# THINKING "SMALL" TO SOLVE BIG: A PRIVATE MORTGAGE FUND

## Investment Thesis

Our fund aims to increase access to homeownership by providing small dollar mortgage loans that have been historically underutilized by traditional banking institutions. Through simplifying the application process and reducing the managerial costs associated with administering loans, our fund will increase homeownership for diverse individuals, which will result in positive social change for underrepresented communities.

## PROBLEM STATEMENT & OPPORTUNITY

Home ownership is a significant source of wealth generation in America, but the opportunity to own a home is denied to many qualified applicants, specifically those applying for "small dollar mortgages" ("SDMs"). These SDMs– typically defined as a home mortgage of less than $100,000 - are denied at much higher rates than large mortgages. In 2019, denial rate for conventional loans over $100,000 was ~6%, compared to a denial rate of ~22% for SDMs. This outcome has widespread implications, as approximately 20% of owner-occupied homes in the US are valued at under $100,000. Moreover, it disproportionately affects would-be homebuyers in Black and LatinX communities, pushing them to either: a) continue renting, or b) engage in risky alternatives to mortgages, such as rent-to-own schemes.

SDM denials occur for reasons largely independent of traditional mortgage criteria (e.g., sufficient down payment, adequate income levels). Instead, they are primarily the product of structural factors in the mortgage industry – namely, high underwriting costs, and incentives paid to mortgage brokers. When evaluating mortgage applicants, conventional lenders must weigh fixed underwriting costs (estimated at $2,500 per applicant) and potential commissions (traditional a fixed percentage of the loan size) against the size of the desired loan. For SDMs, these costs simply are not justified.

High denial rates are not unique to the commercial lending space, but also exist for Federal Housing Authority (FHA) loans, primarily because the underlying homes may not meet FHA minimum property standards. Violations of those standards could include issues as minor as peeling paint or damaged flooring and are more likely to exist in the homes for which someone would need an SDM.

Opportunities to streamline the lending process for SDMs and improve the habitability of affordable homes can help improve access to home ownership for millions of Americans, thereby promoting wealth generation and stable communities.

## OUR SOLUTION

We propose a private mortgage fund that will provide loans specifically for small dollar mortgages in amounts of $100,000 or less. Our aim is to provide individual loans to consumers and pool these funds to reduce costs associated with managing the fund and to lower risk for investors. We will streamline the loan application process by only requiring critical documents from borrowers commensurate with the loan size.

To compliment our streamlined underwriting process, we propose a credit model that assesses borrowing risk of individuals who lack a business credit score or have a low personal credit score. In order to identify the credit worthiness of our applicants, we will utilize "credit proxies" that offer 3 layers of analysis:

**1.** Assess credit-worthiness through public records and alternative data sources
**2.** Develop a risk profile based on online activity
**3.** Partner with fintech startups (e.g., Tala) who provide alternative assessments of credit worthiness

## FUND STRUCTURE

- **Target Investment:** $100 million
- **Return:** ~4.0% (LIBOR +250bp)
- **Tenor:** 15 years
- **Fees:** Origination fee + $1 million/yr. mgmt. fee
- **Target investors:** Institutional investors

## TARGET & SCALABILITY

**Target Geography**: U.S. homebuyers applying for "small dollar mortgages" (< $100k).

**Size of Addressable Market**: ~30% of home sales were for homes priced < $100k. Given that total home sales were ~6M in 2019, we can target 1.8M homebuyers as the market for small dollar mortgages.

**Scalability**: Our initial program considers financing mortgages for 1,250 homes but can easily be replicated across the the regions with the highest concentrations of homes with values below 100k.

UC Berkeley Haas: Hannah Gable, Danny Gorczyca, Maelym Medina, Julian Ramirez.

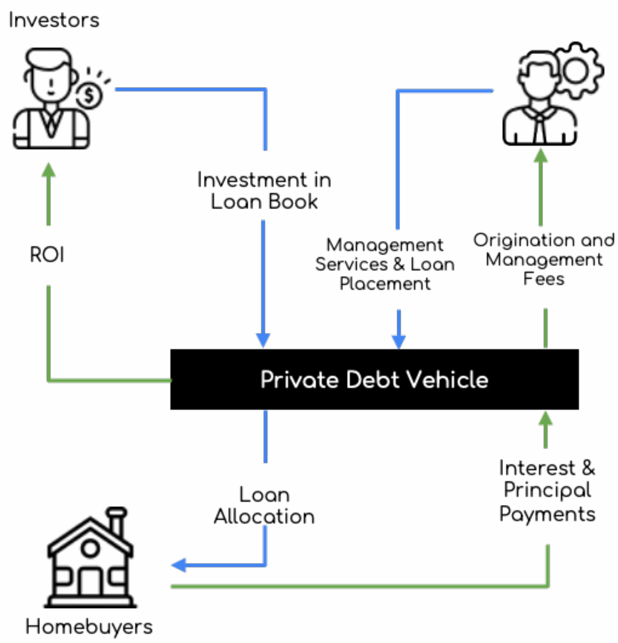
## FINANCIAL MODEL

| Principal Risks and Mitigation | | |
|---|---|---|
| *Loss of Capital* | *Interest Rate Risk* | *Liquidity Risk* |
| Loans issued by the Fund are subject to repayment by individual borrowers, who may default on their obligation. We seek to mitigate repayment risk by (1) relying on credit histories or credit proxies (where appropriate), (2) recording a Deed of Trust on the underlying properties until the loans are repaid in full, and (3) creating a reserve equivalent to one year of debt service for investors in case of default of underlying securities. | Loans issued by the Fund are subject to prevailing interest rates, and those interest rates will correspondingly dictate the returns of the Fund. Periods of low interest rates will reduce the returns of the Fund, and it is possible that returns may even be negative during deflationary periods. | The Fund intends to lend as much of its capital base to SDMs as prudent, and these loans will have terms up to 15 years. It is possible the Fund will be unable to repackage and sell these loans to third parties, and therefore the Fund may experience liquidity issues in the near term if there are large-scale redemptions. Loan default would take deed of trust on the home. |

### ADDITIONAL FUND DETAILS

- **Target Investor Pools**: The Fund is well-suited to institutions and accredited investors seeking moderate yields over long-time horizons including, to wit, pension funds and life insurance companies. The Fund may also offer a unique appeal to commercial banks who may receive Community Reinvestment Act (CRA) credits as investors in the Fund.
- **Due Diligence Process**: Standardized process for reviewing loan applicants – we will not automatically deny applicants based on low credit score. Additional details in “solution” section on p. 1.

| Example of Mortgage Loan Terms | |
|---|---|
| Amount | Up to 80,000 |
| Tenor | 15 years |
| Interest Rate | Fixed – US-T 10yrs + 400bp |
| Origination Fee | $3,308 |




## IMPACT

- Increase **access to homeownership for low-income individuals**.
- Increase **property tax revenue** in communities from homeowners.
- Provide a **critical source of housing for low- and moderate-income families**, typically first-time homebuyers and people of color.
- Bridge the **racial wealth gap** between Black and White homeownership rates.
- Provide **financial literacy training** to a portfolio of lenders to ensure long-term success for buyers.

## METRICS

# Homes Purchased by Low- and Moderate-Income Families.

# Homes Purchased by Underrepresented Minorities through Small Dollar Mortgages.

% Increase in Net Worth for Communities of Color.

# Years Home Owned by Portfolio Borrower.

## PARTNERSHIPS

Fannie Mae®

Freddie Mac

FHA

ESUSU

TALA