

MORTGAGE ACCESS INITIATIVE ▶

PHASE 1 POLICY RECOMMENDATIONS

WHAT IS THE MORTGAGE ACCESS INITIATIVE?

In 2020 and 2021, we as a country bore witness to racial disparities on multiple fronts. From police violence against Black people and the unrest that ensued, to the COVID pandemic's disproportionate impact on Black and Brown communities, structural racism was front and center. In Chicago, we read the study by WBEZ and City Bureau showing that lenders had originated more mortgages in a single White neighborhood than all Black neighborhoods combined. Together, these events drove policymakers to develop legislative solutions such as the Illinois Community Reinvestment Act and the Chicago Lending Equity Ordinance.

Neighborhood Housing Services of Chicago (NHS) and Woodstock Institute saw an opportunity to have an honest conversation with mortgage lenders about the barriers to homeownership for borrowers of color. Learning from the experiences of past initiatives with similar goals, the decision was made to convene representatives from different kinds of mortgage lenders (banks, credit unions, and mortgage companies) of different sizes (from regional to national) to share their expertise in closed-door meetings – so the Mortgage Access Initiative (MAI) began in the Fall of 2021.

The end goal was to develop industry, policy and regulatory recommendations rooted in the decades of industry experience that MAI members brought to the table, but without the challenges associated with those recommendations being tied to any of the participating institutions. The first step was to map the mortgage lending process from soup to nuts. MAI members helped fill in the gaps and details from the lender side of the process, and housing counselors through interviews with borrowers of color helped fill the gaps from the borrower perspective.

This process map allowed for better questions of everyone involved in the process and identified intersection points with other important stakeholders like appraisers, real estate professionals, and the government sponsored enterprises (GSEs) like Fannie Mae and Freddie Mac. A link and QR code to view the full Mortgage Process Map online can be found at the end of this report.

After 18 months of meetings, both in-person and virtual, Phase 1 concluded with three main recommendations:

- 1 Create an Equitable Mortgage Product**
- 2 Ensure FHA Loans Only Go to Borrowers Ineligible for Conforming Loan Products**
- 3 Address Loan Officer Compensation Structure & Optimize Relationships with Housing Counselors**



RECOMMENDATION #1 ►

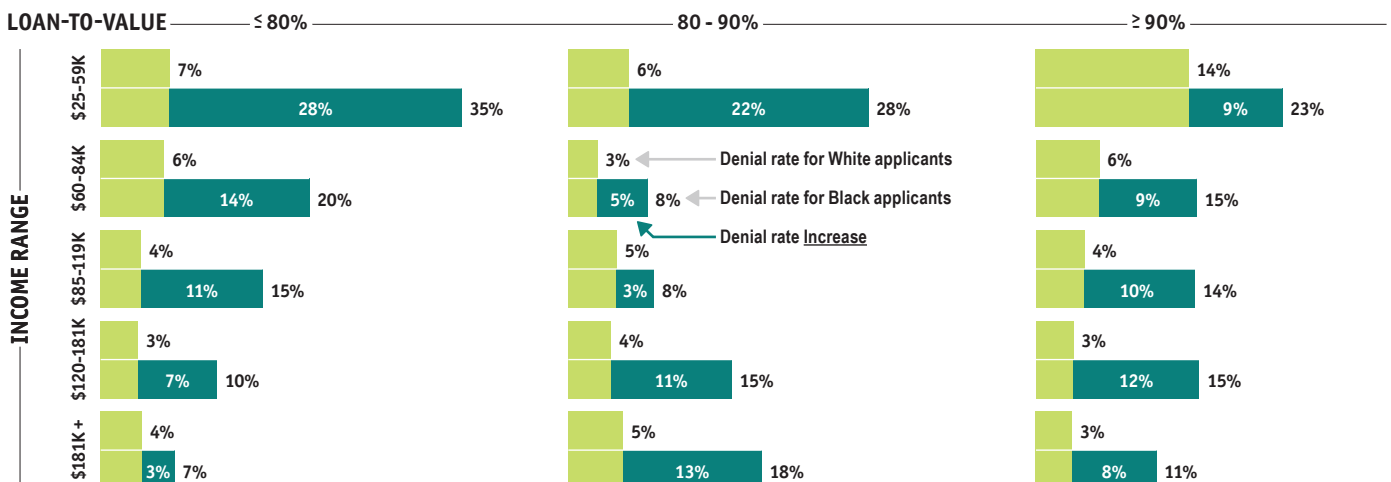
CREATE AN EQUITABLE MORTGAGE PRODUCT

Mortgage borrowers and home buyers of color face multiple, long-standing barriers to mortgage access as a result of historic and systemic inequities. These barriers range from lack of generational wealth and substantial savings for down payment and other costs associated with buying a home, to a credit scoring system shown to disadvantage applicants of color, low property valuations in formerly redlined and majority-minority neighborhoods, and more. To materially improve access to mortgage credit for people of color, a widely available mortgage product with terms that address these barriers is needed.

We recommend that the GSEs develop and agree to purchase an equitable mortgage product with underwriting terms that address identified barriers while minimizing additional risk. During this process, we identified a number of institutions (some MAI members, but others not) providing a mortgage product with innovative underwriting terms that specifically address many of the barriers that borrowers of color encounter in the mortgage process. However, to our knowledge, only one of these products is currently being purchased by a GSE.

Denial Rate Increase

Black Applicants Compared to White Applicants, by Income Range and Loan-To-Value



Data source: 2021 HMDA Data on Mortgage Lending.

We recommend a loan product with the following terms, at minimum:

- ▶ Down payment as low as 3%, available to all income levels, with flexibility as to the source of the down payment
- ▶ No Private Mortgage Insurance (PMI), or PMI paid by the lender, a municipality or philanthropy
- ▶ No Loan Level Pricing Adjustments (LLPA)
- ▶ Up to 50% debt-to-income (DTI) or higher
- ▶ Manual or flexible underwriting, with no “bright line” disqualifiers, such as credit score
- ▶ Using alternative measures of credit history, such as rental and utility payment history, as well as or instead of credit score for underwriting
- ▶ Provide financing for purchase and purchase-rehab bundled (rehab up to \$50,000 or 75% After Rehab Value, whichever is greater)
- ▶ 97% after-repair loan-to-value (LTV) on any 1st mortgage; up to 110% LTV for a 2nd mortgage

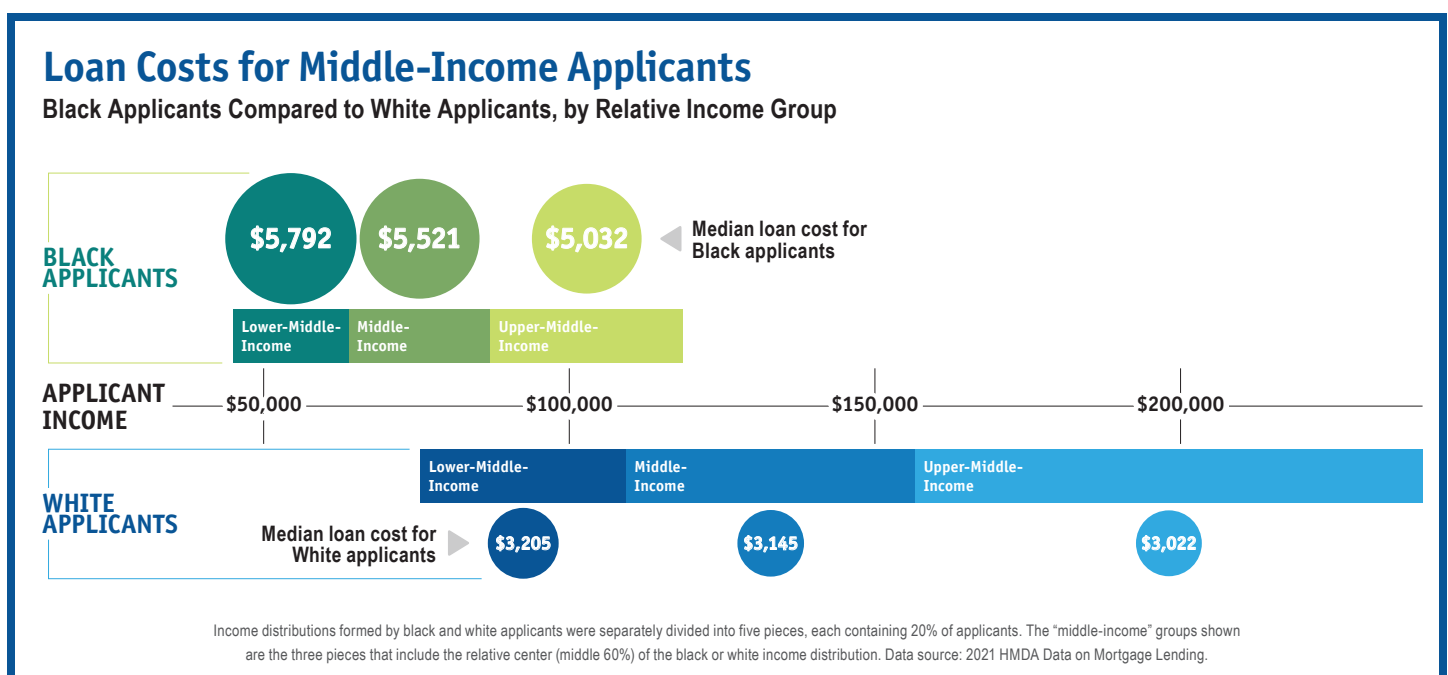
RECOMMENDATION #1 COMMENTS

Some of these underwriting parameters are self-explanatory or reflect characteristics that are similar to other existing products on the market,

some of which are being purchased by the GSEs. Others are a greater shift from what is already available.

PURCHASABLE BY GSES: We heard from other MAI members that the main barrier to providing products like these is that they have to keep these loans on their books rather than selling them on the secondary market to free up capital. Fannie Mae and Freddie Mac represent approximately 70-80% of the secondary market, providing the primary liquidity that supports the mortgage market nationwide. Given that two-thirds of mortgages originated in the United States come from non-bank lenders, who typically cannot hold loans on their books long-term, the decisions made by GSEs as to the loans they will purchase dictate the overall mortgage market. In order for equitable mortgage products to become widely available across institutions and geographies and reduce racial disparities, they must be purchasable by the GSEs. This is a critically important role that these government sponsored enterprises can and must play in reducing racial disparities in mortgage lending, and consistent with their statutory Duty to Serve obligations.

NO LOAN LEVEL PRICING ADJUSTMENTS (LLPAS): Loan Level Pricing Adjustments (LLPAs) are risk-based adjustments based on factors like credit score, loan-to-value ratio, and loan product type. In practice, LLPAs are punitive towards groups that have been financially marginalized, particularly people of color; are the primary contributing practice to people of color being disproportionately put



into more expensive loans; and create barriers to credit for those borrowers. For example, LLPAs result in higher interest rates for borrowers with lower credit scores, which reflect racially biased data. LLPAs also contribute to an already opaque process that leaves many borrowers of color feeling cheated and turns them off from the homebuying process entirely. Mission-driven lenders like NHS have found no negative impact on loan performance by abandoning this practice.

AVAILABLE TO ALL INCOME LEVELS: Families of color have historically been denied equal access to the wealth-building power of homeownership. Revitalizing disinvested communities requires promoting income diversity and a vibrant middle class in those communities, and not perpetuating the concentration of poverty and racial segregation caused by past government policies. From an equity standpoint, limiting access to mortgage credit to only the lowest incomes that can afford homeownership does exactly the latter, and locks moderate income families out of resources to access an upward economic trajectory and wealth building. That’s not “equity.” As home prices and interest rates continue to rise, homeownership will continue to be inaccessible to more and more Americans, especially aspiring homeowners of color. Therefore, an equitable loan product should be available regardless of income to help redress the widening homeownership gap and promote sustainable community revitalization and income diversity in communities of color.

AUTOMATED UNDERWRITING SYSTEM (AUS): Similarly, we recommend a product that uses manual or flexible underwriting standards, instead of an Automated Underwriting System (AUS) built on decades of disparate lending activity. More flexible underwriting allows for a lender to consider a borrower’s financial profile more holistically. We heard from MAI members, both lenders and housing counselors, that “bright line” disqualifiers, like a minimum credit score, can block a borrower with an otherwise ideal financial profile from getting a mortgage. Flexible underwriting would allow a loan officer to weigh many different parts of a borrower’s financial profile, rather than denying them for one criterion they don’t meet.

Flexible underwriting standards would also allow a loan officer to supplement a borrower’s credit score with other forms of payment histories, such as rent and utilities. It is well known that credit scores reflect racially biased data and perpetuate financial racial disparities. To reach more potential homebuyers of color, underwriting standards must take that into account and allow for supplementary information. As discussed in Recommendation #3, leveraging housing counseling agencies as partners in the lending process can also help high-volume lenders achieve more holistic underwriting.

FINANCING FOR PURCHASE AND PURCHASE-REHAB: Due to decades of disinvestment and resulting deferred maintenance, the housing stock in many communities of color often needs significant

Comparing our proposed product to existing models in the market

	EQUITABLE LOAN PRODUCT (PROPOSED)	US BANK AMERICAN DREAM	FREDDIE MAC HOME POSSIBLE	CHASE DREAMAKER
AMI	All	<100%	<80%	<80%
DP	3%	3%	3%	3%
PMI	No	Lender-paid	Yes	Reduced, no up-front fee
Interest	No LLPA	LLPA	LLPA	LLPA
Credit	Flexible	>640	>660	>620
DTI	50%	43%	45%	45%
Underwriting	Manual	Manual	Automated Underwriting System (AUS)	Unknown
Rehab	<\$50,000	<\$5,500	With CHOICE Renovation product up to 75% of post-rehab value	None



rehab upon purchase for a homebuyer to make the home safe. From the experiences of housing counselors and stories that have appeared in the media, we know that it is not uncommon for a Black borrower in Chicago, for example, to be unable to purchase a home in their community of choice because they cannot get financing for rehab. To eliminate this barrier, an equitable mortgage product needs to be pairable with rehab financing. Purchase-rehab is also often the most cost-effective pathway to homeownership for many borrowers in low- to moderate-income urban and rural communities.

RECOMMENDATION #2 ►

ENSURE FHA LOANS ONLY GO TO BORROWERS INELIGIBLE FOR CONFORMING LOAN PRODUCTS

While FHA loans are a useful addition to the suite of home loan products available on the market, it seems they are being used far beyond the scenarios where they are appropriate. Anecdotally, we know that borrowers of color are often steered into FHA loans, even when they otherwise could qualify for a conforming loan product. We also know that mortgage brokers and lenders make more profit on FHA loan originations than conventional loans. While this kind of steering may not always be deliberate, there is a systemic profit incentive for a loan officer to make an FHA loan over others, which makes anecdotal evidence all the more troubling.

As part of the MAI process, research and policy staff from NHS and Woodstock Institute interviewed borrowers of color who had recently gone through the mortgage application process, to learn more from their perspective about the barriers they encountered. Some were successful in getting a mortgage and purchasing their home; others had not yet been successful. Regardless of the outcome for each individual borrower, all encountered barriers of some kind, and certain experiences were extremely common.

100% of the interviewed borrowers who submitted a loan application were offered FHA loans as opposed to conventional loans, despite the majority of them fitting the financial profile of someone who could qualify for a conventional loan. One borrower was offered an FHA loan even though they had an 850 credit score, 0% DTI, and \$20,000 to put towards a down payment.

While these qualitative interviews add invaluable detail to our understanding of this problem, existing quantitative data does not allow for a robust analysis of this phenomenon. To determine the true scope of this problem, we need better quantitative data.

FHA loans include PMI for the life of the loan, whereas for other loan products PMI phases out at some given point. Giving a borrower who would otherwise qualify for a conventional loan an FHA mortgage saddles them with an additional financial burden until they pay off their home, ultimately making homeownership significantly more expensive in the long term. If closing the racial homeownership gap is to meaningfully contribute to closing the racial wealth gap,



homeownership cannot be disproportionately more expensive for people of color.

A prospective borrower must be shown *all* loan products that they qualify for with their lender and the features of those products, so they can make a fully informed decision. The information currently available suggests that additional regulatory oversight and accountability are needed on this point.

RECOMMENDATION #3 ►

ADDRESS LOAN OFFICER COMPENSATION STRUCTURE & OPTIMIZE RELATIONSHIPS WITH HOUSING COUNSELORS

Finally, we must reform other incentive structures in the mortgage lending process in order to better serve historically marginalized borrowers. A recurring theme that we heard from MAI members, housing counselors, and real estate professionals was that it often takes more time and attention to get a prospective homebuyer of color “mortgage-ready” and then find a loan product with terms that will work best for them, because of the historic and systemic barriers borrowers of color face.

ADDRESS LOAN OFFICER COMPENSATION STRUCTURE:

Existing compensation structures for loan officers disincentivize spending more time or attention on prospective borrowers. Compensation is often based on loan size and the number of originations in a given period. In practice, this means that loan officers

have an incentive to minimize the amount of time spent on an individual loan and to focus on larger loans – while a prospective borrower of color, especially a first-time homebuyer, is more likely to need more time and a smaller loan size.

Furthermore, many prospective homebuyers of color also come to this experience with a history of financial trauma due to the many, many places in our financial system where racial bias and disparities persist. Because of that history and experience, when a barrier arises, many of these borrowers need additional transparency and encouragement to stick with the process – but neither of these are automatic in the mortgage process.

Overall, the mortgage process needs to meet borrowers where they are and loan officers need to have a greater stake in the success of historically underserved borrowers. We urge the industry to address the components of loan officer compensation that put prospective borrowers of color at a disadvantage and create a new standard of industry best practice in this area. For example, lenders could require that all their loan officers’ portfolios include a range of loan sizes, geographies, and borrowers, including loans to low- and moderate-income borrowers and borrowers of color – not just their CRA loan officer teams. This would ensure greater equity across their entire retail lending platform.

OPTIMIZE RELATIONSHIPS WITH HOUSING COUNSELORS:

Sometimes a borrower could benefit from additional attention beyond what a loan officer can provide, so we also recommend that mortgage lenders optimize their relationships with HUD-certified

housing counselors. Housing counselors can help get borrowers mortgage-ready before they approach a lender, and they can also help prospective borrowers who were denied a loan. We also suggest that lenders work in tandem with housing counselors throughout the application and closing process. Especially for applicants seeking modest loan sizes, housing counselors can help provide time and attention to applicants, which can be challenging for loan officers.

As experts in the process that also have client-service training, housing counselors can provide the transparency and encouragement that prospective homebuyers of color may need in order to overcome any barriers. Rather than simply denying a borrower, a lender could refer that borrower to a housing counseling agency to help address whatever specific part of their financial profile made them ineligible for a loan. That way, a borrower would not be completely disillusioned with the process – they could stick with the process and return to the lender when they are ready. Working with housing counselors will ensure that loan officers successfully close more loans and would be well worth the cost of associated counseling agency compensation.

CONCLUSION ►

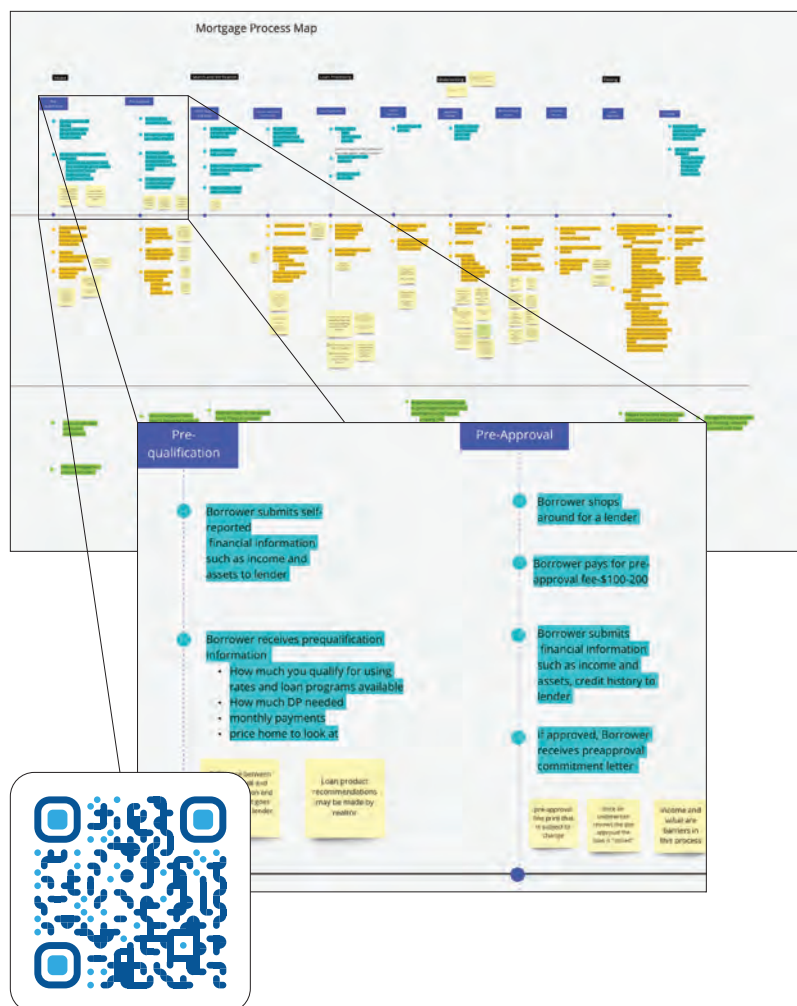
These three sets of recommendations are the result of 18-months of intensive conversations with mortgage lenders of all types and sizes, as well as interviews with borrowers and real estate professionals. In mapping out the mortgage process, we also found that there are other significant actors in the process that we need to engage as well. The MAI will continue with future phases as we engage other stakeholders like appraisers, real estate professionals and the GSEs.

We want to extend our sincere thanks to the Phase 1 Mortgage Access Initiative members. We're so grateful for your counsel and willingness to share your expertise and have frank conversations about your industry. It wasn't always easy or comfortable, but we appreciate the trust you put in us.

The racial disparities in our mortgage lending and housing system are the result of a century of government policy and industry practices. But in the face of that history, there are concrete steps that we can take today to make this system work for everyone and close the racial homeownership gap. The work continues.

MORTGAGE PROCESS MAP ►

View our Mortgage Process Map identifying intersection points with important stakeholders like appraisers, real estate professionals, and the government sponsored enterprises (GSEs) like Fannie Mae and Freddie Mac. Click bit.ly/mai-map-1 or scan the QR code below.



Neighborhood Housing Services of Chicago (NHS) is the preeminent mortgage lending Community Development Financial Institution (CDFI) in the Chicago area. We help to transform neighborhoods and empower families through homeownership, by providing community outreach, real estate development, mortgage lending, education, counseling and policy advocacy. Learn more at www.nhschicago.org.

Woodstock Institute envisions a society where all people experience economic security and prosperity. We advance economic justice and racial equity within financial systems through research and advocacy at the local, state, and national levels. Learn more at www.woodstockinst.org.

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