The MicroMortgage Marketplace Demonstration Project

Building a Framework for Viable Small-Dollar Mortgage Lending

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Housing affordability is a major barrier to homeownership for low- and middle-income (LMI) renters. Across the United States, many communities have affordable, low-cost properties in urban, suburban, and rural areas. Financing for this affordable housing, however, is replete with challenges. Access to small-dollar mortgages is not readily available, forcing buyers to turn to cash, land contracts, or personal unsecured (chattel) loans, and providing advantages for speculative non–owner occupants. Recent tightening of mortgage credit has made it harder to obtain small-dollar mortgages. And long-standing segregation, disinvestment, and redlining have increased barriers to homeownership in neighborhoods of color that have low-cost housing stock. The most affordable homes for sale around the country lack financing options and are out of reach to renter households seeking affordability, stability, and wealth-building opportunities.

Research has documented the lack of small-dollar mortgage availability (McCargo et al. 2018), providing evidence that homes mortgaged for $70,000 or less (or that are sold for less than $85,000) are not as likely to be financed with mortgages as higher-price homes. In fact, research shows that only one in four low-cost homes sold was likely to be financed with a mortgage. In this brief, we define small-dollar properties as those priced below $100,000, given market appreciation and our market focus in Louisville, Kentucky, and its surrounding metropolitan statistical areas (MSAs). Using national property records data, we found that in 2019, 26.7 percent of home sales[1] nationwide were for homes priced below $100,000. Of those, only 23.2 percent were purchased with a mortgage, compared to 73.5 percent of homes priced at or above $100,000, consistent with prior findings.

In many US markets, families pay more for rent than the monthly principal, interest, taxes, and insurance required to own a home, leaving them continuously rent burdened with few options for upward mobility and ownership. This dramatic lack of access to credit, therefore, is a major barrier to moving from renting to owning.

About the Reconstruct Project

In partnership with Fahe, a community development financial institution (CDFI), and the Homeownership Council of America (HCA), a technical assistance advisory firm, Urban Institute researchers developed a solution to address the lack of financing in low-cost housing markets. Using an Access Ventures Reconstruct Challenge grant (box 1), the team launched the MicroMortgage demonstration project in the Louisville, Kentucky, metropolitan area.

Leveraging evidence-based research and analysis, the team developed and tested the feasibility of creating a viable small-dollar option delivered through CDFIs. The goal is to simplify processing, reduce costs, and provide underwriting flexibility to break through barriers and make the most affordable housing stock accessible to underserved potential homeowners, especially low-income renters of color who live in the communities where these homes are located. Although the Reconstruct Challenge covers the three counties of the Louisville metropolitan area, our initial focus is on highly segregated pockets in the city of Louisville.

In developing the MicroMortgage demonstration, we focused on improving access to home financing while safely expanding the mortgage credit box and focused on reducing the fees and friction that cause a lack of lending in this space and make the cost to originate high relative to the loan amount. In this brief, we describe the problem, document the MicroMortgage intervention and challenges, and explore ways to originate small-dollar mortgages while cutting fees and costs and leveraging community-based and nonprofit lenders to make a solution available that can be expanded nationwide.

BOX 1

The Reconstruct Challenge

In 2019, Access Ventures—a Louisville-based private operating foundation initiating systemic change in communities that produces a more inclusive and creative economy—launched the Reconstruct Challenge:[a]

- designed to address the housing gap in the Louisville metropolitan area of Jefferson County in Kentucky and Floyd and Clark Counties in southern Indiana, adjacent to Louisville
- aimed to spur innovation and ideas for eliminating the ancillary costs that may cause housing to be unaffordable for low-income households
- funded innovations to decrease these costs; winners of the national competition received a $300,000 grant to test, demonstrate, and implement ideas
- focus initially on the three counties in the Louisville metropolitan area, but the projects selected might be expanded to other markets

As a team in developing the MicroMortgage solution, the Urban Institute provides research and evaluation; Fahe, based in nearby Berea, Kentucky, is the lender; and HCA, a nonprofit with expertise in CDFI capacity building, provides technical assistance.

[a] Mallory Sanborn, "Access Ventures Launches Reconstruct Challenge," Access Ventures blog, February 6, 2019, https://accessventures.org/blog/access-ventures-launches-reconstruct-challenge/.

The demonstration project, which gained national attention,[2] was launched in summer 2019 with the goal of originating and closing 50 small-dollar mortgage loans as part of the pilot.

The Louisville Metropolitan Area Landscape

Many homes in the greater Louisville area are still affordable to LMI families, but less than half of those priced below $100,000 are not purchased with a mortgage. Nationwide, small loans are less likely to be financed with a mortgage than loans with higher balances, and the three counties in the Louisville metropolitan area that are the focus of the Reconstruct Challenge are no different.

The Louisville MSA comprises 13 counties. It is the 45th-largest US MSA, and Louisville, Kentucky, is the country's 29th-largest city. The Reconstruct Challenge covers three selected counties in the Louisville MSA: Jefferson, Floyd, and Clark. This section highlights demographic and lending data about these three counties, focusing on Jefferson County, which contains Louisville, and highly segregated pockets of Louisville.

Jefferson County had the lowest homeownership rate (61.1 percent) of the three counties as of 2019, compared with 64.1 percent nationally, 74.5 percent in Clark County, and 73.4 percent in Floyd County. Jefferson County also had the lowest median household income among the three. American Community Survey and First American property records data show that 40.0 percent of home sales in

Jefferson County priced below $100,000 were financed with a mortgage, compared with 77.7 percent for home sales priced at or above $100,000 in 2019. Floyd County, despite having the highest median household income among the three counties, still had only 46.6 percent of small-dollar home sales financed with a mortgage, compared with 89.3 percent for home sales priced at or above $100,000. These gaps in financing-to-home-sales ratios are indicative of problems related to accessing credit for low-balance properties, and they substantiate the need for greater access to credit to help renters transition to homeownership in the Louisville MSA.

TABLE 1

Key Demographics and Housing Statistics

Three demonstration project counties and nationwide, 2019

	Jefferson County	Clark County	Floyd County	United States
Total population	766,757	118,302	78,522	328,239,523
Number of households	316,174	43,704	28,544	122,802,852
Non-Hispanic white homeowner share	70.4%	86.7%	90.9%	66.7%
Black homeowner share	22.0%	7.1%	4.2%	12.5%
Owner-occupied housing units	193,237	32,555	20,944	78,724,862
Homeownership rate	61.1%	74.5%	73.4%	64.1%
Median household income	$59,049	$59,064	$63,219	$65,712
Median house value for all owner-occupied housing units	$185,700	$164,200	$187,900	$240,500
Number of home sales	19,476	461	379	7,705,421
Share of home sales priced below $100,000	23.2%	83.5%[a]	23.2%	26.7%
Share of home sales priced at or above $100,000	76.8%	16.5%	76.8%	73.3%
Share of home sales priced below $100,000 with a mortgage	40.0%	N/A	46.6%	23.2%
Share of home sales priced at or above $100,000 with a mortgage	77.7%	N/A	89.3%	73.5%

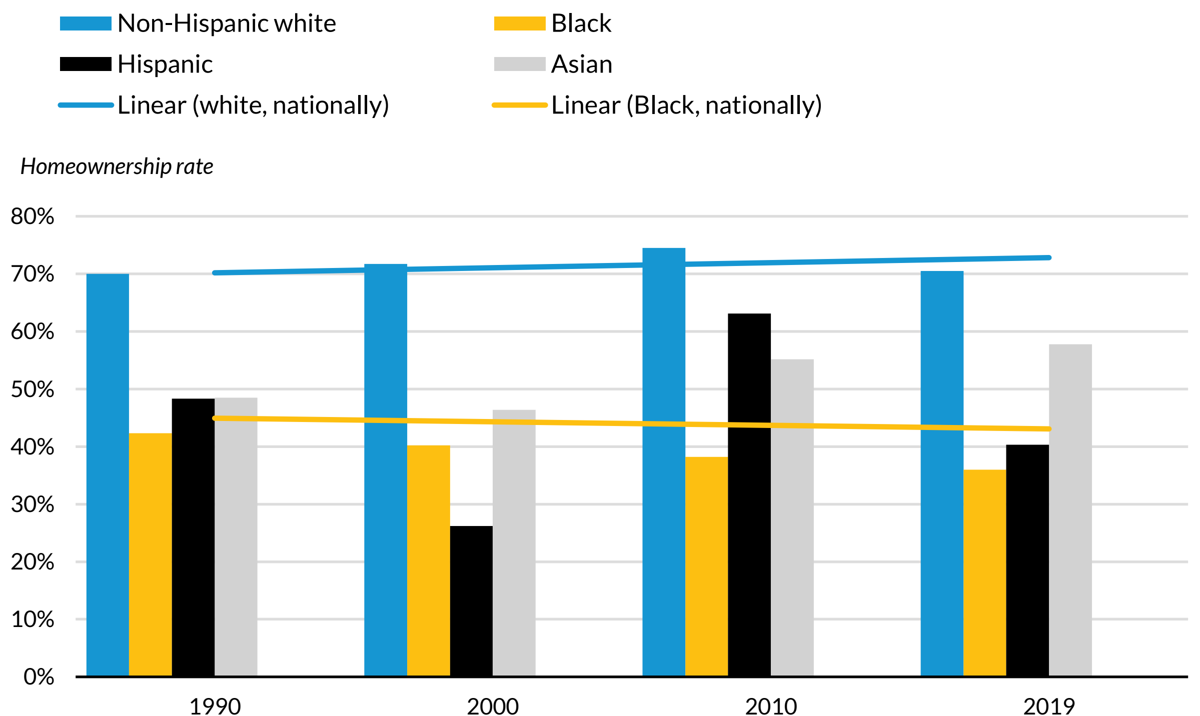
Source: Urban Institute calculations of property records data and American Community Survey data.

[a] We found the proportion of arm's-length transactions with a zero sales value is very high in Clark County, causing this high share of low-cost homes. This could be an issue with data quality in this area.

Looking at homeownership rate changes by race or ethnicity in Jefferson County, we found the racial homeownership gap has been widening since the 1990s, as the Black homeownership rate has decreased from 42 percent in 1990 to 36 percent in 2019, with the white homeownership rate staying above 70 percent over same period. Though Jefferson County has a higher Black population share, its Black homeownership rate has been historically lower than the national Black homeownership rate. We believe this lack of access to purchase financing for low-cost properties contributes to this significantly lower homeownership rate for Black households. Accordingly, one way to reduce the racial homeownership gap is to provide greater access to small-dollar mortgages.

FIGURE 1

Homeownership Rate, by Race or Ethnicity, in Louisville and Jefferson County



Source: Urban Institute calculations using Decennial Census data and American Community Survey data.

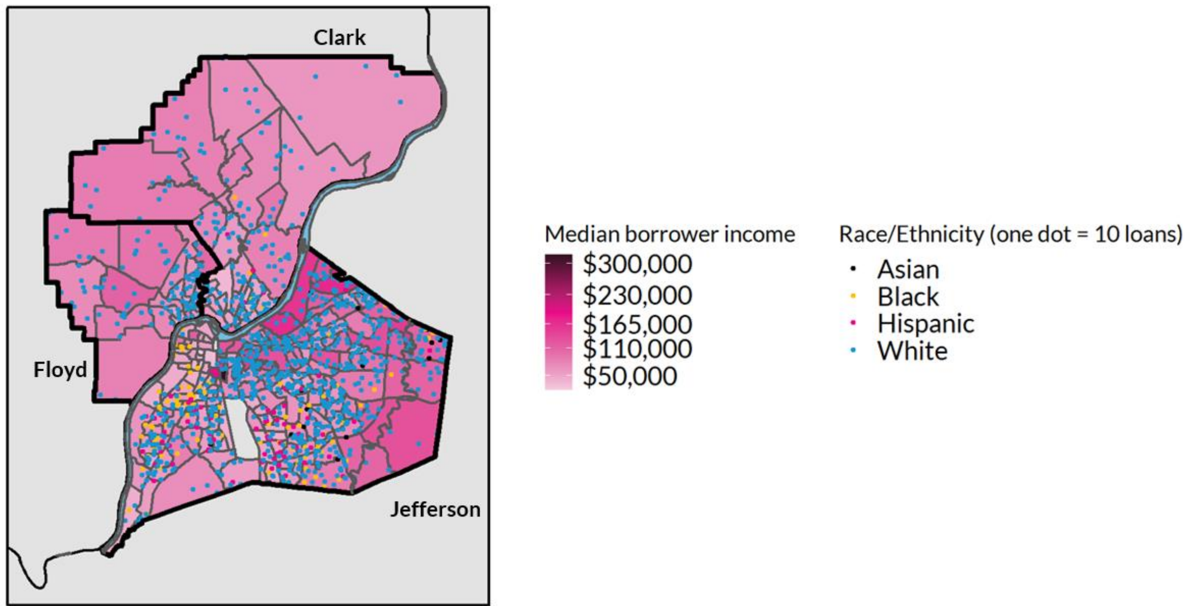
To understand access to mortgages for homeownership in the Louisville area, we analyzed Home Mortgage Disclosure Act (HMDA) data at the neighborhood level and determined where homes are being purchased and the mortgage lending patterns.

Though Jefferson County has the lowest median household income, mortgage borrowers there have relatively higher incomes than borrowers in Clark and Floyd Counties, especially in neighborhoods in north and southeast Jefferson County (figure 2). Borrowers in western Jefferson County and southern Clark County have the lowest incomes. The Jefferson County housing market has more concentrated segregation than Clark and Floyd Counties, with greater gaps in borrower income. We find similar patterns in mortgage amounts. As we would expect, neighborhoods with lower borrower incomes tend to have smaller mortgage amounts.

Jefferson County has the highest number of loan originations for Black and Hispanic households, but these loans are highly concentrated in western and southern neighborhoods, where both incomes and mortgage amounts are lowest. Moreover, loan amounts for white households are higher and are concentrated in high-income areas. Highly segregated communities have historically lacked investment and have experienced wide homeownership gaps, which is consistent with what we see in Louisville, and those factors exacerbate racial wealth gaps in this region.

FIGURE 2

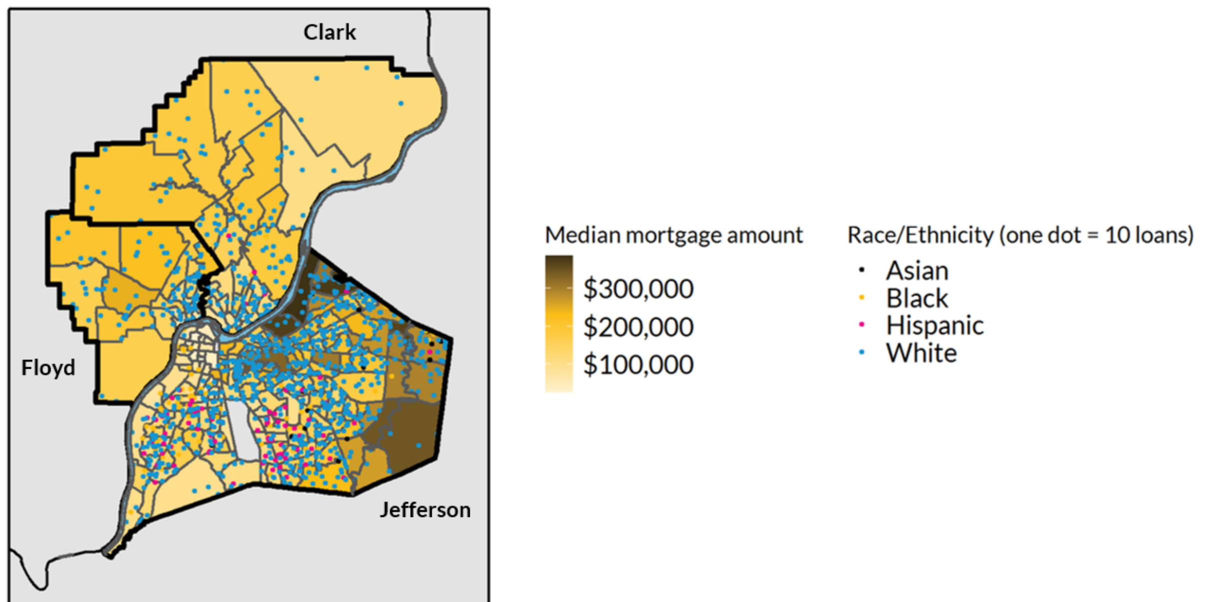
Median Borrower Income, by Race or Ethnicity, in 2019



Source: Home Mortgage Disclosure Act data.

FIGURE 3

Median Mortgage Amount for Purchase Loan Originations, by Race or Ethnicity, in 2019

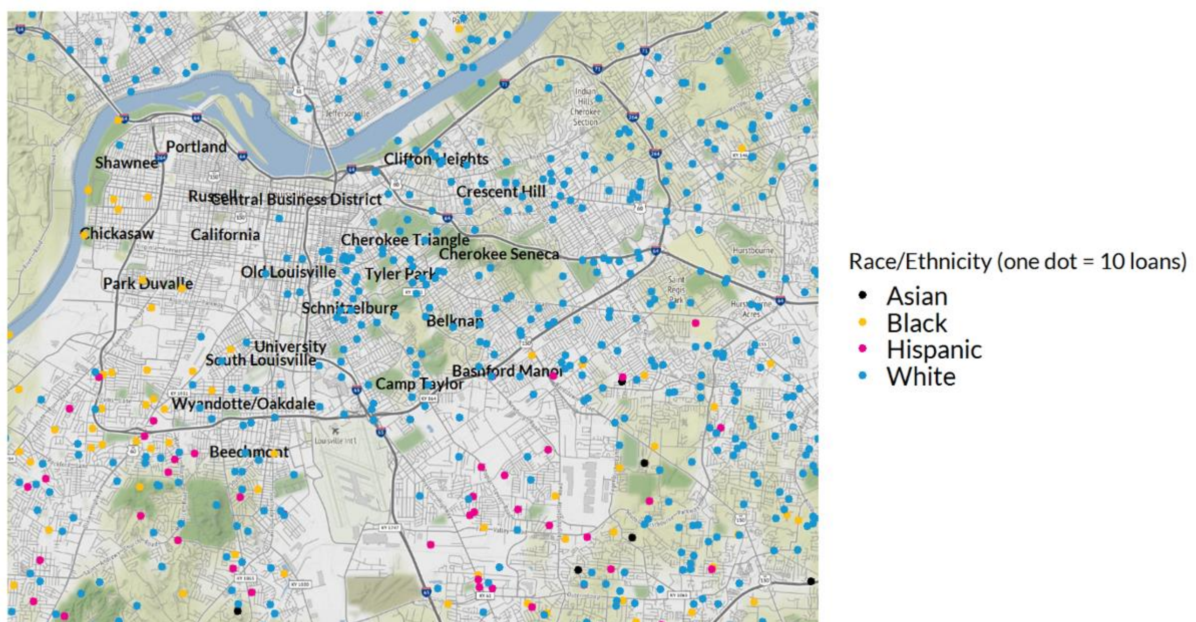


Source: Home Mortgage Disclosure Act data.

Looking more closely at the Jefferson County and Louisville area, we find that mortgages to white homeowners are concentrated in the city center, but mortgages to Black and Hispanic households are concentrated in western and southern low-income neighborhoods, such as Shawnee, Chickasaw, Park Duvalle, Oakdale, and Beechmont. City center neighborhoods such as the Central Business District, Cherokee Triangle, and Clifton Heights, had no loans originated for Black or Hispanic households in 2019. The persistent gaps in homeownership, the uneven geographic distribution of loan originations, and differences in loan amounts between racial and ethnic groups show the urgent need to advance small-dollar mortgage loans for communities of color.

FIGURE 4

Louisville and Jefferson County Purchase Loan Originations in 2019



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Source: Home Mortgage Disclosure Act data.

To better understand who is making access to credit available at the low end of the market, we used 2019 HMDA data[3] to identify the 10 lenders that made the most small-dollar loans in Jefferson, Clark, and Floyd Counties with loan amounts smaller than $85,000.

Although the sample size of 829 loans is small, 7 of these 10 lenders charged higher average interest rates for small-dollar loans than for the rest of their portfolios, with the rate premium ranging from 16 basis points to 74 basis points. Local and small banks are the backbone for supporting small-dollar loans in Louisville, with less participation by large national banks in this part of the market.

TABLE 2

Top 10 Lenders for Small-Dollar Loans in Three Selected Counties in 2019

Lender	Number of Loans		Average Interest Rate (%)		
	Small-dollar loans	All loans	Small-dollar loans	All loans	Premium (bps.)
Republic Bank and Trust Company	169	864	4.62	4.44	18
Commonwealth Bank and Trust	147	809	4.57	4.41	16
Stock Yards Bank and Trust	95	366	3.91	4.25	-34
Century Mortgage	90	1,127	4.58	4.38	20
Fairway Independent Mortgage	78	359	4.27	4.42	-15
Stockton Mortgage Corporation	64	299	4.68	4.47	21
Park Community Credit Union	52	326	4.77	4.58	19
Fifth Third Bank, National Association	51	333	3.89	4.13	-24
United Shore Financial Services	44	1,314	4.91	4.28	63
First Savings Bank	39	247	5.20	4.46	74

Source: Urban Institute calculations of Home Mortgage Disclosure Act data.

Notes: bps = basis points. Small-dollar loans are loans for less than $85,000.

The Case for Increasing Small-Dollar Mortgage Lending

The US lacks an economically viable housing finance option to serve low-income households in low-cost, affordable housing markets. Lack of mortgage credit in this space persists for several reasons, including loan production costs, investor competition, and the housing stock's composition and condition. But addressing the barriers and realizing the opportunities to increase access to small-dollar mortgages will expand opportunities to move renters into homeownership sustainably, allowing them to reap the benefits of America's most important wealth-building mechanism.

Recognizing Costs and Fees

One of the most significant headwinds to small mortgages is the fixed costs of loan origination. According to the Mortgage Bankers Association, the average cost to originate a mortgage is over $7,000.[4] The manufacturing costs per loan are almost all fixed, regardless of the loan balance, making it about the same to originate a $500,000 mortgage as it is to originate a $50,000 mortgage. Lenders also have expressed concerns about violating the Consumer Financial Protection Bureau's qualified mortgage rule, which limits points and fees. Although small loans might receive premium pricing that helps lenders compensate for limited points and fees, under traditional mortgage financing, lenders have little incentive to make these loans. Thus, the presence of fees and commissions in our real estate and mortgage lending systems makes lending for (and selling) low-cost properties less attractive for businesses. Real estate agents and loan officers who are typically given incentives through transactional commissions usually have lower earnings potential from selling low-cost homes. These structural issues suggest the need for specialized focus and innovation to make homeownership possible at this most affordable segment of the housing market.

Promoting Affordable Homeownership

These challenges perpetuate families remaining renters, and many households in these affordable communities are paying more for rent than they would to own a home with a small mortgage. In Jefferson County, the median monthly rent was around $880 in 2019, according to the American Community Survey, although more recent online listings show median rent above $1,000.[5] Small loans could make homeownership more accessible and equitable in the Louisville area. As of this writing, approximately 550 homes are for sale below $100,000 in Jefferson County,[6] and a MicroMortgage monthly payment, including taxes and insurance, on a mortgage of $85,000 could be less than $575 (box 2). Households would likely have lower monthly housing payments and would lock in a stable monthly payment and begin to build wealth. This also makes payments affordable long term, essentially building in forced savings and allowing homeowners to build reserves and prepare for maintenance costs associated with long-term homeownership.

BOX 2

Comparing Monthly Housing Costs for Renters and Homeowners

The following table illustrates the opportunity to decrease monthly housing expenses by owning versus renting, using the median rent in Louisville and MicroMortgage terms for an $85,000 mortgage:

Monthly Housing Payments for Renters and Homeowners

	Renters	Homeowners
Rent or mortgage payment	$880	$431
Insurance	$20	$67
Property tax	$0	$75
Monthly housing payment	**$900**	**$573**

Notes: The mortgage payment is based on current MicroMortgage 30-year terms at 4.5 percent interest. Other figures are illustrative from Fahe, Jefferson County government sources, and https://policyadvice.net/.

Advancing Racial Equity and Homeownership Opportunity through Small-Dollar Mortgages

Increasing access to homeownership for low-cost affordable housing is an essential step in closing the racial wealth gap. Homeownership is the primary way people build wealth in the US (Goodman and Mayer 2018). Nationwide, the median white household had 7.8 times more wealth than the median Black household.[7] Disparities in homeownership are a big driver of this wealth gap. In 2018, the gap between the white homeownership rate and the Black homeownership rate was 30 percentage points, which is higher than it was in 1968, when race-based housing discrimination was legal.[8] There are many structural barriers to accessing homeownership, including bias in lending practices in racially segregated neighborhoods, devaluation in Black neighborhoods, and unequal access to housing finance

options. Traditional bank lending in majority-Black or majority-Hispanic communities is lacking, and getting capital into the hands of people so they can own their home continues to be a major hurdle. Research outlining a five-point framework for reducing the Black-white homeownership gap suggests that putting more financing tools in place, leveraging local community-based banks and CDFIs that offer affordable housing microfinance options, is one way to address this gap and open up homeownership opportunities (McCargo, Choi, and Golding 2019).

The Louisville area suffers from the same inequities as the nation as a whole and has a long history of segregation and disinvestment in communities of color. Figure 1 shows stark differences in the white and Black homeownership rates, which are slightly larger than the nationwide homeownership gap.

The *2019 State of Metropolitan Housing Report* shows that between 2000 and 2017 in Louisville and in Jefferson County, Black homeownership rates declined and Black homeowners experienced disproportionate declines in home values, which has exacerbated the area's racial wealth gap (Metropolitan Housing Council 2019). The report further documents the differences in wealth accrual for Louisville's Black households, who are highly concentrated in 22 census tracts and have seen median home values decline. A decline in home values has profound effects on long-term wealth building and has other public and social consequences connected to overall disinvestment in communities, schools, and other public assets.

The legacy of undervaluing properties in Black communities is well documented (Perry, Rothwell, and Harshbarger 2018), and the MicroMortgage product was developed based on a hypothesis that lack of capital and lending to these communities and households would spur more investment and revitalization and strengthen the tax base in these communities while improving the lives and stability of families living in them as renters.

Black neighborhoods, however, are historically underserved by traditional financial institutions and banks. In the three counties covered by our demonstration project, small-dollar mortgage lenders in the footprint of our study did not include any large national financial institutions (table 2).

Improving Affordable Housing Stock through Small-Dollar Financing

Often, low-cost homes for purchase seem "affordable," but needed repairs and lack of energy efficiency can add significant housing expense. And current owners of low-cost homes often cannot take advantage of low mortgage rates to refinance their homes or tap into home equity to renovate or repair their homes because of the same lack of small-dollar financing. This inability to leverage home equity and improve a deteriorating home feeds into a perpetual cycle that leads to long-term maintenance issues and persistent degradation of housing values, impeding how much wealth a homeowner will ultimately have in the home. The ability to sustain homeownership is key to reducing the racial homeownership gap. Greater access to small-dollar mortgages could improve the affordable housing stock and help existing homeowners sustain homeownership, both critical areas for race-conscious policymaking and investment in communities.

Developing a Solution: The MicroMortgage Intervention

Given the significant need for small-dollar mortgages in communities of color, we designed the MicroMortgage solution to address the biggest underwriting factors creating disparities in mortgage access between white households and Black and Hispanic households. Specifically, the MicroMortgage solution allows for alternatives to the traditional FICO credit score, which fails to account for rental payment history. Research shows that rental payment history is a strong indicator of which borrowers will be successful in paying a mortgage, but this information is not included in most credit score models.[9]

Making Small-Dollar Mortgage Loans Feasible and Accessible

ALTERNATIVE UNDERWRITING AND LOAN PERFORMANCE

When developing underwriting standards, we focused on serving borrowers who may be wrongly overlooked by traditional underwriting.

The MicroMortgage product allows for the following:

- borrowing of up to 100 percent of the cost of the home
- debt-to-income ratios of 45 percent, with the ability to increase to 50 percent for compensating factors such as sufficient cash reserves, vested retirement, employment tenure, and rental history
- contribution of family member gifts and grants, and no minimum borrower contribution
- down payment assistance, allowing for a combined loan-to-value ratio of up to 105 percent

Expanded underwriting criteria is mitigated by required homebuyer education. MicroMortgage borrowers must complete a course through any provider approved by the US Department of Housing and Urban Development, such as a local housing organization or one with a national online presence. In the demonstration project, local housing groups such as the Urban League and the Housing Partnership Inc. offered the required education but also served as a critical resource for helping potential borrowers navigate the homebuying process.

As the mortgage servicer, Fahe will provide insight on the performance of MicroMortgage loans going forward. As a community lender, it has a high-touch approach to servicing and loss mitigation should a homeowner run into distress. Fahe will also supply Urban Institute researchers with data on MicroMortgage payments for analysis, which will add to our body of work to understand the risk profiles and performance of small-dollar mortgage loans. Recent analysis shows that small-dollar loans are not necessarily riskier than higher-balance loans (McCargo, Bai, and Strochak 2019).

REDUCING FEES

Another key strategy of the MicroMortgage product is to reduce ancillary mortgage fees and costs in the origination process, such as full appraisals, title, and origination fees. To streamline the appraisal process and reduce costs, the MicroMortgage permits use of automated valuation models (AVMs),

saving the borrower up to $500 in fees and shortening the origination timeline. This decision was informed by new Urban Institute research that compared AVMs with traditional in-person appraisals in Kentucky, with a focus on low-cost properties. For research purposes using property records and AVM data, we observed that AVMs track closely with sales prices in the demonstration project counties. Additionally, we evaluated loan originations Fahe had made in the past that received an in-person appraisal and had an AVM match in their records, and we saw no difference between low-cost and high-cost homes. Although our sample size was too small to ensure statistical significance, further research on appraisals and small-dollar mortgages in several geographies, including majority-Black neighborhoods, is under way.

AVMs are allowed for the MicroMortgage if a home inspection is available and if the AVM returned value is within a tolerance of $10,000 of the purchase price. Fahe is using its valuation provider to operationalize this process.

Title insurance offers another opportunity to reduce fees. Lender's title insurance is required even though the borrower's title insurance is optional. Borrowers can choose their own title company or closing agent, but in the demonstration project, we negotiated discounted fees with a local agent. Furthermore, Fahe reduced underwriting fees to $200, saving borrowers hundreds of dollars over the average on a traditional mortgage.[10]

Leveraging CDFIs and Community Banks to Support Small Mortgages

CDFIs are a natural vehicle for bringing small-dollar mortgage lending to market, as they can originate at a lower cost, underwrite using alternative models, and fund and service loans made in these communities. They can also monitor loan performance. Although they are private financial organizations, they are driven by a mission to bring mainstream finance and economic inclusion to underserved communities. CDFIs can be for-profits, nonprofits, credit unions, banks, loan funds, or venture capital funds, but all are certified by the US Treasury Department's CDFI Fund[11] to help communities grow equitably by offering affordable and sustainable financial services, as well as affordable credit and investment capital. Many also pair loans with additional technical assistance, such as financial education and business development, and advocate for such issues as borrowers' rights in the face of predatory lending. As trusted community leaders, CDFIs can bring businesses, governments, residents, and community-based organizations together to make positive changes.

A CDFI with an organizational structure like Fahe's, together with the technical assistance of HCA, was best suited for the initial MicroMortgage demonstration (box 3). CDFIs of all sizes and capabilities, however, will play an important role in expanding the MicroMortgage and small-dollar lending. They can be primary lending agents like Fahe or technical assistants and brokers in their local communities.

BOX 3

Spotlight on Fahe and the Housing Council of America

Fahe is a nationally recognized CDFI focused on eliminating persistent poverty in Appalachia and is unique among CDFIs in that it does direct home lending at scale. Its JustChoice Lending program is offered in 16 states and originated $71 million in single-family first mortgages in 2019. Fahe also has expertise in originating and servicing small rural loans through the US Department of Agriculture's guaranteed and direct loan programs.

Fahe works with nonprofit mortgage brokers, loan packagers, and other CDFIs as correspondent lenders. This allows local nonprofits and other CDFIs working in homeownership in underserved communities the opportunity to engage with prospective homeowners, provide assistance and education, and send mortgage loan applications to Fahe for underwriting and closing.

The Housing Council of America is a nonprofit dedicated to developing and expanding homeownership through lending pathways and provides tools and technical assistance to CDFIs to increase their lending capacity. It builds products and partnerships for sustainable loan delivery systems, providing vital pathways to homeownership for people of color, low- and moderate-income borrowers, and rural communities.

Community banks also are important players in supporting the low-cost housing communities they serve. Black neighborhoods, which can significantly benefit from increased access to small-dollar mortgage financing, are underserved by traditional financial institutions and banks. In other recent research, we looked at opportunities for Black-owned banks as sources of local economic support in predominately Black communities (Neal and Walsh 2020). We found that the typical Black-owned bank is considered a community bank and typically serves predominantly Black communities. But the number of these banks is declining, as they face headwinds that extend beyond those of the community banking sector generally. Addressing the regulatory burdens and access to capital to ensure Black-owned banks can be vehicles for small-dollar mortgages will be an important part of the ongoing conversation and market expansion.

Challenges and Opportunities

As of this writing, MicroMortgage loans have yet to be closed. Bringing the demonstration to market, however, is providing us insight into the challenges posed, and the opportunities needed, to refine the offering and expand this concept nationally.

Liquidity Needs for Small-Dollar Mortgages

Accessibility and flexibility of the MicroMortgage came at a cost. Traditional mortgages that can be sold in the secondary market enjoy the low financing rates available in today's environment. A loan originator must rely on alternative funding sources to be able to offer a MicroMortgage. At the project's onset Fahe was able to tap a capital source that relied on funds originating from a bond program. This,

however, established the interest rate on the MicroMortgage at 4.5 percent. Although homeowners with nontraditional credit often face higher interest rates through alternative lending sources, a rate that is perceived to be higher than the market rate has limited product adoption among potential homeowners, as well as real estate agents who can be reluctant to market the program. The project team is working to secure a lower cost of funding to pass on a more competitive interest rate to MicroMortgage clients. To be successful, capital sources must be found so the interest rate to the borrower can be competitive with conventional and government loan market rates. Participation in pilots by secondary market investors Fannie Mae and Freddie Mac would also help provide the liquidity needed to serve this market.

Renovation Financing

Small-dollar mortgage credit is scarce for rehabilitation and renovation projects in older homes, which often make up the bulk of low-price homes. Properties at the low end of the market tend to be old and in need of repair or up-front costs. Coupling renovation financing with purchase and addressing the appraisal gap issues that arise in low-cost markets are areas where further research is needed and additional product features should be added. Our work for this demonstration pilot's first phase focuses on making access to new home purchase possible, without added rehabilitation, but there is much work to do on these other points, which we hope to address in future phases and testing.

Bringing Together a MicroMortgage Marketplace

A product alone cannot solve the challenges of bringing small-dollar mortgages to communities with low-cost housing opportunities. To access, qualify for, and obtain financing for low-cost properties, potential borrowers must have direct engagement with key players in the market. This takes intention and a systems approach to solve. Local nonprofits, housing developers, counselors, real estate professionals, lenders, and even local employers can help potential homeowners understand the opportunity and how to access resources to make it happen. For example, real estate listings need to show financing alternatives accessible to low-income homebuyers, and resources aimed at those seeking a rental property can raise awareness that some may be able to qualify to buy a house.

An online platform could connect and support these stakeholders, as could a greater focus on educating and raising awareness in the community about financing options. In the demonstration project, Fahe and HCA worked with the local National Association of Real Estate Brokers, the Urban League, the small Louisville CDFI LHome, and Housing Partnership Inc. to provide training and show how the full housing payment for ownership is often hundreds of dollars less per month than renting a similar home.

Potential for Scale and Expansion

What started as a local solution driven by small community-oriented lenders and a regional CDFI can transform into a national solution. Using this product framework, other CDFIs, housing authorities, and local banks can adopt this purchase mortgage and its features that help it reach underserved

communities. Markets with similar needs include neighborhoods within and around Memphis, Buffalo, Rochester, Cleveland, and Pittsburgh. The MicroMortgage product can also be leveraged to take advantage of refinancing and renovation financing opportunities.

Developing an online marketplace will also provide the recognition and credibility the program will need to gain traction. Such a presence can provide prospective homeowners access to low-cost properties, information and tools such as calculators, and lists of local organizations and lenders working under the program and how to engage with them. It can also support nonprofits and lenders by identifying prospective new homeowners.

Conclusion and Policy Considerations

The MicroMortgage Marketplace demonstration project has provided a framework for a viable small-dollar mortgage product that can help LMI families access credit for low-cost properties and move from renting to owning a home. It also highlights the opportunity to implement race-conscious policies and practices and to make investments in communities affected by racial housing and wealth equity gaps. One of the key hurdles is shining a light on this market segment and getting agencies to focus and target resources toward this as a viable strategy for increasing homeownership in historically underserved markets. To be able to expand across the country, however, requires further attention and investment using the following methods:

- Identify funding sources of capital for CDFIs and community banks to support direct lending and the ability to originate small-dollar mortgages in low-cost areas. Portfolio purchases and participation pools are two ways large institutions could support affordable housing goals. And secondary market players like the government-sponsored enterprises and Federal Home Loan Banks can pilot opportunities to bring the MicroMortgage terms and conditions to the capital markets, which will allow for interest rates to be more in line with traditional mortgage products or support direct equity investments according to the Duty to Serve rule.
- Enhance and improve on the Federal Housing Administration (FHA) small-dollar lending insurance program, with more resources in the agency to support direct lending, improved and simplified underwriting and servicing requirements, and enhanced pricing and reduced costs, such as removing the life-of-loan mortgage insurance requirement. FHA loans are not currently meeting the low-cost market need, and most small-dollar loans that are made come through conventional financing channels. 2019 HMDA data show that 73.7 percent of small-dollar loans in the Louisville metropolitan area were financed through conventional channels, and only 19.3 percent were financed via FHA loans.
- Ensure broad marketing and showing (access) by agents of these properties, leveling the playing field for who gets to see them and buy them. This would include real estate agencies and real-estate-owned holders (such as the government-sponsored enterprises), making sure to enforce their agents using first look on small-balance properties and ensuring owner-occupant borrowers can access them for possible purchase. This will expand fair housing opportunities

and prevent the practices that led to the most recent lawsuit against a national real estate brokerage firm that requires properties to be listed for sale at a specific minimum price for buyers and sellers to be able to work with its agents.

- Expand upon the work on low-cost housing valuations, racial equity in housing, lending patterns and practices that might create barriers, and performance of small-balance loans to identify where there are gaps and opportunities to improve access to credit for LMI borrowers purchasing or renovating affordable housing.
- Work with policymakers and local stakeholders, including mayors and housing community development arms, as well as state housing finance agencies, to coordinate city housing programs and initiatives with financing for low-cost housing. Leverage research, analysis, and observations from the demonstration project to help these and other stakeholders understand the need to break down regulatory and legal lending barriers faced by CDFIs and community banks, particularly those that can and would serve populations affected by racial inequity.
- Build in additional features to the MicroMortgage that are necessary for the characteristics of most affordable homes, which tend to be older and in need of repairs. Consider more robust options for purchase and refinancing for renovation so low-cost properties are safe and efficient and do not create high monthly utility or untenable repair costs.
- Use innovation and technology to expand outreach and make sure low-cost properties are accessible and visible to those who are traditionally underserved, particularly Black communities. Develop an online marketplace platform that brings together community partners who can help LMI families identify and realize viable opportunities to move from renting to homeownership. This includes information about small-dollar mortgages and resources to help locate and view affordable housing stock, technical assistance on how to rehabilitate homes in need of repairs, homebuyer education, and support for sustaining homeownership.

Notes

[1] We exclude non-arm's-length transactions and real-estate-owned sales in our sample.

[2] Matthew Goldstein, "Where a Little Mortgage Goes a Long Way," *New York Times*, August 2, 2020, https://www.nytimes.com/2020/08/02/business/mortgages-affordable-housing.html.

[3] Some small lending institutions may not report to HMDA, so we might have selection bias here.

[4] Mortgage Bankers Association, "IMB Production Profits Soar in Second Quarter of 2020," news release, September 2, 2020, https://www.mba.org/2020-press-releases/september/imb-production-profits-soar-in-second-quarter-of-2020.

[5] "Rent Trend Data in Louisville, Kentucky," Rent Jungle, accessed December 12, 2020, https://www.rentjungle.com/average-rent-in-louisville-rent-trends/.

[6] See Jefferson County listings at https://www.realtor.com.

[7] Signe-Mary McKernan, Caroline Ratcliffe, C. Eugene Steuerle, Caleb Quakenbush, and Emma Kalish, "Nine Charts about Wealth Inequality in America (Updated)," Urban Institute, last updated October 5, 2017, https://apps.urban.org/features/wealth-inequality-charts/.

[8] Margery Austin Turner, "Recommitting to the Promise of the Fair Housing Act 50 Years Later," *Urban Wire* (blog), Urban Institute, April 3, 2018, https://www.urban.org/urban-wire/recommitting-promise-fair-housing-act-50-years-later.

[9] Laurie Goodman and Jun Zhu, "Rental Pay History Should Be Used to Assess the Creditworthiness of Mortgage Borrowers," *Urban Wire* (blog), Urban Institute, April 17, 2018, https://www.urban.org/urban-wire/rental-pay-history-should-be-used-assess-creditworthiness-mortgage-borrowers.

[10] "Mortgage Underwriting Fee," The Mortgage Insider, accessed December 12, 2020, http://themortgageinsider.net/definitions/underwriting-fee.html.

[11] See the website for the US Treasury Department's CDFI Fund at https://www.cdfifund.gov/.

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