



# Small-Dollar Mortgages: A Loan Performance Analysis

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**Many communities across the US have low-cost single-family homes. In 2015, over 640,000 home sales nationwide were valued at \$70,000 or less. Our recent study on small-dollar mortgages documents how the housing finance market is absent from small-dollar mortgages for low-cost single-family home purchases (McCargo et al. 2018). The lack of financing available for small-dollar home purchases, refinancing, and renovations limits affordable homeownership for creditworthy families who live in low-cost and often underserved housing markets.**

In 2015, roughly 25 percent of homes purchased for \$70,000 or less were financed with a mortgage, and almost 80 percent of homes worth between \$70,000 and \$150,000 were bought with a mortgage. Several reasons explain this difference. First, the fixed costs of originating and servicing a mortgage make small loans less attractive to lenders and servicers. In many low-cost housing markets, home sales may be dominated by investors purchasing with cash. Housing stock composition can also play a role. Some low-priced units, such as manufactured homes and condos, can be difficult or impossible to finance with a mortgage.

Another perceived challenge of small-dollar loans is their riskier borrower profile. We decided to dig deeper into the risk profiles of small-dollar mortgage loans that have been originated to see how they stack up against larger loans across several risk factors.

## Borrowers of Small-Dollar Loans Have Similar Credit Profiles

Although fewer small-dollar mortgages have been made, small-dollar loans have comparable credit profiles with midsize mortgages between \$70,000 and \$150,000 across government, portfolio, government-sponsored enterprise (GSE), and private-label security (PLS) channels.

Small and midsize loans exhibit comparable credit scores across all channels (table 1). For the Fannie Mae and Freddie Mac GSE channel, small-loan borrowers had a median FICO score of 727 from 2001 to 2018, compared with 737 for borrowers of midsize loans. This difference has been consistent and never larger than 10 percentage points throughout the years. In the government and portfolio channels, the FICO score differences were larger during the precrisis period and the housing boom but have narrowed significantly since the crisis. For the PLS channel, the FICO score differences between small and midsize loans were over 20 percentage points during the precrisis and boom periods, when PLS dominated the market before collapsing after the crisis.

Loan-to-value (LTV) ratios are comparable for small and midsize mortgages. Debt-to-income (DTI) ratios are about 3 to 4 percentage points lower for small-dollar mortgage borrowers across all channels, likely because of lower monthly payments from lower loan balances.

**TABLE 1**  
Median FICO Score, DTI Ratio, and LTV Ratio by Loan Size and Channel

	GSE		Government		Portfolio		PLS	
	\$10,000- \$70,000	\$70,000- \$150,000	\$10,000- \$70,000	\$70,000- \$150,000	\$10,000- \$70,000	\$70,000- \$150,000	\$10,000- \$70,000	\$70,000- \$150,000
<b>FICO score</b>								
2001	725	729	643	653	704	715	603	625
2006	713	723	636	642	683	700	612	633
2011	767	770	682	686	758	761	607	671
2018	748	756	692	694	744	749	N/A	688
2001-18	727	737	665	672	707	722	615	642
<b>LTV ratio (%)</b>								
2001	79.8	80.0	98.5	98.5	80.0	80.0	85.0	90.0
2006	80.0	80.0	98.5	98.9	80.0	80.0	100.0	100.0
2011	74.6	80.0	97.5	97.5	80.0	80.0	N/A	N/A
2018	85.0	90.0	98.2	98.2	80.0	82.0	N/A	N/A
2001-18	80.0	80.0	98.4	98.5	80.0	80.0	95.0	98.3
<b>DTI ratio (%)</b>								
2001	27.0	28.0	30.0	31.8	32.0	34.0	37.5	40.3
2006	32.3	37.0	34.0	38.9	35.9	38.5	38.9	42.1
2011	30.3	32.3	36.0	39.7	31.8	34.0	N/A	N/A
2018	35.3	37.4	36.0	39.5	32.1	36.0	N/A	N/A
2001-18	31.0	35.0	34.9	38.7	33.0	36.5	38.0	41.1

Sources: CoreLogic and the Urban Institute.

Note: DTI = debt-to-income; GSE = government-sponsored enterprise; LTV = loan-to-value; PLS = private-label security.

## Small-Dollar Loans Perform Similarly to Loans with Higher Balances

Small-dollar mortgage loans generally perform like loans with higher balances. Part of the difference in performance can be explained by the similarly small differences in credit scores, DTI ratios, and LTV ratios discussed above.

For example, in the government channel, during the precrisis period, small loans had noticeably higher default rates, and borrowers of those loans had lower credit scores. When the credit score gap narrowed following the crisis, the default rate also narrowed (figure 1).

In contrast, in the GSE and portfolio channels, though small-dollar mortgages have consistently lower credit scores, they performed similarly and, in some cases, better than larger loans during the housing boom years leading up to the crisis. For 2006 origination cohorts, the default rates are 17.5 percent for loans up to \$70,000 and 18.6 percent for loans between \$70,000 and \$150,000.

Compared with other channels, the PLS channel had much higher default rates overall. Small loans originated from 2001 to 2004 have consistently higher default rates than their midsize counterparts. But during the 2005 to 2007 bubble years, when the PLS market surged, small loans for purchasing homes exhibited similar or even lower default risks, despite their lower credit scores and weaker credit profiles.

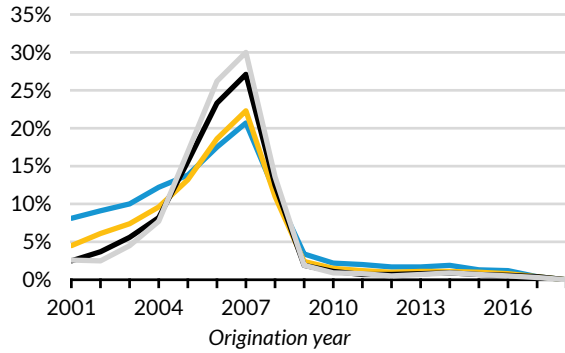
FIGURE 1

**Delinquency Performance by Loan Size**

*Government-sponsored enterprise channel*

— \$10,000–\$70,000      — \$70,000–\$150,000  
 — \$150,000–\$300,000      — > \$300,000

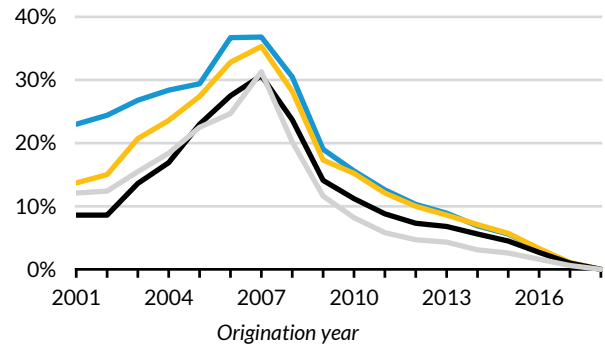
*Delinquency rate (90+ days)*



*Government channel*

— \$10,000–\$70,000      — \$70,000–\$150,000  
 — \$150,000–\$300,000      — > \$300,000

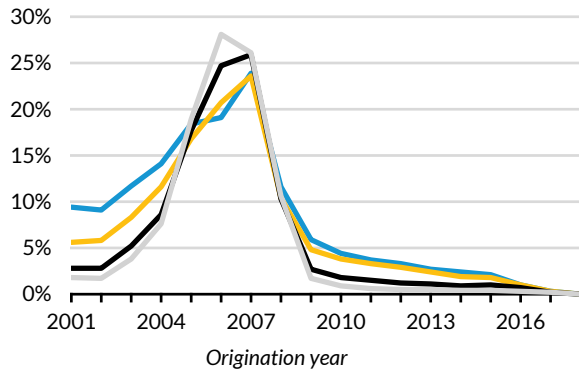
*Delinquency rate (90+ days)*



*Portfolio channel*

— \$10,000–\$70,000      — \$70,000–\$150,000  
 — \$150,000–\$300,000      — > \$300,000

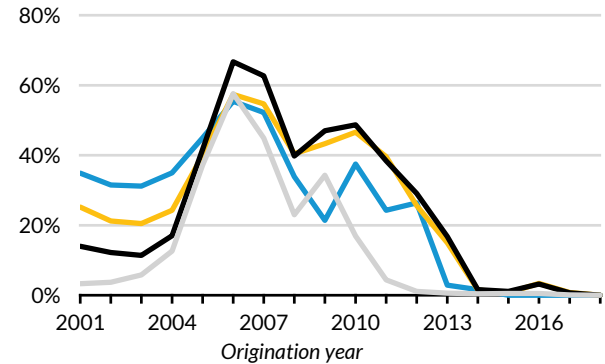
*Delinquency rate (90+ days)*



*Private-label security channel*

— \$10,000–\$70,000      — \$70,000–\$150,000  
 — \$150,000–\$300,000      — > \$300,000

*Delinquency rate (90+ days)*



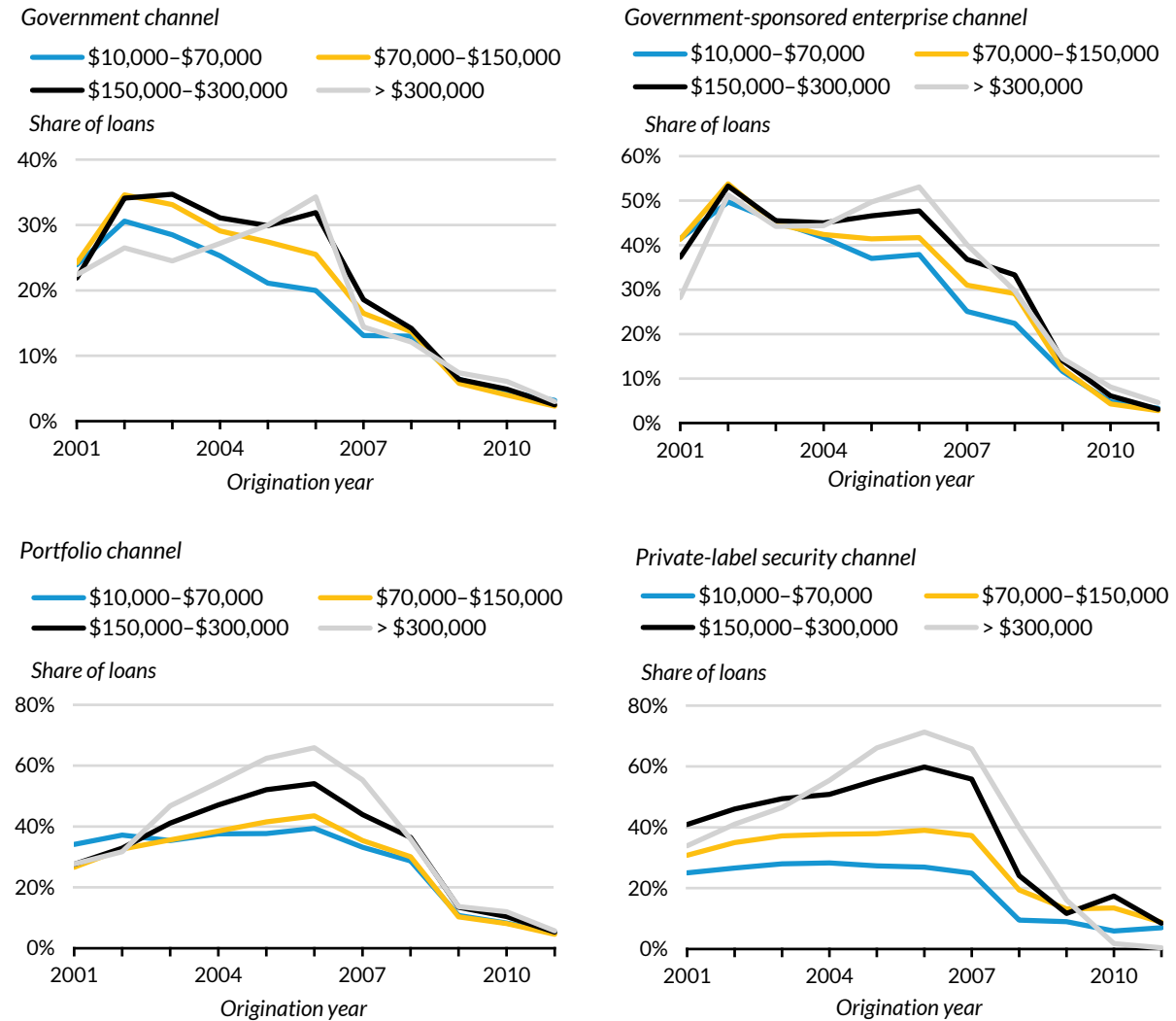
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Sources: CoreLogic and the Urban Institute.

During the bubble years of 2004 to 2007, loans that were originated saw delinquency rates skyrocket as a result of loose lending standards, and many loans were made with little or no documentation. Despite having lower credit scores, small loans performed similarly and sometimes better than their midsize counterparts during this period. This result can be partially explained by small loans having a lower share of originations with low or no documentation requirements (figure 2). For the PLS channel, 27 percent of smaller loans were made without full documentation, compared with 39 percent of midsize loans.

FIGURE 2

Shares of Small-Dollar Loans with Little or No Documentation during the Housing Boom



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Sources: CoreLogic and the Urban Institute.

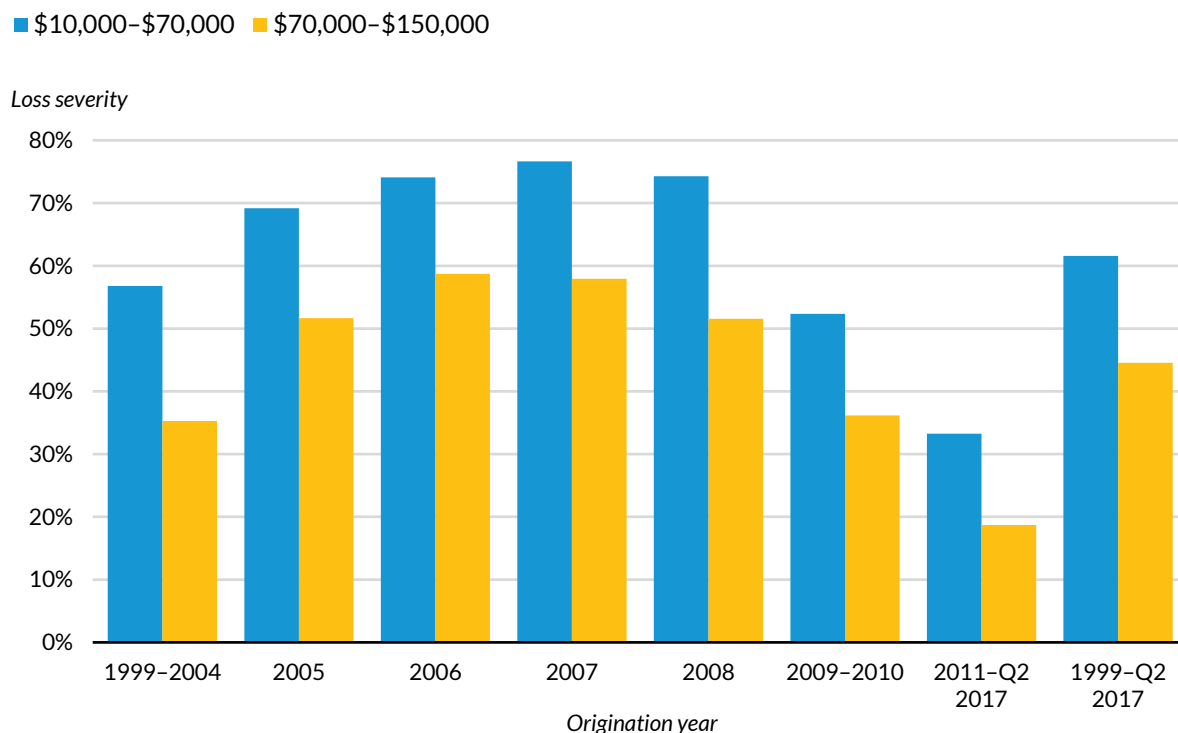
Note: GSE = government-sponsored enterprise; PLS = private-label security.

## Loss Severity on Small-Dollar Mortgage Loans Is Higher Than for Larger Loans

Despite comparable performance, small-dollar mortgages have higher loss severity than larger loans. We examine this outcome using the GSE credit data on 30-year fixed-rate mortgages. Although the GSE channel is one part of the small-loan market, we have detailed data for this channel that can explain what happens to distressed small-dollar mortgages. The loss severity for small-dollar loans originated from 1999 to the second quarter of 2017 was 61.6 percent, compared with 44.6 percent for loans with a balance between

\$70,000 and \$150,000. The higher loss severity for small loans is consistent for all origination years over the housing cycle since 1999.

**FIGURE 3**  
**GSE Loss Severity by Loan Size and Origination Year**



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**Sources:** Fannie Mae and Freddie Mac loan-level credit data and the Urban Institute.

**Note:** GSE = government-sponsored enterprise; Q2 = second quarter.

There are several explanations for the higher loss severity of small loans. First, the same fixed origination and servicing costs apply to small and midsize loans. And when a loan defaults, the lender incurs additional costs to manage the distressed loan. Although these costs are largely the same for all loan sizes, the loss severity, which is calculated as a percentage of the loan balance, is high for smaller loans.

Additionally, loss severity tends to be higher for small loans because they are often located in weaker housing markets where lenders may be more likely to experience greater losses as a share of the unpaid balances and less loss recovery from selling the property.

Finally, lower loan balances are more likely to be written off to avoid the cost of attempting loss mitigation or other liquidation options.

Even though the greater loss severity on small loans is a symptom of the cycle of weak demand for small-dollar mortgages, it is also a cause, as the lack of such mortgages can depress home price appreciation and make it more difficult to recoup losses on the property. A more robust market for small-dollar

mortgages could remedy this issue, as would implementing cost-efficient measures for originating and servicing small-dollar loans.

## Conclusion: Improve the Market for Small Loans, but Do Not Penalize Them

This analysis shows that adding risk-price premiums or assuming small-dollar loans are riskier is not correct or fair. There are hundreds of low-cost and distressed communities where affordable housing is available but not accessible to families who want to buy homes because the system for financing purchases is not robust enough. Understanding how small loans perform once they are originated can fill in this missing piece of the mortgage market and serve a broader base of potential homeowners. Otherwise, naturally occurring, affordable single-family housing will continue to be the province of investors and speculators who can buy homes with cash and will not be an option for the millions of credit-worthy potential first-time homebuyers and working families who could become homeowners if mortgage financing were available.

## References

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**Alanna McCargo** is vice president for housing finance policy at the Urban Institute, where she focuses on management, development, and strategy for the Housing Finance Policy Center, including the cultivation of innovative partnerships within Urban and with external stakeholders. McCargo has over 20 years of experience in housing finance, policy, and financial services. She has worked in the private, public, and nonprofit sectors on programs, policies, and research to improve access to housing and mortgage finance. Before joining Urban, McCargo was head of CoreLogic Government Solutions, working with federal and state government agencies, regulators, government-sponsored enterprises, think tanks, and universities to deliver custom data, analytics, and technology solutions to support housing and consumer policy research. Previously, McCargo held leadership roles with Chase and Fannie Mae, managing portfolios, policy efforts, and mortgage servicing transformation and alignment. From 2008 to 2011, she was an agent of the US Treasury Department on housing programs, such as Making Home Affordable and Hardest Hit Funds, working with industry stakeholders on the recovery. McCargo serves on nonprofit boards and committees, focusing on her passion for helping underserved populations with financial literacy, economic stability, and housing security. She works with Doorways for Women and Families, Women in Housing and Finance, and DC Habitat for Humanity. McCargo has a BA in communications from the University of Houston, an MBA from the

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