August 14, 2023

Director Sandra L. Thompson
Federal Housing Finance Agency
Constitution Center
400 Seventh Street, SW
Washington, DC 20219

Re: Enterprises' Single-Family Mortgage Pricing Framework

Dear Director Thompson:

The National Fair Housing Alliance® (NFHA™)[1] and the undersigned civil rights, housing, and other advocacy organizations appreciate the opportunity to comment on the Federal Housing Finance Agency's (FHFA) Request for Input (RFI) regarding Fannie Mae and Freddie Mac's (the Enterprises or the GSEs) Single-Family Mortgage Pricing Framework.[2] We commend FHFA for seeking input on this important topic and we hope that our comments below will help inform FHFA's views.

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<u>Background</u>

Any discussion of the GSEs' pricing must be grounded in an understanding of the origins of the current pricing framework. In the wake of the 2008 financial crisis and Great Recession, FHFA required the Enterprises to charge lenders upfront guarantee fees known as Loan Level Pricing Adjustments (LLPAs), which were based on certain attributes of the borrower or the loans (e.g., loan-to-value/credit-score grid, cash-out refinance, investor properties, secondary financing at origination, jumbo conforming loan). These attributes had a disparate impact on borrowers of color as they unjustifiably and highly correlate to race.[3] That is, although the financial crisis was

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[1] The National Fair Housing Alliance® (NFHA™) leads the fair housing movement. NFHA works to eliminate housing discrimination and ensure equitable housing opportunities for all people and communities through its education and outreach, member services, public policy, advocacy, housing and community development, tech equity, enforcement, and consulting and compliance programs.

[2] FHFA, *Request for Input regarding the Enterprises' Single-Family Mortgage Pricing Framework* (May 2023), https://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/Single-Family-Mortgage-Pricing-Framework-RFI.pdf.

[3] For a fuller discussion of how credit scoring and loan-to-value attributes highly correlate to race, *see Advocates Comment to FHFA's Request for Input for the Enterprises' Equitable Housing Finance Plans* (Oct. 25, 2021), https://nationalfairhousing.org/wp-content/uploads/2021/12/FHFA-Equitable-Housing-Finance-Plans_NFHA-et-al_FINAL2_2021-10-25.pdf; Missing Credit: How the U.S. Credit System Restricts Access to Consumers of Color, Hearing before the U.S. House Committee on Financial Services, *Testimony of Lisa Rice, President and CEO, National Fair Housing Alliance* (Feb. 26, 2019), https://nationalfairhousing.org/wp-content/uploads/2019/04/Missing-Credit.pdf.

driven by financial institutions' appetite for excessive profits and lax regulation,[4] the LLPA pricing framework placed the burden of the Enterprises' financial recovery and future catastrophic risk on borrowers of color, despite the fact that it was the Enterprises' purchases of Alt-A loans to borrowers who were wealthier and White that led to the need for a government bailout of the Enterprises. This approach was inherently unfair as borrowers of color were the victims of the financial crisis, not the cause.[5] Black and Latino communities lost $1 trillion in wealth to unnecessary foreclosures after being targeted for abusive and unsustainable mortgages leading up to the 2008 housing crisis.[6] Asian Americans, Pacific Islanders and other communities of color were also devastated by toxic subprime loans. Just as importantly, it was a misguided effort to correct for a mis-diagnosed problem. The losses suffered by the GSEs were the result of faulty product design, poor underwriting practices (lack of loan documentation) and lax oversight, not the borrower characteristics or loan features that drive the LLPA framework. Although this pricing framework was instituted in the name of safety and soundness, its disproportionate impact on borrowers of color means that it creates significant risk for the future health and stability of the mortgage market, and therefore significant risk for the future viability of the GSEs themselves.

Our organizations urged the Biden-Harris administration to prioritize restoring safe, fair, and inclusive mortgage pricing to promote equitable housing as well as safety and soundness. After careful review of both the safety and soundness and mission-driven concerns, FHFA took steps in the past 18 months to make incremental changes to the pricing framework, including:

- Eliminating upfront fees for the Enterprises' affordable mortgage programs and first-time homebuyers at or below the median income;[7]

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[4] Financial Crisis Inquiry Commission, *Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States* (Feb. 25, 2011), https://www.govinfo.gov/content/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf.

[5] For years, civil rights groups raised concerns about the damaging effects of the GSEs' practices on borrowers and communities of color because discriminatory, predatory, and unsustainable loans were hyper-concentrated in predominantly Black and Latino areas. The National Fair Housing Alliance, NAACP, Center for Responsible Lending, and The Leadership Conference on Civil and Human Rights engaged with both GSEs and their then-regulator (the Office of Federal Housing Enterprise Oversight) to urge a halt to their program of purchasing Alt-A mortgages and subprime mortgage-backed securities (MBS) only to be told that the GSEs needed to purchase these products because the GSEs were hemorrhaging market share, becoming irrelevant, and losing profits. Some argued that the GSEs' affordable housing goal requirements led them to purchase Alt-A mortgages and subprime securities and make loans without income documentation and/or that contained unsustainable provisions like rapidly increasing interest rates and balloon notes. This was patently false.

[6] Debbie Grucien Bocian, Peter Smith, and Wei Li, *Collateral Damage: The Spillover Costs of Foreclosures,* Center for Responsible Lending (Oct. 24, 2012), https://www.responsiblelending.org/mortgage-lending/research-analysis/collateral-damage.pdf.

[7] FHFA, *FHFA Announces Targeted Pricing Changes to Enterprise Pricing Framework* (Oct. 24, 2022), https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Announces-Targeted-Pricing-Changes-to-Enterprise-Pricing-Framework.aspx.

- Increasing upfront fees for vacation homes, cash-out refinances, and large loan amounts;[8] and
- Eliminating the debt-to-income upfront LLPA.[9]

Also, the framework now decreases fees for some creditworthy borrowers who have smaller down payments, but pose a decreased risk to the Enterprises by paying for private mortgage insurance.[10] FHFA now requests input on these incremental changes as well as the vestiges of the pricing framework imposed after the Great Recession.

Recommendations

For the reasons described below, we **strongly recommend** that FHFA:

- Continue with the implementation of the incremental pricing framework changes proposed up to this point; and
- Fully eliminate the unfair and ineffective LLPA pricing framework imposed after the Great Recession, which disproportionately impacts consumers of color, pricing them out of the opportunity to receive a conventional loan and its benefits, and disincentivizes market competition for fairly priced loans to consumers of color.
  - Instead of encouraging re-entry of private capital, LLPAs force consumers of color to be overrepresented in government-backed mortgage loan pools, which exposes the government and taxpayer to 100% of the credit risk.

An equitable single-family mortgage pricing framework is necessary because of the mission, safety and soundness, legal obligations, and historical record of FHFA and the GSEs.

The **mission** of the GSEs is expressly stated in their charters and includes:

- Providing ongoing assistance to the secondary market for residential mortgages (including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities), and

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[8] FHFA, *FHFA Announces Targeted Increases to Enterprise Pricing Framework* (Jan. 5, 2022), https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Announces-Targeted-Increases-to-Enterprise-Pricing-Framework.aspx.
[9] FHFA, *FHFA Announces Rescission of Enterprise Upfront Fees Based on Debt-to-Income (DTI) Ratio* (May 10, 2023), https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Announces-Rescission-of-Enterprise-Upfront-Fees-Based-on-Debt-To-Income-Ratio.aspx.
[10] FHFA, *FHFA Announces Updates to the Enterprises' Single-Family Pricing Pricing Framework* (Jan. 19, 2023), https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Announces-Updates-to-Enterprises-SF-Pricing-Framework.aspx.

- Promoting access to mortgage credit throughout the Nation (including central cities, rural areas, and underserved areas).[11]

Although many of the RFI questions focus on the "return on capital," it is equally important to prioritize the mission imposed by Congress and the GSEs' charters.

A revised pricing framework is also consistent with **safety and soundness** and makes good business sense. Prior to revising the framework, FHFA carefully analyzed which changes would be consistent with maintaining the safety and soundness of the Enterprises. For example, decreasing upfront guarantee fees for borrowers with a loan-to-value ratio of greater than 80 percent is prudent because those borrowers carry a credit enhancement through private mortgage insurance.[12] Moreover, the vast majority of all projected future homebuyers will be borrowers of color.[13] Ensuring their access to safe and affordable mortgages is critical to maintaining a thriving national housing finance system. One study estimates that improving access to housing credit would have resulted in an additional 770,000 Black homeowners and $218 billion in sales and expenditures.[14] Another estimates that addressing racial disparities in homeownership could create nearly 800,000 jobs and generate $400 billion in tax revenue.[15] This analysis found that by not addressing housing inequality, nearly five million people have been denied homeownership opportunities. Eliminating racial inequities in the United States could add $5 trillion of growth to our GDP over the next five years.[16] The inequities in our markets and systems also stifle innovation, productivity, profitability, and economic progress.

Notably, the key business justifications for the LLPAs do not hold up under scrutiny. The factors upon which the LLPAs rely (loan-to-value ratio and credit score) are not related to the key risk features of the majority of the loans that experienced massive defaults in the foreclosure crisis.

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[11] Fannie Mae Charter, 12 U.S.C. § 1716; Freddie Mac Charter, 12 U.S.C. § 1451 note (Statement of Purpose). Although communities of color do not necessarily consist of low- and moderate-income families, there can be overlap between these communities.

[12] *See Testimony of the Honorable Sandra L. Thompson, Director of the Federal Housing Finance Agency* before the House Committee on Financial Services, Hearing entitled FHFA Oversight: Protecting Homeowners and Taxpayers (May 23, 2023), https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=408797.

[13] *See* Laurie Goodman, Jun Zhu, *The Future of Headship and Homeownership*, Urban Institute (Jan. 22, 2021), https://www.urban.org/sites/default/files/publication/103501/the-future-of-headship-and-homeownership_0.pdf.

[14] *See* Citigroup, *In Pursuit of Equity: Why America's Future Depends on Closing the Racial Wealth Gap* (2021), https://www.nytimes.com/paidpost/citi/in-pursuit-ofequity.html.

[15] *See* Jeff Cox, *Morgan Stanley says Housing Discrimination Has Taken a Huge Toll on the Economy*, CNBC (Nov. 13, 2020), https://www.cnbc.com/2020/11/13/morgan-stanley-sayshousing-discrimination-has-taken-a-huge-toll-on-theeconomy.html#:~:text=Morgan%20Stanley%20says%20racial%20inequality,five%20million%20from%20owning%20homes.

[16] *See* Dana Peterson and Catherine Mann, *Closing the Racial Inequality Gaps: The Economic Cost of Black Inequality in the U.S.*, Citi Global Perspectives and Solutions 3 (Sept. 1, 2020), https://www.citivelocity.com/citigps/closing-the-racial-inequality-gaps/.

Those loans failed due to the combination of poor underwriting, little or no documentation, high fees, exploding interest rates, risk layering, and negative amortization. The Truth in Lending Act's Ability to Pay/Qualified Mortgage rule already addresses most of these risks.[17]

Risk-based pricing is also not required to achieve safety and soundness and disincentivizes competition for fair treatment in the marketplace. For instance, lenders are using the upfront LLPA pricing to drive their profitability through discrimination. One study shows that Latino and Black consumers pay $765 million more yearly or 7.9 and 3.6 basis points per loan respectively in extra discriminatory fees.[18] These are the same communities who lost $1 trillion dollars to predatory lending that went unchecked during the housing crisis of 2008 and was never remediated.

Further, upfront LLPAs double charge consumers for the same risk assessed in the loan guarantee fees. These increased fees actually make the consumer more susceptible to default by making the credit less affordable.[19] They also produce a disparate impact on certain regions of the nation such as the South, where it is well-documented that southerners across every income bracket have lower credit profiles than the rest of the nation because of lower incomes and educational attainment rates.[20]

Finally, LLPAs create an unfair burden on communities of color, while other recent housing policies disproportionately benefit wealthier, White homeowners, which has further exacerbated racial homeownership and wealth gaps.[21] Since the start of the COVID-19 pandemic, the Federal Reserve Board's $120 billion in monthly bond purchases, including $40 billion per month in agency mortgage-backed securities, has allowed current homeowners to see their home equity grow by more than $2.9 trillion dollars since the second quarter of 2020.[22] Additionally, the Federal Reserve's actions to mitigate the economic impacts of COVID-19 resulted in lowering the federal funds rate, which helped mortgage interest rates remain at historic lows and stimulated home purchasing and refinancing. However, Federal Reserve researchers found that

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[17] 12 C.F.R. § 1026.43.

[18] Robert Bartlett, Adair Morse, Richard Stanton, and Nicole Wallace, *Consumer-Lending Discrimination in the FinTech Era*, UC Berkeley Haas School of Business (Nov. 2019), http://faculty.haas.berkeley.edu/morse/research/papers/discrim.pdf?_ga=2.22372220.679975626.1594361012-57417667.1594361012.

[19] Kevin A. Park, *Risks of Risk-based Pricing of Mortgage Credit*, UNC Center for Community Capital (Oct. 2014), https://communitycapital.unc.edu/wp-content/uploads/sites/340/2014/10/Risks-of-Risk-based-Pricing.pdf.

[20] Andrew Van Dam, *Why the South Has Such Low Credit Scores*, Washington Post (Feb. 17, 2023), https://www.washingtonpost.com/business/2023/02/17/bad-southern-credit-scores/.

[21] During the COVID-19 fueled housing boom, Federal Reserve data shows the Black-White wealth gap grew by $20 trillion.

[22] *See* CoreLogic, *Homeowners Gained $2.9 Trillion in Equity in Q2 2021*, CoreLogic Reports, (Sept. 23, 2021) https://www.corelogic.com/press-releases/homeowners-gained-2-9-trillion-in-equity-in-q2-2021-corelogic-reports/.

these actions did not benefit the whole housing market equally.[23] The analysis showed that the median Black and Latino mortgage borrowers accumulated significantly less equity. Moreover, only six percent of Black borrowers and nine percent of Latino borrowers refinanced, as compared to 12 percent of White borrowers.

In addition, the GSEs must comply with their **legal obligations** under the nation's fair lending laws, which include the Fair Housing Act,[24] the Equal Credit Opportunity Act,[25] and the Federal Housing Enterprises Financial Safety and Soundness Act.[26] Also, under the Fair Housing Act's Affirmatively Furthering Fair Housing provision, FHFA and the GSEs have an affirmative obligation to further fair housing and to create and maintain more equitable and affordable housing opportunities.[27]

Furthermore, the GSEs' **historical record** shows that up to this point the GSEs have not accomplished their mission or legal obligations. The GSEs have failed to support a housing finance market for borrowers of color, central city areas, low- and moderate-income borrowers, and other underserved groups. Except for the years in which the GSEs engaged in purchasing Alt-A and subprime securities that ultimately stripped wealth from many borrowers, the GSEs have had very low market penetration in communities of color and low- and moderate-income areas. For example, less than 8% of Fannie and Freddie loan purchases for 2022 were from Black borrowers and less than 15.5% were from Latino borrowers.[28]

Finally, it is unfortunate to note that some have intentionally or unintentionally misunderstood the meaning of the pricing framework revisions. Misleading reports have mistakenly alleged that the previous pricing framework was aligned with the GSEs' safety and soundness risk and mission. Due to a mis-reading of the pricing grid for borrowers with a loan-to-value ratio of greater than 80 percent, certain reports have incorrectly stated that borrowers with strong credit profiles would be penalized to cross-subsidize borrowers with weaker credit profiles; this is patently false. Recently, the U.S. House of Representatives adopted this flawed logic and passed the "Middle Class Borrower Protection Act," which would reverse FHFA's recent changes and increase the cost of mortgages for first-time homebuyers and homebuyers of color. Our organizations strongly object to this legislation and other proposals that would roll back FHFA's pricing framework revisions and create unnecessary oversight of FHFA's regulatory functions, which are, in fact, consistent with the GSEs' mission, safety and soundness, and legal obligations.

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[23] Kristopher Gerardi, Lauren Lambie-Hanson, and Paul Willen, *Racial Differences in Mortgage Refinancing, Distress, and Housing Wealth Accumulation during COVID-19*, Federal Reserve Banks of Atlanta, Philadelphia, and Boston (June 2021), https://www.bostonfed.org/publications/current-policy-perspectives/2021/racial-differences-in-mortgage-refinancing-distress-and-housing-wealth-accumulation-during-covid-19.aspx.
[24] 42 U.S.C. § 3601 *et seq*.
[25] 15 U.S.C. § 1691 *et seq*.
[26] 12 U.S.C. § 4501 *et seq.*
[27] 42 U.S.C. § 3608(d).
[28] FHFA, *Fair Lending Data*, https://www.fhfa.gov/DataTools/Downloads/Pages/Fair-Lending-Data.aspx.

Ensuring a fair and equitable national housing finance market is consistent with FHFA's obligation to Affirmatively Further Fair Housing. It also makes good business sense. To fulfill this obligation, FHFA must ensure that the regulatory capital framework avoids discriminatory outcomes and also promotes equitable treatment of borrowers and communities of color.[29] It must carefully balance the need to ensure the safety and soundness of the Enterprises with the need to ensure they fulfill their missions, and avoid unnecessarily or improperly overemphasizing the former at the expense of the latter. Miscalculations about where credit risk actually lies and misguided actions to counter that risk may be counterproductive, reducing mortgage access for creditworthy borrowers upon whom the future vitality of the mortgage market depends. We look forward to working with FHFA and other stakeholders to ensure that the Enterprises' mortgage pricing framework is effective and beneficial for all consumers and communities. We urge FHFA to move forward swiftly with the implementation process.

Thank you for considering our views.

Sincerely,

National Fair Housing Alliance
National CAPACD-National Coalition for Asian Pacific American Community Development
National Community Reinvestment Coalition
National Disability Rights Network (NDRN)
National Urban League

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[29] For additional views on the Enterprises' Regulatory Capital Framework, *see* Advocates Comment on FHFA's Notice of Proposed Rulemaking - Enterprise Regulatory Capital Framework, available at https://nationalfairhousing.org/wp-content/uploads/2021/12/FHFA-Regulatory-Capital-Framework_NFHA-et-al_FINAL2.pdf.