Myths and Facts About Ways to Increase Small-Dollar Mortgage Lending

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It is nearly impossible to get a mortgage loan for below $100,000. Access to "small-dollar" mortgage loans remains a major challenge across the country. This hurts consumers who need credit to purchase or repair lower-value properties.

Some argue that the best way to increase access to small-dollar mortgages is to weaken the regulations that apply to them. But this argument is based on myths and a misunderstanding of existing law. Cutting holes in consumer protections will not increase access to fair and affordable credit. Instead, there are better ways to increase access to small-dollar mortgages while maintaining consumer protections. In this issue brief, we describe why existing law already gives more lenient treatment to smaller balance loans and does not present a true obstacle to mortgage lending below $100,000. We then discuss an array of solutions that would encourage lenders to make more small-dollar mortgages.

Small-Dollar Mortgages are hard to get, so many affordable homes are snapped-up by cash investors and consumers must turn to risky forms of alternative financing.

The dearth of small-dollar mortgages prevents low-income people from building wealth through homeownership. This disproportionately affects people of color and fuels the rise of the predatory financing products such as land contracts and leases with option to buy.[1] One recent analysis shows that just 26% of properties that sold for less than $150,000 between 2018 and 2021 were financed using a traditional mortgage, compared with 71% of higher-cost homes.[2]

Mortgage loans remain out of reach for many creditworthy consumers in rural and urban communities where property values are low. Consumers seeking loans to purchase lower-priced homes, including manufactured homes, or to rehabilitate, repair, or make energy efficient upgrades to such existing homes, rely on alternative, often predatory, high-cost financing. Banks and other lenders either do not offer small-dollar mortgages or deny small-dollar mortgages to creditworthy borrowers at higher rates compared to consumers who apply for larger loans.[3]

The argument that cutting regulation will increase access to small-dollar mortgages is based on myths and misunderstandings

Myth 1: The Qualified Mortgages 3% fees cap from Dodd-Frank era regulation impedes lenders from making small dollar mortgages.

Fact 1: *Dodd-Frank's Ability to Repay and Qualified Mortgage rules are graduated based on loan size.*

The Dodd-Frank rules promote sustainable lending for a range of loan sizes

The Ability to Repay and Qualified Mortgage rules in the Truth in Lending Act already have more lenient requirements for small-dollar mortgages, as described below.

The Dodd-Frank Act requirement to verify the consumer's ability to repay was one of the most important consumer protections to arise out of the 2008 foreclosure crisis. Congress saw that lending without regard to ability to pay had been one of the major causes of the wave of subprime mortgage foreclosures. It amended the Truth in Lending Act to specifically require lenders to document and consider the borrower's ability to repay residential mortgage loans.[4]

At the same time, Congress created a category of presumptively safe mortgage loans, termed "Qualified Mortgages" (QM), entitled to a presumption of compliance with the ability to repay requirement. The Consumer Financial Protection Bureau (CFPB) was granted authority to issue regulations further implementing the statutory framework. There are several different kinds of QMs, all of which must meet certain basic criteria, including up front points and fees below a certain limit. In addition, a mortgage can qualify under the "general QM" definition based on the APR of the loan.[5] The affordability presumption granted through QM status is rebuttable for "higher priced mortgage loans" (loans over a certain APR), and irrebuttable, resulting in a total safe harbor from ability-to-repay claims, for loans below that APR threshold. Many lenders want to qualify for this safe harbor, and thus confine their mortgage lending to loans that meet the QM criteria.

The fixed cost of originating a mortgage and the effect of points and fees on the loan's QM status are certainly a primary cause that lenders cite for the limited number of smaller dollar mortgages being made. However, the QM rules offer considerably more flexibility for smaller-dollar mortgage loans than is commonly recognized.

The QM rules are more lenient for smaller dollar mortgages in two ways: (1) the points and fees limit to qualify as a QM is a larger percentage of the loan amount for smaller dollar loans, and (2) the APR threshold to qualify for the general QM definition based on the price of the loan is higher the smaller the loan amount.

The QM points and fees limit is higher for smaller-balance mortgages.

Lenders often claim that the points and fees cap for QM loans is 3%, but that is only the limit for loan amounts greater than or equal to $124,331. For the smallest mortgage loans, the points and fees can be as high as 8% of the loan amount. The limit according to loan size is described in the table below. Some of these figures are adjusted annually for inflation.

As of January 1, 2024, the points and fees limit to qualify as a QM is as follows:

Loan Amount	Points and Fees Cap for QM Status
Greater than or equal to $130,461	3% of the loan amount
Greater than or equal to $78,277 but less than $130,461	$3,914 (this amounts to between 3-5%)
Greater than or equal to $26,092 but less than $78,277	5% of the loan amount
Greater than or equal or $16,308 but less than $26,092	$1,305 (this amounts to between 5-8%)
Less than $15,541	8% of the loan amount

Source: *Reg. Z § 1026.43(e)(3) (discussing the points and fees caps for small loans); 88 Fed. Reg. 65,113 (Sept. 21, 2023) (threshold adjustments effective January 1, 2024.*

The APR limit for the general QM definition is also more generous for small-dollar mortgage loans.

To meet the general QM definition, the lender must stay below an APR threshold that varies based on the loan amount and type of the loan. The APR threshold ranges from 2.25% to 6.5% above the average prime offer rate (referred to here as the "prime" rate).

As of January 1, 2024, the APR limit to meet the definition of general QM is as follows:

Loan Amount	APR limit for general QM
Greater than or equal to $130,461	2.25% above prime
Greater than or equal to $78,277 but less than $130,461	3.5% above prime
Less than $78,277	6.5% above prime[6]

Source: *12 C.F.R. § 1026.43(e)(2)(vi)(A); 88 Fed. Reg. 65,113 (Sept. 21, 2023) (threshold adjustments effective January 1, 2024. APR limits vary for subordinate liens and liens secured by manufactured homes.*

Myth 2: *Lenders who make small-dollar mortgages will too easily run afoul of the high cost loan rule's points and fees trigger.*

Fact 2: *The high cost loan[7] triggers are also more generous for smaller balance mortgages.*

TILA imposes additional consumer protections for certain "high cost" loans, also known as HOEPA loans. One way of being defined as a "high cost loan" is carrying points and fees above a certain limit, which also depends in part on the loan size. For loan amounts above $26,092, the loan will be deemed "high cost" if the points and fees exceed 5% of the total loan amount.[8]

For loan amounts less than $26,092, the points and fees limit is the lesser of 8% of the total loan amount or $1,305.[9]

A specific example illustrates how the QM and HOEPA triggers work for a small balance mortgage.

As an example of how these rules interact, if a lender is making a residential mortgage loan in the amount of $74,000, it can charge up-front points and fees of up to 5% of the loan amount (here, $3,700) and an interest rate of up to 13.76%[10] and still be deemed a QM loan and a non-high cost loan. In addition, the lender can charge the borrower for third party costs (for example, the cost of an appraisal) that are reasonable and do not benefit the creditor.[11] Given the ample interest rate cap (13.76%), a lender that needs to charge more than $3,700 in origination costs can recoup those costs simply by charging a higher interest rate—which has the side benefit of making the costs of the loan more transparent to consumers.[12] Finally if a lender decides to charge more than $3,700 in up-front "points and fees" and the loan therefore does not meet the QM definition, the only consequence is that there is no presumption that the borrower has the ability to repay the loan—but even then, all the lender has to do is show that it verified and evaluated the borrower's ability to repay if challenged in litigation.

Watering down consumer protections is not the way to increase small-dollar mortgage lending.

It might cost less to build a car without seatbelts, but no one would recommend that solution to increase access to lower-priced cars. The ability-to-repay rules serve an important consumer protection purpose by ensuring that lenders make mortgage loans only after a reasonable determination of ability to repay, and not based on the value of the collateral or the individual lender's up-front profit. Removing this kind of consumer protection is not the right way to expand access to mortgage loans. It also runs the risk of undermining market stability, as we saw in the 2008 financial crisis.

Myth 3: *Loan Originator compensation rule discourages making small-dollar mortgages.*

Fact 3: *Lenders may still pay originators a salary or set a floor on compensation to adequately reward them for their work.*

Some have suggested that the Dodd-Frank era Loan Originator (LO) Compensation rules have posed a barrier to originating small-dollar mortgages. Under the Dodd Frank Act and subsequent regulations, loan originators may not receive compensation that is tied to any term of the transaction other than the amount of credit extended.[13] The purpose of this rule was to ban the practice of paying loan officers more for putting a borrower into a particular product, like an adjustable rate, interest-only, or pick-a-payment loan. If compensation is tied to the loan amount it must be based on a "fixed percentage" of the amount of credit extended, but it still “may be subject to a minimum or a maximum dollar amount.”[14] If a loan officer would typically make 1% of the loan amount in compensation, and if that seems insufficient for the work performed on a $100,000 mortgage loan, then rather than paying the officer $1,000 for such a transaction, the lender could provide for a minimum amount of compensation of, for example, $2,000 or $2,500 per transaction without violating the rule. Moreover, paying loan officers a salaried amount rather than paying them a percent of the loan amount is not prohibited by the LO compensation rule.

The LO compensation rule is not a barrier to originating more small-dollar mortgages. Weakening the rule would only allow originators to increase closing costs or steer borrowers to less advantageous loans that are more profitable to the lender.

Myth 4: *No one knows why there is such a shortage of lenders willing to make small-dollar mortgage loans.*

Fact 4: *The real barriers to making more small-dollar mortgages lending are that they are less profitable than larger loans and that the Government Sponsored Enterprise policies discourage small-dollar lending.*

While lending institutions can charge higher fees and higher APRs for small-dollar loans, larger loans certainly offer greater profits based on the way origination fees are currently calculated and the way loans and mortgage servicing rights are currently priced. Lenders make less off of any origination fees that are calculated as a certain percent of the loan amount, especially because many of their origination costs are fixed. They also make less on the sale of the mortgage servicing rights for smaller balance loans.[15]

Another major impediment to lenders making smaller balance mortgages is dealing with limitations imposed by secondary market players. Fannie Mae and Freddie Mac (the Government Sponsored Enterprises or GSEs) purchase more than half of the mortgages originated in the United States. It is not an easy process to get approved to sell mortgages to the GSEs. Smaller, mission-driven lenders interested in making mortgage loans have found it expensive and difficult to get approval to be a GSE seller-servicer. Once approved, they face consistent pressure to originate a certain volume per year of mortgages, based on the collective principal balance of all loans they originate and sell to the GSE. It is very difficult to meet a target origination volume per year, for example, when your average loan size is $85,000. Fannie Mae and Freddie Mac policies attract sellers that can originate a certain principal balance volume, rather than incentivizing their sellers to make many smaller dollar loans.

Recommendations: There are meaningful ways to expand access to small-dollar mortgages while protecting consumers.

We need a whole-government approach to encouraging lenders to make more small-dollar mortgage loans. This could be done through a combination of requirements, incentives, and subsidy. We recommend that federal agencies take the following steps:

Create a viable secondary market for small-dollar mortgages. The GSEs and their regulator, the Federal Housing Finance Authority (FHFA) should investigate the ways that the GSEs' seller-servicer approval process and volume requirements create barriers to small-dollar GSE lending, and make changes to facilitate the purchase and securitization of more small-dollar mortgages. This could be done under the framework of the Equitable Housing Finance Plans, through which FHFA requires the GSEs to develop a framework for addressing barriers to sustainable housing opportunities for underserved communities.[16] The Enterprise Housing Goals, which ensure that the GSEs fulfill their statutory and charter-based mission of serving low- and moderate-income families and underserved markets, should drive Fannie Mae and Freddie Mac to examine their role in increasing small-dollar mortgage lending.[17] The Duty to Serve rule similarly supports prioritization of this issue in support of the GSEs' statutory mission.[18]

Initiate pilot programs to study the best ways to incentivize lenders to make small-dollar mortgages. FHA has undertaken a study of barriers to small-dollar mortgage loans,[19] but has not yet taken any additional steps. The federal housing agencies should promote small-dollar lending through the development of funded incentive programs. This should include pilot programs in which the agencies utilize different kinds of incentives and different loan officer compensation structures and measure the results and efficacy of the programs.

Support and incentivize special purpose credit programs. Federal housing agencies and lending regulators should promote special purpose credit programs to provide more small-dollar mortgages to low-income borrowers and in communities of color.[20] Special purpose credit programs (SPCPs) are authorized by the Equal Credit Opportunity Act as a means of meeting the special needs of historically economically disadvantaged groups.[21] Fannie Mae and Freddie Mac's Equitable Housing Finance Plans rightly focus on promoting and supporting new SPCPs in the home lending space, and SPCPs can be used as an additional way to expand small-dollar mortgage lending.[22]

Enforce and investigate fair lending issues. HUD and the DOJ should investigate whether, and in what circumstances, the failure to extend more small-dollar mortgages in communities of color constitutes a fair lending violation.

Emphasizing the duties imposed by the Community Reinvestment Act is another possible strategy, but since there are many ways to meet CRA obligations and these obligations do not apply to the non-bank lenders that make more than half of new mortgage originations, the CRA is not likely to play a large role in addressing this issue.[23]

Congress and the agencies should continue to push this conversation forward and to examine questions like the role of loan officer compensation (salaried versus commission structure), servicer compensation and the pricing of mortgage servicing rights,[24] and efficient and automated underwriting systems. Reducing closing costs can also help move the break-even points for lenders, to encourage smaller balance lending.[25] On a basic level, lenders will not originate smaller-dollar mortgages unless it makes financial sense for them to do so.

There are many steps that Congress and federal agencies can take that will both preserve the important consumer protections around mortgage lending and make small-dollar mortgages more available. We need in-depth, factually grounded solutions to meet this important challenge.

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Endnotes

[1] Sarah B. Mancini, "Hijacking the Dream: How Land Contracts and Lease-Options Hinder Rather than Advance Access to Homeownership," Testimony before the Senate Banking Committee, Subcommittee on Housing, Transportation, and Community Development (July 11, 2023), https://www.banking.senate.gov/imo/media/doc/mancini_testimony_7-11-23.pdf; Linna Zhu, Rita Ballestros, *Making FHA Small Dollar Mortgages More Accessible Could Make Homeownership More Equitable*, Urban Institute (April 22, 2021), https://www.urban.org/urban-wire/making-fha-small-dollar-mortgages-more-accessible-could-make-homeownership-more-equitable.

[2] Pew Charitable Trusts, "Small Mortgages Are Too Hard to Get" (June 22, 2023), https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2023/06/small-mortgages-are-too-hard-to-get.

[3] *Id*. *See also* Sabiha Zainulbhai, Zachary Blizard, et al. *The Lending Hole at the Bottom of the Homeownership Market: Why Millions of Families Can't Get Small Dollar Loans*, New America, November 2021.

[4] 15 U.S.C. § 1639c(a)(1).

[5] The "pricing" threshold for the general QM category was promulgated by the CFPB in 2020 as an eventual replacement for the "GSE patch," which temporarily defined loans that are eligible for purchase by Fannie Mae or Freddie Mac as QM loans. In addition to falling below the relevant price threshold, the lender must "consider and verify" the borrower's income, assets, and debts with reliable third-party records. 12 C.F.R. § 1026.43(e)(2).

[6] Consumer advocates argue that this margin of 6.5% above prime for the smallest loan amounts is far too high. *See* Comments of the National Consumer Law Center, Consumer Federation of America, and Prosperity Now on Qualified Mortgage Definition under the Truth in Lending Act (Regulation Z): General QM Loan Definition (Sept. 8, 2020), https://www.nclc.org/wp-content/uploads/2022/08/NCLC-Joint-Long-QM-Comments.pdf.

[7] High cost loans are also referred to as HOEPA loans, after the Home Ownership and Equity Protection Act.

[8] Reg. Z § 1026.32(a)(1)(ii) (effective Jan. 10, 2014); 88 Fed. Reg. 65,113 (Sept. 21, 2023) (threshold adjustments effective January 1, 2024. Notably, the points and fees trigger for HOEPA originally was placed at 8% and lenders routinely evaded the rule placing the costs just below the trigger.

[9] *Id*. (both figures are adjusted annually for inflation).

[10] This assumes an average prime offer rate of 7.26%, plus 6.5%, which equals 13.76%.

[11] *See* 12 C.F.R. § 1026.32(b); 12 C.F.R. § 1026.4.

[12] *See* Elizabeth Renuart and Diane Thompson, "The Truth, The Whole Truth, and Nothing but the Truth: Fulfilling the Promise of Truth in Lending," 25:2 Yale Journal on Regulation 181, 209 (2008) (explaining

that most consumers can compare two stated APRs priced in identical units, but cannot make a comparison across multiple charges or units).

[13] 15 U.S.C. § 1639b(c)(1); 12 C.F.R. § 1026.36(d)(1)(i)-(ii).

[14] 12 C.F.R. § 1026.36 (d)(ii).

[15] *See* Mike Frantanoni et al, "How do Mortgage Revenues, Costs and Profitability Vary by Loan Balance? An Analysis Using Benchmarking Data," Mortgage Bankers Association (Aug. 2023), https://www.mba.org/docs/default-source/research-and-forecasts/research-white-papers/impact-of-loan-size-on-profits-9-7-2023.pdf?sfvrsn=7cf06db1_1.

[16] *See* 12 C.F.R. § 1293; Federal Housing Finance Agency, Fair Lending, Fair Housing, and Equitable Housing Finance Plans Final Rule, 89 Fed. Reg. 42768 (May 16, 2024); (Coalition Comments on FHFA's Request for Information on the Enterprises' Equitable Housing Finance Plans, at 4 (Oct. 25, 2021), https://www.nclc.org/wp-content/uploads/2022/08/FHFA_Equitable_Hsg_Finance_RJ_LEP-1.pdf; Comments of the National Consumer Law Center on Fannie Mae and Freddie Mac Equitable Housing Finance Plans Request for Input (June 7, 2024), https://www.nclc.org/wp-content/uploads/2024/07/RFI-FHFA-on-EHFP-June-2024-FNL.pdf.

[17] *See* 12 U.S.C. §§ 4561(a), 4562, and 4563; Federal Housing Finance Agency, Fair Lending, Fair Housing, and Equitable Housing Finance Plans Final Rule, 89 Fed. Reg. 42768 (May 16, 2024); Federal Housing Finance Authority, Fannie Mae & Freddie Mac Affordable Housing Goals, https://www.fhfa.gov/PolicyProgramsResearch/Programs/AffordableHousing/Pages/Affordable-Housing-FNMandFRE.aspx.

[18] *See* 12 U.S.C. § 4565; Federal Housing Finance Authority, Duty to Serve, https://www.fhfa.gov/PolicyProgramsResearch/Programs/Pages/Duty-to-Serve.aspx.

[19] *See* Financing Lower-Priced Homes: Small Dollar Mortgage Loans, Dep't of Housing and Urban Development, Office of Policy Development and Research (Oct. 2022), https://www.huduser.gov/portal/portal/sites/default/files/pdf/Financing-Lower-Priced-Homes-Small-Mortgage-Loans.pdf; Comments of the National Consumer Law Center on HUD's Request for Information Regarding Small Mortgage Lending (Dec. 5, 2022), https://www.nclc.org/resources/nclcs-comments-to-hud-regarding-small-dollar-lending/.

[20] *See* National Fair Housing Alliance, "Using Special Purpose Credit Programs to Expand Equality," (Nov. 4, 2020), https://nationalfairhousing.org/resource/using-special-purpose-credit-programs-to-expand-equality/.

[21] *Id*.

[22] Comments of the National Consumer Law Center on Fannie Mae and Freddie Mac Equitable Housing Finance Plans Request for Input (June 7, 2024), https://www.nclc.org/wp-content/uploads/2024/07/RFI-FHFA-on-EHFP-June-2024-FNL.pdf.

[23] *See* NCRC's Full Public Comment Letter on Community Reinvestment Act Interagency Rulemaking, National Community Reinvestment Coalition (Aug. 4, 2022), https://ncrc.org/ncrcs-full-public-comment-letter-on-community-reinvestment-act-interagency-rulemaking/.

[24] *See* The Alternative Mortgage Servicing Compensation Discussion Paper, Comments of the National Consumer Law Center and National Association of Consumer Advocates (2011), https://www.fhfa.gov/PolicyProgramsResearch/Policy/Documents/Joint-Mortgage-Servicing-Compensation-Initiative/130_Diane_Thompson.pdf; Adam J. Levitin and Tara Twomey, Mortgage Servicing, Yale Journal on Regulation, Vol. 28, No. 1, 2011 (last revised Sept. 10, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1324023; Mike Frantanoni et al, How do Mortgage Revenues, Costs and Profitability Vary by Loan Balance? An Analysis Using Benchmarking Data, Mortgage Bankers Association (Aug. 2023), https://www.mba.org/docs/default-source/research-and-forecasts/research-white-papers/impact-of-loan-size-on-profits-9-7-2023.pdf?sfvrsn=7cf06db1_1.

[25] See, e.g., Coalition Letter to Sandra Thompson, Federal Housing Finance Authority, on Title Insurance Waiver Pilots (July 12, 2024), https://www.nclc.org/resources/coalition-letter-to-federal-housing-finance-agency-on-title-insurance-waiver-pilots/.