December 5, 2022

Julia R. Gordon
Assistant Secretary for Housing - Federal Housing Commissioner
Department of Housing and Urban Development
451 7th Street, SW
Washington, D.C. 20410

<u>Re: Request for Information Regarding Small Mortgage Lending;</u>
<u>Docket No. FR-6342-N-01</u>

Dear Commissioner Gordon:

The undersigned local, state, and national organizations write to submit comments in response to HUD's "Request for Information Regarding Small Mortgage Lending." We appreciate the opportunity to inform HUD's policy considerations regarding the availability and viability of residential small-dollar lending (SDL), which is essential to building wealth and family opportunity for communities of color and low- and moderate-income families throughout the nation. For too long, homes in lower-priced markets have been starved of quality, sustainable, mortgage credit, both subject to and contributing to a history of residential segregation, neighborhood disinvestment, and lost wealth-building opportunity.

Homeownership in the United States is the primary means of building wealth for families of color and low- and moderate-income individuals. However, the nation's long and unrectified history of residential segregation, discriminatory housing practices, and financial exclusion provided White families with subsidized homeownership programs while excluding people of color. And this history and the failure to make intentional policy shifts toward reversing it has only served to perpetuate racial homeownership and wealth gaps to this day. Because of this legacy, people of color have less family wealth to rely on that can increase economic mobility. Additionally, families have not recovered the trillions in lost home equity during the Great Recession which was overwhelmingly lost in communities of color.[1] Just in the years since the Great Recession, the Black-White homeownership gap has grown from 28.1 percentage points in 2010 to 30.1 percentage points in 2017.[2]

The inaccessibility of SDLs plays a significant role in restraining upward mobility for low- and moderate-income families seeking to buy their first home, many of whom are people of color and homeownership ready if not for the lack of financing for starter homes in their price range. The failure of the mortgage system to provide sufficient lending opportunities for SDLs results in the perpetual rent burden families are facing during our nation's ongoing fair and affordable housing

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[1] Ingrid Gould Ellen and Samuel Dastrup, "Housing and the Great Recession," The Russell Sage Foundation and the Stanford Center on Poverty and Inequality, October 2012, available at https://furmancenter.org/files/publications/HousingandtheGreatRecession.pdf.
[2] Jung Hyun Choi, "Breaking Down the Black-White Homeownership Gap," Urban Institute, February 21, 2020, available at https://www.urban.org/urban-wire/breaking-down-black-white-homeownership-gap.

crisis. This, in turn, creates higher demand for rental properties and further exacerbates the affordability crisis while also starving those same families of the wealth-building opportunities homeownership can provide. Our comments reflect our collective concern over the role that FHA has played in today's low SDL availability and how FHA can better meet its mission to provide mortgage lending to underserved households in a fair and equitable manner and help alleviate the nation's racial homeownership and wealth gaps.

<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?

Finding lenders to provide SDLs has long been a challenge for families seeking starter homes in urban, suburban, and rural communities. Potential homeowners struggle to find lenders willing to make SDLs and also face lower approval rates than applicants seeking larger balanced mortgages.[3] FHA plays a primary role in financing first-time homeownership, but for consumers of color, the lack of SDL financing has a disparate impact on them as it widens the racial wealth gap and reduces wealth-building opportunities. This is for several reasons, primary among them being that families of color are more likely than their White counterparts to be first-time homebuyers. In 2021, 47% of Latino, 49% of Black, and 56% of Asian/Pacific Islanders were first-time homebuyers, compared to 31% of White homebuyers.[4] Since the Great Recession, the availability of SDLs has receded as the Black-White homeownership gap grew from 28.1 percentage points in 2010 to 30.1 percentage points in 2017.[5] In 2019, just 8.9% of mortgages made for owner-occupied homes were made for less than $100,000, and among the 475,000 homes priced below $80,000 only 43% were financed with a mortgage.[6]

<u>Question 2:</u> What housing supply market conditions and purchasing characteristics affect the availability of and demand for small mortgages?

Redlining has a profound effect on the search for low-cost homes that require SDL financing. The proliferation of online real estate search platforms has both democratized access to real estate listings but also limited opportunities for families seeking lower-priced homes. In April 2022, the National Fair Housing Alliance and nine local fair housing enforcement organizations settled a federal lawsuit[7] against Redfin in which the organizations alleged that the company's

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[3] Lauri Goodman and Bing Bai, "Why do lenders deny small-dollar mortgages at higher rates?", July 31, 2018, available at https://www.urban.org/urban-wire/why-do-lenders-deny-small-dollar-mortgages-higher-rates.
[4] National Association of REALTORS™, "2022 Snapshot of Race and Home Buying in America," 2022, available at https://cdn.nar.realtor/sites/default/files/documents/2022-snapshot-of-race-and-home-buying-in-the-us-report-02-23-2022_0.pdf.
[5] Jung Hyun Choi, "Breaking Down the Black-White Homeownership Gap," Urban Institute, February 21, 2020, available at https://www.urban.org/urban-wire/breaking-down-black-white-homeownership-gap.
[6] Clare Trapasso, "Lots of Homes Under $100k Are for Sale, but Most Buyers Can't Get One for This Reason," National Association of REALTORS ™, December 30, 2020, available at https://www.realtor.com/news/trends/small-dollar-mortgages-help-communities-of-color/.
[7] *See* "National Fair Housing Alliance and Redfin Agree to Settlement Which Greatly Expands Access to Real Estate Services in Communities of Color," April 29, 2022, available at https://nationalfairhousing.org/national-fair-

minimum listing price policy had a substantial adverse impact on sellers and buyers based on race and national origin. Minimum home prices varied from area to area, from city to county, and changed throughout the year. The result of these practices was the perpetuation of redlining and residential segregation. Over the course of a two-year investigation, NFHA and fellow plaintiffs found that Redfin offered "No Service" for homes in non-White areas at a greater rate than for homes in White areas, and that Redfin also offered its "Best Available Service" at greater rates in extremely White zip codes. This policy, in practice, meant that Redfin employees would not list a house, show a buyer the house, or process offers or closings for the same house if the sale price was below the minimum home prices. Investigators also found that Redfin did not offer financial incentives to buyers and borrowers in extremely non-White zip codes compared to extremely White zip codes.

Furthermore, the cost to build or rehabilitate distressed homes in disinvested neighborhoods exceeds the likely sale price of such homes. In communities of color that were targeted for unsustainable[8] and subprime[9] lending in the run up to the Great Recession, neighborhoods continue to struggle with a significant inventory of homes that have fallen into disrepair and that require substantial rehabilitation to bring back to market. Unfortunately, and especially during the current supply chain challenges that have driven up the cost of building materials, the cost to rehabilitate such homes on top of the home's original value often exceeds the likely sale price of the home. This scenario is all too common and has created a market ripe for investor purchases of properties in disrepair that could otherwise be sold to low-and moderate-income families, families of color, and first-time homebuyers looking for a starter home if they could secure SDL financing.

The failure to provide enough SDL liquidity can have city-wide impacts. This is pronounced in real-estate markets in Midwestern cities like Detroit that are struggling to access small-dollar mortgages. In 2019, less than a quarter of home sales in Detroit were financed by mortgages, and the 1,700 mortgages that were made were disproportionately made to White borrowers in a city where the Black population is eight times the size of the White population.[10] This has largely been credited to the low property values in the majority of Detroit compared to rising property prices in the gentrified downtown area, which produce significantly less profit and employee compensation than larger balance mortgages.

While there is significant activity in the jumbo loan space, depository institutions continue to fail to serve lower- and moderate-income families and are instead opting to finance larger loans. From 2011 to 2021, the value for loans exceeding $150,000 rose by more than 240%. During the

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housing-alliance-and-redfin-agree-to-settlement-which-greatly-expands-access-to-real-estate-services-in-communities-of-color-%ef%bf%bc/.

[8] *See* "The Financial Crisis Inquiry Report," National Commission on the Causes of the Financial and Economic Crisis in the United States, February 25, 2011, available at https://www.govinfo.gov/content/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf.

[9] *See* "Justice Department Reaches Settlement with Wells Fargo Resulting in More Than $175 Million in Relief for Homeowners to Resolve Fair Lending Claims,' Department of Justice, July 12, 2012, available at https://www.justice.gov/opa/pr/justice-department-reaches-settlement-wells-fargo-resulting-more-175-million-relief.

[10] Ben Eisen, "Dearth of Credit Starves Detroit's Housing Market," Wall Street Journal, Oct. 29, 2020, available at https://www.wsj.com/articles/a-broken-mortgage-market-strands-detroits-black-residents-11603984218.

same period, the value of loans between $10,000 and $70,000 dropped by more than 53%, and the value of loans between $70,000 and $150,000 dropped by more than 21%.[11]

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

As discussed, following the Great Recession, the nation's depository institutions abandoned the small-dollar mortgage space. However, these same institutions have also failed to participate in the FHA program, despite having clear responsibilities to ensure that they are serving all communities equitably and affirmatively further fair housing, in exchange for their FDIC insurance benefits. FHA must make absolutely clear that lenders getting FDIC insurance for their deposits have the responsibility to ensure credit is flowing in the communities they serve. At the same time, FHA must do more to ensure that its small-dollar mortgage space is not dominated by non-depository institutions who are not subject to the same regulations that require consumer protections, and that carry additional costs for consumers.

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?

Lenders' prioritization of profit and employee compensation is the primary barrier to SDLs. At an elemental level, commission-based compensation models create a disincentive for loan officers to spend time making SDLs and fixed administrative costs associated with mortgages create an incentive to originate more profitable larger-balance loans.

Additionally, there is the perception that SDLs are inherently riskier and perform worse than higher value mortgages – an unfounded assumption. Instead, research shows[12] that small-dollar borrowers have comparable credit profiles to borrowers of midsized mortgages, and SDLs perform similarly to loans with higher balances. In short, borrowers of small-dollar mortgages pose relatively the same risk as higher-balance mortgage holders.

Additionally, FHA should work to eliminate the Life of Loan Premium requirement and reduce the annual Mortgage Insurance Premium (MIP) for borrowers with FHA-insured mortgages. Since the start of the pandemic, the cost of buying a home has grown significantly as home prices continue to rise and mortgage interest rates have more than doubled. By taking these simple steps, FHA can reduce debt-to-income ratios that are a leading cause of mortgage denials for people of color, and that reduce the mortgage amount available to low-to moderate-borrowers.

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[11] Nathaniel Lee, "The lack of small-dollar mortgages is preventing Americans from purchasing affordable homes," CNBC, May 27, 2022, available at https://www.cnbc.com/2022/05/25/how-the-lack-of-small-dollar-mortgages-hurts-homeownership-in-the-us.html.

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

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

Our nation's credit scoring system reinforces our history of government-sponsored segregation and financial exclusion.[13] People of color continue to be less likely to have viable options for affordable, sustainable credit, especially if they are low-or moderate-income consumers, and they are often reliant on non-traditional, high-interest credit from sources that only report negative payment information. To that end, we commend FHA for its recent announcement in Mortgagee Letter 2022-17 in which it states it will begin to permit positive rental payment history as an additional factor in the credit assessment performed in the Technology Open to Approved Lenders (TOTAL) Mortgage Scorecard when determining FHA insurance eligibility. FHA's action will help the agency to better serve first-time homebuyers, especially the credit invisible who are more likely to be people of color and low- and moderate-income households.

However, we recommend that HUD eliminate the scoring requirement. As it stands, the new policy requires that an applicant receive a Minimum Decision Score of 620 or greater, which disproportionately disadvantages people of color who are more likely to live in credit deserts, lack access to mainstream financial services, and who are more likely to rely on non-traditional lenders that mostly report negative payment history and not positive performance.[14] FHA should move away from credit scoring mechanisms that negatively consider a borrower's use of finance company credit regardless of payment performance.

We also recommend that FHA add an exception to the definition of "first-time homebuyer" to help qualify individuals who have heir interest in real property. Borrowers with interest in heir property have fractional ownership in a property and are generally unable to access home equity or sell or borrow against their interests in a home. The exception will ensure that Black consumers who have heir interest in real property are not unduly excluded from FHA's new rental payment consideration policy.

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?

We recommend FHA strongly promote the use of Special Purpose Credit Programs (SPCPs) that provide mortgage credit tailored to the specific needs of protected classes under the Fair Housing Act and insure loans that are made through new SPCPs. SPCPs allow lenders to offer mortgage

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[13] *See* Sarah Ludwig, "Credit Scores in America Perpetuate Racial Injustice. Here's How," The Guardian, October 13, 2015, available at https://www.theguardian.com/commentisfree/2015/oct/13/your-credit-score-is-racist-heres-why; Lisa Rice and Deidre Swesnik, Discriminatory Effects of Credit Scoring on Communities of Color, 46 Suffolk U. L. Rev. 935, 952-959 (2013), available at https://cpb-us-e1.wpmucdn.com/sites.suffolk.edu/dist/3/1172/files/2014/01/Rice-Swesnik_Lead.pdf.

[14] *See* National Fair Housing Alliance, "Access to Credit: Not Everyone Has Equal Access to Our Financial Markets," available at https://nationalfairhousing.org/issue/access-to-credit/.

credit to economically and socially disadvantaged borrowers. The National Fair Housing Alliance and the Mortgage Bankers Association developed a Special Purpose Credit Program Toolkit designed to help mortgage lenders create SPCPs. FHA should work to promote NFHA and MBA's SPCP toolkit, just as the Federal Reserve Bank of St. Louis did most recently.[15]

We also recommend that FHA develop a pilot initiative to purchase loans made to borrowers who are first-generation homebuyers. The lack of a downpayment remains the primary barrier to homeownership for people of color largely due to the enduring legacy of exclusion from government-sponsored programs that subsidized homeownership for White families who were then able to pass down home equity to successive generations. The lack of intergenerational wealth disadvantages people of color in the homebuying process, and the existence of standard first-time homebuyer downpayment assistance programs has failed to close the racial homeownership and wealth gaps. The National Fair Housing Alliance and the Center for Responsible Lending developed a policy proposal to target downpayment assistance to people who are first in their family to buy a home.[16] FHA should develop a pilot program to insure a portfolio of loans made using the NFHA/CRL First-Generation Downpayment Assistance Framework.

FHA should also actively consider ways to insure mortgages for shared-equity purchases. Borrowers who are purchasing homes in shared ownership structures often require smaller loan amounts. Communities across the nation are actively considering ways to grow shared equity and community land trust homeownership models, mostly deployed in Black and Latino neighborhoods with lower property values that experience the same small-dollar mortgage financing challenges.

FHA should also consider developing a unique manufactured housing program. Manufactured housing is a highly undervalued market segment that is highly affordable to lower- and moderate-income families. However, affordability in manufactured housing is stifled by the higher cost of financing. Most manufactured homebuyers must access chattel loans to purchase, which cost upwards of 4.4 percentage points more than standard mortgage loans, an expense that potential borrowers may decide is simply too costly.

<u>Question 7:</u> What policies, regulations, features, or processes outside of FHA/HUD impact the availability of small mortgages in the FHA program?

<u>Loan-Level Price Adjustments Make Small-Dollar Mortgages Unaffordable</u>

The Government Sponsored Enterprises (GSEs) are also failing to create liquidity in the market for products such as SDLs resulting in a disparate impact on borrowers of color and entire

[15] *See* Faith Weekly, "Small-Dollar Mortgages Can Increase Affordable Housing Options," Federal Reserve Bank of St. Louis, August 31, 2022, available at https://www.stlouisfed.org/open-vault/2022/aug/small-dollar-mortgages-and-affordable-housing.

[16] *See* "First Generation: Criteria for a Targeted Down Payment Assistance Program," National Fair Housing Alliance and Center for Responsible Lending, May 21, 2021, available at https://nationalfairhousing.org/wp-content/uploads/2021/06/crl-nfha-first-generation-jun21.pdf.

geographies where low-and moderate-income people who may be more likely to be people of color are more concentrated and likelier to apply for SDLs. Among the most consequential of the GSEs' practices is their continuation of the use of Loan Level Price Adjustments (LLPAs) which add increased costs over the life of the loan and are determined by considering a number of consumer attributes that disadvantage borrowers of color and loan features they are more likely to receive.[17] And because consumers of color often have less wealth to use for a downpayment, the use of LLPAs can have a disparate impact on them. LLPAs can also impact LTV and potentially totally price out borrowers from the market.

Community Reinvestment Act Oversight and Examinations Don't Consider FHA Small-Dollar Lending Activity

Additionally, the current Community Reinvestment Act (CRA) examination procedures at the federal regulatory agencies consistently fail to place consequences for banks and financial institutions that fail to lend to all market segments, despite the law clearly requiring meaningful lending to low- and moderate-income consumers. FHA should consider working with the CRA regulators to recommend incorporating an assessment of FHA SDLs into CRA examinations and ratings.

The Real Estate Appraisal System Exercise Widely Recognized Fair Lending Risk Factors

Across the federal government and in the real estate industry, the methodology used to appraise residential property is inherently discriminatory. The nation's current appraisal methodology takes a highly subjective comparison approach that provides appraisers with broad discretion to determine a home's value. The GSEs give appraisers the broad discretion to determine each aspect of the appraisal, including the selection of comparable homes and the ability to emphasize a connection between the home's value and the neighborhood where it is located. These discretionary and geography-based elements are widely considered fair lending risk factors[18] and produce appraisals that undervalue homes in communities of color, increasing the extent to which potential buyers need small-dollar loans and perpetuating the residential segregation and false equivalencies between race and risk.

FDIC-Insured Depositories Should be Subject to Small-Dollar Lending Benchmarks

Finally, we have stated throughout that the private market is not adequately serving borrowers likely seeking homes in the price range requiring SDLs. Depository institutions that have access to the FDIC's Deposit Insurance Fund must do more to finance SDLs, and the FDIC must begin to consider the disparate impact of failing to provide adequate financing for SDLs as part of the fair lending criteria upon which member institutions are scrutinized in the agency's Supervision

[17] *See* FHFA, Fact Sheet: Result of Fannie Mae and Freddie Mac Guarantee Fee Review (April 17, 2015), https://www.fhfa.gov/media/publicaffairs/pages/results-of-fannie-mae-and-freddie-mac-guarantee-fee-review.aspx.
[18] *See, e.g.,* FFIEC, *Interagency Fair Lending Examination Procedures,* 2009, available at https://www.ffiec.gov/PDF/fairlend.pdf.

Program. FHA must work with the FDIC to encourage consideration of SDL when assessing institutions and set performance benchmarks that encourage SDL financing.

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

State housing finance agencies can play a major role in providing liquidity, especially through the adoption of first-generation downpayment assistance to supplement standard first-time homebuyer downpayment assistance programs. As mentioned before, FHA should develop First-Generation Homeowner Insurance program and promote the development of SPCPs among state housing finance agencies.

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

As we have discussed, there is a disparate impact on people of color in the failure to provide liquidity or financing for SDLs. To the extent that lenders drive borrowers to FHA for these loans, they are benefiting from a federal program and are therefore responsible for affirmatively furthering fair housing. FHA should consider working with HUD's Office of Fair Housing and Equal Opportunity (FHEO) to assess the structure of the FHA program to ensure its program is consistent with the requirements of the Fair Housing Act and develop an assessment model and basic criteria for satisfactory SDL lending to qualify lenders for FHA insurance. Additionally, FHA should work regularly with FHEO to monitor SDL lending and consider Secretary-Initiated Complaints enforcement actions against lenders who consistently fail to make SDLs while continuing to accept FHA coverage against possible losses, including through the use of the disparate impact doctrine.

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

The GSEs are responsible for putting together three-year plans for how they will meet their Duty to Serve (DTS), a standard that requires the GSEs to facilitate a secondary market for mortgages for very low-, low-, and moderate-income families. While this requirement is a welcome component of GSE oversight, there is mostly an emphasis on service based on income and no connection between the DTS and the requirement to affirmatively further fair housing in compliance with the federal Fair Housing Act. Under the existing DTS rule, FHFA may provide additional credit for residential economic diversity activities[19] but the rule has the potential to better address the legacy of residential segregation and financial exclusion. FHFA should consider clarifying the Evaluation Guidance to state that additional credit will be awarded to the GSEs if their residential economic diversity activities work toward affirmatively further fair housing. This will also encourage market coverage for both low-income borrowers and borrowers of color, making the overall market more equitable.

[19] *See* 12 C.F.R. § 1282.36(c)(3).

Thank you for this opportunity to comment. Please reach out to Nikitra Bailey, Executive Vice President, and Jorge Andres Soto, Associate Vice President of Advocacy and Government Affairs, at the National Fair Housing Alliance, at NBailey@nationalfairhousing.org and JSoto@nationalfairhousing.org and 202-898-1661 should you have any questions concerning these comments.

Sincerely,

National Organizations

National Fair Housing Alliance
Americans for Financial Reform Education Fund
National Housing Resource Center
Consumer Action
Center for Community Progress
Grounded Solutions Network
National Consumer Law Center (on behalf of its low-income clients)
Unidos US

State and Local Organizations

Organization	**City**	**State**
Southwest Fair Housing Council	Tucson	AZ
Fair Housing Advocates of Northern California	San Rafael	CA
Fair Housing Center of the Greater Palm Beaches	Lantana	FL
Metro Fair Housing Services, Inc.	Atlanta	GA
Louisiana Fair Housing Action Center	New Orleans	LA
Fair Housing Center of Southwest Michigan	Kalamazoo	MI
Fair Housing Center of West Michigan	Grand Rapids	MI
Empire Justice Center	Rochester	NY
Fair Housing Justice Center	Long Island City	NY
Long Island Housing Services, Inc.	Bohemia	NY
Miami Valley Fair Housing Center, Inc.	Dayton	OH
Fair Housing Council of Greater San Antonio	San Antonio	TX
North Texas Fair Housing Center	Dallas	TX
City of Roanoke, VA	Roanoke	VA
Hampton Roads Community Action Program	Newport News	VA
Housing Opportunities Made Equal of Virginia	Richmond	VA
Piedmont Housing Alliance	Charlottesville	VA

Fair Housing Center of Washington	Tacoma	WA
Metropolitan Milwaukee Fair Housing Council	Milwaukee	WI