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GUEST ESSAY

How We Unintentionally Created the Affordable Housing Crisis

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America is in the throes of a deep housing shortage. Building new homes is important, but also expensive and slow. And in the meantime, millions of affordable homes already exist. The problem is that well-meaning banking reforms — created to protect Americans — are pushing these places out of buyers' reach and into the coffers of investors.

If we want to fix the housing crisis, we must make it easier for regular people to buy these homes.

Currently, one in five owner-occupied homes nationwide is valued at less than $150,000. These "small-dollar homes" have long served as a first rung on the economic mobility ladder for millions of American families. But over the past 15 years, the availability of mortgages for small-dollar homes — the mortgages overwhelmingly relied on to buy these homes — has shrunk dramatically. Pew Charitable Trusts estimates that from 2004 to 2021, small-mortgage lending fell by nearly 70 percent.

The withering of the small-dollar mortgage is largely an unintended consequence of regulations passed after the financial crisis that were intended to help low-income households.

After the housing bubble burst in 2007, several hundred banks collapsed, sparking a global financial meltdown, and millions of homeowners lost their homes in foreclosure. In response, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and increased its scrutiny of Federal Housing Administration (F.H.A.) loans, which primarily serve low-income borrowers.

Provisions included stricter compliance guidelines and higher capital requirements, which would ostensibly make the banking system less prone to fail and protect borrowers from taking on mortgages they couldn't afford. But the costs associated with adhering to Dodd-Frank's more than 400 new rules and mandates make it less profitable for most banks to work with small loans. These changes disproportionately hurt community banks, which long served lower-income homebuyers.

Even where loans are theoretically available, small-dollar homes often don't qualify for them because they are too old and in disrepair. That's a growing problem because over the past century, developers have largely stopped building these homes, citing the rising costs of land, materials and permits, as well as rising zoning and homeowners association restrictions. In 2022, only 8 percent of newly built homes were 1,400 square feet or less, compared with nearly 70 percent in 1940.

As a result, prospective homeowners find themselves locked out of their longtime neighborhoods, sometimes renting the very homes they had wanted to buy. Blocks are being transformed, with trimmed lawns standing alongside yards choked with brush and mailboxes overflowing with letters to absentee landlords. Longtime residents no longer know their neighbors and the resulting cycle of disinvestment causes home values to stagnate, which drives further wealth inequality. While the prices of homes above $150,000 rose by about 15 percent between 2009 and 2019, small-dollar homes' prices under $150,000 have barely budged over the same period.

A new report funded by Pew Charitable Trusts analyzed mortgage and demographic data and interviewed dozens of homeowners in St. Louis, Philadelphia and El Paso. In all three cities our research teams found a dramatic drop in mortgage loan applications and approvals for homes valued at less than $150,000 over the past decade. Instead, the increasing norm is investors purchasing these homes with cash and converting them to rental properties.

Take St. Louis. More than 40 percent of the city's 64,000 owner-occupied homes are valued at less than $150,000, yet only two of the 10 residents we spoke with were able to secure a traditional mortgage loan to purchase one.

That dearth of mortgages makes opportunities for investors. Because fewer buyers have the resources to pay cash for a house, demand is lower, depressing purchase prices. And because so many would-be buyers must remain renters, demand increases and rents rise. All this makes purchasing a home for cash and renting it out a more profitable option.

This dynamic is particularly evident in St. Louis's poorer, predominantly Black neighborhoods. In 2022, only 90 people managed to get a small-dollar mortgage loan under $150,000 across the entire northern half of the city (compared with 484 in 2007.) Northern St. Louis lost almost a third of its owner-occupied homes over the past 15 years. Most have been converted to rental properties, though many stand vacant. "There's a lot of abandoned, broken-down homes and now [they are] just being bulldozed over," said one longtime renter in interviews gathered for the report.

Meantime, Wall Street's appetite for homes at the lowest end of the market is voracious: The Urban Institute found that between 2018 and 2021, corporate investors purchased nearly 30 percent of homes costing less than $100,000, compared with just 7 percent of homes costing more than $100,000.

We must make it easier for regular people to purchase these affordable homes that already exist.

We should make it easier for smaller community banks and credit unions, which have historically served low- and moderate-income buyers in rural areas, to write small loans. These lenders are struggling under the burden of Dodd-Frank even though they were far less likely to engage in risky practices that necessitated the regulation.

We also need to make it easier for buyers to qualify for mortgage loans on fixer-uppers by improving programs like the F.H.A. 203(k) Rehabilitation Mortgage Insurance Program. This program allows purchasers to include home improvements in their F.H.A. mortgage, but is cumbersome for borrowers and costly for lenders.

We should change loan-officer compensation practices to provide a flat fee for every loan made, rather than basing compensation solely on a percentage of the mortgage, which would overcome the hesitation loan officers face in considering small-loan applications.

No single fix will unplug the lending bottleneck on affordable homes. Rather, critical tweaks at each step of the home-buying process will improve the odds that regular families can buy the homes they seek.

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