NEW AMERICA

CSEM CENTER FOR THE STUDY OF ECONOMIC MOBILITY WINSTON-SALEM STATE UNIVERSITY

Regulations Division, Office of General Counsel,
U.S. Department of Housing and Urban Development,
451 7th Street SW, Room 10276
Washington, DC 20410-0500

RE: Docket No. FR-6342-N-01 Request for Information Regarding Small Mortgage Lending

December 5, 2022

Dear Commissioner Gordon:

Thank you for the opportunity to submit comments to the Federal Housing Administration (FHA)'s Request for Information (RFI) on the barriers to origination of small dollar mortgages.

We are writing on behalf of New America's Future of Land and Housing Program (FLH) and the Center for the Study of Economic Mobility (CSEM) at Winston-Salem State University. Housed within the think tank New America, FLH aims to help solve today's land and housing rights challenges, both in the United States and internationally. CSEM is a research center housed at Winston-Salem State University, focused on the reduction or elimination of barriers to economic mobility through innovative policy solutions in Forsyth County, North Carolina.

Jointly, FLH and CSEM have conducted research on accessing small dollar mortgages in Forsyth County, North Carolina (where Winston-Salem is located). This research was motivated by the fact that low-and-moderate income communities, notably first-time homebuyers in Black and Hispanic communities, increasingly find it difficult to access financing for homeownership across the country. Since homeownership is one of the main vehicles to build wealth in the U.S., especially in communities of color, any barrier to financing also impacts the racial wealth gap.

Though this research focuses on a local housing market—that of Winston-Salem--we believe that this city in many ways resembles a prototypical housing market in the U.S. On one hand, Winston-Salem ranks high among U.S. cities on inbound net migration, attracting many families from more expensive housing markets with higher taxes. At the same time, the area is one of the least economically mobile with one of the highest growths in concentrated poverty and highest eviction rates in the country.[1] Geographically, Winston-Salem is divided by a four lane

[1] The Upshot, "The Best and Worst Places to Grow Up: How Your Area Compares," *The New York Times*, May 4, 2015, https://www.nytimes.com/interactive/2015/05/03/upshot/the-best-and-worst-places-to-grow-up-how-your-area-compares.html; Elizabeth Kneebone, "The Growth and Spread of Concentrated Poverty, 2000 to 2008-2012, *Brooking Institution*, July 31, 2014, https://www.brookings.edu/interactives/the-growth-and-spread-of-concentrated-poverty-2000-to-2008-2012/; "Top Evicting Large Cities in the United States, *Eviction Lab*, https://evictionlab.org/rankings/.

highway that separates historically Black neighborhoods in East Winston from higher income and whiter neighborhoods to the west of the highway, typifying the growing economic and racial divide that is common in housing markets across the country.

Unless otherwise noted, our responses to this RFI are informed by our previous report, The Lending Hole at the Bottom of the Homeownership Market.[2] While the ability to secure a mortgage lies at the heart of unlocking wealth-building opportunities and helping to close the racial homeownership gap, access to affordable homeownership, including the financing to afford small dollar homes, is a complex issue. In both our report, and our responses, we focus on three interrelated challenges in accessing small dollar homes for low-and-moderate income families in Forsyth County:

1) The decreasing availability of small dollar mortgage loans for LMI buyers;
2) The catch-22 of mortgage standards--or the relatively strict criteria for loan products designed to meet the needs of lower-income buyers; and
3) The competition with all-cash buyers.

We look forward to continuing to engage with FHA and other agencies to ensure that access to financing is not a barrier to LMI communities that can benefit from homeownership. Thank you again for the opportunity to respond and for undertaking this essential work.

Sincerely,

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[2] Sabiha Zainulbhai, Zachary D. Blizard, Craig J. Richardson, Yuliya Panfil, *The Lending Hole at the Bottom of the Homeownership Market,* Future of Land and Housing Program at New America and the Center for the Study of Economic Mobility, 2021, https://www.newamerica.org/future-land-housing/reports/the-lending-hole-at-the-bottom-of-the-homeownership-market/.

While FHA welcomes all comments relevant to expanding small mortgage lending in the FHA mortgage insurance program, FHA is particularly interested in receiving input from interested parties on the questions outlined below:

1. Communities have reported a lack of available financing for small balance mortgage loans in some areas. Have you observed this to be true and is there a particular mortgage loan amount below which the problem is most acute?

2. What housing supply market conditions and purchasing characteristics affect the availability of and demand for small mortgages?

3. What information can you provide regarding the ways in which the FHA program serves or does not serve borrowers seeking small mortgages?

4. What barriers (*e.g.,* origination and servicing costs, compensation, disincentives) exist for mortgage lenders and other industry participants in facilitating transactions that include the origination or servicing of small mortgages in the FHA program?

5. What technology solutions could improve the availability of small mortgages in the FHA program?

6. What changes to policies, regulations, features, or processes of the current FHA program would encourage mortgagees to do more lending for small mortgages in the FHA program?

7. What policies, regulations, features, or processes outside of FHA/HUD impact the availability of small mortgages in the FHA program?

8. What, if any, state and local requirements affect the availability of small mortgages in the FHA program?

9. What consumer protections are unique to small mortgages that should be considered in the FHA program?

10. What issues should be considered relating to provision of liquidity for small mortgage lending through securitization?

11. Offer any additional comments on the role that FHA programs could play in improving the supply of small mortgages.

Our responses specifically focus on questions 1, 2, 3, 4, and 6, as we are still seeking to understand the complexity of the issue, and have not conducted as much research around potential solutions.

1. Communities have reported a lack of available financing for small balance mortgage loans in some areas. Have you observed this to be true and is there a particular mortgage loan amount below which the problem is most acute?

The FLH and CSEM report, The Lending Hole at the Bottom of the Homeownership Market, explores small dollar mortgage origination trends in Forsyth County, North Carolina over the past two decades.[3] We used ATTOM data and Home Mortgage Disclosure Act (HMDA) data, and findings from 31 interviews with real estate agents and lenders, to understand the complexity of the challenges facing LMI buyers. We defined “small dollar mortgages” or “small dollar loans” as those that are below $100,000.[4]

Figure 13 | Small dollar loan originations in Forsyth County have not reached to their pre-crisis levels

Percent difference in mortgage loan originations relative to their 2007-level, by loan size, Forsyth County, North Carolina, 2007-2019

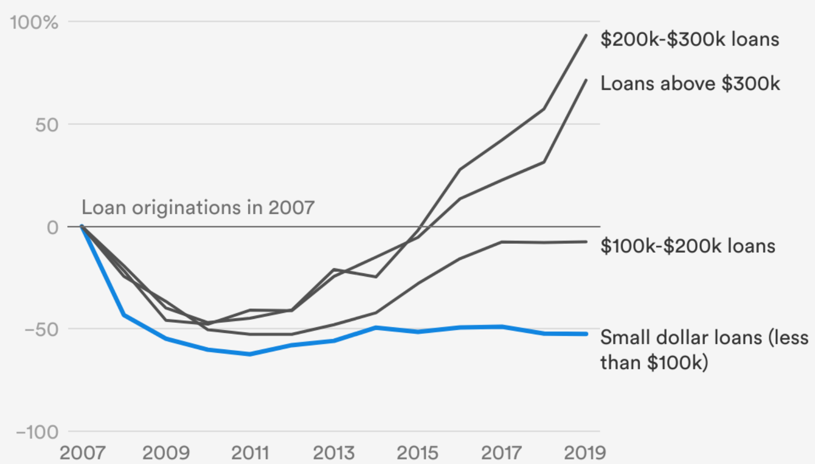

Chart: Center for the Study of Economic Mobility (CSEM) and New America-Future of Land & Housing • Source: HMDA Data

One of the major challenges to accessing small dollar homes for low-and-moderate income households in Forsyth County was the lack of access to mortgage loans for homes below

[3] Zainulbhai et al., *The Lending Hole at the Bottom of the Homeownership Market,* https://www.newamerica.org/future-land-housing/reports/the-lending-hole-at-the-bottom-of-the-homeownership-market/.

[4] Loan amounts vary across small dollar mortgage research, from $70,000 to $150,000 and above, based in part on median home values and other local housing market conditions. See Alanna McCargo, Bing Bai, Taz George, and Sarah Strochak, *Small-Dollar Mortgages for Single-Family Residential Properties.* Urban Institute, 2018, https://www.urban.org/research/publication/small-dollar-mortgages-single-family-residential-properties; and The Pew Charitable Trusts, “New Research Project to Explore the World of Small Home Loans,*”* April 29, 2021, https://www.pewtrusts.org/en/research-and-analysis/articles/2021/04/29/new-research-project-to-explore-the-world-of-small-home-loans.

$100,000, notably since the 2008 financial crisis. Our research shows that by 2019, originations for small dollar loans (those below $100,000) in the County had not reached their pre-2007 levels. This was true for small dollar loans, which were 52.5 percent below their 2007-levels, as well as loans between $100,000 and $200,000, which were 7.5 percent below. Originations for loans above $200,000, on the other hand, are 93.5 percent above their pre-crisis levels. These trends illustrate that, similar to national trends, lenders are extending fewer small dollar loans than they did prior to the financial crisis in Forsyth County, especially relative to larger loan amounts.

While access to small dollar loans is impacted by lenders extending fewer loans under a certain amount, we also see higher denial rates for smaller loans relative to larger loans. Using data from 2017 to 2019, Figure 14 shows that small dollar loans in Forsyth County are denied at a higher rate than large loans, across both conventional and FHA markets. Research conducted by the Urban Institute finds that applicants of small dollar loans have similar credit profiles to applicants of larger loans, and that gaps in the denial rates persist even after accounting for differences in applicants' credit scores.[5]

Figure 14 | Small dollar loans have higher denial rates than large loans in Forsyth County

Percent of mortgage loan applications denied by loan type and loan size, in Forsyth County, North Carolina, 2017-2019

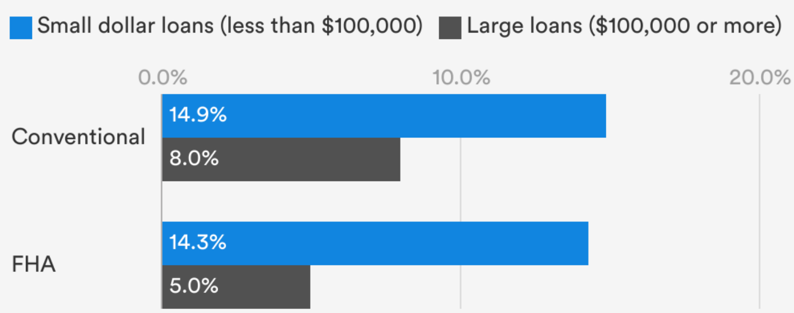

Chart: Center for the Study of Economic Mobility (CSEM) and New America-Future of Land & Housing • Source: HMDA Data

Our research finds that the downward shift in the number of small dollar originations, notably since the 2007 financial crisis, and higher denial rates for small dollar loans relative to larger loans in Forsyth County, results in increasingly less mortgage financing for buyers purchasing homes under $100,000.

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[5] Alanna McCargo and Sarah Strochak, "Debunking the Myth That Small-Dollar Mortgages are Riskier due to Poor Loan Performance and Borrower Credit", *Urban Institute's Urban Wire*, April 17, 2019, https://www.urban.org/urban-wire/debunking-myth-small-dollar-mortgages-are-riskier-due-poor-loan-performance-and-borrower-credit.

2. What housing supply market conditions and purchasing characteristics affect the availability of and demand for small mortgages?

Beyond access to small dollar loans through banks, credit unions and other mortgage lenders, there are several other factors in a housing market that impacts access to this financing. Informed by our interviews with real estate agents, mortgage lenders and other housing leaders in Forsyth County, we explore three commonly-cited conditions that come into play at various stages in the home purchasing process.

The lack of housing supply across the U.S. The U.S. is facing a decades-long decline in new housing construction that has culminated in a current housing shortage of 3.8 million homes. While the shortage is not limited to small dollar homes, an analysis from Freddie Mac finds that shortages have been concentrated among entry-level, starter homes (defined as less than 1,400 square feet).[6] Of all new construction, this analysis found that the share of entry-level, starter homes has steadily declined since the 1970s. By 2020, the share of starter homes built as a share of new construction reached nearly a 50-year low. Supply shortages, especially in times of high demand, drive up prices, leading to rising rents and home prices. Zillow.com estimates find that 37 percent of homes sell over the asking price, up from 13 percent in 2018.[7] While housing shortages impact the entirety of the housing market, the most acute impacts are felt by low-and-moderate income families, who have less room in their budget to spend on housing costs, and less savings to put towards a more expensive home.

In Forsyth County, the lack of affordable homes for sale in decent condition was one of the most commonly cited barriers to homeownership. Several agents and lenders emphasized that while supply is more constrained at the bottom of the market--acutely so for homes below $100,000--the lack of inventory impacts buyers with budgets up to $200,000. One lender insisted, *"Inventory. I would just use inventory three times over. It's not your borrowers, and it's not your lenders. It just actually has to do with inventory."*

While we do not explore housing supply challenges as part of our research, we do note that its impacts reverberate throughout housing markets, disrupting the traditional home purchasing process and exacerbating many of the other challenges homebuyers relying on small dollar loans face. This includes buyer's ability to find homes for sale in good condition within their price range, and the ability to put in a competitive offer on the few homes that do fit this criteria, notably when they are competing with cash offers or those with conventional loans.

Addressing housing supply shortages involves assessing exclusionary land-use regulations that favor sprawling neighborhoods with designated acreage, minimum lot sizes, and single-family residences.[8] Beyond land-use regulation, addressing housing supply challenges will require a

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[6] Freddie Mac, "Housing Supply: A Growing Deficit", May 7, 2021, https://www.freddiemac.com/research/insight/20210507-housing-supply.

[7] Candace Jackson, "House Hunting: Is This Price Right?", *The New York Times,* September 7, 2021, https://www.nytimes.com/2021/09/07/realestate/house-hunting-is-this-price-right.html.

[8] Reid Ewing, Shima Hamidi, James B. Grace, Yehua Dennis Wei, "Does urban sprawl hold down upward mobility?" *Landscape and Urban Planning,* 148 (2016): 80-88, https://www.sciencedirect.com/science/article/pii/S016920461500242X; Elliott Anne Rigsby,

host of solutions, including the need to reduce the costs and barriers to development; creating incentives for new development and redevelopment; and dealing with vacant and abandoned land.

Inability to compete with cash investors. Our research found that cash purchases have increasingly become prevalent in the market for small dollar homes, especially relative to the market for all homes. Figure 18 plots all small dollar homes purchased in Forsyth County from 2001 to 2020, by method of payment: cash or a mortgage loan. The use of cash to purchase small dollar homes has steadily increased over the last two decades, from 30 percent in 2001 to 75 percent in 2020. Between 2008 and 2009, the share of homes purchased in cash overtook the share of homes purchased with a mortgage, and after steep increases between 2014 and 2020, cash purchases now account for three-fourths of small dollar home purchases. This is in contrast with the rest of residential home purchases in Forsyth County, where cash purchases in 2020 accounted for 35.7 percent of transactions, while the use of mortgage loans accounts for 64.3 percent.

Figure 18 | By contrast, small dollar homes in Forsyth County are three times more likely to be purchased in cash than a mortgage

Share of small dollar residential home transactions made in cash vs. with a mortgage loan, in Forsyth County, North Carolina, 2001-2020

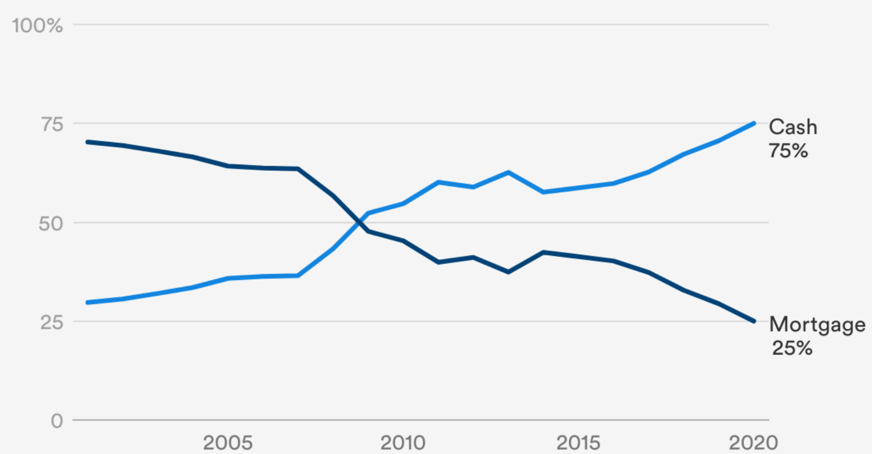

Chart: Center for the Study of Economic Mobility and New America-Future of Land & Housing • Source: ATTOM Data

Buyers who use cash have considerable advantages relative to buyers using conventional or FHA loans. Buyers using cash are able to streamline the transaction process and offer sellers speed and certainty—two major advantages in a process that is typically characterized by

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"Understanding Exclusionary Zoning and Its Impact on Concentrated Poverty", *The Century Foundation*, June 23, 2016, https://tcf.org/content/facts/understanding-exclusionary-zoning-impact-concentrated-poverty/.

uncertainty. According to Zillow.com, it can take as little as two weeks to close on a home with an all-cash offer, whereas mortgage loan applications can take anywhere from 30 to 60 days to process.[9] For buyers also utilizing affordable homeownership programs offered at the city or county-level, this process can be even longer, notably if local programs are understaffed.

Our research only explores trends in home purchases by method of payment, and so it is not clear whether cash purchases are filling the gap left by the absence of mortgage buyers, or whether an increase in cash purchases is driving out mortgage buyers from the market.

Appraisal gaps. Another local housing market condition that contributes to a lack of financing access are appraisal gaps. Appraisal gaps occur in housing markets where homes tend to be assessed for less than their selling price, which in turn impacts lenders' ability to underwrite loans at a price that buyers have agreed to pay. While not specific to small dollar lending, many neighborhoods where appraisal gaps are the largest, also tend to have higher concentrations of small dollar homes for sale.[10]

3. What information can you provide regarding the ways in which the FHA program serves or does not serve borrowers seeking small mortgages?

FHA loans are intended to increase access to homeownership for historically underserved homebuyers, many of whom are first-time, LMI buyers. Despite their intended purpose, nationwide data shows that the FHA underserves borrowers of small dollar loans.[11]

In Forsyth County, we found that the share of small dollar mortgages secured through an FHA loan has plummeted in recent years. Figure 21 plots the share of FHA and conventional loans below $100,000 from 2007 to 2020. At their peak in 2013, 31 percent of all FHA loans in Forsyth were below $100,000; by 2020, this had dropped to around 4 percent. Conventional small dollar loans have also dropped to 11.3 percent in 2020, from 30.5 percent at their peak in 2013, though the decline in small dollar conventional loans has been steadier than the decline in FHA loans.

Describing changes to the FHA market, one Forsyth County real estate agent noted: "We call them the big box banks—SunTrust, Wells Fargo, Bank of America, Capital One, First Capital, First Citizens. All of those sorts of banks abandoned the FHA loan product [a number of years ago] because of the tightened regulations. Some of them have come back with altered products, but the FHA loan product was pretty essential to the lower-income borrowers."

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9 Zillow.com, "The Home-Selling Process for an All-Cash Deal," https://www.zillow.com/sellers-guide/home-selling-process-for-all-cash-deal/.
10 McCargo et. al., Small-Dollar Mortgages for Single-Family Residential Properties, 23.
11 Linna Zhu and Rita Ballesteros, "Making FHA Small-Dollar Mortgages More Accessible Could Make Homeownership More Equitable", *Urban Institute Urban Wire*, April 22, 2021, https://www.urban.org/urban-wire/making-fha-small-dollar-mortgages-more-accessible-could-make-homeownership-more-equitable.

4. What barriers (*e.g.,* origination and servicing costs, compensation, disincentives) exist for mortgage lenders and other industry participants in facilitating transactions that include the origination or servicing of small mortgages in the FHA program?

After the 2007 financial crisis, regulations put in place to protect buyers under Dodd-Frank created disincentives for commercial banks to issue small mortgages. These regulations increased the fixed costs of originating a mortgage loan, regardless of the loan size. At the same time, the Qualified Mortgage rule, implemented by the Consumer Protection Financial Bureau (CPFB), capped the fees and points that lenders can charge for processing a loan on a sliding scale, based on the size of a loan. As a result, the smaller the loan size, the less profit a bank could make, creating a disincentive for banks to originate smaller loans, even though the intent of the rule is to protect buyers from excessive fees.

Figure 6 | Lender Profits under 2021 QM Rule with Two Different Loan Sizes

	Small dollar loan ($90,000)	**Large loan ($400,000)**
Applicable Fee or Profit (QM Cap)	$3,308 ($3,308 or less)	$12,000 (3% of loan amount)
Fixed Origination Cost	$2,500	$2,500
Lender Profit	**$808**	**$9,500**

Table: Center for the Study of Economic Mobility and New America--Future of Land & Housing

While we did not causally assess the impact of Dodd-Frank on small dollar lending in our report, several studies have quantitatively examined Dodd-Frank's effect on lenders and lending markets. In a 2016 paper, Cyree (2016) demonstrates that, following the passage of Dodd-Frank, small banks experienced significant regulatory burden across several key indicators, including decreased returns on their assets.[12] According to the FDIC, between 2006 and 2021, the number of commercial banks fell by nearly 3,200,[13] and the share of total banking assets held by small banks fell by 9.5 percentage points from 2000 to 2014.[14]

[12] Ken B. Cyree. "The effects of regulatory compliance for small banks around crisis-based regulation." *Journal of Financial Research, Volume 39, Issue* 3 (Fall 2016), 215-246, https://doi.org/10.1111/jfir.12096.
[13] Federal Deposit Insurance Company (n.d.). Annual Historical Bank Data. Retrieved from https://banks.data.fdic.gov/explore/historical.
[14] Hester Pierce and Stephen Matteo Miller, "Small Banks by the Numbers, 2000-2014," *Mercatus Center, George Mason University*, March 17 2015, https://www.mercatus.org/publications/financial-markets/small-banks-numbers-2000%E2%80%932014.

In a survey of small banks across the country, respondents frequently cited the greater difficulty of serving the local business community, in addition to issuing small dollar mortgages, due to higher regulatory costs from Dodd-Frank.[15] D'Acunto and Rossi estimate that lenders–regardless of their size–have made 15 percent fewer conforming loans and 21 percent more jumbo loans (loans above $700,000) since the passage of Dodd-Frank.[16] Beyond small dollar mortgage lending, recent studies also show a decline in small dollar business lending since the passage of Dodd-Frank.[17]

6. What changes to policies, regulations, features, or processes of the current FHA program would encourage mortgagees to do more lending for small mortgages in the FHA program?

A related challenge in accessing small dollar loans is the stricter eligibility requirements on FHA loans–namely the criteria used to determine the condition of a home and its suitability for financing, or what some lenders refer to as "mortgage standards." These standards exist to protect lenders from taking on too much risk and to protect buyers from having to make repairs they cannot afford. Loans insured by the FHA will not be approved by a lender unless the home meets minimum property standards for "safety, security and soundness."[18] Common violations include peeling paint, lead paint, openable windows without screens, a leaking roof, and damaged flooring.

While intended to protect buyers and lenders, these mortgage standards create a catch-22: homes that are more likely to be affordable for low- and moderate-income buyers who are relying on FHA loan products are more likely to be older and in disrepair, and therefore less likely to meet the strict eligibility criteria for FHA loans. While the poor condition of a small dollar home alone is not necessarily causing loan denials, it is the combination of the home condition and the reliance on loan products with higher eligibility standards that locks many low- and moderate-income buyers out of the market for homeownership.

Not only is the FHA underserving its intended market, but FHA loans are also less competitive than cash or conventional loans with sellers choosing among several offers. The increased inspection and appraisal requirements for FHA loans, especially in competitive housing markets,

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[15] Hester Pierce, Thomas Stratmann, and Ian Robinson, "How are Small Banks Faring Under Dodd-Frank?" Regulation Working Papers. *Mercatus Center, George Mason University*, February 17, 2014, https://www.mercatus.org/publications/regulation/how-are-small-banks-faring-under-dodd-frank.
[16] Francesco D'Acunto and Alberto G. Rossi. Regressive mortgage credit redistribution in the post-crisis era. *The Review of Financial Studies, Volume 35*, *Issue 1* (January 2022), 482-525, https://doi.org/10.1093/rfs/hhab008.
[17] Francisco Covas. Capital requirements in supervisory stress tests and their adverse impact on small business lending. Staff Working Paper 2017-2. *The Clearing House* (August 2017), https://bpi.com/wp-content/uploads/2018/07/capital-requirements-in-supervisory-stress-tests-and-their-adverse-impact-on-small-business-lending-1-1.pdf; Michael D. Bordo and John V. Duca. The Impact of the Dodd-Frank Act on Small Business, Federal Reserve Bank of Dallas, NBER Working Paper No. 1806 (April 2018), https://www.dallasfed.org/-/media/documents/research/papers/2018/wp1806.pdf.
[18] U.S. Department of Housing and Urban Development, MPS Supplementing Model Building Codes, https://www.hud.gov/program_offices/housing/rmra/mps/modelbuilding.

can lower a buyer's odds of being selected by a seller.[19] In these instances, sellers are likely choosing the path of least resistance: If a home requires costly structural repairs before it can be sold to a buyer relying on an FHA loan, choosing a buyer with a conventional loan or with a cash offer allows a seller to avoid expensive and time-consuming maintenance.

Thank you again for the opportunity to comment on the FHA's RFI on small dollar mortgages. We look forward to continuing to engage on these issues in the months and years ahead.

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[19] Michaelle Bond, "Loan preference is shutting some FHA-backed buyers out of Philly area's hot housing market," *The Philadelphia Inquirer*, May 24, 2021, https://www.inquirer.com/real-estate/housing/fha-mortgage-conventional-home-buyer-assistance-20210524.html.