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Homeownership and Mortgage Loans: How Important is a Conventional Loan?

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Executive Summary

Communities across the United States face a housing crisis that stems in part from a scarcity of conventional home mortgage loans. Conventional mortgage loan application numbers have decreased, and racial disparities persist in mortgage application denial rates. In 2020, the Urban Institute reported that when applying for a mortgage, Black applicants were denied 27.1% of the time, yet White applicants were denied only 13.6% of the time. These denial rates are highly correlated with homeownership rates. Today, despite policy efforts, the difference in White and Black homeownership rates is higher than in the 1960s when the government enforced discriminatory housing policy.

While the federal government has tried to improve access to conventional home mortgages by creating the Federal Housing Administration (FHA) and Department of Housing & Urban Development (HUD), the housing market collapse in 2008 and the COVID-19 pandemic have diminished the effectiveness of their efforts as interest rates and home prices soared.

Because lenders often cite credit score concerns and high debt-to-income ratios as rationales to deny someone's mortgage application, policy alternatives must address these barriers while improving mortgage application approval rates and reducing the mortgage denial gap by race. I present the following policy alternatives as potential solutions to meet these goals:

- **Increase funding for Community Development Financial Institutions competitive grants.** These grants will incentivize alternative lending practices that benefit underserved communities.
- **Create new requirements for homebuyer education that provide information about mortgages, homeownership, etc.** Homebuyer education will be critical for potential homebuyers to successfully receive alternative home financing opportunities, such as lower down payments, and ensure equal access to information.
- **Mandate the inclusion of rental history in credit scores.** This will boost credit scores to reflect someone's ability to make large, scheduled housing payments.
- **Strengthen regulation of unconventional financing options that lack consumer protections.** These regulations will ensure that homebuyers are not exploited by unconventional financing regulation omissions.
- **Compile information about unconventional financing options.** This will assist potential homebuyers in their navigation of the unconventional financing process.

After considering how these policy options advance equity, improve effectiveness, and minimize implementation costs, I make following recommendations to the United States government:

- Enact regulations that **mandate credit reporting agencies include 12 months of positive rental payment history** when computing someone's credit score.
- **Increase access to free educational resources** regarding the homebuying process.
- **Invest in the Consumer Financial Protection Bureau** to ensure that homebuyers receive adequate protections when engaging in unconventional home financing.
- Conduct further research to investigate the **impact of conventional mortgage access on homeownership**.
- **Report data on Black renters in more comparable, easily understood ways**.

Purpose and Overview

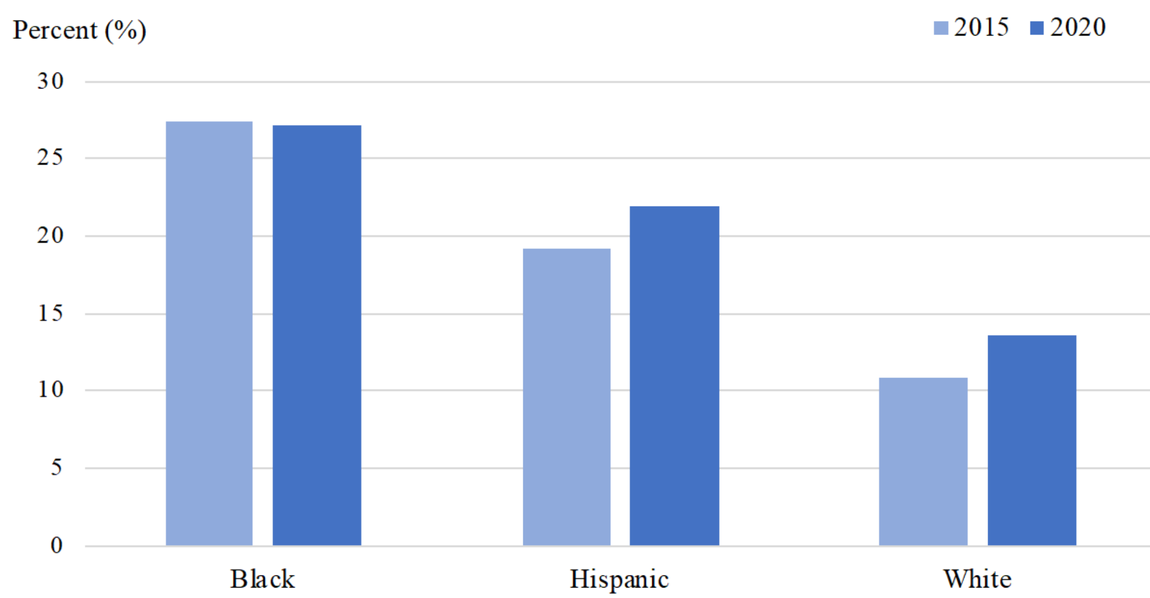
In this policy brief, I aim to inform policymakers and advocates of the challenges people face in accessing conventional home mortgages. Without proper avenues to this critical step towards homeownership, people struggle to obtain affordable housing with proper consumer protections and financial benefits. I also hope to shed light on potentially viable solutions to address these pressing issues. By offering alternative recommendations, the brief will inform legislators on feasible, effective policies to improve access to conventional home mortgages.

Problem Definition

Disparities in Access to Mortgages

Americans have long struggled to access conventional home financing with troubling disparities among applicants by race. Since 2000, despite mortgage application numbers decreasing, mortgage application denial rates remain high. Based on data reported by the Urban Institute in 2020, 27.1% of Black applicants and 21.9% of Hispanic applicants were denied a conventional mortgage loan, whereas 13.6% of White applicants were denied a conventional mortgage loan in the United States.[1] Compared to 2015, when denial of Black applicants was 27.4%, Hispanic applicants was 19.2%, and White applicants was 10.9%, the denial rates have remained relatively constant.[2]

Figure 1: Conventional Mortgage Loan Denial Rates in 2015 vs. 2020



Data Sources: Urban Institute and Pew Research Center

[1] Jung Hyun Choi and Peter J Mattingly, "What Different Denial Rates Can Tell Us About Racial Disparities in the Mortgage Market," Urban Institute, January 13, 2022, https://www.urban.org/urban-wire/what-different-denial-rates-can-tell-us-about-racial-disparities-mortgage-market.

[2] Drew Desilver and Kristen Bialik, "Blacks and Hispanics face extra challenges in getting home loans," Pew Research Center, January 10, 2017, https://www.pewresearch.org/short-reads/2017/01/10/blacks-and-hispanics-face-extra-challenges-in-getting-home-loans/.

Reasons for denial of conventional mortgage applications vary, but it should be noted that the racial disparities reported above have not been found to be caused by explicit bias from lenders. According to a working paper from the Federal Reserve Board in 2022, differential treatment by race plays a relatively minimal role in the racial disparity. Furthermore, differential treatment through unobservable lending practices contributes only 1-2% to the current racial disparity.[3]

In 2015, poor credit and high debt-to-income ratios were cited as root causes for the lack of access to mortgages[4]. Mortgage lenders often identify applicants with a poor credit score as "high risk" and less likely to make full payments on time. If they appear less likely to make payments on time, the lender assumes greater risk. Greater risk often results in higher interest rates and lower chances of approval for the mortgage applicant.

Mortgage lenders are more likely to approve applicants with low debt-to-income ratios. Debt-to-income ratios are a measure of someone's monthly debt payments compared to their monthly gross income.[5] Mortgage lenders are less likely to approve an application if the applicant's income-to-debt ratio is higher than 36%. Moreover, if an applicant spends more than approximately one-third of their monthly income on debt that they have already accrued, the possibility of obtaining a conventional mortgage is very low.

People with poor credit and a high debt-to-income ratio often seek out small dollar mortgages to buy homes with a value of less than $70,000.[6] In 2015, 14% of homes, or 643,000 homes, sold for less than $70,000, but only 25% of these sales were financed with a conventional mortgage. However, nearly 80% of homes valued between $70,000 and $150,000 involved a mortgage.[7] Therefore, there is an immense disparity in the availability of small dollar mortgages when compared to large dollar mortgages. This disparity coincides with the return of investment for small dollar and large dollar loans.[8] Since the mortgage lender earns revenue based on the loan's dollar amount, a large dollar loan yields more profit than a small dollar loan. Furthermore, lenders possess less incentive to offer small dollar mortgages.

Consequences of Limited Access to Mortgages

Access to a conventional mortgage often equates to access to homeownership. Mortgage lending rates are closely correlated with homeownership rates in the United States over the last 20 years.[9] According to a

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[3] Neil Bhutta, Aurel Hizmo, and Daniel Ringo, "How Much Does Racial Bias Affect Mortgage Lending? Evidence from Human and Algorithmic Credit Decisions," Washington: Board of Governors of the Federal Reserve System, https://doi.org/10.17016/FEDS.2022.067.

[4] Desilver and Bialik, "Blacks and Hispanics face extra challenges."

[5] Chris B. Murphy et. al., "Debt-to-Income (DTI) Ratio: What's Good and How To Calculate It," Investopedia, August 21, 2023, https://www.investopedia.com/terms/d/dti.asp#:~:text=to%2DIncome%20Ratio%3F-,As%20a%20general%20guideline%2C%2043%25%20is%20the%20highest%20DTI%20ratio,varies%20from%20lender%20to%20lender

[6] Alanna McCargo and Sarah Strochak, "Debunking the Myth That Small-Dollar Mortgages are Riskier due to Poor Loan Performance and Borrower Credit," Urban Institute, April 17, 2019, https://www.urban.org/urban-wire/debunking-myth-small-dollar-mortgages-are-riskier-due-poor-loan-performance-and-borrower-credit.

[7] Alanna McCargo et. al., "Small-Dollar Mortgages for Single-Family Residential Properties," Urban Institute, April 2018, https://www.urban.org/sites/default/files/publication/98261/small_dollar_mortgages_for_single_family_residential_properties_2.pdf.

[8] Juhohn Lee, "The lack of small-dollar mortgages is preventing Americans from purchasing affordable homes," CNBC, May 27, 2022, https://www.cnbc.com/2022/05/25/how-the-lack-of-small-dollar-mortgages-hurts-homeownership-in-the-us.html.

[9] Tracy Maguze, Tara Roche, and Adam Staveski, "Small Mortgages Are Too Hard to Get," Pew Charitable Trusts, July 3, 2023, https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2023/06/small-mortgages-are-too-hard-to-get.

study from 2021 to 2022 by Pew Charitable Trusts, 78% of homebuyers financed their purchase with a mortgage, and an astounding 97% of first-time homebuyers utilized a mortgage. Given these data and the current disparities, despite nearly two-thirds of households owning their homes, White households are nearly 29% more likely to own their home than Black households.[10]

In addition to homeownership, mortgages provide the homebuyer with various benefits. When the homebuyer obtains a mortgage, it often includes an official inspection of the home and a proper appraisal. Homebuyers are also subject to a regular schedule of payments, tax incentives, and equity in the home when they finance with a mortgage.[11] For potential homebuyers that cannot receive a mortgage and the subsequent benefits, they seek out alternative methods to purchase a home that do not include proper consumer protections. In another survey conducted by Pew Charitable Trusts in 2019, approximately 1 in 5 borrowers, or 36 million people, utilized unconventional financing at least once in their lifetime. Additionally, 34% of Hispanic borrowers and 23% of Black borrowers had used unconventional financing at least once in their lifetime.

A common unconventional financing option involves the homebuyer directly engaging with the seller of the home through a contract for deed, or land contract.[12] In these agreements, the buyer and seller determine the sale price, number of payments, interest rate, and down payment for the home themselves without an official inspection, appraisal, or mortgage. In this scenario, the buyer must make all payments on time and does not receive the deed to the home until the entire amount is paid. Since this method does not involve a mortgage lender or government entity, little is known about whether these alternative methods lead to homeownership. However, contracts for deed come with extreme risk, and a 2012 study in Texas indicated that less than 20% of contracts for deed resulted in homeownership.[13]

Policy Background

The history of mortgage loan troubles begins in the late 1920s. During the Great Depression, mortgage lenders were hesitant to extend mortgage loans to applicants, sometimes requiring a 50% down payment on a property. As such, lenders seldom approved poor families with limited disposable income for conventional mortgage loans. In 1934, Congress acted to address this problem by creating the Federal Housing Administration (FHA), an executive agency which insured mortgage loans by guaranteeing their repayment independent of the borrower's monthly payments. Even if the borrower failed to make payments on the loan, the FHA would pay the balance of the loan to provide more stability for lenders. The Department of Veterans Affairs established a similar program that offered veterans preferable mortgages following World War II.[14]

Recognizing the importance of government intervention in the housing market in 1938, Congress also created Fannie Mae, a government-sponsored enterprise (GSE) that purchased loans from lenders, providing an instant return on investment for lenders, and resold them as mortgage-backed securities (MBS) to investors that would normally not take part in the mortgage market. Since lenders received the

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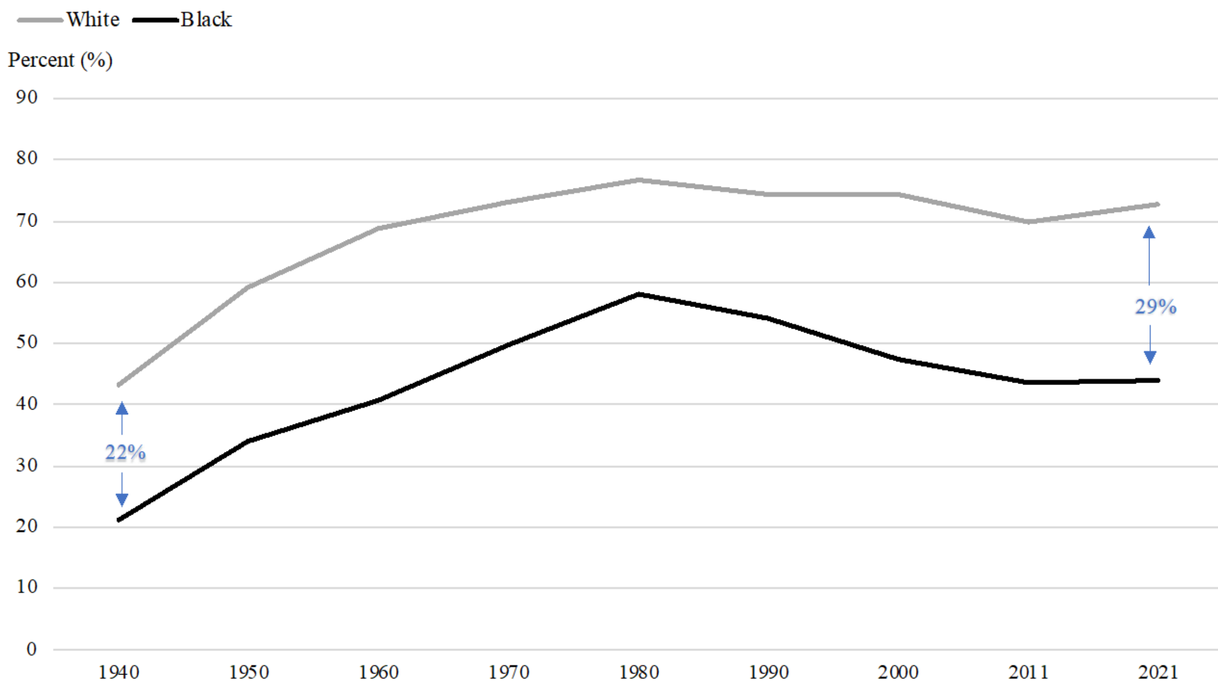
[10] St. Louis Federal Reserve, "Housing and Homeownership: Homeownership Rate," FRED Economic Data, 2023, https://fred.stlouisfed.org/release/tables?eid=784188&rid=296.
[11] Maguze, Roche, and Staveski, "Small Mortgages Are Too Hard to Get."
[12] Pew Charitable Trusts, "Millions of Americans Have Used Risky Financing Arrangements to Buy Homes," April 14, 2022, https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2022/04/millions-of-americans-have-used-risky-financing-arrangements-to-buy-homes
[13] Peter Ward, Heather Way, and Lucille Wood, "The Contract for Deed Prevalence Project," University of Texas at Austin, August 2012, https://law.utexas.edu/faculty/hway/stand-alone-executive-summary.pdf.
[14] Colin McArthur and Sarah Edelman, "The 2008 Housing Crisis," Center for American Progress, April 13, 2017, https://www.americanprogress.org/article/2008-housing-crisis/.

entire value of the mortgage after Fannie Mae's involvement, they possessed more money to offer additional home mortgages with lower interest rates.[15] Originally intended to purchase FHA- and VA-insured loans, Fannie Mae expanded into the conventional loan market in the 1950s to further increase mortgage availability.

Following the implementation of these government supports, homeownership rose rapidly, increasing from 44% in 1940 to 62% in 1960.[16] While economic conditions were encouraging following the war, some of the increase in homeownership is attributed to more widely available mortgage loans, a direct result of government intervention. However, discriminatory practices during this period were frequent, and despite Black homeownership rates increasing, the gap between White and Black homeownership rates increased. In 1940, the difference between White and Black homeownership was 22%, and that disparity increased to 28% by 1960.[17] While this disparity may seem like something of the past, the current disparity in homeownership rates over 60 years later between White and Black people rests slightly below 29%.[18]

Figure 2: Homeownership Rates by Race 1940-2021



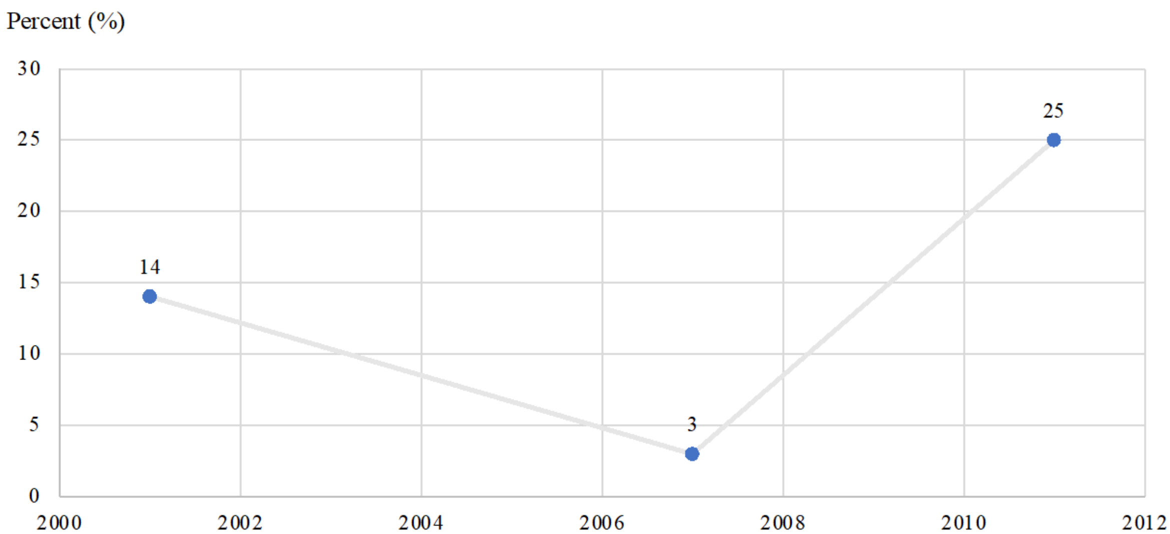
Data Sources: Boston University and National Association of Realtors

[15] Federal Housing Finance Agency, "Fannie Mae and Freddie Mac," n.d., https://www.fhfa.gov/about-fannie-mae-freddie-mac.
[16] McArthur and Edelman, "The 2008 Housing Crisis."
[17] William Collins and Robert Margo, "Race and Homeownership from the End of the Civil War to the Present," Vanderbilt University and Boston University, November 2010, https://www.bu.edu/econ/files/2013/03/101122_sem777_Robert-Margo-Paper-1.pdf.
[18] St. Louis Federal Reserve, "Housing and Homeownership: Homeownership Rate," and Lawrence Yun et. al., "2023 Snapshot of Race and Home Buying in American," National Association of Realtors, 2023, https://cdn.nar.realtor/sites/default/files/documents/2023-snapshot-of-race-and-home-buying-in-the-us-03-02-2023.pdf?_gl=1*1uhttux*_gcl_au*ODYwNzkyMTk5LjE2OTY0MzI2NzA.

The establishment of the Department of Housing and Urban Development, the passage of the Fair Housing Act, and revisions to the Federal Housing Administration's lending practices began to curb this discrimination, but progress was slow, and impacts can still be felt today.[19]

By 2000, lending practices had shifted following the FHA's decreased oversight and insurance of mortgage loans. In 2001, the FHA insured 14% of mortgage loans, yet in 2007, they only insured 3%. Predatory lending practices spiked, and lenders approved much riskier, subprime loans than before. These trends contributed to the housing market collapse in 2008 when housing prices plummeted, and borrowers were less likely to make payments on time. For reference, the percent of subprime borrowers who were at least 90 days behind on payments exploded from under 6% in 2005 to 21% in 2008.[20] Once again recognizing the importance of government oversight and intervention, the FHA took a larger role in the mortgage market. By 2011, they insured 1 in 4 mortgages across the United States.[21]

Figure 3: Share of Mortgages that the FHA Insured 2001-2011



Data Source: Center for American Progress

Note: the housing market crash occurred in 2008

Over time, the FHA's involvement diminished until the COVID-19 pandemic in 2020. The average monthly payment on a conventional 30-year mortgage with a 20% down payment for the median house price was $1,260. However, as interest rates decreased to stimulate economic activity during the pandemic, home prices increased. Given inflation, higher interest rates, and a pandemic, the monthly cost in 2022 skyrocketed to $2,360, an increase of $1,100 per month over a four-year period.[22]

19 McArthur and Edelman, "The 2008 Housing Crisis."

20 Chris Mayer, Karen Pence, and Shane Sherlund, "The Rise in Mortgage Defaults," Federal Reserve Board Washington, DC, November 2008, https://www.federalreserve.gov/pubs/feds/2008/200859/200859pap.pdf.

21 McArthur and Edelman, "The 2008 Housing Crisis."

22 Paul Kupiec and Alex Pollock, "How the Fed's 2008 mortgage experiment fueled today's housing crisis," The Hill, March 10, 2023, https://thehill.com/opinion/finance/3893896-how-the-feds-2008-mortgage-experiment-fueled-todays-housing-crisis/.

Figure 4: Housing Payments, Rates, and Price by Year

	2018	2022	Difference (2022-2018)
Monthly Payments	$1,260	$2,360	$1,100
Interest Rates	3.95%	6.48%	2.53%
Median Home Sale Price	$331,800	$433,100	$101,300

Data Source: FRED Data

At the time of writing, mortgage interest rates rest above 8%, but policy actors in government are working to ease the burden of these rates. In October 2022, HUD authored a request for information regarding the barriers that underserved communities face, especially in the small dollar mortgage market, to solicit feedback.[23] In February 2023, the White House directed the FHA to reduce its monthly mortgage premium from 0.85% to 0.55%. These monthly premiums apply to all FHA-insured mortgage loans, and this change will reduce the burden on those with FHA-insured loans, most of which are first time homebuyers and people of color.[24]

Additionally, the United States Congress has reintroduced the HELPER Act of 2023 that exempts first time homebuyers who are teachers, firefighters, and law enforcement officers from down payment requirements.[25] While it has not yet passed, the Senate's Subcommittee on Housing, Transportation, and Community Development continues their exploration of predatory lending with Congressional meetings.[26]

Policy Alternatives

Status Quo

Maintaining the status quo allows current trends and policy practices to continue without further intervention. At the time of writing, disparities among racial groups remain prevalent for mortgage application denial rates, the number of mortgage applications is declining, and an increasing number of people are utilizing unconventional financing to purchase a home.[27] Federal Housing Administration loan insurance and government-sponsored agencies like Fannie Mae and Freddie Mac are still involved in the mortgage markets, but, despite their current practices, the above issues remain.

[23] US Department of Housing and Urban Development, "Request for Information Regarding Small Mortgage Lending," Federal Register, October 4, 2022, https://www.govinfo.gov/content/pkg/FR-2022-10-04/pdf/2022-21047.pdf.

[24] The White House, "FACT SHEET: BIDEN-HARRIS ADMINISTRATION ANNOUNCES ACTION TO SAVE HOMEBUYERS AND HOMEOWNERS $800 PER YEAR," February 22, 2023, https://www.whitehouse.gov/briefing-room/statements-releases/2023/02/22/fact-sheet-biden-harris-administration-announces-action-to-save-homebuyers-and-homeowners-800-per-year/.

[25] Dan Green, "The HELPER Mortgage Act: Explained," homebuyer.com, May 18, 2023, https://homebuyer.com/learn/helper-act.

[26]United States Senate Subcommittee on Housing, Transportation, and Urban Development, "Exploiting the American Dream: How Abusive Land Contracts Prey on Vulnerable Homebuyers," US Senate Committee on Banking, Housing, and Urban Affairs, July 11, 2023, https://www.banking.senate.gov/hearings/exploiting-the-american-dream-how-abusive-land-contracts-prey-on-vulnerable-homebuyers.

[27] Desilver and Bialik, "Blacks and Hispanics face extra challenges."

Increase Funding for Community Development Financial Institution Competitive Grants & Create New Requirements for Homebuyer Education

Community Development Financial Institutions (CDFIs) provide banking and loan services to traditionally underserved communities. Therefore, these financial institutions have the unique opportunity to fill in some of the current gaps in mortgage accessibility. CDFIs often receive funding from the US Department of the Treasury's "Community Development Financial Institutions Fund" to subsidize their lending practices.[28] Although they receive funding, additional funding through nationally competitive grants could allow these smaller institutions to utilize alternative lending practices to achieve their mission. With these alternatives, more borrowers would be able to borrow 100% of the home's value (without a down payment), have a debt-to-income ratio of up to 45% (instead of 36%), and qualify for down payment assistance. To receive the benefits of alternative lending practices, the borrowers would be required to complete at least two educational courses about mortgages, homeownership, etc. approved by the US Department of Housing & Urban Development (or other federal housing agency).[29]

Mandate the Inclusion of Rental History in Credit Scores

While credit scores generally represent the likelihood that someone will repay a debt on time, credit scores do not include a major expense for some people: their rental payment history. For most renters, their monthly rent is one of their largest expenses, and their ability to pay on time is an important measure of how likely they are to submit their monthly mortgage payments on time. Despite this, the three major credit bureaus do not include any positive rental payment history when calculating someone's credit score. However, if renters miss a monthly payment, credit bureaus will reduce their credit score. Renters are not rewarded for on-time payments, but they are punished for late payments. Credit scores are cited as the most common reason for someone's mortgage loan application being denied, so the inclusion of rental payment history could improve access to conventional mortgages.[30]

Strengthen the Regulation of Unconventional Financing Options & Information about Using Them

Since conventional mortgages are often seen as out of reach for some people, they turn to unconventional or alternative financing options to receive the benefits of homeownership. However, these options often lack consumer protections. New unconventional financing regulations would include mandatory inspections, mandatory disclosures of building code violations, and mandatory delineation of maintenance responsibilities for buyers and sellers.[31] However, enforcing these regulations could prove difficult. In addition to these regulations, an information campaign to shed light on the predatory practices of unconventional financing would be implemented that requires each state across the nation to publish a "buyer guide" to assist potential homebuyers in navigating the financing process.[32] Detroit, MI released a buyer guide in 2022 that outlines stages of the homebuying process using unconventional financing

[28] Sean Peek, "What is a Community Development Financial Institution?," Chamber of Commerce, August 10, 2020, https://www.uschamber.com/co/run/business-financing/what-is-community-development-financial-institution-cdfi.

[29] Alanna McCargo, et. al., "The MicroMortgage Marketplace Demonstration Project," Urban Institute, December 16, 2020, https://www.urban.org/sites/default/files/publication/103381/the-micromortgage-marketplace-demonstration-project_0_0.pdf.

[30] Liam Reynolds, "Including On-Time Rental Payment History in Credit Scoring Could Help Narrow the Black-White Homeownership Gap," Urban Institute, November 29, 2022, https://www.urban.org/urban-wire/including-time-rental-payment-history-credit-scoring-could-help-narrow-black-white.

[31] Matthew Hector, "New law protects real estate purchasers who buy on contract," Illinois Bar Journal, October 2017, https://www.isba.org/ibj/2017/10/lawpulse/newlawprotectsrealestatepurchaserswhobuy.

[32] Erin Panter, "States Offer Consumer Protections to Buyers Who Opt for Alternative Home Financing," National Conference of State Legislatures, June 19, 2023, https://www.ncsl.org/state-legislatures-news/details/states-offer-consumer-protections-to-buyers-who-opt-for-alternative-home-financing.

including resources for housing counseling.[33] This guide stands as one of few released by local and state governments at the time of writing.

Discussion

The home mortgage market is an extremely complex system and creates outcomes that impact everyday people across the country. Without conventional mortgages, people have less opportunities to achieve homeownership and its benefits. Therefore, any policy option to be considered must work to address these issues. Improvement in the overall approval rates for home mortgages and the reduction of the mortgage race gap (White-Black) are two targeted impacts that any solution should aim for. Additionally, administrative concerns such as cost and feasibility of implementation must also be considered to determine the finest solution.

Status Quo

By choosing not to act, consequences that appear today will continue to appear in the future. The disparities between mortgage approval rates by race would persist, and small dollar mortgage opportunities would remain sparse. With these impacts, homeownership rates are unlikely to increase.

Freddie Mac projects that home sales will not increase through 2023, and interest rates for conventional mortgages will remain above 6% during the same period.[34] To further contextualize this, the National Association of Realtors creates a quarterly index based on the likelihood that a first-time homebuyer earning the median income can qualify for and afford a typical home. A rating of 100 indicates that the median family will succeed. While the index displayed an 84.5 rating at the beginning of 2022, the 2023 rating for first-time homebuyers is 67.6. This decline indicates that, even more so than a year before, the index estimates that first time homebuyers are nowhere near the threshold to reasonably qualify for a mortgage and afford a home successfully.[35]

While these patterns are likely to persist, there would be no additional monetary cost associated with maintaining the status quo, and the implementation has already occurred.

Increase Funding for Community Development Financial Institution Competitive Grants & Create New Requirements for Homebuyer Education

CDFIs already offer mortgage lending to underserved communities, so additional funding would allow their services to extend to even more people. The MicroMortgage Demonstration is currently underway in Louisville, KY and includes the previously mentioned initiatives for alternative underwriting with CDFIs and mandated homebuyer education. Alternative underwriting guidelines provide more mortgage opportunities, and homebuyer education allows potential homebuyers to connect with important community resources. While these results have not yet been observed, some conclusions can be drawn about the potential impacts of this project.[36]

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[33] City of Detroit, Enterprise Community Partners, and University of Michigan Poverty Solutions, "Land Contract Buyer Guide," June 2022, https://detroitmi.gov/sites/detroitmi.localhost/files/2022-06/Detroit%20Land%20Contract%20Buyer%20Guide-FinalToPost-June2022.pdf.

[34] Same Khater, et. al., "Economic, Housing, and Mortgage Market Outlook – August 2023," Freddie Mac, August 17, 2023, https://www.freddiemac.com/research/forecast/20230817-economic-housing-and-mortgage-market-outlook-august-2023#:~:text=on%20the%20economy.-,Home%20sales,come%20on%20to%20the%20market.

[35] National Association of Realtors, "First-Time Homebuyer Affordability," n.d., https://cdn.nar.realtor/sites/default/files/documents/hai-q1-2023-first-time-homebuyer-affordability-2023-05-09.pdf?_gl=1*53ncdt*_gcl_au*MTQ0MTc3MjQxLjE2ODk3MDU0NTA.

[36] McCargo, et. al., "The MicroMortgage Marketplace Demonstration Project."

This program will allow CDFIs to deepen their reach in Black communities. Since conventional mortgage financing often skips over some Black households (as seen in conventional mortgage denial rates), the CDFIs would be highly likely to reduce the gap between Black and White applicants in mortgage approval rates. Additionally, because CDFIs will now offer mortgages with fewer restrictions and more flexibility, it is likely that the overall mortgage approval rate would increase, giving way to an increase in homeownership rates.

Throughout the beginning of the MicroMortgage Demonstration, researchers have observed the need for liquidity when providing small dollar mortgages with alternative underwriting. In that study, they had access to alternative funding sources, but for most CDFIs, this is not the reality. Therefore, the federal grants supplied to local CDFIs will provide the liquidity that most would lack otherwise, allowing the program to offer more mortgages to underserved communities.[37]

Current program infrastructure allows for a simple adaptation to include these new grants. In April 2023, Vice President Kamala Harris and Deputy Secretary of the Treasury Walley Adeyemo announced that the CDFI Fund's Equitable Recovery Program (ERP) awarded $1.73 billion to over 600 CDFIs in an effort to recover from the COVID-19 pandemic. As such, the process of applying for, receiving, and being awarded grants has already been established by the ERP. As such, the administrative and implementation costs are low. Assuming that these federal grants would be awarded to a comparable number of CDFIs, the cost would be similar. In 2021, over 1,000 CDFIs were certified, so providing grants to over 600 of them gives approximately 60% of CDFIs across the US monetary assistance to experiment with alternative underwriting.[38]

Mandate the Inclusion of Rental History in Credit Scores

If positive rental payment history of 12 months was included in credit scores, credit scores of less than 600 are likely to increase by 8.9% (or 42 points), and credit scores between 600-660 are likely to increase by 7.6% (or 41 points).[39] Figure 5 displays impacts on other credit score ranges. Since credit score concerns were one of the top reasons for mortgage application denials in 2015, mandated rental history credit reporting is highly likely to improve overall mortgage approval rates.[40]

While regulations could mandate the inclusion of 24 months of positive rental history, the data demonstrates that the difference between 12 months and 24 months is minimal. Therefore, to balance the potential administrative complexities with credit score gains, including only 12 months of positive rental history would be most efficient.

[37] McCargo, et. al., "The MicroMortgage Marketplace Demonstration Project,"
[38] US Department of the Treasury, "U.S. Treasury Awards more than $1.73 Billion in Response to Economic Impacts Caused by COVID-19 Pandemic," April 10, 2023, https://www.cdfifund.gov/news/517.
[39] Reynolds, "Including On-Time Rental Payment History in Credit Scoring…"
[40] Desilver and Bialik, "Blacks and Hispanics face extra challenges."

Figure 5: Credit Score Impact from Inclusion of Positive Rental History, by 12 or 24 Months

Credit Score Range	12 Month Inclusion (Point Change)	24 Month Inclusion (Point Change)
Less than 600	+42	+45
600 - 660	+41	+40
661 - 780	+27	+27
Greater than 781	+7	+7

Data Source: Urban Institute

The equity of this policy alternative remains unknown. According to the Understanding America Study, Black renters are overrepresented in terms of those with 12 months of positive rental history when compared to all households. Therefore, by including rental payment history, Black credit scores are likely to be increased more than others, thereby increasing the likelihood that Black applicants would be approved for a conventional mortgage.[41] However, these findings may mislead readers. To accurately estimate the equity of this policy measure, data must be reported differently. Instead of comparing the racial breakdown of overall households to the racial breakdown of households with positive rental history, the analysis should compare the number of Black renters to the number of Black renters with positive rental history. This would allow a more direct comparison that demonstrates the potentially disproportionate effect of rental history inclusion on Black renters.

Adjusting the credit reporting guidelines would impose an administrative cost on the large credit reporting bureaus, but this adjustment is unlikely to create excessive financial cost. The Consumer Financial Protection Bureau would be able to adjust these regulations as an executive action, rather than an act of Congress, easing its potential implementation.

Strengthen the Regulation of Unconventional Financing Options & Information about Using Them

Regulating the unconventional mortgage market and providing potential homebuyers with more information on it does not inherently solve the root problem regarding access to conventional home mortgages. Despite this, the policy option would create better outcomes for those that are not able to receive a conventional mortgage loan.

Regulation and information on the unconventional mortgage market would be unlikely to reduce the conventional mortgage race gap or increase the conventional mortgage approval rate, but Congressional leaders have become more aware that this unconventional market creates problems. As such, Congress is more likely to pass regulations, thus making the policy more likely to be implemented.

Regulations of this kind would create very little monetary costs, most of which would relate to oversight and enforcement. However, writing, publishing, and advertising the buyer guide could have monetary costs associated with it that include additional personnel, publishing fees, and advertising opportunities. When compared to other policy options, the cost is not enormous, but the cost would fall primarily on states rather than the federal government.

[41] Reynolds, "Including On-Time Rental Payment History in Credit Scoring…"

Policy Implications
When comparing these options to one another, their ability to improve mortgage application approval rates and reduce the mortgage race gap emerge as the most important. As such, the status quo and unconventional financing regulations lack viability when compared to the other options.

The increased funding for Community Development Financial Institution Grants and the mandated inclusion of rental history in credit scores both address these concerns, though not much is known of their efficacy because of limited research. However, if the federal government mandated rental history inclusion for credit scores, there is slightly more evidence that it would reduce the mortgage race gap and increase mortgage approval rates, given the data available. Additionally, the adjusted credit scores inflict minimal cost to the federal government, and that cost appears strictly administrative to ensure compliance by credit reporting agencies.

With the Community Development Financial Institution Grants, the government has more flexibility when providing funding that could create a greater impact. Although that is a possibility, funding will always be of concern, and this could impact its effectiveness in achieving the aforementioned goals. This proposal also includes mandatory homebuyer education that may be hard to obtain without more funding from the federal government and cooperation from government agencies. Therefore, in terms of cost and ease of implementation, these grants are not favorable.

Recommendations

Based on the previously discussed trends, data, and implications, the United States government must act to address this mortgage crisis. I recommend that the United States government take the following actions:

- Enact regulations that **mandate credit reporting agencies include 12 months of positive rental payment history** when computing someone's credit score.
- **Increase access to free educational resources** regarding the homebuying process.
- **Invest in the Consumer Financial Protection Bureau** to ensure that homebuyers receive adequate protections when engaging in unconventional home financing.
- Conduct further research to investigate the **impact of conventional mortgage access on homeownership**.
- **Report data on Black renters in more comparable, easily understood ways**.

Conclusion

With this analysis, I suggest that government action remains the principal option for policymakers to combat the racial disparities of conventional mortgage loans and homeownership. By adopting a well-rounded approach that includes credit score revisions, informative resources, and consumer protection investment, the government will remedy these inequities. While progress may trudge along slowly, each statistical change represents improvements for households across the United States. Policymakers should examine this issue further to determine each policy effect's magnitude and its lasting impact on homeownership rates. If alternatives fail to be enacted, the indecision will perpetuate the troublesome trends of today.

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