of the currently *enrolled* 6.9 million SAVE borrowers,[5] which includes 3.4 million renters.[6] There is ample reason to believe that the actual number of affected borrowers is significantly higher, given that the SAVE program increases the number of borrowers eligible for $0 repayments.

CRL believes that the current administration's commitment to expanding access to homeownership would be better served by ensuring that the policy benefits achieved by SAVE are fully incorporated into its existing mortgage underwriting policies for all federally guaranteed or supported mortgages. CRL also believes that doing so would not increase the default risk borne by these guarantors.

As noted by the Consumer Financial Protection Bureau, DTI is "one way lenders measure your ability to manage monthly payments to repay the money you plan to borrow."[7] To accomplish that objective, DTI calculations are performed by dividing a mortgage applicant's major monthly debt payments by their gross monthly income.[8] The housing agencies noted in Table 4 present guidelines for what constitutes an acceptable DTI, though, in some instances, other compensating factors may be taken into consideration as part of the underwriting decision.

Accordingly, the only possible rationale for requiring lenders to artificially inflate a consumer's debt obligation beyond its actual amount is because that payment might increase in the future. However, a critical feature of the SAVE program is that future increases in the IDR payment can only be driven by corresponding increases in the borrower's income. Therefore, it is inaccurate to presume that an increase in IDR payment would lead to an increase in DTI. SAVE requires a $1.00 increase in a borrower's discretionary income in order to trigger a $0.05 increase in the student loan repayment amount. As a result, any increase in student loan repayment amount will be connected to a much larger increase in income—which would ultimately suggest a decrease in the potential homebuyer's future DTI.

Moreover, DTI is, by definition, a snapshot of the borrower's expected financial capacity at the time the mortgage is originated; DTI cannot capture unexpected future changes in debt obligations or income. As such, there is no reason to adjust the DTI calculation to account for a possible increase in IDR payment. No similar adjustment is taken for the necessary increase in income that would create a higher IDR payment in the first place, and no similar adjustment is taken for other unexpected increases in debt obligations.

Indeed, Fannie Mae has taken this exact stance, advising lenders that:

> "For student loans associated with an income-driven repayment (IDR) plan, the student loan payment, as listed on the credit report, is the actual payment the borrower is making and that payment should be used in qualifying. Any future increases in the IDR payment will be tied to similar increases in the student's income, mitigating concerns that IDR payments may create payment shock."[9]

In addition, CRL's review of the publicly available research related to the use of DTIs in mortgage lending and corresponding default risk found no studies indicating the $0 student loan repayment homebuyers were more likely to default on mortgages than homebuyers repaying a higher monthly student loan payment. These findings support Fannie Mae's policy for IDR payments and CRL's conclusion that government policies requiring the artificial inflation of student loan repayment amounts for applicants qualifying for $0 repayment under an IDR program serve no useful purpose. Moreover, the policies unnecessarily frustrate the administration's objective of responsibly expanding access to mortgage credit by making it harder for lower-income applicants to qualify for government-supported home loans.

CRL's Policy Recommendation

CRL recommends that the administration implement a uniform policy change requiring all federal agency guarantors of mortgage loans and government-sponsored enterprises to adopt underwriting criteria that require the use of a $0 student loan repayment amount in underwriting DTI calculations if that amount is reported on a borrower's credit report or otherwise verified by a student loan servicer.

Conclusion

The burden of student loan debt has prevented far too many families from saving, investing, or acquiring assets such as homes, practices that have traditionally been central to achieving the American Dream of creating financial security and generational wealth. While the SAVE program represents a critical step forward in reducing the barrier repayment presents in achieving these goals, its full effectiveness cannot be realized until all repayment savings are fully incorporated into mortgage underwriting criteria.

By implementing CRL's policy recommendation, the current administration can responsibly expand access to mortgage credit by ensuring that underwriting standards accurately reflect borrowers' true financial capability. This cross-agency approach can create a more equitable path to accessing homeownership for those with student loan debt, contributing to a healthier and more vibrant economy that benefits all Americans at a time when higher interest rates and home prices have made it increasingly difficult for many households to achieve the dream of owning their own home.

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[1] Alisa Wolfson, "This is the No. 1 reason Americans get denied a mortgage — and it's not the reason you might think," (March 7, 2022), available at https://www.marketwatch.com/picks/this-is-the-no-1-reason-americans-get-denied-a-mortgage-01639588234#:~:text="The%20debt%2Dto%2Dincome,to%20avoid%20the%20DTI%20trap.

[2] Christelle Bamona, Lucia Constantine, Evan White, "Unveiling the Potential of Saving on a Valuable Education (SAVE)," November 2023 at 3.

[3] Christelle Bamona, Lucia Constantine, Evan White, "Unveiling the Potential of Saving on a Valuable Education (SAVE)", Center for Responsible Lending (January 2024), available at https://www.responsiblelending.org/research-publication/unveiling-potential-saving-valuable-education-save.

[4] *Id.* at 1.

[5] https://www.ed.gov/news/press-releases/biden-harris-administration-shorten-path-debt-cancellation-some-save-borrowers#:~:text=The%20Biden-Harris%20Administration%20also,another%20income-driven%20repayment%20plan.

[6] Based on the most recent data from the Department of Education, the current enrollment in SAVE is reported at 6.9 million borrowers, and among these enrollees, 3.9 million have a $0 payment. Analysis of our sample of IDR borrowers scheduled for zero-dollar payments reveals that 87% of them do not own a mortgage. Consequently, we can estimate that approximately 87% of the 3.9 million borrowers making zero-dollar payments are potential homebuyers.

[7] CFPB, "What is a debt-to-income ratio?," https://www.consumerfinance.gov/ask-cfpb/what-is-a-debt-to-income-ratio-en-1791/#:~:text=Your%20debt%2Dto%2Dincome%20ratio,will%20have%20different%20DTI%20limits.

[8] *Id*.

[9] Source: What is the policy on income driven repayment plans for student loans? (fanniemae.com).