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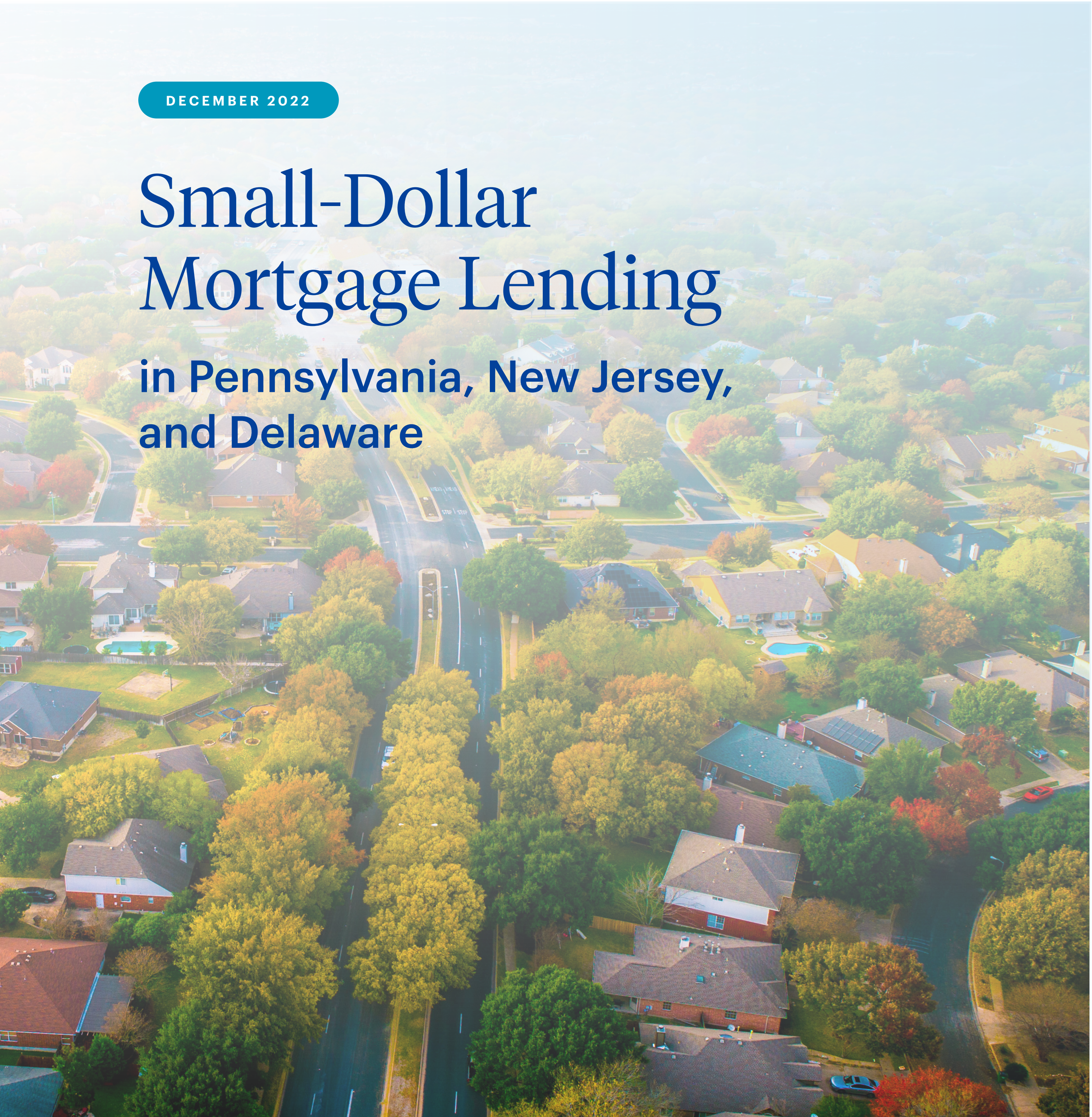
Small-Dollar Mortgage Lending

in Pennsylvania, New Jersey, and Delaware



COMMUNITY DEVELOPMENT AND REGIONAL OUTREACH

By Emily Goldstein and Kyle DeMaria*

Key Findings

- Defined in this report as having a loan value of $100,000 or less, small-dollar mortgages declined 28 percent in Pennsylvania, 43 percent in New Jersey, and 28 percent in Delaware between 2019 and 2021.
- The majority of small-dollar mortgages were originated to White and low- and moderate-income borrowers, and these borrowers composed a greater share of small-dollar borrowers than mortgage borrowers overall.
- The denial rate for small-dollar purchase mortgage applications was about twice that for applications overall. Small-dollar mortgage applicants were more likely to be denied because of credit history than were applicants overall.
- Relative to their overall mortgage lending share, banking institutions played an outsized role in the origination of small-dollar mortgages.

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Introduction

Homeownership is a critical tool for building wealth and financial stability, yet sizeable disparities exist in the attainment of homeownership by race, ethnicity, and income (Joint Center for Housing Studies of Harvard University, 2022; Layton, 2021). Small-dollar mortgages — defined in this report as having a loan value of $100,000 or less — are an important tool for narrowing these disparities because they facilitate the purchase of lower-cost homes for households with limited income and savings. This report explores the prevalence and characteristics of small-dollar mortgage lending in Pennsylvania, New Jersey, and Delaware — hereafter referred to collectively as the tristate area. Using 2021 Home Mortgage Disclosure Act (HMDA) data, we describe the geographic distribution of small-dollar loans, the race and income of borrowers who received them, denial rates and denial reasons on small-dollar applications, and the dominant lender types involved in small-dollar originations.

We find that the number of small-dollar originations declined considerably between 2019 and 2021 in Pennsylvania (28 percent), New Jersey (43 percent), and Delaware (28 percent). While the small-dollar share of originations was greater in counties with a greater share of lower-value properties, about half of originations were in urban communities. The vast majority of small-dollar mortgages were originated to White and low- and moderate-income borrowers. The denial rate for small-dollar mortgage applications was about twice that for mortgage applications overall, and that gap remained after controlling for loan, applicant, lender, and local market factors — excluding credit score. Small-dollar mortgage applicants were more likely to be denied because of credit history than were applicants overall. These findings inform the public policy conversation around small-dollar mortgages and the role they can play in expanding access to affordable homeownership.

Background

During the COVID-19 pandemic, high demand for housing and a limited supply of properties for sale produced a surge in house prices, such that by July 2021, prices had increased by 19.3 percent from a year earlier (Duca and Murphy, 2021). Despite these housing pressures, low-cost properties valued at less than $100,000 accounted for nearly 14 percent of all owner-occupied housing nationally, according to the 2021 American Community Survey 1-year estimates. Even with the availability of low-cost properties, access to small-dollar mortgages was constrained. Applicants for small-dollar mortgages were denied credit at a rate twice that of applicants for larger loans, even though the credit profiles of applicants were similar (Goodman, Bai, and Li, 2019). In addition, the difference in the 90-day delinquency rate between smaller and larger loans has declined since the Great Recession — with the rates nearly converging in 2018 (McCargo, Bai, and Strochak, 2019).

In the years following the Great Recession, the availability of small-dollar mortgages declined. Lending institutions originated fewer lower-value loans in favor of higher-value loans — a reversal that was particularly pronounced for the largest lenders (D'Acunto and Rossi, 2022). In fact, between 2009 and 2016, the number of single-family purchase mortgages with loan values between $10,000 and $70,000 decreased by 17 percent, while there was double-digit or greater growth in loans valued at $150,000 or more (McCargo, Bai, George, and Strochak, 2018). The trend toward larger loans was accounted for in part by home price growth. It is also possible that lending safeguards introduced in the Dodd-Frank Act, passed in 2010, produced the unintended consequence of disincentivizing lending institutions from originating smaller mortgages (D'Acunto and Rossi, 2022; Zainulbhai, Blizard, Richardson, and Panfil, 2021). Lenders seeking a simple way to abide by the "Ability to Pay" rule can choose to originate Qualified Mortgages. Qualified Mortgages impose restrictions on the loan fees that can be charged to prospective borrowers, and the fee structure is progressive: The greater the loan value, the greater the origination fee that can be collected (Consumer Financial Protection Bureau, 2017). Meanwhile, origination costs incurred by lenders tend to be fixed regardless of loan size. As a result, there is an incentive to originate higher-value loans.[1]

Investor demand for low-cost properties can also inhibit the ability of prospective homeowners to make use of small-dollar mortgages. Investor purchases of low-priced

[1] Under Qualified Mortgage rules, it is possible for a lender to see zero or negative returns on the origination of a smaller mortgage if the fixed cost of origination is greater than the allowable fee. See Figure 5 of Zainulbhai, Blizard, Richardson, and Panfil (2021) for a graph illustrating this effect.

homes grew remarkably during the COVID-19 pandemic and peaked in the second quarter of 2021 (Katz and Bokhari, 2022) — representing more than one in five (21.2 percent) low-cost homes sold in that quarter (Katz and Bokhari, 2021).[2] Investors can move on properties quickly because about three-quarters of investor purchases are made in cash (Anderson and Bokhari, 2022). In 2019, nearly one-quarter (23 percent) of homes sold for less than $100,000 were purchased with a mortgage, compared with the nearly three-quarters (74 percent) of homes that sold for $100,000 or greater (McCargo, Zhu, Strochak, and Ballesteros, 2020).

When homebuyers are unable to secure a small-dollar mortgage from a bank or other financial institution, they may turn to alternative financing methods, such as contracts-for-deed, lease-purchase agreements, seller-financed mortgages, or personal property loans. These alternatives may have higher associated costs, less favorable loan terms, and greater financial risks than traditional mortgage purchase agreements (Liang and Roche, 2022). A sizeable share of Hispanic borrowers (34 percent) and borrowers earning less than $50,000 a year (23 percent) use alternative home financing (Canavan, Roche, and Siegel, 2022). Collectively, the various impediments to receiving a small-dollar mortgage underscore the need to better understand small-dollar mortgage lending activity.

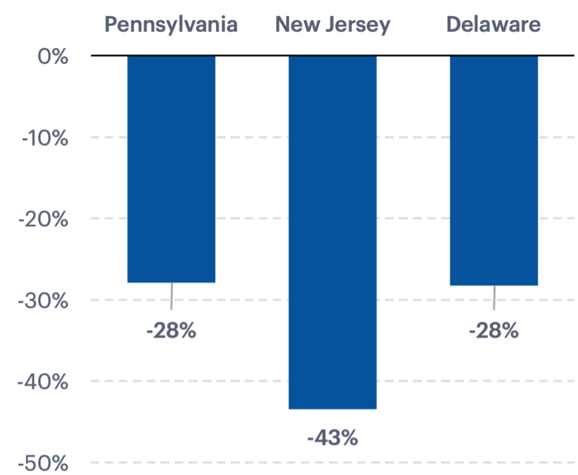
Defining a Small-Dollar Mortgage

In this report, we define a small-dollar mortgage as having a loan value of $100,000 or less. We use this threshold to conform with the convention used in recent research (McCargo, Zhu, Strochak, and Ballesteros, 2020). Further supporting this definition, we examined the cumulative frequency of originations in the tristate area in 2021 by loan amount bins of $10,000 and found that among lower-value loans, the largest increase in cumulative frequency occurred at the $100,000 threshold. Our threshold is static in that it does not vary by place or year. We adopt a static threshold — instead of adjusting the threshold for home price appreciation — because some sales commissions and loan fees paid by buyers are determined based on loan value, and we want to compare the prevalence of similar loans across place. We further limit our analysis exclusively to purchase mortgages and mortgages for one-to-four-unit, owner-occupied properties.

The Landscape of Small-Dollar Mortgage Lending

Despite the growth in home purchase mortgages in the tristate area during the COVID-19 pandemic, both the quantity of small-dollar purchase mortgages and their share of all purchase originations declined between 2019 and 2021. During this period, the number of small-dollar mortgages declined 28 percent in Pennsylvania, 43 percent in New Jersey, and 28 percent in Delaware (Figure 1). By 2021, small-dollar mortgages accounted for 8 percent of purchase mortgages in Pennsylvania (about 12,000 loans), 1 percent in New Jersey (about 1,400 loans), and 2 percent in Delaware (about 300 loans). Because we use a static threshold of $100,000 to define a small-dollar mortgage, an increase in home values is one factor that could have contributed to the declining quantity and share of small-dollar mortgages.

FIGURE 1 **Percent Decline in Small-Dollar Mortgage Originations (2021 vs. 2019)**



Sources: Authors' calculations using 2019 and 2021 Home Mortgage Disclosure Act (HMDA) data.

[2] In Philadelphia in 2021, investors purchased 44 percent of homes sold in the West Philadelphia zip code of 19139 and 40 percent of homes sold in the North Philadelphia zip code of 19133 (Schaul and O'Connell, 2022).

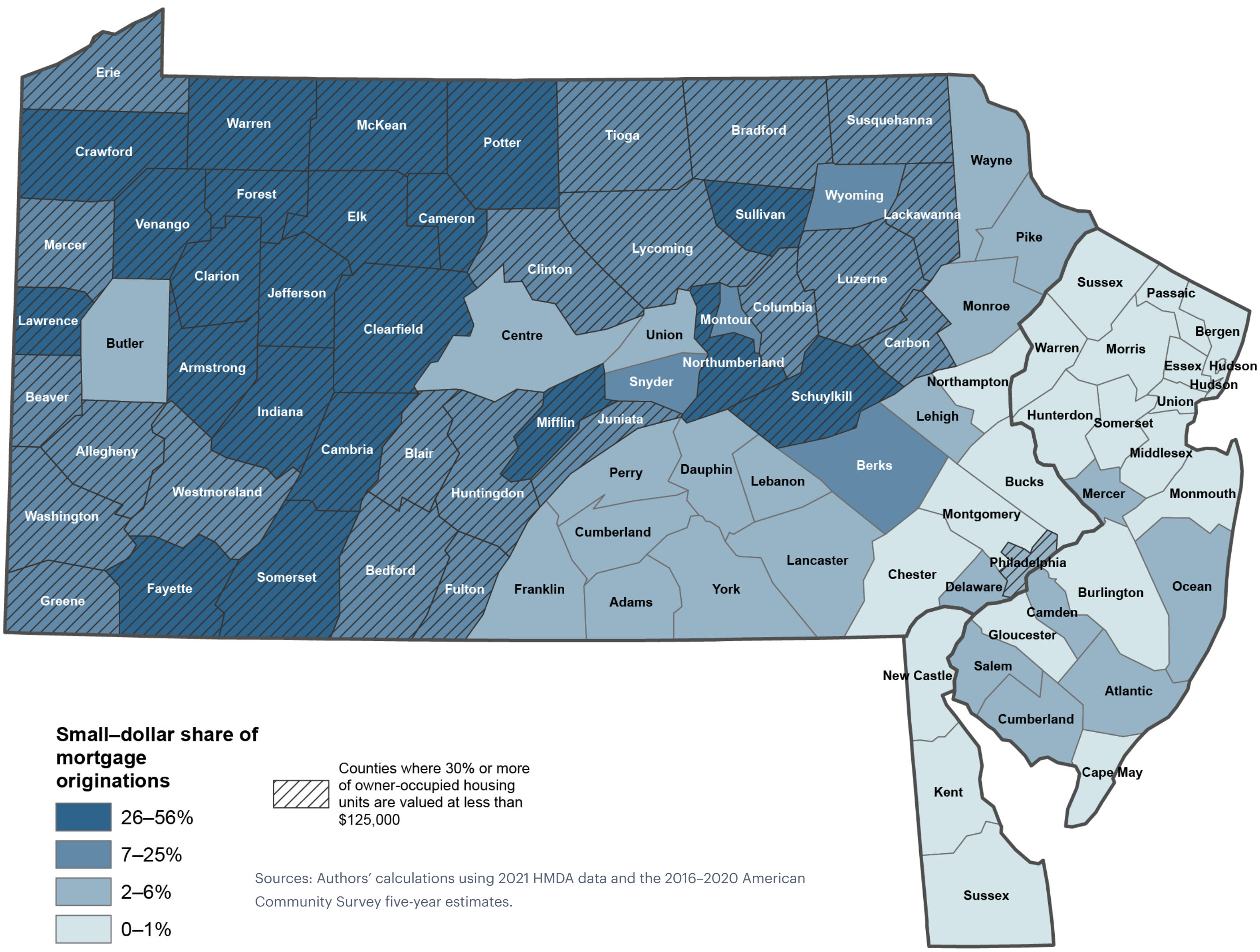
In Figure 2, we map the small-dollar share of originations by county and identify those counties where at least 30 percent of homes were valued at less than $125,000.[3] Generally speaking, counties with a greater share of small-dollar mortgages (indicated by darker shading) tended to have a greater share of lower-value properties (indicated by diagonal hashed lines), and many of these counties are located in western and northern Pennsylvania. By contrast, in northern New Jersey, Delaware, and the suburbs of Philadelphia, small-dollar mortgages were a low share of originations, and homes were of higher value. However, in Philadelphia, small-dollar mortgages were a low share of originations, but at least 30 percent of homes were of lower value.

Figure 2 suggests small-dollar mortgage lending is a rural phenomenon, but a meaningful share of these loans was originated in urban areas.[4] To explore small-dollar mort-

[3] We use a home value threshold of less than $125,000 because of loan-to-value (LTV) considerations. The average combined loan-to-value ratio on small-dollar applications was nearly 84 percent. An LTV of 80 percent on a $100,000 mortgage would yield a property value of $125,000.

[4] HMDA coverage of mortgage lending is sparser in rural areas than urban areas because reporting requirements exempt certain lending institutions from reporting HMDA data if they originate few loans or have a banking or lending presence outside metropolitan statistical areas. An analysis of 2015 HMDA data finds that HMDA coverage is about 80 percent in remote nonmetropolitan counties and is above 90 percent in metropolitan counties (Johnson and Todd, 2019).

FIGURE 2 **Small-Dollar Share of Mortgage Originations and Home Values by County (2021)**



Sources: Authors' calculations using 2021 HMDA data and the 2016–2020 American Community Survey five-year estimates.

gage lending by place, we use a special tabulation of the U.S. Census Bureau urban/rural classification published at the census tract level by the Federal Financial Institutions Examination Council (FFIEC). While the small-dollar share of originations was greater in more rural communities, about half of small-dollar mortgages were originated in urban communities in Pennsylvania (52 percent), New Jersey (62 percent), and Delaware (49 percent) (Figure 3).

A Demographic Snapshot of Small-Dollar Mortgage Borrowers

Borrower Income

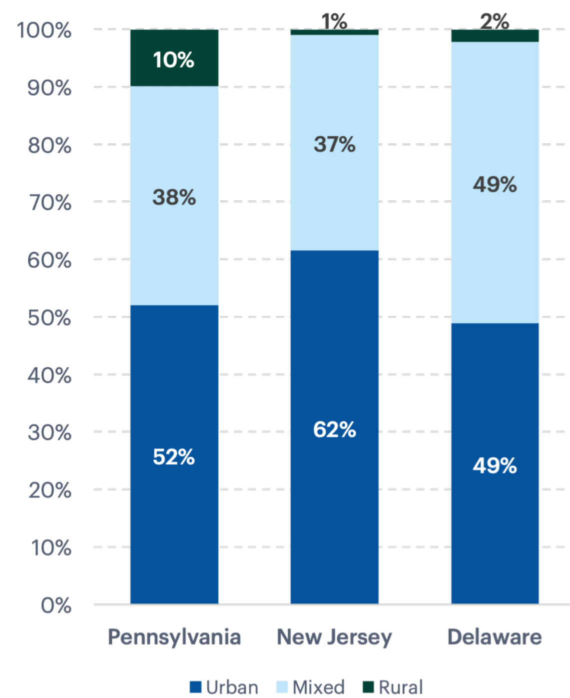
Low- and moderate-income (LMI) borrowers were the primary recipients of small-dollar mortgages in the tristate area in 2021.[5] Whereas about one-third of all purchase mortgages were originated to LMI borrowers, a much higher share of small-dollar mortgages in Pennsylvania (75 percent), New Jersey (81 percent), and Delaware (63 percent) were originated to LMI borrowers (Figure 4). Low-income borrowers — with incomes under 50 percent of the area median family income — made up just over one-third of all small-dollar originations in both Pennsylvania (39 percent) and Delaware (36 percent), and just over half in New Jersey (53 percent).[6] Expressed in dollars, small-dollar mortgage borrowers had a median income of $42,000 in Pennsylvania, $47,000 in New Jersey, and $52,000 in Delaware.

Borrower Race and Ethnicity

In this section, we describe the race and ethnicity of small-dollar mortgage borrowers.[7] The majority of small-dollar borrowers in Pennsylvania (82 percent), New Jersey (64 percent), and Delaware (78 percent) were White, and a slightly greater share of small-dollar borrowers were White than borrowers overall (Figure 5).[8] About one-tenth of small-dollar borrowers were Hispanic (8 to 16 percent) and about one-tenth were Black (7 to 13 percent). The map in Figure 2 and the findings regarding borrower race and ethnicity underscore the connection between place and race. In fact, while nearly all small-dollar borrowers in rural areas were White (97 percent), that share was much less in urban areas (70 percent).

FIGURE 3

Share of Small-Dollar Mortgage Originations by Urban/Rural Classification (2021)



Note: We categorize place at the census tract level using a special tabulation of the census urban/rural classification published by the FFIEC. The FFIEC defines "mixed" tracts as those containing both urban and rural census blocks.

Sources: Authors' calculations using 2021 HMDA data and 2012 census urban/rural classification data accessed via the 2021 FFIEC Census Flat File.

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[5] We define borrower income categories using Community Reinvestment Act (CRA) definitions: low- and moderate-income borrowers have incomes below 80 percent of the area median family income and middle- and upper-income borrowers have incomes that are 80 percent or greater of the area median family income.

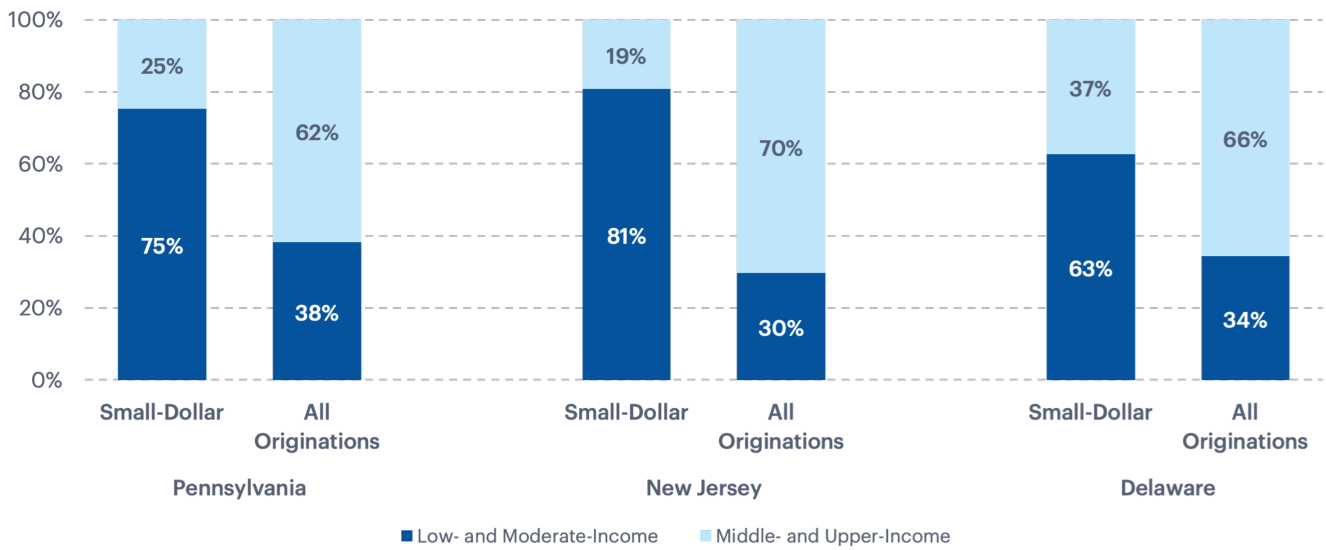
[6] Upper-income borrowers — with an income at least 120 percent of the area median family income — accounted for around one-tenth of small-dollar originations in Pennsylvania (8 percent), New Jersey (8 percent), and Delaware (14 percent).

[7] A meaningful share of HMDA records are missing race or ethnicity data. In one extreme, no applicant race or ethnicity data are available for 15 percent of small-dollar mortgage borrowers in New Jersey. Missing race and ethnicity data in HMDA is a known problem. See Richardson (2022) and Dietrich (2002).

[8] We use mutually exclusive race/ethnicity categories so that White, Black, and other borrowers are non-Hispanic.

FIGURE 4

Composition of Small-Dollar Mortgage Borrowers by Income (2021)

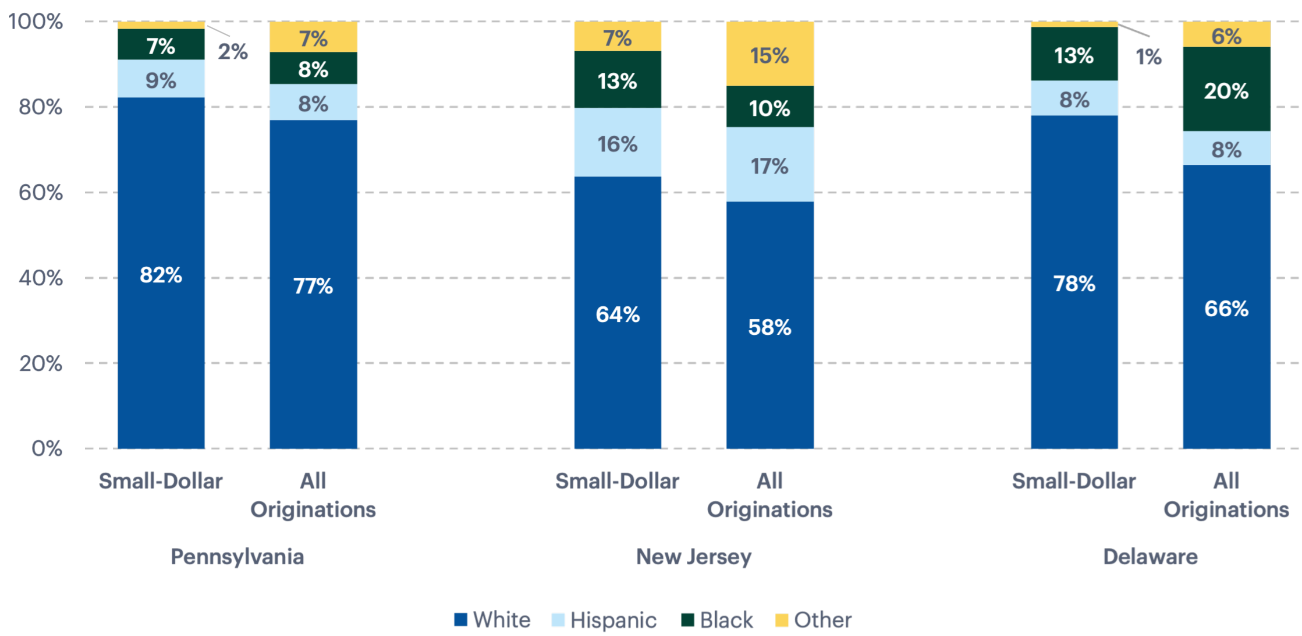


Note: About 1 percent of originations in each state are omitted from this figure because they are missing income information.

Sources: Authors' calculations using 2021 HMDA data and the 2021 FFIEC Median Family Income Report.

FIGURE 5

Composition of Small-Dollar Mortgage Borrowers by Race and Ethnicity (2021)



Note: We omit originations from this figure where race and ethnicity are unknown; these account for 11 percent of originations in Pennsylvania, 14 percent in New Jersey, and 11 percent in Delaware.

Source: Authors' calculations using 2021 HMDA data.

Denial Rates for Small-Dollar Mortgage Applications

In Figure 6, we present denial rates for small-dollar mortgage applicants by race and ethnicity. Applicants for small-dollar mortgages were denied at a rate about twice that of applicants overall in Pennsylvania (16 versus 8 percent), New Jersey (20 versus 9 percent), and Delaware (16 versus 8 percent). For most racial and ethnic groups, the small-dollar denial rate is about twice that for all purchase mortgage applications, with a couple exceptions. In New Jersey, Hispanic small-dollar applicants were denied at a rate (31 percent) nearly three times the denial rate for all Hispanic mortgage applicants (11 percent). In Delaware, Black small-dollar applicants were denied at a rate (39 percent) more than three times the denial rate for all Black mortgage applicants (12 percent).

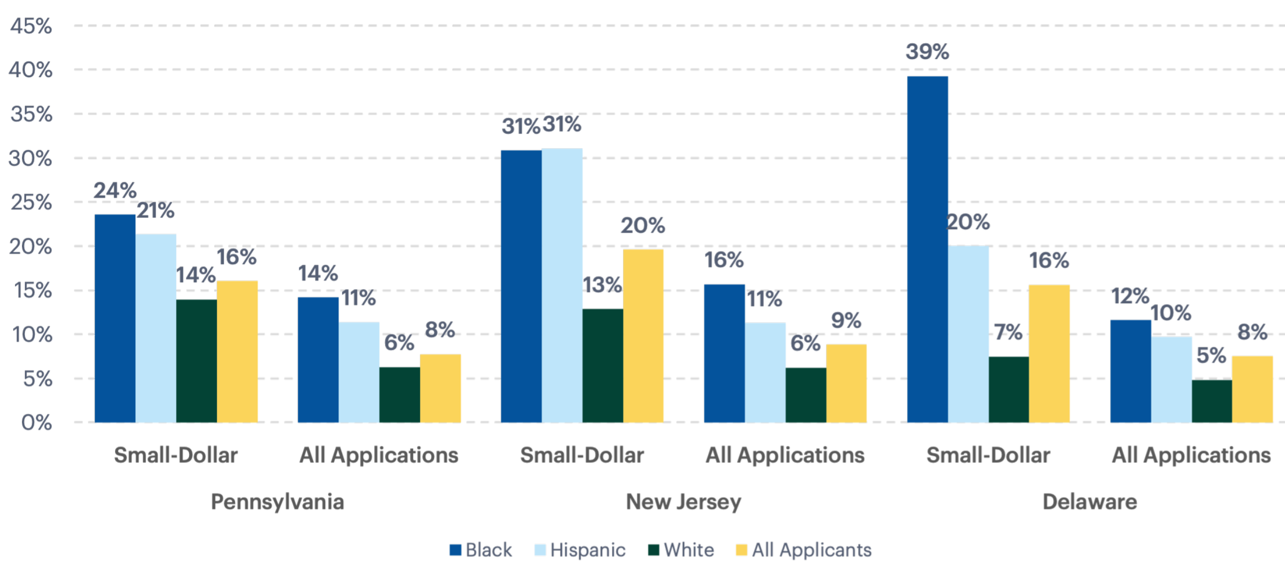
We perform a regression analysis to estimate what percent of the denial rate gap between small-dollar and larger-value mortgages can be explained using variables available in the public HMDA data. These variables include applicant income, debt-to-income (DTI) ratio, combined loan-to-value ratio, existence of a coapplicant, loan type, and county fixed effects. The last variable controls for local market factors, such as the supply of lower-value properties. Collectively, these factors explain only 40 percent of the denial rate gap in Pennsylvania, 19 percent of the gap in New Jersey, and 5 percent of the gap in Delaware. Other characteristics related to loans, applicants (e.g., credit score), or lenders may help explain the gap, and this is an opportunity for future research.

An analysis of denial reasons reveals the important role credit history plays for small-dollar mortgage applicants. For both small-dollar and purchase mortgage applications overall, the most common denial reasons were poor credit history, a high DTI ratio, and insufficient collateral (Figure 7). However, credit history was more commonly cited on denied small-dollar applications (30 percent) than on applications overall (19 percent). In addition, a high DTI ratio was cited less frequently on denied small-dollar applications (24 percent) than on applications overall (33 percent).

Lenders of Small-Dollar Mortgages

In this report, we classify lending institutions according to whether they take deposits (i.e., banks) or do not take

FIGURE 6 **Denial Rates by Loan Amount and Applicant Race and Ethnicity (2021)**



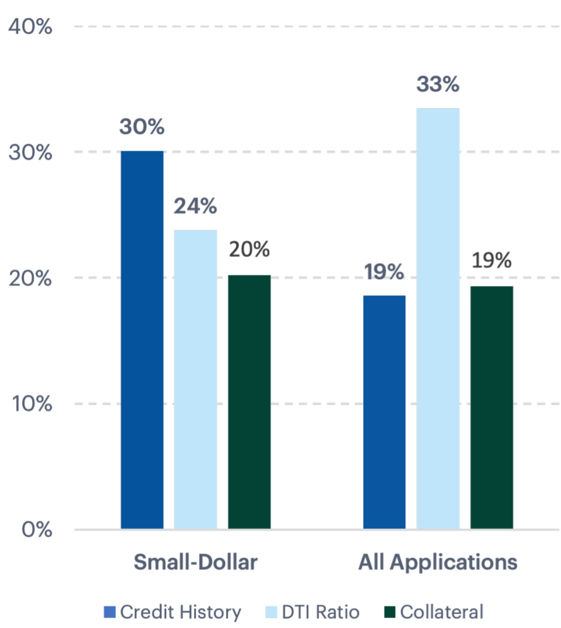
Source: Authors' calculations using 2021 HMDA data.

deposits (i.e., nonbanks). We further classify banks according to the size of financial assets held on their balance sheets: Community banks had assets of less than $10 billion and large banks had assets of $10 billion or more.[9]

Despite originating the majority of purchase mortgages in the tristate area, nonbanks notably originated a disproportionately low share of small-dollar mortgages (Figure 8). For example, in Pennsylvania, the nonbank share of small-dollar mortgages (48 percent) was 15 percentage points less than the nonbank share of all purchase mortgages (63 percent). Credit unions originated a small and generally consistent share of both small-dollar mortgages and mortgages overall.

Banking institutions played an outsized role in the origination of small-dollar mortgages in 2021. Together, large and community banks originated a greater share of small-dollar mortgages than they did mortgages overall in Pennsylvania (46 versus 33 percent), New Jersey (33 versus 23 percent), and Delaware (32 versus 29 percent). In New Jersey and Delaware, most of this additional small-dollar market share was captured by large banks, but in Pennsylvania, the difference was primarily attributable to community banks.[10]

FIGURE 7 **Most Common Denial Reasons Provided on Denied Mortgage Applications (2021)**



Source: Authors' calculations using 2021 HMDA data.

Discussion

In this report, we examine the landscape of small-dollar mortgage lending in the tristate area by describing the geography of small-dollar lending, the composition of borrowers by income, race, and ethnicity, the denial rates and reasons for these loan denials, and the lender types originating these loans. Small-dollar mortgages represented a minimal share of purchase originations in the tristate area (1 to 8 percent) in 2021, and the number of small-dollar originations declined considerably in recent years. While nonbanks were the largest small-dollar lender, we find that banks originated a greater share of small-dollar mortgages than mortgages overall. That most small-dollar borrowers have low or moderate incomes underscores the importance of these types of loans for banking institutions in meeting their lending obligations under the Community Reinvestment Act (CRA).

However, accessing credit through a small-dollar mortgage remains a challenge. The denial rate for small-dollar mortgage applications was about twice that for mortgage applications overall, and a meaningful denial rate gap remained even after controlling for applicant, loan, lender, and local market factors, excluding credit score. Black and Hispanic applicants for small-dollar mortgages were denied more often than White applicants, but that disparity was generally not greater for small-dollar mortgage applicants in particular. In addition, a greater share of small-dollar mortgage applications (30 percent) were denied because of credit history than were applications overall (19 percent).

Credit scores — a key factor used in mortgage lending decisions — have been shown to be less predictive of

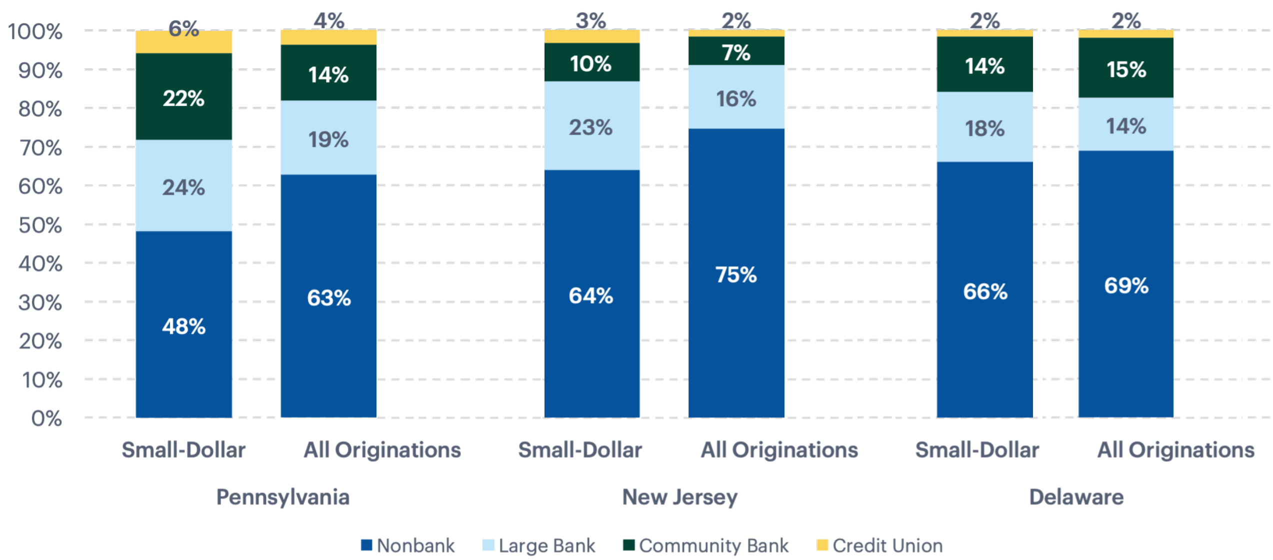
[9] Nonbanks are commonly private, independent mortgage companies, including those that are online only.

[10] Looking within lender categories, small-dollar mortgages represented a low share of purchase originations at community banks (9 percent), credit unions (9 percent), large banks (6 percent), and nonbanks (4 percent). Interestingly, for a subset of community banks with assets less than $500 million, we find that more than one-fifth (21 percent) of their originated mortgages were small-dollar loans.

default risk for minority and lower-income applicants than they are for nonminority and higher-income applicants (Blattner and Nelson, 2021). Thin credit files (i.e., a lack of credit data) rather than credit models are largely responsible for this disparity (Blattner and Nelson, 2021). Recently, government-sponsored enterprises (GSEs) such as Fannie Mae and Freddie Mac have made it possible for lenders to consider the demonstration of consistent and on-time rental payments in underwriting decisions for GSE loans (Fannie Mae, 2022; Freddie Mac, 2022). Alongside strategies to minimize lender origination costs, these efforts could expand access to small-dollar mortgages and affordable homeownership opportunities for low- and moderate-income borrowers.[11]

[11] In 2019, the Urban Institute and partners launched the MicroMortgage Marketplace Demonstration Project in the Louisville, KY, metropolitan area to test whether community development financial institutions (CDFIs) could improve access to small-dollar mortgages by expanding underwriting criteria and reducing fixed origination costs (McCargo, Zhu, Strochak, and Ballesteros, 2020).

FIGURE 8 **Share of Small-Dollar Mortgage Originations by Lender Type (2021)**



Source: Authors' calculations using 2021 HMDA data and the Federal Reserve National Information Center (NIC) database via the HMDA Lender File published by Robert Avery (2021).

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