The Push and Pull of Alternative Pathways to Affordable Homeownership

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The Push and Pull of Alternative Pathways to Affordable Homeownership
Key Takeaways

1. There are not enough small mortgages despite low-cost homes available across the U.S. and qualified buyers to purchase them.

2. Millions have used alternative financing at some point to pursue their homeownership goals.

3. These arrangements are often riskier and costlier than mortgages, and protections vary widely.

4. Policies often overlook people who use alternative financing, though some recent initiatives have explicitly included these homeowners.
What Is Alternative Home Financing?

- Land contracts / contracts for deed
- Lease-purchase / rent-to-own arrangements
- Seller-financed mortgages
- Personal property / home only / chattel loans (manufactured homes)
Alternative Financing Market Size

36 million Americans have used alternative financing

- Approximately 1 in 5 home borrowers—those who have ever borrowed to finance a home—have used alternative financing at least once
- Roughly 1 in 15 current home borrowers are in alternative financing today
Personal Property Loans Are the Most Common Alternative Arrangement

Percentage of home borrowers who have ever used each type of financing

- Personal property loan: 11%
- Lease-purchase agreement: 6%
- Seller-financed mortgage: 6%
- Land contract: 5%
- Any alternative arrangement: 21%
Almost a Quarter of People Who Have Used Alternative Arrangements Have Used More Than 1 Kind

Percentage of alternative financing borrowers by number of types used

- 22% Have used 2 or more types of alternatives
- 78% Have used 1 type of alternative
Hispanic Borrowers Are Most Likely to Have Ever Used Alternative Financing

Percentage of borrowers who have used alternative arrangements by race and ethnicity

- Hispanic: 34%
- Black, non-Hispanic: 23%
- White, non-Hispanic: 19%
- Other: 14%
- All borrowers: 21%

THE PEW CHARITABLE TRUSTS
Nearly a Quarter of Borrowers Earning Less Than $50,000 Annually Are Using Alternative Financing

Percentage of current borrowers using alternative financing by annual household income

- Under $50,000: 23%
- $50,000 or more: 3%
- All current borrowers: 7%
Alternative Financing Laws

➢ Federal
  ▪ **Personal property loans:** Truth in Lending Act (TILA), Home Ownership and Equity Protection Act (HOEPA), Uniform Commercial Code (UCC) on secured transactions, Home Mortgage Disclosure Act (HMDA), etc.
  ▪ **Seller-financed mortgages:** Dodd-Frank requirements for some sellers who finance multiple homes per year

➢ State
  ▪ A weak and highly varied patchwork of statutes and case law; sometimes tenant protections apply
Risks of Land Contracts, Lease-Purchase

➢ Risks to buyers: Lack of equity; unable to borrow against home; unclear ownership; eviction/foreclosure; habitability issues and unclear responsibilities; unforeseen fees and costs; often excluded from policies protecting other homeowners

➢ Risks to sellers: Borrower nonpayment; possible home value decline if home goes under judicial sale; unable to sell property if buyer exits transaction early

➢ Risks to state & local governments: Unclear tax and maintenance responsibilities; possible home value decline from lack of upkeep; lack of records a barrier to resource distribution during disasters, e.g., pandemic
Evidence from Qualitative Research

➢ Interviews with 50+ legal aid attorneys across 26 states
➢ Focus groups, interviews, Q&As with homeowners
➢ Analysis of 210+ online complaints about lease-purchase agreements

➢ Overarching theme
  - Responsibilities of homeownership without all the same rights and protections as mortgage borrowers
Federal Policy Opportunities

Federal and state policy often excludes many types of alternative financing, but there are some recent changes, opportunities.

- Equity plans across the Administration (HUD, Fannie Mae, Freddie Mac, etc.)
- Treasury’s *Homeowner Assistance Fund Guidance*
State Legislation

➢ Manufactured housing
  ▪ Since January 2021: 70 manufactured housing bills introduced, 13 passed

➢ Alternative financing
  ▪ Since January 2021: 12 alternative financing bills introduced, 1 passed
Key Takeaways

1. There are not enough small mortgages despite low-cost site-built and manufactured homes available across the U.S. and qualified buyers to purchase them, in part, because lenders have difficulty issuing these loans profitably.

2. 36 million Americans have used alternative financing at some point to pursue their homeownership goals. But some are more likely to do so than others, for example, Hispanic homebuyers.

3. These arrangements are often riskier and costlier than mortgages and have a relatively weak patchwork of federal and state laws that vary widely.

4. Policies often overlook people who use alternative financing, but some recent initiatives have explicitly included these homeowners and offer opportunities to further understand challenges and opportunities for improvement.
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The Role of Manufactured Housing in Increasing the Housing Supply: Opportunity and Challenges

Karan Kaul
Housing Finance Policy Center
Annual MH Shipments: 1975 to 2021

Thousands of units

Source: US Census Bureau
MH is more affordable than site-built homes

**Key Characteristics, 2021**

<table>
<thead>
<tr>
<th></th>
<th>New Manufactured homes</th>
<th>New Site-built homes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average sales price, excluding land</td>
<td>$108,100</td>
<td>$365,900</td>
</tr>
<tr>
<td>Average price per square foot</td>
<td>$72</td>
<td>$144</td>
</tr>
<tr>
<td>Median homebuyer income</td>
<td>$57,000</td>
<td>$93,000</td>
</tr>
<tr>
<td>Number of units completed</td>
<td>105,800</td>
<td>970,000</td>
</tr>
</tbody>
</table>

**New-Home Sales Price Distribution, Excluding Land**

<table>
<thead>
<tr>
<th></th>
<th>Below $124,999</th>
<th>$125,000-249,999</th>
<th>$250,000+</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufactured Housing</td>
<td>67.3%</td>
<td>32.1%</td>
<td>0.6%</td>
</tr>
<tr>
<td>Site-Built Housing</td>
<td>0.0%</td>
<td>25.3%</td>
<td>74.7%</td>
</tr>
</tbody>
</table>

**Source:** US Census Bureau Manufactured Housing Survey & Survey of Construction; HMDA 2021
Quality of MH Has Improved Substantially Over Time

<table>
<thead>
<tr>
<th>Period Home Built</th>
<th>AHS Survey Year</th>
<th>Share of MH homes found inadequate</th>
<th>Share of Site-built homes inadequate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970-79</td>
<td>1989</td>
<td>9.3%</td>
<td>6.6%</td>
</tr>
<tr>
<td>1980-89</td>
<td>1999</td>
<td>4.2%</td>
<td>3.7%</td>
</tr>
<tr>
<td>1990-99</td>
<td>2009</td>
<td>2.4%</td>
<td>2.5%</td>
</tr>
<tr>
<td>2000-04</td>
<td>2013</td>
<td>2.2%</td>
<td>1.5%</td>
</tr>
</tbody>
</table>

Younger homebuyers appear more receptive to MH

Share of Homebuyers Under Age 45, MH vs. Site-Built

Manufactured home financing hurdles

Manufactured homes are financed one of two ways:

- Manufactured home mortgages, secured by home and structure
- Personal property (chattel) loans, secured by home only

Chattel loans finance lower-priced homes, but financing is expensive and scarce

<table>
<thead>
<tr>
<th>2021 Purchase Loans</th>
<th>Chattel loans</th>
<th>Manufactured home mortgages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase originations</td>
<td>$4.9 billion</td>
<td>$15.2 billion</td>
</tr>
<tr>
<td>Median term</td>
<td>20 years</td>
<td>30 years</td>
</tr>
<tr>
<td>Median mortgage interest rate</td>
<td>7.8%</td>
<td>3.5%</td>
</tr>
<tr>
<td>Median Loan Amount</td>
<td>$75,000</td>
<td>$155,000</td>
</tr>
</tbody>
</table>

Source: 2021 Home Mortgage Disclosure Act data.
Why is chattel financing expensive?

- Non-federally backed product; GSEs currently don’t finance chattel and FHA volumes are small

*Purchase lending volume, 2021*

Source: 2021 Home Mortgage Disclosure Act data.
Why is chattel financing expensive?

- Highly concentrated industry
- Less competition between lenders
- Small loan size
- Lending on depreciating structure

**Top 10 Lender Share (2021 volume)**

<table>
<thead>
<tr>
<th>Lender</th>
<th>Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chattel</td>
<td>84.6%</td>
</tr>
<tr>
<td>MH Mortgage</td>
<td>29.3%</td>
</tr>
<tr>
<td>SB Mortgage</td>
<td>31.5%</td>
</tr>
</tbody>
</table>

*Source: 2021 Home Mortgage Disclosure Act data.*
Chattel loans enable greater minority homeownership than MH mortgages

**Racial distribution of Purchase Lending 2021**

<table>
<thead>
<tr>
<th></th>
<th>White</th>
<th>Black</th>
<th>Hispanic</th>
<th>Asian</th>
</tr>
</thead>
<tbody>
<tr>
<td>MHM</td>
<td>81.3%</td>
<td>4.3%</td>
<td>13.6%</td>
<td>0.7%</td>
</tr>
<tr>
<td>Chattel</td>
<td>67.1%</td>
<td>10.2%</td>
<td>21.6%</td>
<td>1.1%</td>
</tr>
</tbody>
</table>

**Number of Purchase Loans Originated (2018-2021)**

<table>
<thead>
<tr>
<th></th>
<th>White</th>
<th>Black</th>
<th>Hispanic</th>
<th>Asian</th>
</tr>
</thead>
<tbody>
<tr>
<td>MH</td>
<td>196,560</td>
<td>9,314</td>
<td>29,356</td>
<td>1,424</td>
</tr>
<tr>
<td>Chattel</td>
<td>115,065</td>
<td>16,517</td>
<td>37,187</td>
<td>1,608</td>
</tr>
<tr>
<td>Total</td>
<td>311,625</td>
<td>25,831</td>
<td>66,543</td>
<td>3,032</td>
</tr>
</tbody>
</table>

**Chattel share**

- White: 37%
- Black: 64%
- Hispanic: 56%
- Asian: 53%

Chattel loans have very high denial rates

Denial rates for purchase loans, 2021

- MH Mortgage
- Chattel
- Site built

Chattel loans are rarely refinanced

Refi share of originations

<table>
<thead>
<tr>
<th></th>
<th>White</th>
<th>Black</th>
<th>Hispanic</th>
<th>Asian</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chattel</td>
<td>8.9%</td>
<td>1.7%</td>
<td>11.2%</td>
<td></td>
</tr>
<tr>
<td>MHM</td>
<td>44.5%</td>
<td>27.1%</td>
<td>30.6%</td>
<td>32.5%</td>
</tr>
<tr>
<td>Site-Built</td>
<td>61.4%</td>
<td>53.8%</td>
<td>53.2%</td>
<td>57.7%</td>
</tr>
</tbody>
</table>

Source: 2021 Home Mortgage Disclosure Act data.
Final thoughts

- Manufactured housing is one of the most affordable types of housing, but production remains low due to zoning and financing barriers.

- Compared to MH mortgages, chattel loans are expensive, harder to qualify for, and are rarely refinanced.

- These burdens fall disproportionately on Black and Hispanic households because of the role chattel plays in enabling homeownership.

- Policymakers are increasingly recognizing chattel financing hurdles – FHFA’s final Duty to Serve rule; administration’s supply Action Plan; FHA/Ginnie Mae’s joint RFI on chattel financing.

- As solutions are developed, we must remember that these inequities, if left unaddressed, could further widen the racial homeownership gap we’re aiming to close.
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Lease to Purchase: How to Build Homeownership

Based on a paper released by Moody’s Analytics
By Michael Stegman, Jeb Mason, and Mark Zandi
The Proposition

- Homeownership is no higher today than it was two generations ago, and the prospects for increasing homeownership are daunting given higher mortgage rates, declining housing affordability, and broader demographic trends in which new household formation is likely to increasingly come from households with less generational wealth.

- Policymakers would benefit from some new tools to expand homeownership.

- With appropriate guardrails and government financing support, the nascent lease-to-purchase industry is poised to offer such a tool.
Contemporary Lease-to-purchase arrangements

- Unlike previous generations of lease-to-purchase arrangements, the new business models offer participating households the *right*, but not the *obligation*, to purchase the home at a predetermined price when they are ready.

- In single-family housing markets fueled by investor-based cash purchases, lease-to-purchase companies help level the playing field for aspiring homeowners by negotiating cash offers on homes selected by participating households.

- And they are a way for households to use their rental tenure to improve their credit scores by making regular rent payments, build a credit history, and save for a down payment.
The last decade has seen the emergence of a number of private companies focused on lease-to-purchase

- The most mature of these are Trio, established in 2001, and Home Partners of America, founded in 2012.

- Other newer firms include Divvy, Halo and Verbhouse (2017); Dream America and ZeroDown (2018); and Pathway Homes (2022).

- All Lease-to-purchase companies set a so-called buy box, which provides a lower- and upper-price limit on the homes they are willing to buy on a household’s behalf.

  - Halo, for example, limits its customers to homes with asking prices between $150,000 and $600,000. Dream America’s buy box goes from $150,000 to $400,000, and Divvy’s varies by market, ranging from $60,000 to $375,000 in St. Louis to $240,000 to $600,000 in Miami.
Who the Lease-to-Purchase Industry Serves

- Minimum income requirements generally range between $30,000 and $48,000 a year, and minimum credit scores between 480 and 620.

- Because single-family homes listed for sale have asking prices, but not asking rents, using proprietary algorithms, lease-to-purchase companies estimate live rents for the single-family homes in their active markets.

- Based upon the company’s underwriting requirements, approved applicants receive a “rent budget” that enables them to shop for a home they can afford to rent and ultimately purchase.
The Major Elements of a Lease-to-Purchase Arrangement

- **Term.** The maximum number of months the contract is in force.

- **Purchase price.** The price the household pays for the home when it closes at some future date, including periodic price escalators, all of which are specified in the contract.

- **Option fee.** An upfront payment that becomes part of the household’s down payment if the option to purchase is exercised. Option fees range from $0 to ~5% of the home price.

- **Rent credit.** Any additional above-market rent paid by the household to the seller, which becomes part of the household’s down payment when the option is exercised.
Policy Recommendation: Improve Transparency

**Right-to-purchase option.** As a condition for consideration for federal financing, policymakers should require appropriate disclosures that apply to the purchase option, including option cost, annual rent and house price escalators, and the financial consequences of not exercising the purchase option.

**Fully account for disposition of forced savings.** In addition to a market-based rent, some companies also require households to make additional monthly payments to help grow a down payment that is available when they exercise their right to purchase. While these funds would be routinely accounted for in the event of a successful household purchase, their disposition and refundability should be made clear for households that do not exercise their option.
Companies accessing federal financing should periodically report the number and rate at which their households successfully transition to homeownership by buying the homes they initially occupied as renters.

<table>
<thead>
<tr>
<th>Origination year</th>
<th>Success rate</th>
<th>Resident purchases</th>
<th>All residents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prior to 2018</td>
<td>16%</td>
<td>1,253</td>
<td>8,005</td>
</tr>
<tr>
<td>2018-2021</td>
<td>23%</td>
<td>1,441</td>
<td>6,336</td>
</tr>
<tr>
<td>2019-2021</td>
<td>30%</td>
<td>974</td>
<td>3,271</td>
</tr>
<tr>
<td>2020-2021</td>
<td>38%</td>
<td>513</td>
<td>1,356</td>
</tr>
<tr>
<td>2021</td>
<td>38%</td>
<td>184</td>
<td>487</td>
</tr>
</tbody>
</table>

Home Partners’ Homeownership Success Rate by Year of Acquisition, through 2021

- From its inception through May 2022, Home Partners has helped approximately 30,000 households in 33 states, including more than 4,300 who bought the home they initially moved into as a renter.
- The homeownership creation rate has risen to 43% in 2022 for all households independent of when they moved in.
Government-backed financing should be available only to lease-to-purchase companies whose products are structured in a manner consistent with the prudential, affordable housing and equitable finance policies of the FHA and GSEs.

Companies that receive federal financing should offer products that leave households not materially worse off than their counterparts in the private rental market should they choose not to exercise their right to purchase.

Regulators should permit any paper equity generated from house price gains during the household’s lease period determined by an appraisal that exceeds the option sales price to accrue to the household to cover all or some portion of the required down payment at loan closing.
FHA and GSE Financing Recommendations

FHA’s single-family purchase mortgage already has an assumable feature, which should be streamlined and broadened to make it more widely available and effective in supporting increased homeownership through lease-to-purchase.

FHFA should set the terms for and encourage Fannie Mae and Freddie Mac to pilot lease-to-purchase mortgage products as part of their affordable housing and equitable housing finance missions via the provision of term financing, and the addition of an assumable feature to their affordable, low-down-payment mortgage products.
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