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Assistant Secretary for Housing
Federal Housing Commissioner
Department of Housing and Urban Development
451 7th Street, SW, Room 10276
Washington, DC 20410-0500

Regulations Division
Office of General Counsel
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**Re: Comment on the Request for Information Regarding Small Mortgage Lending [Docket No. FR-6342-N-01]**

Dear Commissioner Gordon:

The National Consumer Law Center (NCLC) submits these comments on behalf of its low-income clients in response to the U.S. Department of Housing and Urban Development's (HUD) Request for Information Regarding Small Mortgage Lending. We applaud HUD's goal to proactively strengthen and protect vulnerable and underserved communities and advance housing justice. The lack of availability of small-dollar mortgages prevents low-income communities, and communities of color from building wealth through homeownership, and fuels the rise of predatory financing products in communities already suffering from discrimination and disinvestment. Removing the systemic barriers that prevent the origination of FHA-insured small-dollar mortgages will support affordable homeownership opportunities in underserved communities with lower housing prices, and narrow the nation's racial wealth and homeownership gap.

Nearly twenty percent of owner-occupied homes in the United States are valued at $100K or less, according to the 2019 American Community Survey. These lower-priced homes are a critical source of affordable housing for low-and moderate-income families, many of whom are first-time homebuyers, and households of color. Lower-priced homes are dispersed across the nation including in many rural communities in the Southeast and Great Plains, industrial areas of the Midwest, and urban areas throughout the South.[1]

Homeownership remains out of reach for creditworthy consumers in these communities. Consumers seeking loans to purchase lower-priced homes, including manufactured homes, or to rehabilitate, repair or make energy efficient upgrades to existing homes, rely on alternative, often predatory, high-cost financing. Access to small dollar mortgages remains scarce. Only 23.2 percent of homes nationwide priced below $100K were purchased with a mortgage, compared to 73.5 percent of homes sold for above $100K in 2019.[2] Banks and other lenders either do not offer small-dollar mortgages, or deny small-dollar mortgages to creditworthy borrowers at higher rates compared to consumers who apply for larger loans.[3] Lack of small-dollar refinance credit also made it impossible for households to benefit from recent historically low interest rates.

Mortgage financing for lower-priced homes has been constrained for over a decade, and has gotten worse since the Great Recession.[4] Lenders exited this end of the mortgage market at a fast clip, leaving consumers, particularly those seeking loan amounts of less than $70K, in credit deserts. By 2016 loans with a balance between $10K and $70K made up only 5 percent of all originations.[5] During that same period, loans from $150K to $300K increased 61 percent; loans greater than $300K increased 142 percent, nearly doubling in market share.[6] The appreciation in home prices accounted for some but not all of this shift given the number of low-cost homes still on the market at that time.

All-cash buyers and investors, some with Wall Street backing, have scooped up large swaths of lower priced homes, locking ordinary Americans out of homeownership opportunities. This current wave of speculators are flush with cash and purchasing low-priced homes for the rental market, and when tenants cannot afford the higher rents they are swiftly evicted.[7] In one North

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[1] *Financing Lower-Priced Homes: Small Mortgage Loans*, U.S. Department of Housing and Urban Development, Office of Policy Development and Research, October 2022.

[2] Linna Zhu, Rita Ballestros, *Making FHA Small Dollar Mortgages More Accessible Could Make Homeownership More Equitable*, Urban Institute, April 22, 2021.

[3] *Id*. See also Sabiha Zainulbhai, Zachary Blizard, et al. *The Lending Hole at the Bottom of the Homeownership Market: Why Millions of Families Can't Get Small Dollar Loans*, New America, November 2021.

[4] Alanna McCargo et al., *Small-Dollar Mortgages for Single-Family Residential Properties*, Urban Institute, 2018. See also Ann Carpenter, Taz George and Lisa Nelson, *The American Dream or just an Illusion? Understanding Land Contract Trends in the Midwest Pre- and Post – Crisis*, Joint Center for Housing Studies of Harvard University, August 2019.

[5] Alanna McCargo et al., *Small-Dollar Mortgages for Single-Family Residential Properties*, Urban Institute, 2018 at 1-2 (also noting that the rebound in the mortgage market after 2011 did not extend to the origination of loans with balances of $70K or less).

[6] *Id*.

[7] Bo McMillan and Reggie Jackson, *Corporate Landlords Profit from Segregation, at Cost of Black Homeownership and Wealth*, Shelterforce, October 19, 2022 (citing Congressional subcommittee data showing corporate landlords

Carolina county, 75% of homes below $100K were purchased with cash in 2020, up from 30% in 2001.[8] The market is now so lopsided that even a consumer who is able to obtain a conventional or FHA-insured small-dollar mortgage to purchase a home may be outbid by a cash buyer.[9]

This increase in investment activity is particularly harmful to historically redlined communities with large concentrations of Black households. These communities have long been targeted by speculators because the homes are undervalued. As discussed below, this included the mass purchase of single-family homes foreclosed during the Great Recession.

Although very low-priced homes constitute a declining share of the market because of the rapid appreciation of home values, the problems discussed herein are migrating up to higher priced homes that may still be affordable to low-and-moderate income consumers. Preserving the existing supply of affordable housing means opening up financing channels for lower dollar mortgages. The affordable housing crisis, with high rents, increasing interest rates, and low inventory means HUD should look anew at opportunities for consumers to obtain sustainable loans to purchase or rehab modestly priced homes.

**The dearth of small-dollar mortgages has a disparate impact on consumers of color and is a contributor to the racial homeownership gap.**

Residential segregation and long-standing discriminatory practices in the credit and housing markets have resulted in significant racial and ethnic disparities in homeownership and the accumulation of wealth. In 2020, the average white family held 12 times the wealth of the average Black family. Home equity is a particularly important source of wealth for households of color. Home equity makes up 57% percent of the net worth for Black households and 67% for Hispanic households, compared with 43% of total net worth for white households.[10]

The decline in the availability of small-dollar mortgages over the last decade parallels the decline in the Black homeownership rate. After the Great Recession, Black homeownership steadily declined to a low of 40.6% at the end of 2019. The gap between the Black and white homeownership rates in the United States is at its highest level in 50 years, up from 28.1

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are purchasing homes in neighborhoods where the percentage of Black residents is over three times their level of representation in the U.S., where home prices are cheaper than in average neighborhoods, where average rents are conversely higher than in average neighborhoods, and where levels of homeownership are higher than in most neighborhoods across the country). *See also* Matthew Goldstein, *Where a Little Mortgage Goes a Long Way*, New York Times, August 2, 2020.

[8] Sabiha Zainulbhai, Zachary Blizard, et al. *The Lending Hole at the Bottom of the Homeownership Market: Why Millions of Families Can't Get Small Dollar Loans*, New America, November 2021 at 42.

[9] See id at 24-25.

[10] Michael Neal, Alanna McCargo, *How Economic Crises and Sudden Disasters Increase Racial Disparities in Homeownership*, Urban Institute, June 2020 (based on calculations from the 2016 Survey of Consumer Finances).

percentage points in 2010 to at or near 30 percentage points since 2017.[11] Researchers note that roughly 17 percent of the homeownership gap remains unexplained by observed variables and could be caused by policies and structures that have made it difficult for Black households to obtain and benefit from homeownership.[12] Through sustained advocacy, including the promotion of Special Purpose Credit Programs and down payment assistance, there has been an uptick of the homeownership rate in the last year.[13] Yet the need for sustainable forms of credit remains as the mortgage market cools.

Small-dollar loans are particularly critical for Latino households who make up the fastest growing demographic in the homeownership market. These consumers are more likely to be first-time homebuyers in search of affordable entry level homes.[14] Many are moving to communities in the South and Midwest with lower-priced properties in search of homeownership opportunities.[15] Those ready to purchase homes are likely to rely on FHA-insured loans or other low-down payment loan products.[16]

Native American populations living on reservations or in rural areas face unique challenges in accessing small, affordable mortgages. These consumers are far more likely to receive higher-priced loans, in large part due to the difference in costs associated with loans for manufactured homes.[17] Though manufactured housing remains a major source of affordable housing for Indigenous families, the current system of chattel financing hobbles wealth development. News reports have documented discriminatory conduct in the private market when consumers are steered away from low cost options such as the Section 184 Indian Home Loan Guarantee Program.[18] Low loan amounts, limited terms, and other structural issues limit consumers' use of the FHA's Title I program.

During the pandemic many consumers were sidelined and missed out on an important opportunity to stabilize housing by purchasing affordable homes in their community in a low-rate environment. Some are now trapped in markets with rapidly rising rents.

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[11] Jung Hyun Choi, *Breaking Down the Black-White Homeownership Gap*, Urban Institute, Feb. 21, 2020; *2022 Snapshot of Race and Home Buying in America*, National Association of Realtors, February 2022, at 7.

[12] Jung Hyun Choi, Alanna McCargo, et al., *Explaining the Black White Homeownership Gap: A Closer Look at Disparities across Local Markets*, Urban Institute, October 2019.

[13] See Abha Bhattarai and Alyssa Fowers, *Pandemic led to sharp spike in Black, Asian and Latino homeownership*, Washington Post, November 1, 2022.

[14] See 2021 *State of Hispanic Homeownership Report*, National Association of Hispanic Real Estate Professionals.

[15] *Id*. at 7.

[16] *Id*.

[17] Donna Feir, Laura Cattaneo, *The Higher Price of Mortgage Financing for Native Americans*, The Center for Indian Country Development, Working Paper Series, No. 1906, September 2019.

[18] Mike Baker, Daniel Wagner, *Minorities Exploited by Warren Buffets Mobile Home Empire*, Seattle Times, Dec. 2015.

We offer the following observations in response to the questions posed in the RFI.

**<u>Question 1</u>:** 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?

Communities of color with lower-priced, often older homes, have been cut off from sustainable small mortgages as discussed above. The absence of small-dollar mortgages contributes to the concentration of predatory, high-cost lenders and speculators in communities of color.[19] A respondent to a recent UnidosUS Wealth and Housing Alliance and UnidosUS Affiliates survey put it succinctly, "our Latino community is not aware of where there are smaller loans available, they go to a place like a payday lender and other predatory lending locations that give them the line of credit or the money they are looking for at a much higher interest. The requirements are not as stringent as it is for a home loan."[20] Homeowner advocates report that it is extremely difficult for consumers to obtain a mortgage for below $70K and some loan officers tell homeowners that if they are borrowing less than a certain figure in this range, the loan will be much more expensive.[21]

Predatory lenders fill the void in communities that lack access to sustainable small mortgages.[22] This includes high-cost predatory financiers who hold out the illusory promise of home ownership through land installment contracts, leases with options to purchase and sales with seller-financed wrap-around mortgages. These schemes, generally backed by private investors, proliferate in credit deserts created by the lack of small-dollar loans and reduce rather than improve homeownership opportunities.[23] This type of financing is rapidly displacing conventional loans in some communities. For example, in Detroit just a few years ago, data showed there were more land contracts originated in a given year than mortgage transactions.[24]

Land installment contracts, also known as land contracts, are often marketed as an alternative approach to homeownership.[25] In a land contract, the buyer agrees to purchase a home for a certain price, at a certain interest rate, over a period of time, but does not obtain a deed until

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[19] See Linna Zhu, Rita Ballestros, *Making FHA Small Dollar Mortgages More Accessible Could Make Homeownership More Equitable*, Urban Institute, April 22, 2021.

[20] Survey of UnidosUS Wealth and Housing Alliance and UnidosUS Affiliates, November 2022, on file with authors.

[21] Phone interview and email correspondence with legal services attorneys, Nov.-Dec. 2022, on file with authors.

[22] Ann Carpenter, Taz George and Lisa Nelson, *The American Dream or just an Illusion? Understanding Land Contract Trends in the Midwest Pre- and Post – Crisis*, Joint Center for Housing Studies of Harvard University, August 2019 at 3, 4.

[23] Adam Staveski and Tara Roche, *Amid Small Mortgage Challenges, Some Homeowners Turn to Alternative Financing*, Pew Charitable Trusts, Oct. 4, 2022; *What has Research Shown About Alternative Home Financing in the US?* Pew Charitable Trusts, May 31, 2022.

[24] Joel Kurth, *Land Contracts Trip Up Would be Homeowners*, The Detroit Press News, Feb. 29, 2016.

[25] Battle, J. J., Mancini, S., Saunders, M., & Williamson, O., *Toxic Transactions: How Land Installment Contracts Once Again Threaten Communities of Color*, National Consumer Law Center, 2016.

the full purchase price is paid. If the buyer defaults at any time, the contract can be canceled and in many states the buyer loses all of their investment and is evicted like a tenant. Especially when larger investors have employed the model, land contracts have been used to sell older homes in poor condition. Homebuyers, enticed by the promise of home ownership, end up spending hard-earned dollars and sweat-equity refurbishing uninhabitable homes. While the buyers have all the responsibilities of homeownership, they have none of the associated rights that come with clear title. Additionally, lack of clear ownership prevents buyers from accessing grants or financing for home improvements and repairs. Roughly half of the states in the country have no statute addressing land contracts and many of the statutes that do exist provide minimal protections.[26] Often the lack of protections means that a home on which the buyer has paid for many years can be claimed by an unknown lienholder if the seller failed to pay property taxes or a higher priority mortgage. In addition to the lack of legal clarity about their rights, buyers often are not aware of title issues, prior liens, or code violations.

Another model that has been heavily pushed on would-be homeowners unable to obtain a mortgage to buy a modest home is the lease with option to buy. Lease-options carry many of the same risks and problems as land contracts. First, the buyer in a lease-option is nothing more than a tenant unless they can obtain financing to exercise the option within the allowed option period (usually six months to two years). Many consumers have spent their hard-earned savings making a home habitable in the belief they will ultimately own it, only to find that they cannot obtain a mortgage within the option period either because the home is overpriced, because there are significant conditions problems, or because of the same tight credit market that led the consumer to enter into a lease-option to begin with. Tenants entering into a lease-option are typically required to put down a large option fee, often $3,000-$5,000, which they lose if they are not able to exercise the option.

Some think tanks have touted “responsible” lease-options as a way to close the homeownership gap, and have even pushed for FHA and the Government Sponsored Enterprises to play a larger role in promoting lease-purchase.[27] Yet there is no evidence to support any significant conversion rate to actual homeownership from the existing private programs. One study suggests a roughly 25 percent success rate among two lease-purchase companies that were willing to share their data publicly.[28] The enormous gap between this figure and the typical success rate of FHA borrowers of around 95%,[29] and the fact that lease-

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[26] Pew Charitable Trusts, *Less than Half of States Have Laws Governing Land Contracts*, Apr. 30, 2021.

[27] Carol Galante, Carolina Reid, Rocio Sanchez-Moyano, *Expanding Access to Homeownership Through Lease-Purchase*, Terner Center, Jan. 9, 2017; Michael Stegman, Jeb Mason, Mark Zandi, *Lease-Purchase: How to Build Homeownership*, July 2022.

[28] *See* Michael Stegman, Jeb Mason, Mark Zandi, *Lease-Purchase: How to Build Homeownership*, July 2022. The paper shows a 25 percent success rate for Home Partners of America’s program. While it claims that Trio’s program had a 78 percent success rate, this gives an inaccurate picture. Trio provides for a 3-year option period. Of the 183 consumers who entered the program in 2016-2018, the report claims that 75 of them had purchased the home - a success rate of just 41 percent. Even these numbers are uncertain due to the way the data is presented.

[29] *FHA Single Family Loans Performance Trends*, Office of Risk Management and Regulatory Affairs, Oct. 2022 (seriously delinquent rate averages around 5 percent).

purchase consumers are generally left much worse off if the transaction fails, points to the need for FHA to focus on viable mortgage lending, rather than promoting lease-purchase. Consumers who shoulder the burden of making major home repairs during their tenancy, default on their rental payments as a result, face collections and rental reporting that make it nearly impossible they will own a home any time in the foreseeable future.[30]

Yet another alternative that ensnares a number of consumers unable to access the traditional mortgage market is seller-financed mortgage loans. In this type of transaction, the seller offers to make the loan to the buyer, and conveys a deed and takes back a security interest. The buyer then makes their monthly payments to the seller. More often than not, the seller has an existing, higher priority mortgage that remains in place (and the buyer's mortgage "wraps around" that existing mortgage). This poses a significant risk to the buyer, who might make all of their payments on time, only to lose the home if the seller fails to pay the underlying mortgage. Seller-financed mortgages also have a significantly higher failure rate than mortgage loans made by banks because sellers do not engage in underwriting for ability to pay, and charge astronomical interest rates, in addition to an often-inflated sale price for the home.

In addition to harming the consumers who enter into them, land contracts, lease-purchases, and seller-financed mortgages also have a destabilizing effect on communities. More often than not, these transactions end in default and the property is churned through multiple would-be homeowners. The investors "milk" the property for multiple large down payments, while never investing in bringing the property up to a habitable condition. Surrounding communities feel the effects of this long-term disinvestment. The same communities which bore the brunt of the foreclosure crisis and subsequent economic meltdown are most often targeted by these investors.

While there is still a market in many areas of the country for low-cost home sales, land contracts, lease-options, and seller financing, despite all of their well-documented problems, are the only options available to non-cash buyers to purchase homes. This is demonstrated by HMDA data which shows a clear dearth of loan originations for low-cost mortgages.[31] Non-predatory small-dollar mortgage loans are sorely needed to fill this void.

**<u>Question 3</u>:** What information can you provide regarding the ways in which the FHA program serves or does not serve borrowers seeking small mortgages?

Access to mortgage credit is critical for equalizing homeownership rates across racial and ethnic lines. Despite the FHA's mission to increase credit access for these underserved communities, FHA-insured small-dollar loans are not available in many low-cost counties or cities with heavy

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[30] Many of the major lease-purchase companies, including Trio, require tenants to make necessary repairs to the home during the lease term, even though this violates landlord-tenant law in 48 states.

[31] Ann Carpenter, Taz George and Lisa Nelson, *The American Dream or just an Illusion? Understanding Land Contract Trends in the Midwest Pre- and Post – Crisis*, Joint Center for Housing Studies of Harvard University, August 2019, at 23.

concentrations of Black and Latino residents. Other underserved populations, including low-and-moderate income consumers and first-time homebuyers are also feeling the impact of this scarcity.

FHA-insured loans are critical for borrowers of color and first-time homeowners. FHA endorsements for mortgages made to Black borrowers comprise over 18 percent of FHA's total endorsements, roughly three times that of the rest of the market.[32] Similarly, Hispanic borrowers made up 23 percent of FHA's total endorsements, more than two times the rest of the market, according to 2021 HMDA data.[33] Latinos are twice as likely to use FHA-insured loans to finance their home purchases than their non-Hispanic white counterparts.[34] Eighty-four percent of FHA-insured purchase money loans went to first-time homebuyers in 2021.[35]

Yet research has documented that even when consumers apply for small-dollar mortgages, lenders deny these loans at higher rates. According to the Urban Institute, small-dollar mortgage loan applications in 2017 were denied by lenders at double the rate of denial for larger mortgage loans, and this difference in denial rates cannot be fully explained by differences in applicants' credit profiles.[36]

Denial rates are higher for both conventional and FHA-insured small-dollar loans. However, small-dollar mortgages, when made, are originated primarily through conventional financing channels.[37] This includes smaller banks and mission driven lenders, like CDFIs. Despite the need, especially for first-time homeownership, the FHA's share of small-dollar purchase loans remains significantly lower than for purchase loans made through conventional channels.[38]

Outside of purchase money mortgages there is a critical unmet need for loans to repair and rehabilitate homes in low-cost markets. The housing stock in these communities tends to be older, with some vacant or abandoned homes in distressed neighborhoods.[39] Rehabilitating and repairing these properties and getting them back on the market can provide a significant source of affordable housing for low-income consumers. Small-dollar renovation mortgages allow homeowners to maintain their homes and benefit from property price appreciation, and add rental units to help alleviate the affordable housing crisis.

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[32] *Annual Report to Congress Regarding the Financial Status of the Federal Housing Administration Mutual Mortgage Insurance Fund*, U.S. Department of Housing and Urban Development, Fiscal Year 2022 at 26.

[33] *Id*.

[34] *2021 State of Hispanic Homeownership Report*, National Association of Hispanic Real Estate Professionals.

[35] *Annual Report to Congress Regarding the Financial Status of the Federal Housing Administration Mutual Mortgage Insurance Fund*, U.S. Department of Housing and Urban Development, Fiscal Year 2021 at 22.

[36] Laurie Goodman, Bing Bai, *Why do Lenders deny Small-Dollar Mortgages at Higher Rates*, Urban Institute, July 2018.

[37] Linna Zhu, Rita Ballestros, M*aking FHA Small Dollar Mortgages More Accessible Could Make Homeownership More Equitable*, Urban Institute, April 22, 2021

[38] See id.

[39] Alanna McCargo et al., *Small-Dollar Mortgages for Single-Family Residential Properties*, Urban Institute, 2018 at 14.

Despite the demand for this type of financing the FHA's 203(k) Rehabilitation Mortgage Insurance Program, which has been updated and streamlined, is underutilized. We urge HUD to conduct a fresh review of this program to uncover the structural barriers which prevent consumers from accessing this source of financing for home repairs. HUD should weigh programmatic changes, including those related to property standards, with the need for low-income consumers to obtain sustainable loans so they can maintain their homes in a safe and habitable condition.

**Question 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?

Small-dollar loans perform comparably to other loans. However, lenders have less of an economic incentive to make small-dollar mortgages because they generate lower profit. Small-dollar loans are more likely to be made by smaller banks or community-based or mission driven lenders. Large banks, including those who benefit from access to subsidized capital, have abandoned this part of the market.

The average fixed costs and per loan costs of extending a mortgage have increased over time, making it less profitable to originate smaller loans.[40] Loan production costs, including compensation, totaled $8.6K per loan in 2021.[41] However, costs vary by originator based on loan characteristics, experience of staff, use of technology and other factors. A study of loan production costs by Freddie Mac noted that the most efficient retail-only lenders had per-loan costs that were 45% less costly, on average, than other lenders.[42] The increased costs of loan production over time cannot be attributed solely to regulatory compliance with the now twelve-year old Dodd-Frank rules. Other factors, including excess capacity during periods of low loan production volume, inefficient loan manufacturing processes, and the cost of technology, play a role.[43]

Despite loan production costs, and the COVID-19 pandemic, the mortgage industry experienced an extraordinary year in 2020, with record high lender profits across the industry.[44] The Mortgage Bankers Association (MBA) reported that independent mortgage banks and mortgage

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[40] See Freddie Mac Single Family, *Cost to Originate Study: How Digital Offerings Impact Loan Production Costs*, Nov. 2021, at 6.

[41] Mortgage Bankers Association, *IMB Production Profits Fall in 2021 from Record in 2020*, MBA Newslink, April 12, 2022. This includes commissions, compensation, occupancy, equipment and other expenses.

[42] See Freddie Mac Single Family, *Cost to Originate Study: How Digital Offerings Impact Loan Production Costs*, Nov. 2021, at 9.

[43] Id.

[44] Id. See also Mortgage Bankers Association, *IMB Production Profits Fall in 2021 from Record in 2020*, MBA Newslink, April 12, 2022. The MBA Annual Mortgage Bankers Performance Report said independent mortgage banks and mortgage subsidiaries of chartered banks made an average profit of $2,339 on each loan they originated in 2021, down from the record $4,202 per loan in 2020.

subsidiaries of chartered banks made an average profit of $4,202 on each loan they originated in 2020, and had “stellar” profits 2021.[45] While the historically low interest rates that drove higher mortgage origination volume have increased and the mortgage market has cooled, the operating efficiencies that lenders gained during this period, including through investment in technology, should keep some production costs in check. The fast adoption of digital tools and automation may do the same. In light of generous profits overall, the fact that lenders may lose money on a per-loan basis when they make smaller dollar loans should not be an acceptable reason for lenders to fail to serve this segment of the market.

In addition to the fixed loan origination cost issue, individual loan officer compensation similarly incentivizes the origination of larger dollar mortgages to the exclusion of smaller dollar loans. It remains typical in the mortgage industry for loan origination fees and loan officer compensation to be tied to the principal balance of the loans made. However, recognizing the problems this creates, some lenders have moved away from commissions and toward a salaried model for some, if not all, of their loan officers. If the goal is to increase access to small-dollar mortgages, addressing loan officer compensation so that these loans will be equally incentivized is key.

## Recommendations

NCLC offers its recommendations in response to the following questions:

**Question 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?

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

Given FHA’s crucial role in expanding access to homeownership and its duty to affirmatively further fair housing, we recommend the agency take the following steps to promote access to small-dollar mortgages. Our **top three** recommendations are:

**Develop an FHA small-dollar mortgage demonstration program and explore the impact of innovations such as subsidized origination costs and salaried loan originators**.

FHA should implement a pilot program in particular geographic markets where homes are available for under $100,000 and should study the impact of several key policy interventions over a period of time. These interventions, which could be piloted separately, with an outside evaluator to assess impact and operational challenges, should include, at a minimum, (a) providing a subsidy to cover part of the origination cost of the loan, and (b) providing an

[45] Mortgage Bankers Association, *IMB Production Profits Fall in 2021 from Record in 2020*, MBA Newslink, April 12, 2022.

incentive or an MIP discount to lenders who maintain a group of loan originators working on salary, rather than commission, who are encouraged to serve underserved communities. The demonstration program could also evaluate other mechanisms, such as alternative ways of reducing closing costs.

**Require FHA participating lenders to show that they are making a proportionate number of small-dollar mortgages**.

As we discuss above, failing to make mortgage loans below $100K has an exclusionary and discriminatory impact on borrowers of color. All mortgage lenders have an obligation, under the Fair Housing Act and the Equal Credit Opportunity Act, to avoid causing disparate impacts on communities of color and to seek out less discriminatory alternatives.[46] HUD also has a duty to affirmatively further fair housing, which would be advanced by ensuring that FHA lenders serve the broad spectrum of the market.[47]

Given the impact on communities of color of the dearth of small-dollar loans, HUD should consider imposing a requirement on all FHA participating lenders that they demonstrate on an annual basis that their overall lending is reflective of the home purchase marketplace they serve. This could be done by comparing loans made to overall market sales data or by reviewing the loan amounts sought by mortgage applicants compared to loan amounts of approved loans. If a lender failed to perform within a permissible range in this metric of serving the full marketplace, FHA could require remedial steps through an affirmative small-dollar mortgage promotion, or if the failure persists, could remove the lender as an approved FHA participant. In the alternative, FHA could provide additional incentives for lenders who meet the threshold for making a proportionate number of small-dollar loans in their service area. (Below we discuss connecting small-dollar lending with Community Reinvestment Act (CRA) obligations, which already apply to many FHA lenders, and Special Purpose Credit Programs, which are being implemented across the market.)

**Develop a direct loan program for small-dollar mortgages**.

Direct loan programs such as the USDA's Section 502 program are underutilized and have not been given sufficient resources to function optimally. However, direct lending programs can play an important role in the face of market failure. Given the incentive problems in the private market, small-dollar mortgage lending may be an appropriate place for FHA to fill the void as a direct lender. FHA should consider and evaluate this option of developing a direct loan program for small-dollar mortgages.

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[46] *See* 42 U.S.C. §§ 3601-19; 15 U.S.C. § 1691, *et seq*.; and, *e.g.,* O.C.G.A. § 8-3-200 *et seq*.

[47] Fair Housing Act, 42 U.S.C.A. § 3608(d) (all federal executive agencies and departments to administer their programs and activities related to housing and urban development in manner that affirmatively furthers fair housing); § 3608(e)(5) (requiring the HUD Secretary to "administer the programs and activities relating to housing and urban development in a manner affirmatively to further" the policies of the FHA).

We also recommend that FHA take the following key steps:

**Convene a cross-agency working group on small-dollar mortgage loans**.

The problem of lack of access to small-dollar mortgages is not unique to FHA lending, although data suggests that FHA loans comprise a smaller percent of small-dollar mortgages than other players. The problem requires broad market participation in order to address it. FHA should convene a working group including FHFA, the GSEs, the CFPB, and the prudential regulators to advance and attempt various solutions, including pilots and any further regulatory guidance that may be needed. Particularly if FHA explores measures that focus on whether and how lenders are serving the whole market, this analysis should also apply to GSE lenders. All agencies should be aligned and looking at this issue through a fair housing lens, with HUD's Office of Fair Housing and Equal Opportunity involved.

**Audit and streamline FHA programs**.

Industry participants report that the FHA's 203(k) program is unworkable.[48] HUD should engage with lenders, consumer advocates, and HUD certified housing counselors to determine what changes are needed to make the program more accessible. Similarly, HUD should review other FHA program requirements to minimize burdens on market entrants, without jeopardizing important borrower safeguards.

**Encourage small-dollar mortgage lending as a means of meeting CRA obligations and as part of Special Purpose Credit Programs.**

Although FHA is not tasked with implementing the Community Reinvestment Act, it should collaborate with the OCC and other regulators to ensure that banks can obtain CRA credit for making small-dollar mortgage loans or supporting CDFIs that originate these loans. In addition, banks and lenders that are creating Special Purpose Credit Programs should be encouraged to address the problem of small-dollar mortgage access through these programs. Many of the first-time homebuyers of color who are intended to benefit from SPCPs would benefit from the affordability aspects of purchasing a home at the lower end of the cost spectrum. HUD and other agencies should encourage banks that are developing SPCPs to include features like salaried loan officers, subsidies for loan origination costs, funds for home repairs (through grants or a 203(k)-type program), and a specific emphasis on making mortgage loans below $100,000 or $125,000. Small-dollar mortgage loans for home repairs for existing homeowners of color, including subsidy, could also be part of a well-designed SPCP.

[48] Phone interviews with industry participants, Oct.-Nov. 2022, on file with authors.

**Promote and incentivize strong servicing of small-dollar mortgages**.

In the small-dollar mortgage market, consumers are more likely to be first-time homebuyers with lower savings and less access to family wealth. Therefore, as with SPCP loans targeting disadvantaged groups, effective mortgage servicing is key. FHA should continue to emphasize better controls for monitoring mortgage servicer loss mitigation practices in general. HUD's small-dollar mortgage loan pilot could include various forms of higher touch servicing, in addition to a matched savings or other insurance program to help with home repairs and unexpected hardships.

We thank you for this opportunity to comment.  Should you have any questions regarding these comments please reach out to Odette Williamson, owilliamson@nclc.org or Sarah Mancini, smancini@nclc.org, at the National Consumer Law Center.  We look forward to working with HUD to improve consumers' access to this critical source of financing for the purchase and repair of modest, affordable homes.