Homes Too Cheap for a Mortgage:

Learning from Baltimore and Eastern Kentucky about Small Mortgages and National Solutions

A CFA Working Paper

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September 2024

This Working Paper is based on a summer project at the Consumer Federation of America. It represents a work in progress and is the culmination of the internships of Aditya and Devan, with help of their supervisor Sharon. We would like to thank the Princeton Internships in Civil Service Program, the Harvard Joint Center for Housing Studies, and The Pew Charitable Trusts for their funding and support.

A special thank you to the fourteen experts from national and local organizations who generously took the time to speak to us about their experiences with small-dollar mortgage lending. We thank Come Dream Come Build (CDCB), CoreLogic, the Federal Housing Agency (FHA), Grounded Solutions, Healthy Neighborhoods, Inc., Hope Credit Union, the Housing Development Alliance, HUD Community Block Grant Assistance, Louisville Urban League, National Community Stabilization Trust, Neighborhood Housing Services, New America, and Self-Help Federal Credit Union.

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Executive Summary

Rising housing costs are locking American households out of homeownership. But lower- and moderate-income households struggle to acquire mortgages even for lower-valued homes. Small-dollar mortgages, which are mortgages below $150,000, can be difficult or impossible to secure. Usually found in rural areas or distressed urban markets, small-dollar mortgages have higher denial rates than larger loans and their applicants face serious obstacles. These challenges block paths to homeownership, even for our nation's affordable housing stock.

This working paper underscores the challenges in expanding access to small-dollar mortgages. Drawing on a literature review and 14 in-depth interviews with housing market stakeholders across the Eastern Kentucky, Baltimore, and national markets, it shows:

- Historic discrimination and predatory lending practices have and continue to harm Black and Brown Americans in their efforts to try and secure mortgages.
- The affordable housing stock in distressed, deeply affordable markets is often in disrepair or vacant. Significant rehabilitation needs add burdensome costs and financing difficulties for homebuyers.
- Given fixed closing costs and a commission-based compensation structure, lenders are incentivized to focus on originating higher-value mortgages. This structure contributes to high denial rates for small-dollar mortgages.
- First-time homebuyers often remain unaware of the availability of government and nonprofit programs to facilitate homebuying access through financial counseling, subsidized loans, or other means.

New policy proposals that will help scale small-dollar mortgage origination nationwide, include:

1. Increasing the **supply of affordable, high-quality housing units** by making FHA rehab loans more accessible, passing the Neighborhood Homes Investment Act, and supporting and scaling local government initiatives;
2. Increasing the **supply of small-dollar mortgage originations** by subsidizing small-dollar loans, encouraging the expansion of Special Purpose Credit Programs, and moving away from loan officer compensation structures based on dollar amount originated; and
3. Increasing the **ability of households to afford and access small-dollar mortgages** through increased education outreach on financial well-being, mortgage applications, and legal rights, while also using alternative credit scoring models.

Consumer Federation of America

Introduction

This working paper offers an in-depth look at the national need for small-dollar mortgages and examines possible policy solutions. Small-dollar mortgages, also called small mortgages or low-balance mortgages, are mortgage loans valued at or below $150,000.[i] They are primarily accessed by lower- and moderate-income households, especially in rural and urban areas where home values remain depressed.[ii] Small-dollar mortgages have significantly higher denial rates and lower origination rates than large mortgages.[iii] Small-dollar mortgages offer a promising pathway towards affordable homeownership, at a time when homeownership has become priced out of reach in most of the country.

Our research focuses on the challenges in expanding access to small-dollar mortgages. We conducted a literature review on small-dollar mortgages and generated insights from 14 in-depth interviews with local and national stakeholders to develop policy proposals to help consumers access small-dollar mortgages.

Why is Homeownership Important?

In the US, national homeownership rates have fluctuated over time, but have remained between 60 and 70 percent since the 1960s.[iv] Homeownership offers both social and economic benefits, plays a significant role in racial economic disparities, and is increasingly vital due to rising housing costs across much of the US.

Homeownership provides households with an avenue to build wealth as well as a hedge against risk. By paying a portion of their mortgage payment towards the principal balance every month, homeowners slowly build up home equity. In addition, home value appreciation increases a household's net worth, enhanced by financial leveraging from debt financing. In 2022, the median wealth gap between homeowners and renters was an astonishing $390,000.[v] A long-term mortgage with a stable interest rate also provides hedging against unpredictable rent increases and rent inflation. With steeply rising rental costs in the US over the last few years, this is an especially significant benefit.

While purchasing a home poses potential financial risks, a study using the Panel Study of Income Dynamics, which analyzed financial returns across several US housing markets from 1979 to 2000, found that owning a home is associated with tangible gains in wealth for each year a home is owned.[vi] This trend is consistent across income brackets, though financial gains are smaller and homeownership tends to be riskier for people of color and lower-income homeowners.[vii] Several reports highlight the potential social benefits of homeownership, including increased civic engagement, improved educational outcomes for children, and enhanced life satisfaction. These benefits are well-supported by evidence and seem to arise from a stronger commitment to one's community.[viii]

The benefits of owning a home are not enjoyed equally, as the racial homeownership gap remains large. While homeownership rates for white households hover around 75 percent, the rate for Black households is around 45 percent.[ix] The pandemic brought historically low interest rates, resulting in boosted homeownership rates among Black households. However, the gap between Black and white homeownership rates has now widened to 29 percentage points, and the gap between Hispanic and white homeownership rates has reached 25 percentage points—both the largest disparities in a decade.[x]

One factor behind this looming homeownership gap is the difficulty for households of color to successfully access mortgages, including for lower-value homes. Higher interest rates and housing costs have meant that the number of Black Americans who were "mortgage ready" decreased from 3.4 million to less than one million in the short timeframe between 2021 and 2023.[xi] Given the financial benefits of homeownership, it should be no surprise that the homeownership gap is a core driving factor behind the racial wealth gap. Research by the Hope Policy Institute found that in the Southeast US, the racial wealth gap would be 38 percent smaller if the homeownership gap was closed, and these figures are mirrored in other regions.[xii]

Most of the recent attention to rising housing costs and affordability challenges has been focused in higher-cost markets. However, these issues persist even in rural areas and historically distressed cities where homes are valued below $200,000 or less. In these places, some homes paradoxically become "too cheap" to finance, and homebuyers face unique challenges to attain and sustain homeownership.

What are Small-Dollar Mortgages?

Small-dollar mortgages refer to secured financing for residential properties under a certain value level.[xiii] The Pew Charitable Trusts defines small-dollar mortgages (also called small mortgages or low-balance mortgages) as mortgages for less than $150,000.[xiv] This is not a universal figure. Recent research by the Urban Institute used $100,000 as a threshold.[xv] In our interviews, a representative from Grounded Solutions had seen usage of a $120,000 threshold as well. Criteria for a small-dollar mortgage vary depending on location and broader shifts in costs of living due to inflation. One representative from Come Dream Come Build in Southern Texas reported anything less than $110,000 is considered a small mortgage, while "anything above about $150,000 is like, we got a huge loan." While these prices are ordinary in most rural and depressed markets, they are unheard of in high-cost markets - a reminder of how much local housing markets vary.

The volume of small mortgages has decreased across the US. Over the last decade, new mortgage loans between $7,000 and $150,000 have dropped by 26 percent, while originations for loans greater than $150,000 have risen by 65 percent.[xvi] In 2009, lenders extended roughly 171,000 mortgages with balances between $10,000 and $70,000, but by 2018 this number had fallen to 106,000.[xvii]

As a result, homebuyers within that segment often have turned to alternative financing means, such as contracts-for-deeds or cash. In 2019, only 23 percent of single-family homes under $100,000 were purchased with mortgages, while 74 percent of homes valued above $100,000 utilized mortgages.[xviii] An estimated 18 million borrowers have used alternative financing to purchase their homes.[xix] This includes seller's financing such as land contracts, where a buyer makes regular payments to the seller but does not transfer the deed until all payments are completed. These are associated with worse outcomes for households, often have much higher interest rates, few consumer protections, and greater risks of losing the home.[xx] A recent report from the National Consumer Law Center notes common issues with land installment contracts, including that many are structured to fail because sellers profit by having high churn on buyers, they shift the cost of critical repairs onto the resident, often exceed the fair market value in the purchase price, and disguise themselves as lease-purchase deals.[xxi]

Small-dollar mortgages are often less profitable for financial institutions than regular-sized loans. When a lender originates a loan, they incur fixed closing costs that do not vary significantly depending on the value of the housing unit.[xxii] Additionally, most mortgage originators are paid on commissions totaling a certain percentage of the mortgage. Consequently, even as it takes the same work – and often more work – to originate a small mortgage, originators are paid less compared to when they pursue higher-balance loans: this incentive is true both for home purchase and refinance mortgages. Commission-based pay creates an incentive for lenders to avoid small-dollar lending.

Current financial regulations have not addressed this need for small-dollar mortgage lending. The Community Reinvestment Act (CRA) designates assessment areas for financial institutions depending on where they receive deposits and puts forward an obligation to serve those areas through lending in turn. However, CRA does not place requirements on *dollar amounts* for individual loans, and so indirect "redlining" through the avoidance and denial of small-dollar mortgages persists.[xxiii] Furthermore, the post-financial crisis Dodd-Frank regulations worked to discourage predatory lending by requiring that fees and closing costs be included in the disclosure of a borrower's effective interest rate. However, the qualified mortgage rules flagged a greater share of small-dollar mortgages as "high-cost" as origination costs comprise a large percentage of the mortgage.[xxiv] Many lenders, therefore, experience incentives to avoid small-dollar mortgages, hurting lower- and moderate-income homebuyers.

Partly due to these financing challenges at the lowest end of the housing markets, investors are more likely to purchase low-valued housing units: often paying all-cash. An Urban Institute study using property records found that in 2020, 600,000 units, or 13.1 percent of all home sales, were valued under $100,000, and only half of these were noted as purchased by owner-occupants.[xxv] As will be discussed later, many of these low-valued homes have daunting rehabilitation needs, discouraging owner-occupant borrowers from purchasing and ensuring greater denial rates.

Case Study Overviews: Small-Dollar Mortgages in Rural and Urban Housing Markets

Baltimore: Mortgage Needs in a Distressed Urban Market

We looked at Baltimore to better understand the *urban* market conditions under which there is a broader need for small-dollar mortgage origination. We identified three market characteristics as key obstacles for households attempting to secure a small-dollar mortgage: (a) rampant vacancy and neighborhood decline necessitating major rehabilitation needs, (b) discriminatory lending practices toward Black residents, and (c) limited access to financial support. These factors have made acquiring and maintaining a small-dollar mortgage in Baltimore extremely difficult for lower- and moderate-income households. These characteristics are not unique to Baltimore but rather remain common throughout larger and smaller post-industrial cities that have sustained historical depopulation and decline.[xxvi] The next section on Eastern Kentucky will show these challenges bear semblance to rural housing issues.

1. *Neighborhood Decline and Vacancy*

Baltimore has a critical housing vacancy problem. In December 2023, it was estimated that around 14,000 housing units in the city were either vacant or abandoned.[xxvii] Vast swathes of local neighborhoods are rife with abandonment. While exacerbated by the 2008 Great Recession, this is primarily the result of long-term population decline. Between 1950 and 2010, Baltimore fell in population by 34.6% due to suburbanization and the loss of economic opportunity.[xxviii] Urban populations, primarily Black Americans, have felt the weight of these trends in the form of neighborhood decline, presenting in diminishing housing values and neighborhood disinvestment, shrinking municipal budgets and services, rising vacancy rates, and a myriad of other negative outcomes.

Abandonment and high vacancy rates present significant challenges both to first-time homebuyers and pre-existing community residents. The levels of neighborhood distress and prevalence of mortgages valued under $100K are much greater in Baltimore than in many cities of comparable sizes. For example, 3.0% of owner-occupied housing units in Baltimore are valued under $20K, compared to 1.4% in Atlanta and 2.2% in Memphis.[xxix]

Figure 1: **Housing Unit Values for Owner-Occupied Housing in Baltimore**[xxx]

Value ($K)	Cumulative Share of Housing (%)	Number
< 20	3.0	3,668
< 50	6.5	7,889
< 100	14.7	17,801
< 150	30.4	36,799
< 300	72.6	87,980

Source: 2022 American Community Survey (ACS) Data

Figure 2: **Housing Unit Values for Owner-Occupied Housing in Atlanta**[xxxi]

Value ($K)	Cumulative Share of Housing (%)
< 20	1.4
< 50	2.3
< 100	3.5
< 150	6.1
< 300	28.7

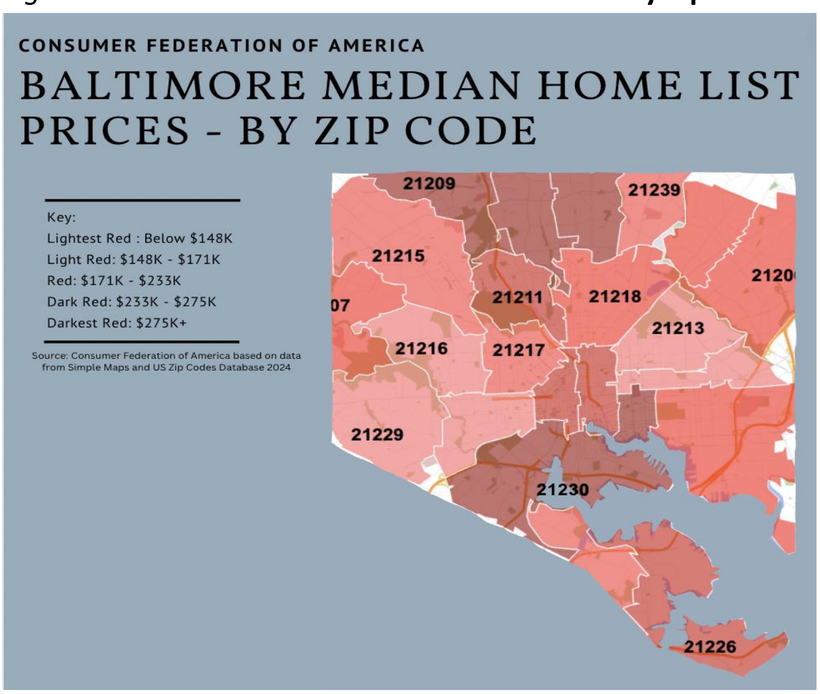
Source: 2022 American Community Survey (ACS) Data

Declining areas often inspire a reinforcing cycle of disinvestment, as their presence discourages investment and perpetuates issues in the area.[xxxii] This community deterioration impacts current residents and creates barriers to homeownership. While properties in such areas are often inexpensive, degradation and lack of maintenance can lead to significant rehabilitation needs before homebuyers can inhabit them.[xxxiii] The costs and time associated with the necessary renovations add difficulty to the process and depress home sales. Successfully obtaining a mortgage for a distressed property in a disinvested neighborhood adds further challenges. These factors combine to create a housing market that fails to support lower- and moderate-income Baltimore homebuyers in distressed neighborhoods. Addressing neighborhood rehabilitation needs in Baltimore and similar cities is crucial to improving access to homeownership.

Gentrification is often blamed for its impact on major housing markets, but neighborhood decline in underserved neighborhoods is both more common and more dispersed across regions.[xxxiv] In the one hundred largest American metro areas, 40% of poor tracts experienced a population drop in both the 1990s and 2000s, while only 20% saw an increase in both decades.[xxxv]

It is critical to reckon with the impact of neighborhood decline on housing policy, especially concerning small-dollar homes and mortgages, one of the most visible outgrowths of this trend. **Figure 3,** based on an analysis of median home list prices by zip code, shows that multiple zip codes in East and West Baltimore have a median home list price *under* $148,000. Juxtaposed against other neighborhoods, it is clear that these areas need significant support in rehabilitation and revitalization efforts.

Figure 3: **Median Home List Prices in Baltimore by Zip Code**



2. *Historical and Ongoing Discrimination against Black and Brown Residents*

Baltimore's majority-Black population has historically faced the brunt of joblessness, neighborhood disinvestment, and discrimination in housing practices. In 1972, half of all Black renters in Baltimore lived in structurally deficient housing, exacerbated by historical discrimination that directed investments to white neighborhoods.[xxxvi] Even more recently, from

2004 to 2016, majority-white neighborhoods within the city experienced *three times* the average investment level of majority-Black neighborhoods.[xxxvii] Distressed properties in Baltimore are most common in majority African-American neighborhoods. Fundamentally unequal racial dynamics within the city, and between Baltimore and its suburbs, are mirrored in lending practices.

Mortgage lenders have historically employed discriminatory measures targeting majority-Black neighborhoods with predatory loans, junk products, and more frequent denials on high-quality mortgage loans.[xxxviii] In July 2012, the City of Baltimore settled a fair lending case against Wells Fargo, which engaged in some of these practices. The city alleged that the mortgage lender "intentionally targeted the City's minority communities for predatory mortgage loans with discriminatory and unfair terms" in the leadup to the subprime mortgage crisis.[xxxix]

As recently as 2020, Black residents in Baltimore were denied mortgages at a rate 2.1 times that of white applicants. Furthermore, only five of the ten largest mortgage lenders (many of which are credit unions) were required to meet CRA guidelines.[xl] National Community Reinvestment Corporation (NCRC research found that African-Americans in Baltimore saw a ratio of loans to percentage of population of 37% as compared to white residents at 210%.[xli] As a representative from Neighborhood Housing Services noted in our interview, when her organization helped a Black woman improve her credit score from the 500s to 716 and still saw a rejection, it can be incredibly discouraging.[xlii] These trends align with the dual phenomena of persistent disinvestment in much of the city and the flow of mortgage money, business investments, and other wealth-generating capital into the more affluent suburbs.

3. Limited Housing and Financing Opportunities

The availability and accessibility of Baltimore's housing stock is also limited by the pressures of investor purchases and the challenge of reaching out to prospective homebuyers with important educational and financial resources.

In the wake of the Great Recession, investors have been buying homes in Baltimore, especially in lower-income, majority-Black neighborhoods with high vacancy rates. As of October 2022, investors owned more than *one-fourth* of city homes with vacant building notices, primarily through cash purchases.[xliii] Adverse effects on communities in declining neighborhoods are worsened by the limited availability of homes for owner-occupants due to investor purchases.

City Councilwoman Ramos noted higher likelihoods of eviction in rental properties owned by investors,[xliv] Many investors in Baltimore also sit on the properties as speculation and purchase them only with hopes of selling at a profit without investing in sustainable repairs.[xlv] These investment strategies drain wealth from communities rather than build wealth, and further promote housing abandonment while depressing home values.

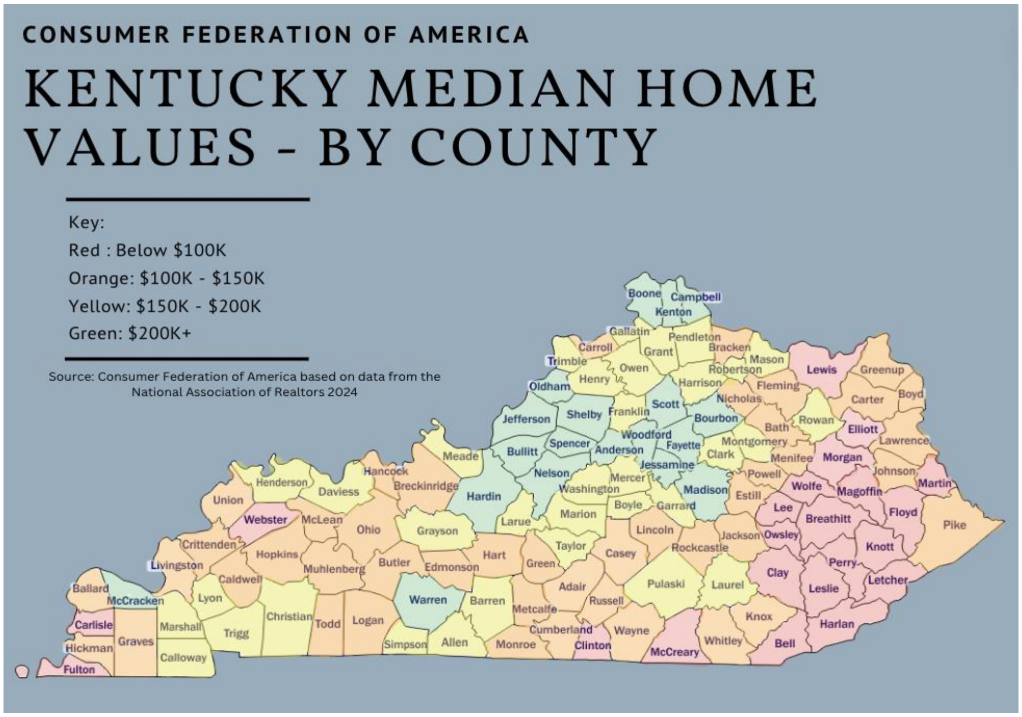
As prospective homeowners struggle to secure mortgages, they are often unaware of the governmental and philanthropic financial support and counseling available. For example, the Baltimore Office of Rehabilitation Services accepts applications from homeowners and landlords to finance repairs for more accessible homes, emergency repairs, and energy savings, but many such programs are available only to seniors or current homeowners.[xlvi] Many first-time homebuyers are similarly ineligible for impactful programs, inhibiting their ability to acquire a mortgage. Interview stakeholders noted that a large share of the populations they served were unaware of both government loan programs as well as programs headed by local nonprofits and community development organizations. Even when individuals try to seek out assistance programs, a Louisville Urban League representative said in an interview, "they can Google all day long and get 10 different responses".[xlvii]

Eastern Kentucky: Case Study of a Distressed Rural Market

As a predominantly rural, low-density region, Eastern Kentucky provided a stark contrast to Baltimore's housing market. Despite this, we noted similar factors in the difficulties lower- and moderate-income households faced in the journey to homeownership. Key obstacles to scaling sustainable and affordable small mortgage originations include an aging housing stock, difficulties with sourcing and executing new construction, and risk of natural disasters.

Figure 4 below offers an overview of median home values across the state of Kentucky. Much of the State, particularly in the rural East, has a median home value below $100,000. The higher home values are found around the state's larger cities, notably Louisville and Lexington as well as the suburbs of Cincinnati in the north.

Figure 4: **Median Home List Prices in Kentucky by County**



Extremely Limited and Aging Housing Stock

Data from the University of Kentucky shows that 13.2 percent of homes in the state have at least one of four housing problems - overcrowding, high housing costs, lack of kitchen facilities, and lack of plumbing facilities.[xlviii] Much of the housing in the state, particularly in its more rural regions, is plainly inadequate, aging, and low in quantity. According to the Housing Development Alliance, an organization that helps rural Kentuckians access affordable housing, "there's a little under two million housing units in Kentucky. Sixty-seven percent are actually like stick-built structures. They're detached single-family homes."[xlix] Indeed, most homes in Eastern Kentucky were built before the 1970s,[l] and a shortage of between 78,000 and 100,000 affordable housing units existed as recently as 2019.[li] Manufactured housing is on the rise in Kentucky, though, as 29.3 percent of new homes constructed since 2022 have been manufactured.[lii]

Severe rehabilitation needs hinder efforts to secure affordable mortgages, as repairs can often add a significant share to the initial home price in costs. Given major housing shortages, any homes without such costly rehab requirements are quickly purchased. A representative from the Housing Development Alliance pointed out that the aging housing stock often suffers from inadequate weatherization, lead paint, and various other issues. These problems add significant costs to the properties beyond just the mortgage price.

While investors purchasing housing units with cash are less prevalent in Eastern Kentucky compared to Baltimore, we still found indications of notable investor activity, particularly around popular and tourist sites such as Red River Gorge.

Issues in Sourcing and Executing New Construction

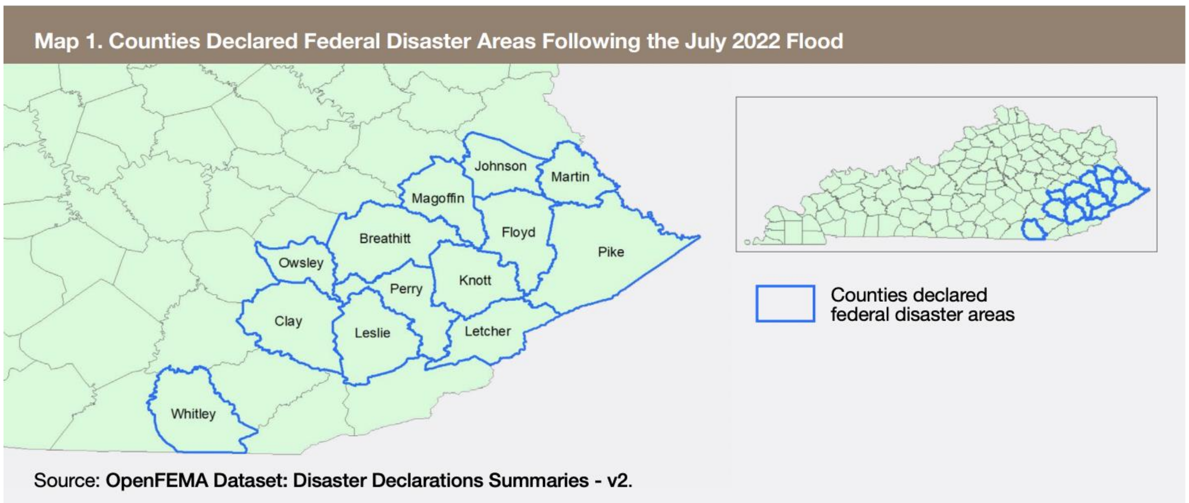
Rural areas such as Eastern Kentucky face distinct challenges compared to urban centers like Baltimore in maintaining an adequate housing stock. A primary issue is the difficulty of scaling and affording new construction. Large-scale housing developments are historically rare in rural regions, resulting in fewer construction companies and workers operating locally. This scarcity drives up construction costs and reduces private investment, a trend that has been exacerbated by builders leaving the region following the 2008 Great Recession.[liii] Financing can also impede projects in the region. High interest rates discourage developers from larger investments, and major banks have exhibited reluctance in the past to extend credit for the number of projects that would be required.[liv] Additionally, the lack of *buildable land* available for housing contraction is scarce, as indicated by our interview with the Housing Development Alliance. Much of this region has restrictive zoning laws that prevent the construction of denser multifamily units and the majority of flat, buildable land is owned by coal companies – even after coal mining ceased in most places.

Risks from Natural Disasters

In July 2022, massive flooding in Eastern Kentucky damaged or destroyed over nine thousand housing units, displacing thousands of households at a time when the impacted counties did not have a sufficiently sized housing stock to rehouse them.[lv] This led to a major local housing crisis, as many residents did not have flood insurance due to the prohibitive cost and as most impacted residents lived outside FEMA-designated flood zones.[lvi] Initial findings reported that only 5 percent of damaged homes had flood insurance and that the cost of flood insurance accounted for nearly 7 percent of median household income in impacted counties.[lvii] The bulk of damaged homes belonged to lower- and moderate-income households.

As of January 2023, "more than 800 eastern Kentucky residents remain temporarily housed in state parks and travel trailers after last summer's flooding."[lviii] Households without flood insurance could be awarded up to $37,900 from FEMA to rebuild, depending on the type of structure and the nature of the damage. However, due to the severity of the damage done to many homes and the cost of construction, this sum is insufficient for many households.

Figure 5: **Map of Impacted Kentucky Counties by the July 2022 Flood**



The July 2022 Eastern Kentucky flood is not an isolated incident. Climate change has increased the likelihood of extreme weather events and has caused greater flooding risks in Kentucky.[lix] Communities of color and lower-income communities are disproportionately at risk, are more likely to have an older housing stock least equipped to cope with extreme weather events, and are likely to have a greater share of uninsured homeowners.[lx] Once-in-a-hundred-year flooding maps are being redrawn, as extreme storms become more common. Climate vulnerabilities shape new housing needs in rural regions such as Eastern Kentucky, requiring both new construction and the retrofitting of housing units.

The challenges posed by an aging housing stock, the difficulties of scaling up affordable housing construction in rural areas, and emerging climate risks are interconnected and impact each other. In rural areas such as Eastern Kentucky, they have exacerbated local housing supply issues and made it more difficult for a new generation of potential homebuyers to find and afford a resilient and affordable home. Even though home values remain very low in Eastern Kentucky, with median home values below $100,000 in most counties, the state of the housing stock and financing difficulties still create barriers to homeownership.

Proposed Policies and Programs

Based on the literature review and in-depth interviews, we developed several policy proposals to support scaling the origination, sale, and successful maintenance of small-dollar mortgages across the country.

We identified three key targets of intervention:

1. ***Increasing housing supply***: supporting the supply of affordable and qualifying housing units.
2. ***Increasing financing supply***: expanding the supply of small-dollar mortgages that can help finance lower-valued home purchases.
3. ***Increasing demand:*** buttressing the ability of lower- and moderate-income households to buy their first home with the help of small-dollar mortgages.

1. Increasing the Supply of Affordable Housing Units

Encourage the Passing of the Neighborhood Homes Investment Act

The Neighborhood Homes Investment Act calls for a new federal tax credit to help generate new investments for developing and renovating one-to-four family housing in distressed neighborhoods.[lxi] The tax credit is intended to spur investments in rehabilitation needs in housing units by narrowing the gap between the cost of rehabilitation and the unit's post-construction value in depressed markets. This is particularly relevant for small-dollar mortgages, which trend towards extremely low-value housing. This tax credit would act as a potential solution for fixing up vacant homes in neighborhoods. The Neighborhood Homes Investment Act resembles the Low Income Housing Tax Credit (LIHTC) system for the construction of affordable multi-family housing. Like LIHTC, it has already received bipartisan support from over a hundred representatives in the House as well as from two dozen senators, indicating a strong possibility of passage. In one of our interviews, an analyst from the National Community Stabilization Trust noted that they are “gearing up for final passage in 2025.”[lxii]

With sufficient investment, this tax credit could provide a valuable influx of funds to develop or rehabilitate low-valued homes across the nation. That being said, its similarity to LIHTC may mean that it will cater primarily to the very top of the income and value restrictions and be less impactful for the most marginalized. Studies show LIHTC properties are more often focused on the top income groups within the allotted requirements and cost more than comparable developments. A Minneapolis study found that an average LIHTC unit cost $250,000 compared to $200,000 for an unsubsidized unit.[lxiii] Thus, tax incentives from the Neighborhood Home Investment Act must be supplemented with other measures to guarantee impact across the board. Provisions could be implemented to reserve a significant portion of rehabilitated homes for homeowners and sub-groups such as first-time owners, ensuring homebuyers are benefitting, not just investors or commercial landlords.

Expand Provision and Allowances for Federally-Insured (FHA) Rehab Loans

Federally insured rehab mortgages, through the Federal Housing Administration 203(k) rehab program, provide major opportunities to aid households in financing both the purchase and rehabilitation of a home. In both Eastern Kentucky and Baltimore, disrepair needs were a major issue for the lower-valued housing stock. Small-dollar mortgage origination, consequently, can greatly benefit from making more rehab-and-purchase loans available.

The FHA-insured 203(k) loan is the most common rehab loan and has supported home rehabilitation since 1978. Recent changes have addressed concerns about its previous $35,000 limit by increasing the maximum loan amount to $75,000 for repair needs.[lxiv] Despite this important update, the program is not at a sufficient scale to support the number of homes in need of rehabilitation, which totals in the hundreds of thousands. 203(k) loan endorsements are also decreasing, falling to 4,032 in 2023 as compared to 5,695 in 2021.[lxv] Compared to FHA's overall market volume, with 839,141 FHA purchase loans in 2021, this means that less than 1 percent of FHA loans are 203(k). [lxvi] Clearly, much more can be done to scale its usage nationwide.

FHA loan programs are falling short of their potential impact due to several factors. Despite comprising a substantial portion of mortgages for low-balance home purchases, these programs, particularly the 203(k) loans, have a significantly higher denial rate. Moreover, many households either lack awareness of FHA's 203(k) options or are reluctant to utilize them. As the National Community Stabilization Trust (NCST) and The Homeownership Alliance recommended in a comment letter, the FHA should work to make its programming more accessible across the industry, particularly to mission-driven organizations dedicated to property rehabilitation.[lxvii] The letter's core recommendation is to engage with an alliance of CDFIs and non-profits to create educational materials on using FHA funding. It suggests broadening the scope of loan programs to support housing models beyond traditional single- and multi-family units. Additional recommendations include targeting distressed neighborhoods with substantial lower- and moderate-income populations and partnering with local community development organizations to increase rehabilitation funding. Another strategy involves leveraging the modernized Community Reinvestment Act by providing additional funds to enhance loan appeal and support lower- and moderate-income borrowers.[lxviii]

Fannie Mae and Freddie Mac both offer loan products - HomeStyle and CHOICERenovation - to support lenders and buyers, but these are utilized less often than the FHA loans and have a lower impact. In alignment with the Housing Supply Action Plan, Fannie Mae and Freddie Mac extended their first-look period, wherein owner-occupants and non-profits receive an opportunity to purchase properties in typically lower-income neighborhoods of color, from 20 to 30 days.[lxix] Similar process changes as with the 203(k) system could positively impact lenders' take-up levels.

Spread Success Stories and Expand Funding on Prior Municipal Programming

Municipal governments across the US support small-dollar loans, increased construction, and rehabilitation of affordable low-balance housing through unique programs and incentives. According to a representative from Healthy Neighborhoods in Baltimore, their organization has been able to take advantage of multiple incentives across different city programs, known as "stacking," to accelerate their operations and expand impact.[lxx]

The Baltimore City Department of Housing and Community Development operates multiple programs through its Housing Rehabilitation and Repairs team to support low- and moderate-income residents in financing home improvements. In its FY2025 budget plan, the city apportioned \$6.9 million to housing rehabilitation services, \$6.7 million of which is sourced from federal funding.[lxxi] This funding is spread thin as it addresses lead hazard reduction, weatherization, emergency assistance, and other services - not just rehabilitation and repairs. The Office of Rehabilitation Services accepts applications from homeowners and landlords to finance repairs for more accessible homes, emergency repairs, energy savings, and preservation, but many of these programs are available only to seniors or current homeowners.[lxxii] As a result, first-time homebuyers and younger applicants are often excluded from program support.

In December 2023, Baltimore Mayor Brandon Scott announced a multi-billion-dollar investment collaboration to solve the city's vacant building crisis over the next 15 years.[lxxiii] In agreement with Baltimoreans United in Leadership Development (BUILD) and Greater Baltimore Committee

(GBC), the city plans to redevelop up to 45,000 vacant properties. The city committed $300 million in investment dollars to this task and plans to raise three billion dollars over the course of the project. As home renovation costs continue to rise each year, substantial investments like these could significantly impact deteriorating neighborhoods.[lxxiv] Other local programs such as the Vacants to Value project seek to entice middle-income households to purchase rehabilitated vacant properties via down payment support.[lxxv]

In Eastern Kentucky, $223 million from the Kentucky Housing Corporation (KHC) and Kentucky's disaster recovery program will finance the construction of 953 rental housing units in Christian, Graves, Hopkins, and Warren County.[lxxvi] The project is expected to be the largest housing development investment executed by both agencies.[lxxvii] Contract provisions will keep rent affordable and most units will have 2-3 bedrooms with some 4-bedroom and single-bedroom ones. Construction is expected to begin "no later than spring of 2025."[lxxviii]

Other cities and counties can take inspiration from previous success stories and public-private partnerships that inject funding and resources into such efforts. Notable policies to investigate further include possible restrictions on the purchase of small-dollar homes to owner-occupants and updates to zoning codes to allow for more manufactured housing.

2. **Increasing the Supply of Small-Dollar Mortgage Originations**

Encourage Originations through Increased Subsidies and Funding

One key reason for the lack of small-dollar loans is that they offer lower profit potential for lenders. To support greater parity across mortgage sizes, subsidizing the lending process to reduce fixed and third-party costs to lenders could do much to encourage more originations. The Dodd-Frank Qualified Mortgage (QM) Rule protects against predatory lending by capping the fees lenders can charge on a sliding scale, from 8% of the total loan amount for values up to $13,378, to 3% for values at or above $110,260.[lxxix] However, due to the lower profits lenders can make on such loans, these regulations disincentivize small-dollar mortgages.

To address this issue while maintaining consumer protections, new programs could offer subsidies to incentivize small-dollar mortgages by equalizing profits for lenders. One strategy is to encourage the creation or expansion of Special Purpose Credit Programs to target underserved communities of color with small-dollar mortgage needs.[lxxx] These, alongside CDFIs and other mission-based mortgage lenders, could engage with impacted communities and support first-time homebuyers purchasing low-cost homes.

Encourage Updates to Loan Officer Compensation Structures

Professionals across the housing ecosystem overwhelmingly earn money through a commission-based system, where they are paid a percentage of the value of the originated mortgage or home sale. As a result, an incentive is created for real estate agents and mortgage lenders to heavily prioritize sales of homes valued higher than small-dollar units. A shift away from the commission compensation model may prove effective in incentivizing more small-dollar originations.

Representatives from Hope Federal Credit Union and Self-Help Credit Union, which are both CDFIs, noted that, given their own salary-based models for staff, they faced few issues from staff preferences in issuing small-dollar mortgages. Thus, policies that encourage salary-based compensation structures are likely to support scaling small-dollar originations. These can be accompanied by internal incentives for originating small-dollar mortgages such as financial awards for mission-focused (for CDFIs), membership-focused (for credit unions) or CRA-credit origination (for banks). Where lenders want to maintain a commission-based structure to remain competitive in retaining their best loan officers, a hybrid payment model (part salary and part commission), or flat fee commissions based on loan volume rather than loan size should be implemented.

3. Increasing the Ability of Households to Afford and Access Small-Dollar Mortgages

Financial Literacy, Education, and Counseling Resources

In our research, many interviewees highlighted the limited financial education available to lower- and moderate-income households regarding financial planning, mortgage applications, and legal rights. This knowledge gap has led to poor credit, higher denial rates, and even property loss due to inadequate estate planning and heir designations. To address this, governments and local organizations should work together to share information on homeownership best practices and small-dollar mortgages. This could involve developing counseling programs to support financial and estate planning for these communities.

CDFI representatives emphasized that the most effective way to support mortgage acquisition and long-term retention is through one-on-one relationships. Regular in-person meetings are crucial for building financial stability, guiding households through the application process, and assisting with payments. Our research found that local organizations operating within the target neighborhoods are best at reaching potential homebuyers and understanding the unique subsidy programs available.[lxxxi]

Empower Homebuyers by Promoting Alternatives to Credit Evaluations

Another option to support homebuyers is to explore and promote alternatives to credit scores. For example, in 2022, Fannie Mae and Freddie Mac piloted a program to directly share rental payment histories from potential homebuyers to credit bureaus on a real-time basis.[lxxxii] Additionally, examinations of utility and rent payments provide an alternative means of judging mortgage readiness for households that may not have strong credit but do have the ability to regularly make payments.

Conclusion

Small-dollar mortgages are an effective way to help first-time homebuyers and lower- and moderate-income households build wealth through homeownership, particularly in low-cost housing markets such as rural areas and distressed urban neighborhoods. However, scaling the origination and maintenance of these mortgages is hindered by high denial rates, poor quality of available housing, competition from investors, and limited profit opportunities in a largely commission-based industry. As a result, even in affordable housing markets, households in distressed urban areas and rural locations still face significant challenges in securing mortgage financing.

Government programs at both the federal and municipal levels, along with local community development organizations, have supported these populations through subsidized loans, construction and rehabilitation, and financial counseling. Despite these efforts, there remains a significant gap between large and small mortgage origination rates. To scale small-dollar mortgages, the US needs both supply and demand-side solutions. National and local actors must collaborate to increase the supply of available and affordable housing, encourage the supply of small-dollar originations, and improve the ability of lower- and moderate-income households to afford and maintain such housing. Doing so will help alleviate the persistent racial wealth gap dividing white and non-white households and offer more stability and financial growth opportunities to lower- and moderate-income families. These efforts will also ensure that distressed neighborhoods have an avenue to build local wealth, promote upward mobility, and support greater opportunities.

Future research may identify new obstacles across other types of housing markets and best practices to avoid them when expanding small-dollar mortgages. Key areas to explore include analyzing additional types of small-dollar housing markets, such as tribal communities, lower-income, majority Hispanic border communities, and small rural cities. Moreover, this Working Paper demonstrates the value of engaging with an even broader range of stakeholders across the housing ecosystem. This approach could enhance the analysis presented in this paper, providing a more comprehensive view of the national landscape and potentially revealing overlooked solutions.

Methodology

This work relied on qualitative research, including an extensive literature review, two local case studies, and in-depth interviews with national and local experts. The methodology used to gather information included: (1) the compilation of a library of academic sources, quantitative data, existing policies, and news reports on the topic of small-dollar mortgages. Sources included analyses of existing proposals, notably the HUD 2022 comment letters on small-dollar mortgages, HMDA data, and news articles focused on the housing markets of the two case studies; (2) we conducted 14 in-depth interviews, including with national housing experts, lenders, and local housing professionals in Eastern Kentucky and Baltimore.

Eastern Kentucky was selected due to a desire to study a rural market with a high quantity of housing stock falling under small-dollar mortgage qualifications. Baltimore was chosen as a key example of a distressed lower-cost urban market with significant stocks of vacant houses. Interview questions focused on participants' experiences with small-dollar mortgages, how they are originated, the financial structures of such loans, and common challenges faced by prospective homebuyers. **Figure 1** below offers an overview of all organizations interviewed. Based on this dataset, we developed a set of policy proposals to support the origination of small-dollar mortgages.

Figure 1: **Interviewed National and Local Organizations**

Hope Credit Union
Federal Credit Union

HUD Grant Block Assistance
Federal Funding Organization

Core Logic
Research Organization

New America
Research Organization

Grounded Solutions
National Policy Network

FHA
National Policy

National Community Stabilization Trust
National Policy and Housing Support

CDCB South Texas
HUD-Certified Housing Agency

Self Help Credit Union
NC, SC, FL, Chicago, CA & WA Credit Union

Healthy Neighborhoods, Inc.
Baltimore Lender

Neighborhood Housing Services
Baltimore Financial Services

Louisville Urban League
Kentucky Community Development Organization

Housing Development Alliance (x2)
Kentucky House-building Organization

Source: CFA 2024

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