The Social Impact of MDI Mortgage Lending

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Executive Summary

Homeownership is a cornerstone of the American dream for many households. Beyond the pride of owning one's home, many families can build intergenerational wealth through property value appreciation and the ability to borrow against home equity to support entrepreneurship or higher education. In addition to fulfilling housing needs, homeownership is a hallmark of strong communities.

Unfortunately, the effects of systemic racism have left an enduring homeownership gap. During the mid-twentieth century, the United States segregated cities and excluded minorities from wealth-building through exclusionary housing practices. In 1933, the Federal Housing Administration began to subsidize developers who built suburban homes in communities designated for whites only.[1] Furthermore, they insured mortgages in white neighborhoods yet refused to insure mortgages in and near Black neighborhoods – a practice known as redlining.[2] This capital disparity left drastic effects on the landscape of our country, resulting in racial and economic segregation that persists in our communities to this day.[3]

In 1977, Congress passed the Community Reinvestment Act (CRA)to ensure that federally insured depository institutions were granting credit in communities where they collected deposits.[4] Along with the Fair Housing Act, this law is the primary legislation created to end redlining. CRA compliance is necessary for banks to apply for new charters, branches, mergers, and acquisitions. However, many advocates warn that CRA enforcement is neither effective nor sufficient. For example, there are no lending benchmarks, and nearly every bank receives at least satisfactory ratings from federal regulators, despite ongoing racial disparities in lending outcomes.

Minority Depository Institutions (MDIs) pride themselves on their commitment to closing the racial wealth gap. MDIs are minority-owned mission-driven institutions that are located in underserved communities and are focused on providing greater access to capital by applying context and community knowledge to lending decisions. Because of this holistic approach to lending, MDIs provide countercyclical credit access and help to recirculate dollars within minority communities rather than exporting dollars out.

In this paper, we explore MDI mortgage lending from 2019-2022. Recent Federal Reserve data illustrates that homeownership was a key driver of wealth for U.S. households during this pandemic era, and especially for minority households.[5] Our analysis highlights the social impact of MDI mortgage lending, particularly as compared to lending from other types of financial institutions. In addition to statistical analysis, our paper also features insights from seven MDIs, gleaned from interviews with key personnel at these institutions. These interviews help provide an understanding of the MDI mortgage landscape, including the major challenges, needs, opportunities, and goals of the MDI sector.

[1] Gross, T (2017). A 'Forgotten History' Of How The U.S. Government Segregated America. NPR https://www.npr.org/2017/05/03/526655831/a-forgotten-history-of-how-the-u-s-government-segregated-america

[2] Best, R, MejÍa, E (2022). The Lasting Legacy Of Redlining. FiveThirtyEight. https://projects.fivethirtyeight.com/redlining/

[3] All Things Considered (2017). 'The Color Of Law' Details How U.S Housing Policies Created Segregation. NPR. https://www.npr.org/2017/05/17/528822128/the-color-of-law-details-how-u-s-housing-policies-created-segregation

[4] NCRC https://ncrc.org/treasureCRA/

[5] Aladangady, et all. (2024). "Greater Wealth, Greater Uncertainty: Changes in Racial Inequality in the Survey of Consumer Finances." Federal Reserve. https://www.federalreserve.gov/econres/notes/feds-notes/greater-wealth-greater-uncertainty-changes-in-racial-inequality-in-the-survey-of-consumer-finances-20231018.html

Key Findings from Our Quantitative Analysis

65 MDIs issued mortgages in the 2019-2022 pandemic period, representing lending from nearly half (43%) of all MDIs.

Collectively, **MDIs originated 164,000 mortgages**, for a total of nearly $58billion in originations.

MDIs originated a higher share of mortgages to minority borrowers and to minority communities than did non-MDI lenders.

MDIs have lower denial rates but higher interest rates than other financial institutions.

Communities that received MDI mortgage lending **face disproportionate climate risk relative to the overall nation.**

Key Themes from MDI Interviews

- **MDIs create significant social impact through portfolio loans**, which can have more flexible underwriting criteria around areas such as credit scores, income sources, and debt-to-income ratios compared to loans sold on the secondary market. However, portfolio lending requires strong balance sheets, and the current rate environment has increased the cost of liquidity for MDIs, thus limiting their ability to originate these impactful loans.
- **Digitalization enables MDIs to lower origination and compliance costs while increasing efficiency**, but high touch and in-person interactions still matter, particularly for financial education to help individuals get mortgage-ready.
- **The regulatory burden including the cost of generating compliance reporting poses a significant barrier to entry for MDIs**, and it also affects the risk appetite and willingness to experiment and innovate with more financially inclusive product offerings.
- In addition to providing mortgage lending, **MDIs are partnering with developers to finance affordable housing, solar installation, and revitalization of cities block by block**.
- **Impact investors, philanthropists, and other stakeholders are needed to support MDI mortgage lending.** This type of stakeholder support can be channeled through strategies that enhance liquidity, absorb risk, subsidize costs, grow capacity, and enable scale. Additionally, government at all levels can play a pivotal role by adjusting underwriting criteria, allocating funds, creating tax credits, and removing red tape to streamline housing development.

Based on these insights, we establish several moonshot goals for expanding lending from the sector, including: **1)** the creation of a secondary market specifically for portfolio loans; **2)** the development of a digital marketplace to facilitate loan purchases for CRA credit; **3)** the creation of tools and strategies to augment staff constraints and build backend support; and **4)** and the passage of an Inflation Reduction Act size piece of legislation focused on creating equitable opportunity for MDIs in affordable housing.

Lending Analysis

Broad Summary

Our analysis finds that a total of 65 MDIs issued mortgages in the 2019-2022 pandemic period, representing originations from roughly 43% of the total sector. Collectively, these MDIs originated 164,000 mortgages, totaling nearly $58 billion.

The remainder of this paper's analysis focuses on a slightly smaller subset of loans, specifically conventional loans which are not backed by the government. This choice allows for a more natural apples-to-apples comparison across institutions and lender types.[6] Fifty-six MDIs issued 81,533 conventional mortgages within this four-year window for a total of $29.5 billion.

Across all four years of analysis, the median MDI issued 71 conventional mortgages. But predictably, there was a wide range in the number of loans issued by a given MDI each year, with around 10% issuing less than 6 loans and 10% issuing more than 1,450 loans. The median conventional mortgage loan size ranged from $205,000 to $295,000, with each year's median increasing relative to the preceding year. In comparison, the median for non-MDI loan sizes ranged from $235,000 to $305,000.

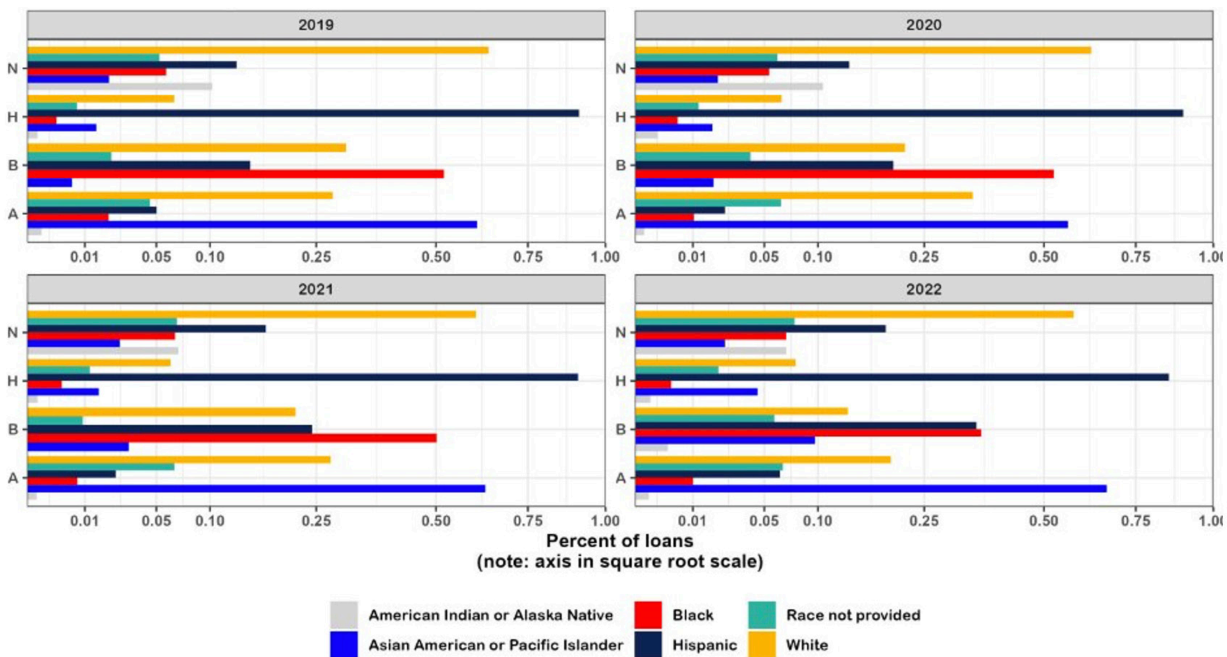
Lending Disaggregated by MDI Type

Among all types of MDIs, the vast majority of loans were issued by Native American (37%) and Asian American MDIs (47%), followed by Hispanic American (14%) and Black American MDIs (1.6%.) For each of the four years, the median loan size was highest for Asian MDIs, followed by Native American MDIs, then Black MDIs, then Hispanic MDIs.

[6] Government-backed loans include FHA, VA, and USAID loans, each of which has differing rules around eligibility, and each of which can impact a financial institution's balance sheet differently. In addition, the specific loan mix – e.g., the percentages that are various types of government-backed loans versus conventional loans – varies from institution to institution and across lender types.

Research from the Federal Deposit Insurance Corporation (FDIC) examining years prior to 2019 found that MDIs issue the largest share of loans to borrowers of the same race/ethnicity.[7] Our analysis of 2019-2022 finds a similar pattern in each of the years analyzed, as illustrated in Figure 1 below. Summed across all four years, 62% of Asian MDI loans went to Asian borrowers, 48% of Black MDI loans went to Black borrowers, 91% of Hispanic MDI loans went to Hispanic borrowers, and 10% of Native loans went to Native borrowers.[8]

Figure 1: Percent of loans by race and by MDI ownership type, 2019-2022.



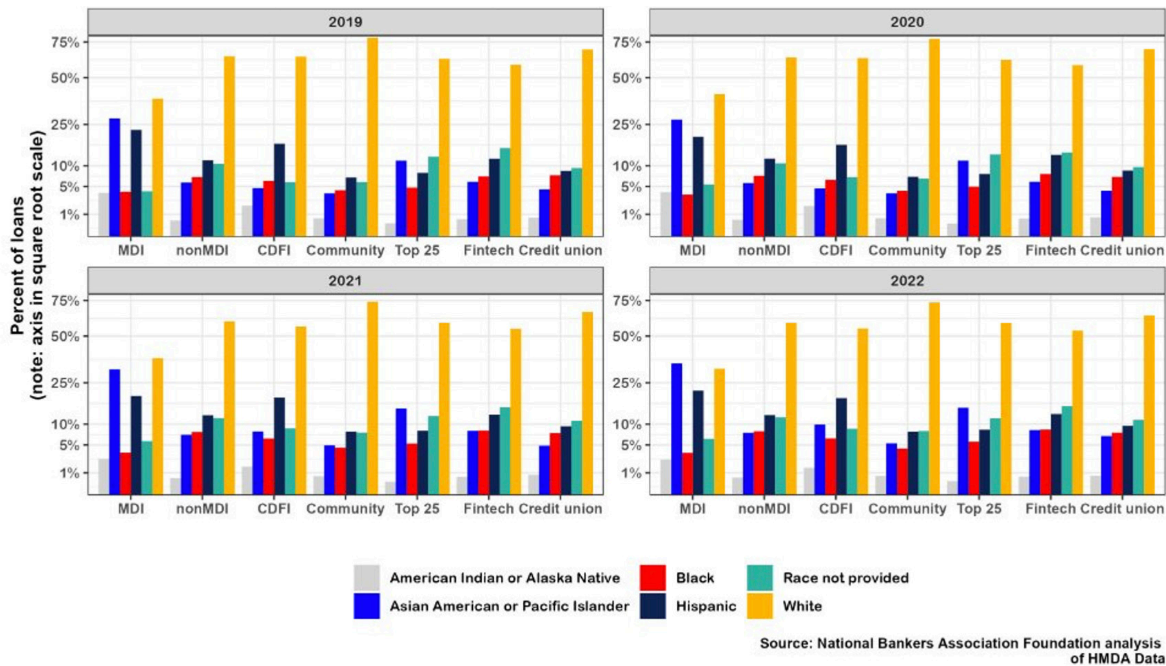
[7] Breitenstein, Eric. C., et all. (2019). "Minority Depository Institutions: Structure, Performance, and Social Impact." FDIC. https://www.fdic. gov/regulations/resources/minority/study.html

[8] These percentage shares are calculated after dropping loans from each type of MDI for which the race/ethnicity of borrower is unknown. This excludes 17,103 loans, or 10.43% of all total loans issued from 2019-2022.

Comparison with Non-MDI Lending, Including Big Banks, Community Banks, and Nonbank Lenders

Fifty-eight% of MDI mortgages from this pandemic period were originated to minority borrowers, versus only 27% of non-MDI mortgages. Throughout our analysis, we also examine lending by community development financial institutions (CDFIs), community banks (small banks that are $10 billion in assets or less), the top 25 largest banks, fintechs (nonbank digital-based lenders), and credit unions. As shown in Figure 2 below, **MDIs outperformed all other financial institutions in originating mortgages to minorities in each of the four years** – and specifically the share of loans to Asian, Hispanic, and Native American borrowers.

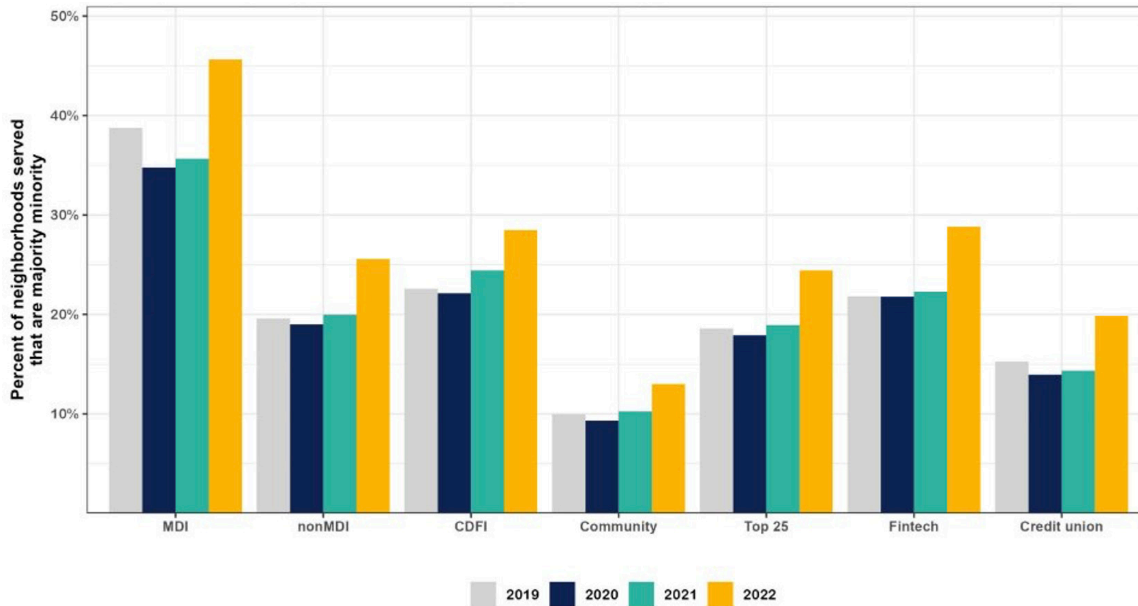
Figure 2: Percent of loans by race and by lender type, 2019-2022



Source: National Bankers Association Foundation analysis of HMDA Data

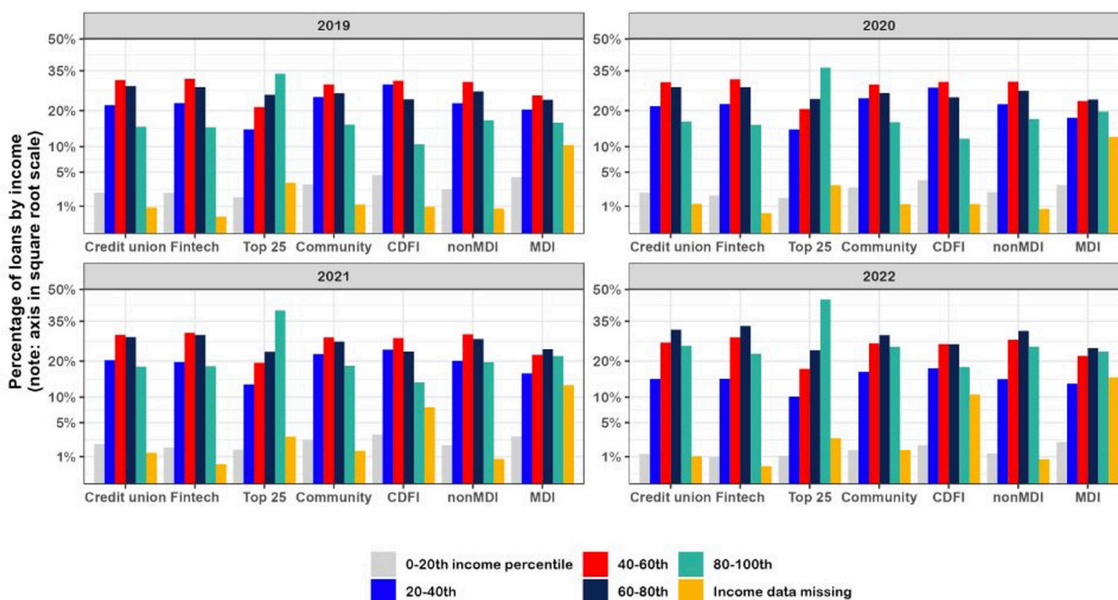
In addition to originating higher shares of lending to minority borrowers, MDIs also outperformed other lender types in their share of lending to minority-majority census tracts, as shown in Figure 3. Over the four-year period as a whole, **39% of MDI loans went to minority-majority census tracts versus only 21% of non-MDI loans.**

Figure 3: Majority-minority neighborhoods served by lender type, 2019-2022



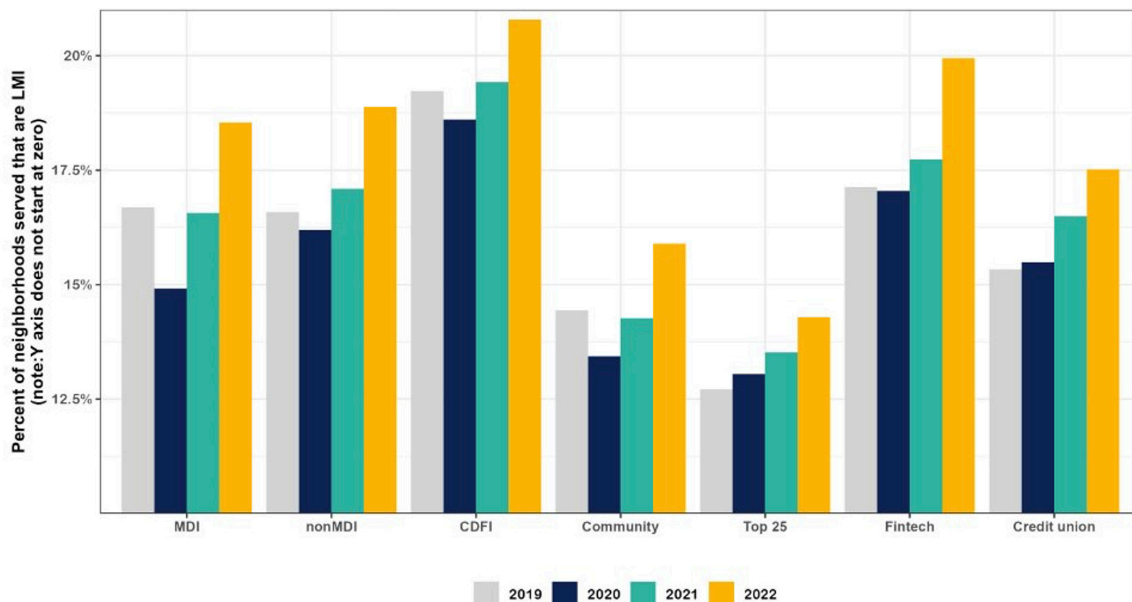
MDIs also excelled at serving low-to-moderate income (LMI) borrowers and communities. Figure 4 below demonstrates that while the share of lending across income percentiles is comparable across the banking sector, **MDIs and CDFIs issued higher shares of loans to borrowers in the lowest income percentile relative to other lender types.**

Figure 4: Income of borrowers by lender type, 2019-2022



Similarly, Figure 5 below shows that MDIs and CDFIs outperformed community banks, credit unions, and the largest banks in their share of lending to LMI census tracts.

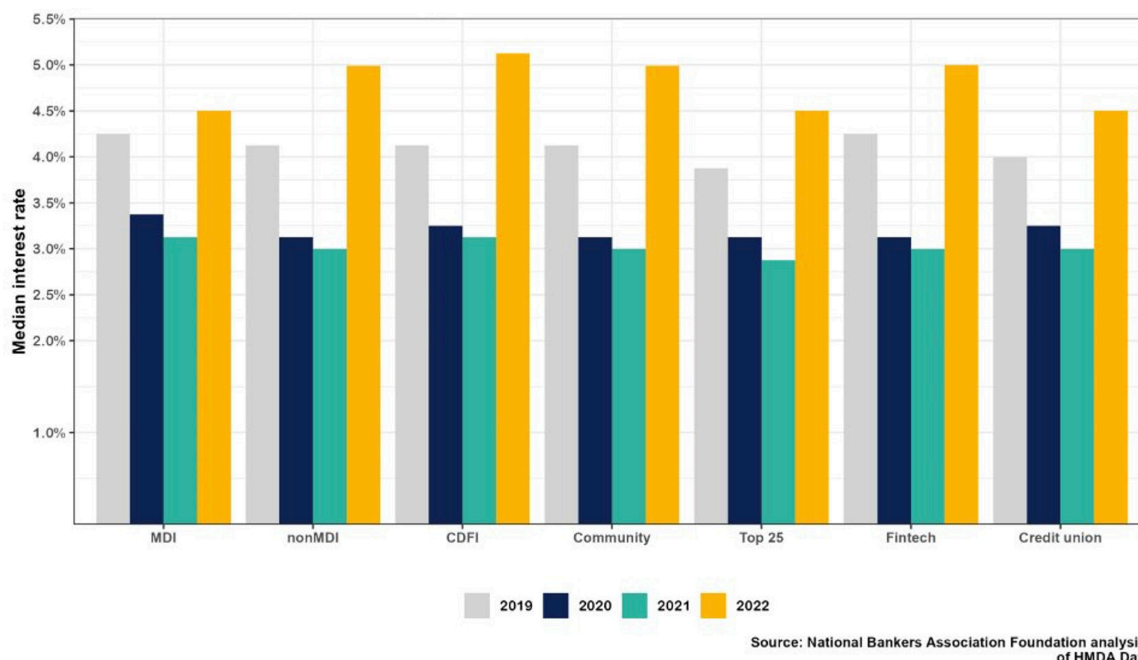
Figure 5: LMI neighborhoods served by lender type, 2019-2022



Interest Rates by Lender Type

The Consumer Financial Protection Bureau identifies seven factors influencing mortgage interest rates: credit scores, home location, home price, loan amount, down payment, loan term (duration), interest rate type (fixed or adjustable), and loan type (e.g., convention, FHA).[9] Given that MDIs predominantly serve low-and-moderate income borrowers who typically have lower down payments and lower credit scores, it is unsurprising that MDIs have had the highest median interest rates in three of the four years analyzed, as shown in the Figure 6 below.

Figure 6: Median interest rate by lender type, 2019-2022



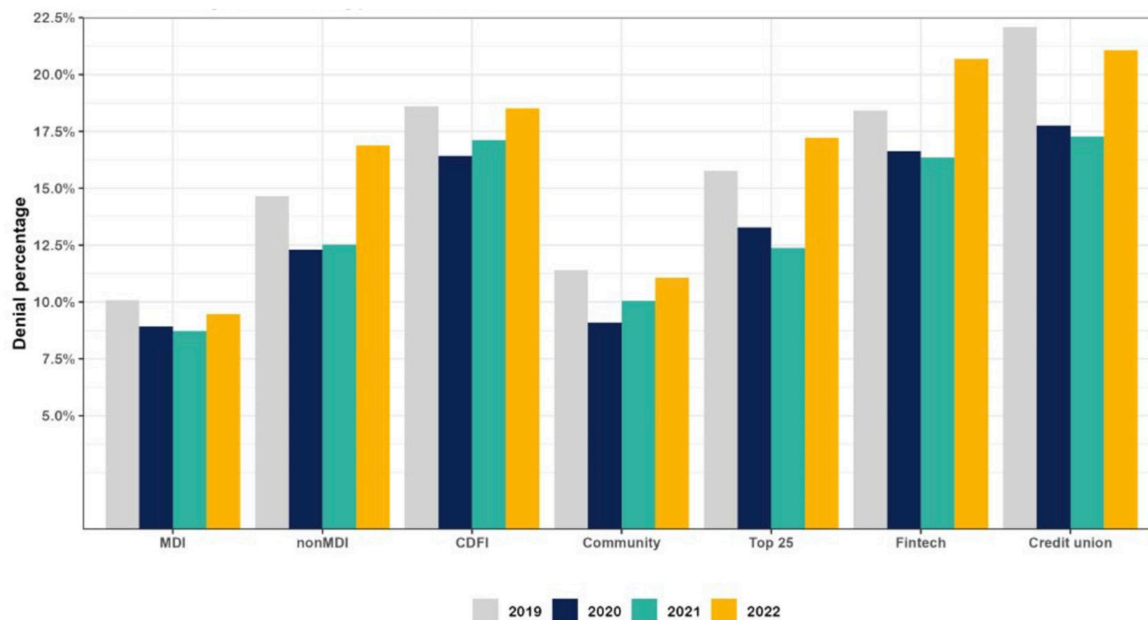
Similarly, differences in the borrower pool and specific housing markets around the seven factors cited help to explain why Black MDIs have the higher median interest rate of 7.4%, while the other MDI types have interest rates closer to the median for all lender types.

[9] Shea, Nicole. (2017.) "Seven Factors That Determine Your Mortgage Interest Rate." CFPB. https://www.consumerfinance.gov/about-us/blog/7-factors-determine-your-mortgage-interest-rate/

Denial Rates and Reasons

In addition to reporting data on originated loans, financial institutions are required to report data on loan denials. As shown in Figure 7 below, **in all four years analyzed, MDIs had the lowest denial rates across all lender types.**

Figure 7: Denial rate by lender type, 2019-2022



The lower MDI denial rates are particularly driven largely by Asian and Native American lenders who account for the greatest number of loan activity and who have the lowest denial rates among all MDI types.

Financial institutions can choose from the following reasons (alone, or in combination) when denying a mortgage: debt-to-income, economic history, credit history, collateral, insufficient cash, mortgage insurance denied, and others. Our analysis finds minimal differences in the reasons for denials at MDIs relative to other lenders. **Across all lender types, we find the main reasons for denials tend to be debt-to-income, credit history, collateral, and other. However, MDIs are much less likely to list credit history and much more likely to list collateral relative to other lender types**. Notably, when disaggregating by MDI type, we find that Native American lenders are disproportionately more likely to list lack of mortgage insurance, a puzzling finding that warrants additional research to understand the relevant dynamics.

Taken together, the lower denial rates but higher interest rates suggest that though MDIs prioritize serving consumers that are underserved by the broader financial industry, the cost of credit is necessarily higher to offset risk stemming from less collateral, smaller down payments, lower income, or poorer credit history. As we will explore later in this report, partnerships with MDIs that can help address those areas of risk among borrowers can help to make credit even more affordable.

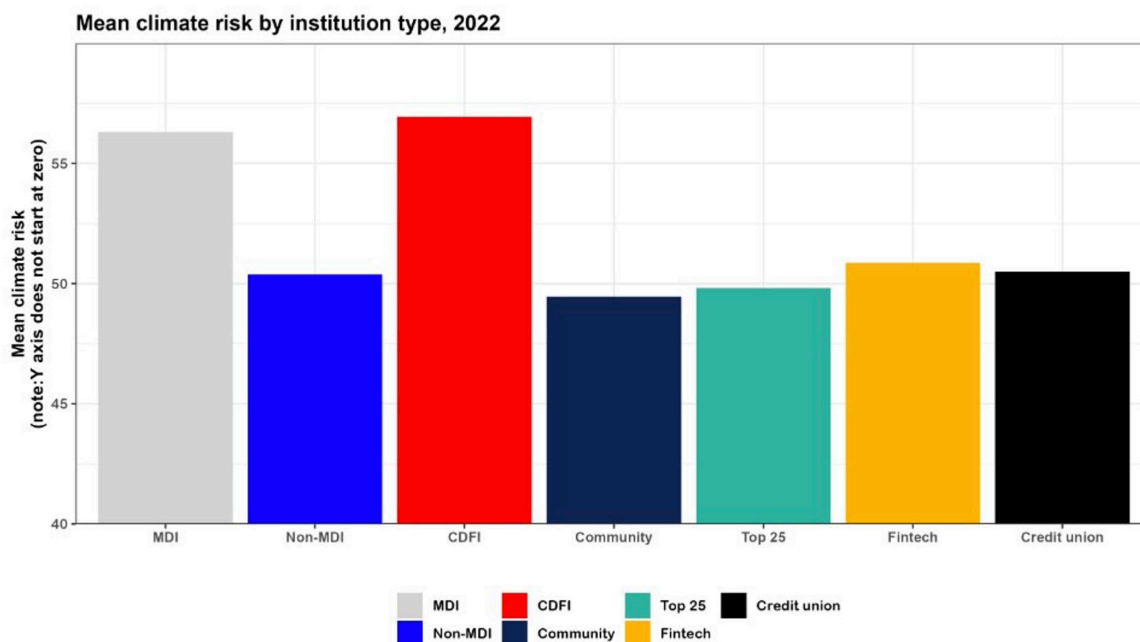
Mortgage Lending and Climate Risk

In our prior research using data from First Street Foundation and Moody's RMS, we show that MDIs are lending in communities with elevated climate risk.[10] For this paper, we use the Federal Emergency Management Agency's (FEMA) climate risk framework to evaluate the climate risk of locations receiving lending from each type of lender.[11]

FEMA examines risk across 18 natural hazard risks: avalanche, coastal flooding, cold wave, drought, earthquake, hail, heat wave, hurricane, ice storm, landslide, lightning, riverine flooding, strong wind, tornado, tsunami, volcanic activity, wildfire, and winter weather. Based on estimated risk exposure, FEMA gives every census tract a "Risk Rating" ranging from "Very Low" to "Very High." MDIs were much more likely to give loans in census tracts ranked as "Relatively High" and "Very High." 17% of MDI loans went to these higher-risk communities, compared to 14% of non-MDI loans.

FEMA further assigns each community a risk score of 0-100, where 0 indicates the lowest risk percentile and 100 indicates the highest risk. Figure 8 below shows that the average (mean) climate risk score is higher in places served by MDIs and CDFIs relative to the other lenders.

Figure 8: Average climate risk by lender type, 2022

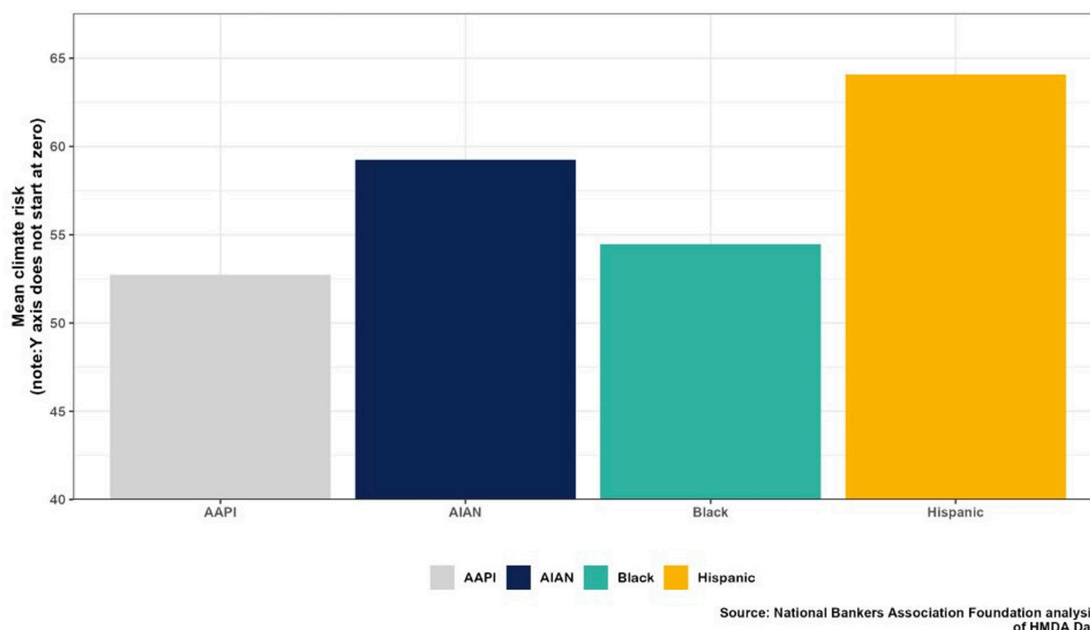


[10] Barr and McComas (2022). 'Minority Depository Institutions: State of Knowledge, Sector Summary & Lending Activity, and Impact, 2010 – 2022.' National Bankers Association. https://www.nationalbankers.org/research-state-of-mdi-report

[11] FEMA. National Risk Index. Accessed June 12, 2024. https://hazards.fema.gov/nri/report/viewer?dataLOD=Census%20tracts&-dataIDs=T05147490100,T05147490200

Importantly, the average climate risk score for communities served by each MDI type is higher than the average for non-MDI lending. But as shown in Figure 9 below, climate risk is particularly elevated for communities served by Hispanic and Native American MDIs.

Figure 9: Average climate risk by MDI type, 2022



Furthermore, most MDI types issued a greater share of lending to higher climate risk communities than the 14% of non-MDI loans that flowed to higher risk communities. Specifically, 27% of Native American loans, 24% of Black loans, and 19% of Hispanic loans flowed to higher risk communities. And while only 14% of Asian loans flowed to higher risk communities, this is consistent with the finding that the communities served by Asian MDIs had a lower median risk score than the communities served by the other MDI types.

The disparate climate profile faced by the communities that MDIs serve matters because it suggests vulnerabilities, including economic vulnerability. For example, insurance costs are likely to be higher in places that face risk of flooding, and if both chronic weather conditions or natural disasters damage, degrade, or destroy the homes of borrowers, this will, of course, limit their ability to safeguard and build wealth. Climate risk may also limit property appreciation based on changing market desirability, or in some cases even cause property value deflation, which can undermine wealth creation for homeowners and the communities in which they live.[12]

In summary, our quantitative analysis finds that: **1)** MDIs issue a greater share of their loans to minority borrowers, to minority communities, and to communities with elevated climate risk than do other lenders and **2)** MDIs experience lower denial rates than other lenders, but typically list similar denial reasons. While these numbers help document the social impact and significance of MDI lending, there is even greater insights to be found in the context surrounding those numbers, which is explored in the next section.

[12] First Street Foundation. 2023. "The Insurance Issue." https://firststreet.org/research-library/the-insurance-issue

A Qualitative Understanding of MDI

To enhance our understanding of MDI mortgage lending, we spoke with staff at seven MDIs who are members of the National Bankers Association.[13] In selecting the MDIs, we aimed for diversity across asset size, geographic region, and volume of mortgage lending. Three of the banks we spoke with are $1 billion or above in asset size, and the seven banks are spread across and do lending in all four regions of the U.S. In addition, we spoke to two MDIs regarding their perspective on the benefits or challenges of not offering single family mortgage loans.

The MDIs interviewed recognized that home ownership is essential to closing the wealth gap and creating better intergenerational and communal outcomes. Some of the MDIs highlighted the benefits to immigrants accessing the American dream of homeownership. Other MDIs provided insights on the benefits of homeownership as it pertains to preventing displacement and ensuring that long-time residents benefit from economic development. The interviewees were also excited about initiatives around creating affordable single-family homes and multifamily homes with affordable rents, as well as mitigating the impacts of climate change through financing residential solar.

Despite the gains made, MDIs were candid about the many barriers in the mortgage lending space, for the MDI and their borrowers. For some of the MDIs, lower property values – including low appraisals or lack of recent sales activity – in the markets they serve means that the fixed costs associated with originating and servicing a loan (on the bank side) and paying for closing costs (on the borrower side) make it less economical. Other MDIs spoke about the sheer cost of time and labor to work with a borrower over a period of months or even years to get them mortgage-ready, often with the deal falling through right before closing due to a sudden change in debt-to-income.

All the MDIs we spoke to highlighted staffing constraints, regulatory burdens, compliance reporting burdens, and the possible penalty risks to them should compliance errors be identified. A notable comment from one MDI is that the only viable path for them and other similar institutions to offer mortgages would be to merge with or acquire a bank that is already doing mortgage lending to secure the necessary staffing, systems, and expertise needed to be successful.

These interviews were immensely helpful in moving beyond the numbers to provide a greater understanding of the context in which MDIs operate, the challenges they face, and the opportunities that exist or could exist to deepen the social impact of this sector. In this section, we highlight insights from the interviews around five key themes:

1. **The power of portfolio lending.**
2. **The tradeoffs between automation and high-touch and in-person.**
3. **The challenges with navigating regulation.**
4. **The additional ways that MDIs support affordable housing beyond mortgage lending.**
5. **The opportunities for philanthropy, government, and other stakeholders to engage to increase the size and scale of MDI mortgage lending.**

[13] Founded in 1927, the National Bankers Association is the voice for the nation's $349 billion minority depository institutions (MDIs) banking industry, and the only organization focused solely on the survival and strengthening of MDIs. Its members include Black, Hispanic, Asian, Pacific Islander, Native American, and women-owned and -operated banks across the country, all working to help communities who are underserved by traditional banks and financial service providers. MDIs are located in 32 states and territories.
Learn more at nationalbankers.org.

Portfolio Lending: Finding More Credit-Worthy Borrowers

Insight #1: MDIs are able to create the most social impact through portfolio loans because these loans can have more flexible underwriting criteria around areas such as credit scores, income sources, and debt-to-income ratios than loans that are sold on the secondary market.

Mortgages can be generally grouped into two categories: portfolio loans that remain on the books of the lender that originated the mortgage and securitized loans that are sold on the secondary market. This includes mortgages sold to the government-sponsored enterprises Fannie Mae and Freddie Mac that exist to ensure adequate liquidity in the financial system.

Regulations around underwriting securitized loans are much stricter now than before 2008 because poor and sometimes malicious underwriting by major lenders saddled borrowers with debt they could not afford and was a significant contributor to the financial crisis that created the Great Recession. As a result, loans that originate with a goal of selling on the secondary market have rigid parameters that must be adhered to. For example, Fannie Mae loans require a minimum credit score of 620, a maximum debt-to-income ratio of 36% (for manually underwritten mortgages), and various additional rules around loan-to-value ratios, income sources and employment history. While concern for safety and soundness is important, the strict underwriting criteria creates barriers for many of the borrowers and communities MDIs serve. As one MDI explained, this strict underwriting *"doesn't work for those that have inconsistent income, seasonal income, [who] don't have their tax returns, [who] don't have a grandmother who left $50,000 to use as a downpayment."*

The MDIs we spoke to see portfolio lending as a significant way they can help the borrowers they serve access mortgage loans. In keeping with their mission, these MDIs serve a high share of borrowers with low or moderate income, meaning that even a small amount of debt can push them above the debt-to-income thresholds, functionally barring many of them from homeownership. One interviewee told us, "I can't remember the last time I saw an application where there's no student loan debt." And several other lenders highlighted the significance of even a single car payment as a major barrier.

"I usually put individuals in our portfolio that will not qualify to go on the secondary market."

Even if the debt ratio is higher than the maximum set for the secondary market, portfolio lenders will use non-traditional income verification such as rent and utilities payments and bank statements to ascertain whether a borrower has sufficient cashflow to reliably make their mortgage payments. Since some of these lenders also use innovations like 80-10-10 mortgages they are able to keep the monthly payments lower in accordance with the cashflow capabilities of the borrower, thus ensuring that their underwriting is still safe while also providing greater financial inclusion.[14]

Similarly, portfolio lenders can look past the credit score itself. One lender used the example of a borrower having poor credit because of a recent divorce but who otherwise had a history of stable income, on-time rent and utilities payments. This instance, although specific, illustrates the larger point that credit scores often overlook key indicators of credit worthiness. Although this type of loan cannot be sold on the secondary market, it makes sense to the bank because it meets the fundamental mission of the MDI and is still low risk and profitable.

[14] 80-10-10 mortgages are basically two mortgage loans that allow a borrower to only pay 10% upfront but still avoid needing to have mortgage insurance despite the borrower not having a 20% down payment.

One lender described the collaborative nature of the decision-making around portfolio lending: *"[W]e huddle as a group and we talk about the transaction, and we make the decision collectively, is this a transaction that we think we want to keep in our portfolio? Do we want to approve the loan? And what is the likelihood that this particular loan will perform?" As part of the process, the group "looks very thoroughly at the pay stubs, bank statements, [and] the tax returns, and then makes the decision based on our calculations of whether or not we'd have an appetite to take on the risk."*

Similarly, another bank explained that flexibility is about balancing *"what kind of appetite does the bank and the board have"* in a way that is responsible to the consumer and that does not put the bank in an unsafe and unsound position. In other words, *"being flexible within certain boundaries that just kind of make sense and are proven."* As a practical example, this particular bank has been involved in ITIN lending – loans where a borrower has a tax identification number but no social security number – and began by purchasing ITIN loans from a more experienced lender in this space. This gave them the opportunity to study the risk profile, learn about the strategies for successfully underwriting these loans, and ensure that their bank regulator was comfortable with the safety and soundness. As the model was proven out, the bank was able to begin offering this loan product themselves, thereby increasing financial access to an underserved population.

In addition to using portfolio lending to provide mortgages to individuals who would otherwise struggle to be approved for a loan, MDIs also use portfolio loans to ensure loans are more affordable. One of the MDIs noted that they also use portfolio loans when it can mean offering the borrower a better interest rate than what would be offered through the secondary market loan buyer. Conversely, another MDI noted that while their portfolio loans often have a slightly higher interest rate, because they also offer better financing (including 100% financing), that removes the PMI requirement, meaning the monthly payment becomes much more affordable for that borrower than would be the case for a non-portfolio loan.

Portfolio lending allows MDIs to maximize their mission by originating loans to borrowers who would otherwise not be able to access a mortgage. But in addition to this aspirational reason, MDIs can also find comparative advantages through specializing in making sound loans to borrowers that are overlooked and underserved by other lenders.

Nevertheless, our interviewees stressed that portfolio lending requires a strong balance sheet to satisfy capital reserve requirements. Portfolio lending also requires liquidity sources, and the current rate environment has made liquidity more expensive for MDIs which constrain the ability of MDIs to originate more loans in general, and especially 15- and 30-year mortgages that remain on their books.

As one bank explained: *"Funding is a problem, the competition for deposits is a problem. And the margins between what we can charge for the mortgage and what we paid for the money to fund it have gotten very thin."* Similarly, another bank noted that even mission-driven lenders are *"having to price up just to make some sort of a margin on top of your cost of funds."* On the other hand, that same bank emphasized that *"the relationship piece is important. Because if you can bring deposits as you bring in a new person into the bank, that is helping drive down our cost of funds."* Finally, several of the MDIs highlighted the ongoing importance of the Federal Home Loan Banks as an important source of cheaper liquidity that also allows them to keep prices lower for borrowers.

Digitalization, Automation, and High Touch

Insight #2: Digitalization enables MDIs to lower origination and compliance costs and increase efficiency, but high touch and in-person still matter, particularly for financial education to help individuals get mortgage ready.

Digitalization and automation can help financial institutions in a variety of ways, both on the customer-facing side and on the backend in terms of internal bank processes. For example, digitalization can streamline how the bank markets its products, develops its pipeline, receives loans, completes its underwriting, stores relevant data, and handles compliance reporting.

In our conversations, many of the MDIs focused on the power of digitalization in the loan origination process. One bank noted that *"the cost to generate a $300,000 mortgage and a $3 million mortgage is the same," but that automation has made it possible for them to do more small dollar mortgages: "whereas before you get a manual process, now it's automated so that our ability to gain efficiency and scale up is a lot easier now because I don't need as many people because systems are in place."* This same bank also readily acknowledges that automation is often cost-prohibitive (particularly for smaller institutions), sharing that they have spent *"literally millions of dollars between implementing a customer relationship management system, automating loan underwriting, automating loan servicing, etc."* These insights around digitalization cost and economies of scale mirror those noted in a previous National Bankers Association Foundation report on digitalization for mission-driven lenders.[15] That report highlighted how implementing automation can be more difficult for small banks both in terms of affording the upfront cost and in terms of how quickly they can recoup the benefits based on their loan volume.

Digitalization can also support mortgage-adjacent banking activities. For example, one MDI shared a fintech partnership that allows them to originate a substantial volume of solar loans. The bank noted that *"the reason we love it is because it's basically making homeownership more affordable and sustainable"* by reducing energy costs. Through this partnership, the MDI can quickly review applications, underwrite loans, and successfully screen for reputable developers. The partnership also makes it easy to ensure that the loans are CDFI-eligible and that the MDI is meeting its own internal benchmarks around mission-driven lending. Notably, this lender stressed that one of the reasons it's easier to do this lending relative to mortgage lending is because there is a lot less regulation around underwriting for solar: *"It's an example of when you remove some of the handcuffs safely, you now have a viable product, and the financial friction is removed [for both the lender and the borrower]."* Nevertheless, the interviewee shared that there could be potential benefits of fintech partnerships in the mortgage space, too, especially in terms of aggregating a steady supply of eligible borrowers.

Digitalization matters, but there is no escaping the importance of high touch, in-person connection. The MDIs we spoke with take pride in the level of engagement with individuals and communities as an essential part of their mission and operational strategy. One interviewee stated, *"We're so hands on with the community. They want to see us, they want to talk to us, they want a relationship with us. It is particularly important for them to walk into a bank branch and say is [so and so] in today and I can just walk downstairs and have a conversation. And it speaks volumes to what we are willing to do for our customers."* This same interviewee shared that part of the value of this in-person connection is all the other relationships that the bank brings to the table to assist the borrower: *"I meet with title companies, I meet with attorneys because I believe that when it's all said and done, you just can't beat those community partnerships in those relationships."*

[15] Barr, Anthony, et. all. (2023). "Navigating The Digital Frontier in Banking." National Bankers Association. https://www.nationalbankers.org/research-digitalization-re

Several of the MDIs spoke about providing financial education as a key component of their mission. In some cases, the MDIs provide this education directly through staff members, including loan officers. In other cases, MDIs participate in programs that bring in HUD-certified counselors to the bank branch to work directly with prospective borrowers to help them get to a place where they can qualify for a mortgage with the bank. Financial education is also part of community engagement, with several of our interviewees highlighting their goal of creating communal trust to help pull folks who are currently outside of the financial system into the formal banking sector and away from potentially predatory situations like rent-to-own models. One MDI framed this engagement as part of a broader borrower journey in which a credit invisible person is invited into the financial system, given a free checking account, provided with tools and education to develop their financial acumen, and eventually helped to be mortgage ready.

While much of the financial education noted here is around technical knowledge and social capital, some of the education is also about building trust in the banking sector. For example, some of the MDIs spoke about originating loans to borrowers who are self-employed. Many of these borrowers seek to lower their reportable income for tax purposes, but this practice undercuts their ability to qualify for a mortgage. Helping these borrowers requires lots of trust, because as one MDI pointed out, *"when you are telling a business owner, trust me, you need to show more income, you know, it goes against their grain."*

Equally important to building trust in the financial system and banking is building confidence in the borrower themselves. One interviewee explained that much of her work is with individuals who are mortgage-ready on paper, but afraid to take that next step.

"They have fear of losing the home, they have fear of not being able to keep up with the maintenance, they have fear of trying to maintain the home and make sure that they keep a roof over their head."

In helping these individuals, the interviewee discusses home warranties, but also just works to help the individual grow more confident in their ability to be a successful homeowner. She shares with them: *"don't sit there and live in rental [long-term] because what you're doing essentially is paying a mortgage, just not your own mortgage, you're paying somebody else's mortgage off."*

Nevertheless, because the high-touch model is labor-intensive, it can be difficult to scale up. One bank observed that while the recent capital infusions into the sector enable more lending from a balance sheet perspective, *"if you don't have the people to deal with the plumbing, you're just going to have all this money that you can't deploy." On the other hand, most of the MDIs spoke about all the pent-up demand in the communities they serve, with one institution noting that "if you make the economics work, we will make the pipeline."* Thus, as we'll explore later, partnerships that can help develop the pipeline, including by providing tailored coaching to help borrowers qualify, could enable much greater volume in lending at institutions that are limited in staff or level of digitalization. Similarly, investments in technological solutions for backend support could also free up staff capacity and make it easier to increase lending volume.

Regulations, Regulations, and More Regulations

Insight #3: The regulatory burden including the cost of generating compliance reporting is a barrier to entry or expansion for MDIs, and it also affects the risk appetite and willingness to experiment and innovate with more financially inclusive product offerings.

In the first section of this paper, we wrote about significant legislation passed in the 1970s to counter the racist legacy of redlining. One major piece of enacted legislation was the Home Mortgage Disclosure Act (HMDA) – a law that mandates data collection and reporting for banks issuing above a certain threshold of mortgage loans a year. From the standpoint of lenders, HMDA reporting involves capturing and reporting on as many as 110 data points *for every mortgage loan application received* – a particularly daunting task for small banks where a team of one to three people are often responsible for all the bank's compliance reporting. And HMDA is just one set of regulations around mortgage lending. In the post-2008 lending environment, Dodd Frank legislation alone has added 2,300 pages containing more than 400 new rules and mandates for lenders, several of which directly involve mortgage lending practices.

Our quantitative analysis found that the median MDI issued only 71 loans, but about 10% are doing 5 or less loans a year, and 10% are doing more than 1,400 loans a year. For banks doing a smaller amount of lending, much of the decision-making around loan volume is decided by implications around regulation which involves understanding all the rules and requirements, ensuring the mortgage lending program follows those rules, and generating compliance reports.

One of our interviewees told us that from the standpoint of the regulatory burden, *"it definitely does not make sense for you to have a mortgage program if you are doing [only] 30 or 40 mortgages a year. In that case, you might as well just do what we do occasionally, which is have a referral relationship or a correspondent lending status."* On the other hand, doing too many mortgages can put a bank over the threshold where reporting regimes or supervisory bank examinations become more intensive. As another interviewee shared, *"when we were a small size bank, we weren't looked at with a microscope,"* versus now that the bank is bigger, the level of scrutiny is greater. Thus, for some MDIs – even if the market demand and loan officer capacity would support greater lending – there are strategic and operational reasons why the bank might still be unable or unwilling to increase their scale of lending.

In addition to influencing whether and to what extent MDIs participate in mortgage lending, regulations and various exposure to regulatory scrutiny also shape how flexible MDIs can be in using portfolio-lending to increase financial inclusion. As one interviewee observed, *"anything you want to do that's outside the box, you're going to immediately be subject to scrutiny, potential fair lending issues, and risks that you don't want to take on."* The fair lending concern is particularly apt because compliance requires that underwriting be reasonably consistent, even for the non-conforming portfolio loans, to ensure lack of bias or discriminatory practices, effectively ruling out ad-hoc adjustments that are highly customized based on the needs of an individual borrower. This also underscores why MDIs might not want to be doing only 30 or 40 mortgages versus 400 or 1,400. One MDI even shared about being severely penalized in the past by their regulator for a minor error on a mortgage that helped rather than hurt the borrower. And so that fear of running afoul of rules, despite lack of ill intent, further constrains even portfolio-lending that would otherwise be fiscally sound.

Nevertheless, our interviewees were not exclusively pessimistic about regulation. And indeed, a few of the MDIs even observed that the sector can be quick to use regulators as an excuse for not doing something simply because it might be difficult or daunting. Of course, as one interviewee aptly noted, *"it doesn't hurt to have a former bank regulator on staff"* – a theme that a couple of MDIs expressed in explaining their confidence of delivering more flexible underwriting or loan products that do not run afoul of applicable laws and regulations. Our interviewees also highlighted the importance of consistent communication with bank supervisors including about future plans or checking in as the institution starts to scale up a particular mortgage product.

One interviewee spoke at length about navigating agencies and regulations for portfolio lending:

> *"I engage in a lot of conversations with our regulators as well. I explain what we're doing or planning to do and ask if they have any questions, and if so tell me how I can make sure we address them. Ultimately, what we do is deploy an agile method to a lot of this; we don't just go all in at once, we kind of test the waters a little bit. We set very tight limits and we say to our regulators, we're comfortable taking a little bit of risk here, we're going to try this out, we're going to report back to you. And then we're going to build robust risk management systems and management information systems."*

Given the insights around regulators, we believe we need ongoing conversations with regulators and lawmakers about how to better fine-tune regulation to balance safety and soundness with opportunities to extend the impact of mission-driven lenders. To aid in these conversations, limited experimentation to provide proof of concept could help ensure that changes do not pose systemic risks. In addition, any regulators or lawmakers involved in formulating new rules around compliance for other loan products should center conversation with MDIs and CDFIs to ensure that there are not unintended consequences that hamper the mission or restrict credit. Additionally, it is important to ensure that these regulations do not overly burden smaller financial institutions.

It’s Not Just Mortgages – Other Ways MDIs Support Affordable Housing

> **Insight #4:** In addition to providing mortgage lending, MDIs are also partnering with developers to create affordable housing, install solar installation, and revitalize cities block by block.

Earlier in this section, we mentioned an MDI that is doing residential solar loans to help drive down energy costs for homeowners. Several MDIs we interviewed shared exciting examples of how they are supporting affordable housing beyond just single-family mortgages. A powerful example, one MDI uses a portion of their balance sheet to buy a portfolio of loans for residential lots, which are often predatory products issued by non-bank lenders with excessively high interest rates aimed at borrowers with low income or who are outside the formal banking system. As part of their mission, this MDI builds a relationship with the borrower, helps them integrate into the banking system with a free checking account and access to services, and immediately lowers the interest rate on the loan, no strings or conditions attached.

Some of the MDIs that we spoke to are directly financing the construction of new affordable housing. As one lender stated, *“One of the things that we’ve done is when a home’s not affordable, we build it ourselves and make it affordable.”* This same lender also shared that they are currently working to get their developers certified under the Fortified standards for construction that is more weather resilient given the outsized climate risks facing the communities the bank serves.

The MDIs we spoke to leverage longstanding relationships with developers – often minority developers and developers who are willing to provide some projects at cost – to make homes available in markets lacking affordable housing supply. Some of the MDIs engaged in this work have created entities like Community Development Corporations (CDCs) that sit underneath or alongside the bank, that may have equity invested from the bank and operate as a not-for-profit partner to further the overall mission of financial inclusion. These CDCs dive deeper into solving our housing crisis by acting as the developer of affordable housing units. For another MDI we spoke with, the supportive entity is a standalone loan fund that can participate in co-lending with the bank or offer subordinated debt in the financing, which helps lower the default risk for the regulated bank. Regardless of the exact structure, these kinds of strategies can often allow MDIs to extend their mission while earning revenue from both the development and sale of affordable homes.

Another creative financial product one bank uses is a mortgage for homes in need of renovation. This product appraises a home based on a post-renovation evaluation. This enables home buyers to access credit on homes they purchased with cash, filling a missing gap for mortgage lending. This product is critical for distressed communities with devalued properties and an aging housing stock and is a direct tool for broader neighborhood revitalization.

While homeownership is the focal point of this paper, we also interviewed MDIs about multi-family housing. It is apparent that many people rent, either because they need to or because they want to, and they also need affordable housing options. Several interviewees stressed that financing multi-family housing can help expand the stock of affordable housing and ease pressure on rent prices, especially if at least some of the units will be offered at below-market rates. One interviewee was particularly passionate about this subject:

> **"*If* we're not building *multi-family* affordable *[housing]*, if we're just thinking about single family affordable *[housing],* we will not get the *[increased]* supply of housing that we need to increase broader affordability."**

This same interviewee also noted that financing multi-family can help preserve naturally occurring affordable housing (NOAH). This is particularly important because non-mission driven investors and developers will often buy up this typically older housing stock, refurbish it, and then raise rent prices, thereby leading to displacement and contributing to further rent inflation in the broader regional market. Thus, multi-family financing can help long-term renters remain in the communities where they have roots. In some cases, financing multi-family development can even involve opportunities for wealth building for those renters. For example, this same MDI described a current project they are financing in which tenants have a meaningful shared percentage of ownership and will thus reap some benefits from the development. And of course, all these projects can also help address the wealth gap by helping minority developers and investors build wealth through their real estate portfolio.

One of the MDIs we spoke with also described a new focus area around financing the development of independent senior living properties. This MDI is passionate about ensuring that the elderly can remain in the community even if they have limited income or wealth, which is why these developments must ensure an ample number of units can be paid 100% through vouchers from the local housing authority. This development also works to ensure that the living center looks nice and integrates with the surrounding neighborhoods.

Finally, beyond housing itself, MDIs are also helping to address the social determinants of health and wellbeing in the communities where these homes are located. For example, one MDI outlined their parallel work in *"community facility financing and working capital for not for profit"* which includes things like *"healthcare facilities, charter schools, daycare centers that are not for profits, as well as other social service providers."* Here, homeowners and renters alike can benefit from the strengthened community safety net and social services ecosystem, all of which can pay dividends in terms of outcomes around health, education, job mobility, and more.

Stakeholder Engagement and Philanthropic Support

Insight #5: Impact investors, philanthropists, and other stakeholders can support MDI mortgage lending through strategies that provide liquidity, absorb risk, subsidize costs, grow capacity, and enable scale. Government can also play a role by adjusting underwriting criteria, allocating funding, creating tax credits, and removing red tape to streamline housing development.

Since the 2008 financial crisis, a declining share of mortgage loans are being originated by banks. Recent analysis finds that over the past 15 years, nonbank lenders account for the majority of originations.[16] The MDI sector has likewise seen a drop in mortgage lending. In the words of one of our interviewees, *"there's not too many of us (MDIs) that do mortgages, not right now. I want that to change."*

To reverse the trend and grow the amount of MDI mortgage lending, we need bold strategies and enduring partnerships. One MDI stated that we are trying to *"reverse 400 years of systemic disparities,"* and noted that to really close the homeownership gap, we need *"a sustained 10-year multibillion dollar effort that pulls in immense philanthropic and government resources."* Suggestions from MDIs on how philanthropy, corporate, and big banks can partner with them fall into a few main buckets.

First, many of the MDIs recommended philanthropic solutions focused on helping prospective borrowers. For example, increased funding for down payment assistance or interest rate buy-downs through grants or soft/silent seconds (second mortgage loans) can help households who are credit-worthy afford to purchase a mortgage while lowering the monthly payment cost, including by eliminating the added expenses of private mortgage insurance.

Second, several of the MDIs outlined the need for "mission-aligned" deposits to provide greater liquidity for lending and, in some cases, increased capital investments to meet reserve requirements to support greater volume of lending. Importantly, mission-aligned deposits need to be both sticky and low-cost, and investments need to be patient and willing to accept modest rates of return to fully operationalize this strategy. One MDI noted that the mindset needs to be that of using subsidies to address market failures:

"Capitalism has failed *[these communities.]* And so just applying traditional capitalistic principles, to try to move more folks into homeownership opportunities is just not going to work. The economics *[of the deals]* do not work. So, you are going to have to short circuit economics and the way to do it is some level of subsidy."

[16] Brown, Dan. (2024). "More than mortgages: Hidden ways banks contribute to housing access." ABA Banking Journal. https://banking[1]journal.aba.com/2024/01/more-than-mortgages-hidden-ways-banks-contribute-to-housing-access/

Third, several MDIs noted that the philanthropic sector could leverage a portion of their endowments as a reserve to cover bank losses, a move that would enable MDIs to issue more portfolio loans while remaining compliant with regulators. As one interviewee explained, people often fixate on mitigating credit risk, but most MDIs are experts at that already: the main need is balancing the balance sheet, interest rate risk, liquidity risk, *“and I think that’s where philanthropy could step in.”* In particular, the interviewee noted that a philanthropy *“can leverage [their] endowment 100 times over, because you could have some actuary tell you how the most you’d stand to lose is 3%, so you could provide that backstop for these balance sheet(s) for a meaningful amount of mortgages that would stay on the balance sheet of the MDIs.”* That same MDI noted that the structure could still involve a risk share so that the bank is still invested in making sensible loans, but that this strategy would allow banks to lever up. Similarly, another MDI shared that having foundations take a first loss position would allow them to loosen the underwriting criteria to be even more inclusive, for example with borrowers with lower credit scores, though of course the criteria would be dependent on the risk appetite and would need to remain within the parameters set by the regulators.

Fourth, a few MDIs highlighted that impact funds, foundations, or other entities could buy the portfolio loans that are not eligible to be sold to Fannie Mae and Freddie Mac. As one MDI explained, holding too many loans on their portfolio limits their growth and ties up capital that could go to other purposes. But if some of those loans were bought, they could scale up the volume of lending.

Finally, for an even more ambitious play, foundations, big banks, and other strategic partners can go all in on larger scale projects including housing construction. For example, one interviewee stated that *“if anybody just wants to go out and build a subdivision with us, and help us make it in an affordable way, let us know.”* Similarly, another interviewee noted the significance of partnerships aimed at block-level development, particularly in disinvested neighborhoods or in communities that suffered from natural disasters:

“We have learned that that’s if you really want to change a city and change the trajectory of individual property ownership, you really have to do a block at a time, you can’t do one house here, five streets down another house, you really have to do a block at a time.”

For this MDI, a strategic and long-lasting partnership with a big bank that provides a loan loss reserve as described above has been instrumental in successfully implementing this city-wide block-by-block development in two different major cities. But more can be done nationwide if we are able to create coalitions that bring all relevant stakeholders to the table to coordinate action. This collaboration can include family foundations and large philanthropic organizations, corporations and banks with local and regional presence, and developers and contractors who are motivated to work on affordable housing projects.

In addition to the philanthropic and private sectors, government also has a substantial role to play. At the federal level, lawmakers can allocate more dollars to the CDFI Fund and pass legislation that provides sizeable resources to be deployed at the state and local level to address housing. One interviewee stated that *"to me, the next big thing after the Greenhouse Gas Reduction Fund [needs to be] a many more billion-dollar bill to support affordable housing creation."* Such legislation should focus especially on levers that can create the supply of housing materials and drive down the costs of developing affordable housing. Federal lawmakers debating policies around medical debt, student debt, and other forms of debt should also consider how these policies can influence the ability of low-and-moderate income households to qualify for mortgages based on debt-to-income (DTI) ratios.

Our interviewees also stressed that state and local level government matters too. One MDI spoke about how laws around rent stabilization, tax incentives and abatements, and similar policies can all directly influence local market outcomes in ways that either help or hurt efforts to expand affordable housing. Another MDI talked about the power of city-run housing corporations that can provide down payment assistance in the form of forgivable loans and grants. And a third MDI shared the need for local activists embodying the YIMBY (yes in my backyard) movement to counter the outsized oppositional power of NIMBY (not in my back yard) voices who get *"very angry and loud when they don't want someone to expand their home or build multifamily or build senior housing."* YIMBY advocacy can help push local politicians to pass less restrictive zoning policies that can streamline the development of affordable housing.

Finally, both lawmakers and agencies can review rules based on increased contextual understanding of local dynamics to ensure maximum inclusivity in accordance with broader program aims. As just one example, one MDI shared the challenges associated with using Area Median Income (AMI) in low-income contexts where even a small amount of debt pushes the borrower above the DTI ratio and prohibits them from accessing programs including down payment assistance: *"We have [the] Federal Home Loan Bank saying, we're issuing out millions of dollars, why aren't y'all using it fast enough? And I am thinking, have you seen the restrictive income levels for qualifying for these programs?"* Instead of this status quo, the MDI suggested the creation of a default minimum, so that *"in the event that your area median income is so low [it would] default to $50,000."*

Notably, these solutions only scratch the surface of what is imaginable for generating sustainable accomplishments in this area. In future projects, we hope to leverage the insights presented here to build and pilot models in local markets to address some of the challenges described and unlock opportunities. Once we and our partners see what is successful on a smaller scale, we can work to scale it up, while also constructing our programs to fit the different, unique geographies these institutions serve.

Conclusion: Four Moonshot Areas and Call to Action

This paper has highlighted the substantial social impact of MDIs. Compared to all other lender types, MDIs originate a higher share of their mortgages to minority borrowers and communities. But there is a wonderful opportunity to extend and deepen this impact even more. In the previous section, we highlighted meaningful actions that philanthropy, the private sector, and government can take to assist MDIs in closing the homeownership gap. Beyond individual strategies like loan loss reserves and down payment assistance programs, we also think there is potential for bigger "moonshot" goals that could drive impact at an even ever-larger scale.

The first moonshot goal is to develop a large-scale secondary market for portfolio loans that cannot be sold to Fannie Mae or Freddie Mac.

Currently, many of the mission-aligned mortgages issued by MDIs do not qualify to be sold on the secondary market and are thus held on the bank's banks as portfolio loans, tying up their capital and limiting their ability to issue more lending. If philanthropy and other stakeholders bought these loans as a part of a new secondary market, it would free up capital to allow even more lending. As an example of what this looks like at a smaller scale, Inclusiv – a trade organization for community development credit unions – operates a secondary market program for its members in which it buys mortgages (individually or in bulk) to replenish its institutions' capital, allowing them to expand their lending. In keeping with its mission, the program allows for more inclusive underwriting, including credit scores as low as 550. According to their website, "as of January 2022, Inclusiv's mortgage portfolio is comprised of $20 million in affordable home mortgages originated by 30 community development credit unions across the country." Similarly, Calvert's $55 million Mortgage Access Fund, which buys loans from CDFIs as part of its portfolio, also frees up the balance sheet of lenders, allowing them to issue a greater volume of highly mission-aligned loans. We think that expanding on this strategy at a larger scale – with greater available capital to purchase loans and a wider net of mission-driven lenders selling loans – may have the potential to increase overall lending by several orders of magnitude.

A second related moonshot goal is creating tech-enabled marketplaces that can match mission-lenders looking to offload loans with other banks looking to buy loans for CRA credit.

The newly revised CRA rules allow banks to receive credit for purchased loans, based on the understanding that "purchased loans can provide liquidity to banks and other lenders, such as CDFIs, and extend their capacity to originate loans to low- and moderate-income individuals and in low- and moderate-income areas." The revised rule also provides credit for volume of loans not just loan dollars which can reverse incentives for purchasing banks to ignore small-dollar mortgages. Nevertheless, without a matching platform, it can be challenging to facilitate the purchase of loans at a meaningful scale for the mission-driven sector. Currently the CRA Note Exchange platform operates for a similar purpose, but is aimed at allowing nonprofit homebuilders and community housing development organizations to sell their mortgages to banks. A model customized for MDIs and CDFIs could likewise help them sell their portfolio loans to community, regional, and big banks who are looking for CRA credit broadly or looking to improve their performance in a specific assessment area where an MDI or CDFI might have better advantage in making the originations. It is also worth noting that the new CRA rule provides credit for weather resilience and mitigation, suggesting that matching climate related loans like solar for purchase may also help.

A third moonshot goal is creating scalable backend and capacity-building support to help MDIs serve a greater number of clients and issue a greater number of loans.

As a recent promising example of an innovation in this area is CredEvolv, an organization that matches banks, borrowers, and HUD-certified housing counselors. In this model, a bank can hand off a prospective borrower who is not currently mortgage-ready to receive coaching to improve their financial health, and then that borrower is returned to the bank when ready for a mortgage. Increasing the power of networks like this that can free up loan officers and increase the capacity of banks to serve a wider client base could be incredibly helpful to the goal of increasing lending by the sector. Two other strategies within this moonshot category include trade associations negotiating collective purchase agreements for technological solutions for their members to lower the cost barriers and enable smaller institutions to reap the benefits, and big banks providing a pool of rotating staff to loan to community lenders to help them spin up or scale up mortgage lending.

Finally, a fourth moonshot goal is drafting and passing a multi-billion dollar affordable housing bill from the federal government that is the equivalent to the transformational power of the recent infrastructure and climate legislation.

A landmark federal bill that fits with the scope imagined here could include everything from provisions to improve the Low-Income Housing Tax Credit (LIHTC) and other tax credits aimed at incentivizing the development of affordable housing, to increased funding for down payment assistance programs, to offsetting costs associated with energy retrofit or health and safety-based refurbishment, and more. Such a bill should be explicitly tied with additional legislation aimed at streamlining development through permitting reform, environmental impact study reform, and incentives for less cumbersome local and state zoning policies. Of note, states and localities can also implement legislation in this same spirit, at the scale that their more limited resources would allow.

In conclusion, this report has spotlighted the important work that MDIs are doing to close the homeownership gap, documented the obstacles and barriers that inhibit greater lending, and suggested steps that relevant stakeholders can take to better support the sector in its efforts. In future work, we plan to build on the findings in this paper to design, test, and scale interventions that can further increase MDI mortgage lending. Ultimately, we believe that supporting the MDI sector in its mortgage lending will help diminish the homeownership gap, reverse decades of disinvestment, and lead to new opportunities for wealth building for individuals and communities of color.

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