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MORTGAGE BANKERS ASSOCIATION

December 5, 2022

The Honorable Julia Gordon
Assistant Secretary for Housing and Federal Housing Commissioner
Office of Housing – Federal Housing Administration
U.S. Department of Housing and Urban Development
451 7th Street, SW
Washington, DC 20410

Re: Request for Information Regarding Small Mortgage Lending (Docket No. FR-6342-N-0)

Dear Commissioner Gordon,

The Mortgage Bankers Association[1] (MBA) and our members thank the Federal Housing Administration (FHA) for the opportunity to provide feedback on its request for information (RFI) concerning barriers to the origination of mortgages with principal balances of $70,000 or less ("small mortgage lending"). We appreciate FHA's continued commitment to addressing the nation's housing affordability crisis that continues to impact low- and moderate-income borrowers. This goal is shared not only by the Biden-Harris Administration and FHA, but MBA and its members.

Addressing the nation's housing needs requires stakeholder engagement at all levels. MBA understands this RFI comes in response to a statutory obligation of FHA to review "single-family mortgage insurance policies, practices, and products to identify any barriers or impediments to supporting, facilitating, and making available mortgage insurance for mortgages having an original principal obligation of $70,000 or less."[2] MBA is pleased to work with FHA on improving access to affordable mortgages, and is confident that together we can find solutions to overcome the barriers that can impact small mortgage lending.

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 390,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of more than 2,100 companies includes all elements of real estate finance: independent mortgage banks, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies, credit unions, and others in the mortgage lending field. For additional information, visit MBA's website: www.mba.org.

[2] Request for Information Regarding Small Mortgage Lending, 87 FR 60186 (October 4, 2022) Available at: https://www.federalregister.gov/documents/2022/10/04/2022-21047/request-for-information-regarding-small-mortgage-lending

The Role of Small Mortgage Lending and its Impediments

Small mortgage lending can play a significant part in helping more Americans achieve homeownership, particularly in suburban and rural areas, where small balance mortgage lending is more prevalent. When borrowers find properties on the most affordable end of the market, it is important to ensure there are mortgage products available in turn.

Small balance loans are often used in the purchase of factory-built, or manufactured housing. Manufactured housing holds the potential to solve multiple issues related to housing in America today. Efficiencies created by the production process lessen the environmental footprint of the home at a rate suitable for scale. The efficiency of production makes for a more affordable product, and the advancements made in manufacturing housing have grown to the point where some factory-built housing is nearly indistinguishable from site-built homes. The market for these homes, however, remains limited. Improving financing available for small mortgage balances holds the potential to help expand this market, which could do much to ease the housing supply issues that face the Nation.

Cost Barriers

The most prominent barriers to small mortgage lending are the fixed costs the consumer pays related to the origination, and the cost of servicing a small mortgage loan. The mortgage servicing yield from the fixed servicing fee is much less on a small mortgage balance yet the cost to service is the same as any loan, negatively impacting the consumer by driving up the all-in cost to originate and service.

The fixed origination costs associated with small mortgage loans make them considerably less economically viable. Fees such as those for the appraisal, recordation, and title search are set at a fixed rate. Lenders must ensure that the total points and fees charged is compliant with the FHA mortgagee closing requirements as outlined in 4000.1 II.A.6.a.x *Closing Costs and Fees*. If points and fees are too high, lenders can consider absorbing some of the costs, often resulting in originating the loan at a loss. While some lenders may engage in this activity to fulfill mission-oriented goals, it stands to reason that lenders will seek to manage or limit their exposure to such loans so as not to undermine overall returns and financial viability. These underlying economics unfortunately result in restricted availability of small balance mortgages.

There are also downstream impacts of small mortgage loan balances, namely that of a lower value of mortgage servicing rights (MSRs). Lenders either sell the rights to service the loans they originate or elect to retain those servicing rights, and the profits from either the sale of the MSR or the servicing of the loan are considered at the point of origination. The party servicing the loan charges a servicing fee to borrowers for keeping a record of payments, collecting and making escrow payments, and delivering principal and interest payments, and making advances to investors, local governments and property insurers when borrowers are delinquent. The fee is generally a percentage of the unpaid principal balance. Because the loan balance on a small mortgage loan is significantly lower than a standard mortgage balance, the servicing fee collected is proportionately lower. Therefore, these loans are less advantageous for the servicing entity, who in turn pays less to the originator for the MSR. Consequently, MSR values for small balance mortgages are low. As a lender considers originating a small balance mortgage, they are aware not only that their upfront profit margin will be thin, but the loan will, additionally, produce a lower gain on sale.[3]

Regulatory Barriers

FHA minimum property requirements also have an adverse influence on borrowers who seek to acquire small mortgage loans. Properties potentially secured by small dollar loans often do not meet needed property standards to be insured by FHA. These homes regularly need repairs and rehabilitation that the property seller will not cover. FHA minimum property requirements not only add an additional cost burden for the consumer but also increase the wait time to close on the home, depending on the repair timeframe. FHA should consider relaxed minimum property requirements based on loan size and updates to its 203(k) Rehabilitation Mortgage Insurance program.[4]

Understanding that the Qualified Mortgage (QM) rule falls outside the scope of this RFI and the authority of the Department of Housing and Urban Development (HUD), MBA would nevertheless be remiss if it did not call attention to its impact on small mortgage lending.[5] The QM statute—and FHA's adoption of large parts of it—governs the allowable points and fees a lender may charge based on the size of the loan. In circumstances where a lender produces a small mortgage loan, there are instances where the points and fees may exceed the allowable limits imposed by the QM rule. Lenders are forced to absorb these fees or provide the consumer with a less desirable product. MBA urges HUD to examine the QM rule's impact on small mortgage lending.

Potential Solution

Fixing the FHA QM definition with a higher fees and points threshold would help address the underlying fixed-cost concerns, but would also impose higher costs on borrowers.

As a solution, MBA proposes HUD create an internal fund dedicated to issuing grants to offset the upfront cost of originating small balance mortgages which meet certain qualifying criteria. Grants issued from the fund would offset the high fixed costs associated with origination and will create an incentive for lenders to market and execute FHA-insured small balance mortgages.

MBA proposes that the grant fund subsidizing small mortgage FHA-lending have the following characteristics. The fund should be financed through congressional

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[3] It should be noted that while small balance loans may enjoy a relatively advantageous sales price on the secondary market due to lowered prepayment expectations, this does not offset the factors discussed above.

[4] MBA Recommended Updates to the FHA 203(k) Mortgage Program to Address America's Housing Supply Issues

[5] MBA response to CFPB Request for Information Regarding Mortgage Refinances and Forbearances

appropriation, and separate from the FHA Mutual Mortgage Insurance Fund. Grants issued from the fund should be made available on FHA loans with a balance of $100,000 or less. The grant money can be used to offset costs such as the appraisal, title fee, recording fee(s), or other fees as determined by FHA.

Given that many of the fees associated with closing a mortgage are born of regulation and fixed in nature, MBA believes a grant program subsidizing small mortgage loan origination, funded by congressional appropriation, would be the most direct and successful solution to combatting the costs that make small mortgage lending impracticable.

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MBA appreciates the opportunity to provide feedback to FHA in response to its RFI. Should you have questions or wish to discuss these issues further, please contact Darnell Peterson, Senior Policy Advisor, at (202) 557-2922 or dpeterson@mba.org.

Sincerely,

Pete Mills
Senior Vice President
Residential Policy and Strategic Industry Engagement
Mortgage Bankers Association