June 7, 2017

Director Mel Watt
Federal Housing Finance Agency
400 7th St SW
Washington, DC 20024

Re: Comments on Duty to Serve Evaluation Guidance

Dear Director Watt:

The Center for Responsible Lending (CRL)[1] files this comment in response to FHFA's proposed evaluation guidance for the Duty to Serve Rule. The evaluation guidance is the method for FHFA to assess Fannie Mae and Freddie Mac's (the Enterprises) Duty to Serve Underserved Markets Plans. Thank you for the opportunity to provide input on this important matter. The strength and clarity of the evaluation guidance will greatly inform the Enterprises' plans. A successful evaluation process is inextricably linked with a successful plan development process. Our comments provide recommendations with respect to public input and transparency, assessing the content of the plans to ensure meaningful objectives, and the evaluation and scoring process.

Our overarching concern is to help FHFA and the Enterprises develop plans and process that produce *meaningful impact* in the three underserved markets. To achieve that end, the duty to serve process needs to encourage the Enterprises to achieve impactful objectives. The evaluation guidance is an important guiding force that shapes the objectives the Enterprises propose as well as holds them accountable for achieving these objectives. We are concerned that the current evaluation guidance permits the Enterprises to "pass" by simply achieving objectives, without taking into consideration the impact of those objectives until later in the scoring process. We recommend the following:

- Adding transparency to FHFA's process for issuing a finding of "non-objection" to the Enterprises' plans.
- Incorporating market data in the Step 1 quantitative score for loan purchase objectives.
- Clarifying and resolving potential conflicts in the Step 2 qualitative score.
- Making extra credit available for objectives scoring lower on the Step 2 qualitative score.

[1] The Center for Responsible Lending (CRL) is a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, one of the nation's largest nonprofit community development financial institutions. Self-Help has provided $6 billion in financing to 70,000 homebuyers, small businesses, and nonprofits and serves more than 80,000 mostly low-income families through 30 retail credit union branches in North Carolina, California, and Chicago.

- Incorporating public review more fully into the duty to serve plan process including in: making significant revisions, determining an infeasible objective, and providing information needed to assess plan objectives.

Importance of the Duty to Serve Rule and a Robust Process to Assess the Enterprises' Plans

The duty to serve process and the obligation of the Enterprises to serve the entire market and ensure that underserved borrowers (including those from rural, African-American and Latino communities, prospective first-time homeowners, millennials, and low- and moderate-wealth households) have access to responsible forms of mortgage credit is critical.[2] This is particularly important now as today's market offers few opportunities for such borrowers. African-American borrowers received just 2.7% of conventional mortgages in 2015 and Latino borrowers received just 5.1%.[3]

FHFA and the Enterprises also have an explicit duty to broadly increase liquidity in the mortgage market. Not only is this obligation addressed by the Enterprises' charters and statute, it is essential to the recovery of the housing market and the US economy.[4] FHFA should continue to invest as much effort as possible to ensuring access to responsible credit for more communities, as many of the groups described above will constitute the majority of the housing market in the near future.[5] Homeownership is a critical component of family wealth, particularly for low-income families and people of color, and has been shown to explain much of the observed racial wealth gap.[6]

Communities in underserved markets have been deeply harmed by irresponsible lending in the last decade. Today, rather than remediate the damage done by subprime lending and its disproportionate impact on communities of color, lenders' overcorrections in the market have instead closed off lending options for these communities. One reason the conventional market is struggling to serve communities of color and low to moderate-income families is that credit is now more unnecessarily constrained than it has been in a generation.

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[2] Stated in a coalition letter to the Senate Banking Committee, available at http://www.responsiblelending.org/mortgage-lending/policy-legislation/2014-Civil-Rights-Groups-Comments-toSenate-Banking-Comm-on-Housing-Finance-Reform-Bill-Feb-24.pdf.

[3] CENTER FOR RESPONSIBLE LENDING, THE NATION'S HOUSING FINANCE SYSTEM REMAINS CLOSED TO AFRICAN-AMERICAN AND LATINO CONSUMERS DESPITE STRONG ECONOMIC RECOVERY IN 2015, available at http://www.responsiblelending.org/research-publication/nations-housing-finance-system-remains-closed-african-american-latino-and-low.

[4] 12 U.S.C. § 1716; 12 U.S.C. § 1451 note.

[5] JOINT CENTER FOR HOUSING STUDIES OF HARVARD UNIVERSITY, THE STATE OF THE NATION'S HOUSING 2014, available at http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/sonhr14-color-full.pdf

[6] SHAPIRO, T., THE ROOTS OF THE WIDENING RACIAL WEALTH GAP: EXPLAINING THE BLACK WHITE DIVIDE, available at http://iasp.brandeis.edu/pdfs/Author/shapiro-thomas-m/racialwealthgapbrief.pdf and HERBERT, C ET. AL., IS HOMEOWNERSHIP STILL AN EFFECTIVE MEANS OF BUILDING WEALTH FOR LOW-INCOME AND MINORITY HOUSEHOLDS (WAS IT EVER?) available at http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/hbtl-06.pdf.

Since the financial crisis, many lenders and the Enterprises have limited lending and increased prices for borrowers with lower credit scores and/or lower down payments. Borrowers of color, low and moderate-income families, and first-time homebuyers tend to have both lower FICO scores and fewer resources to put towards a down payment due, in part, to generations of discrimination. Historically, federal housing policies provided credit access to whites and wealthier Americans while excluding others, preventing generational wealth building.

More recently, predatory loan products were targeted to these communities[7] stripping wealth[8] and depressing credit scores.[9] As a result, eligibility limits and pricing based on FICO scores and Loan-to-Value ("LTV") ratios serve as barriers to homeownership for these borrowers. Evidence of this can be seen in the increase in the median credit score for all new purchase originations to 727, rising 27 points in the last decade.[10] Furthermore, less than 10% of loans were made to borrowers with FICO scores at 645, even though about a third of the population has a credit score in this range.[11] The Urban Institute calculated that, as result of tight restrictions based on credit score, 5.2 million fewer loans were made between 2009 and 2014 than would have been expected based on historically safe lending standards.[12]

While we note and fully support that the Enterprises have since reinstated lower down payment programs and additional pilots to address these issues, we believe a robust duty to serve process will further access to credit initiatives by promoting and incentivizing responsible and sustainable lending to lower wealth households.

Additionally, it is important to recall that the Enterprises' duty to serve underserved markets is but one method to achieve their charter mandate to "promote access to mortgage credit throughout the Nation (including central cities, rural areas, and underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment

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[7] CRL's report LOST GROUND, 2011: DISPARITIES IN MORTGAGE LENDING AND FORECLOSURES (available at: http://www.responsiblelending.org/mortgage-lending/research-analysis/Lost-Ground-2011.pdf) found that "African Americans and Latinos were consistently more likely to receive high-risk loan products, even after accounting for income and credit status."

[8] CRL's report 2013 UPDATE: THE SPILLOVER EFFECTS OF FORECLOSURES (available at: http://www.responsiblelending.org/mortgage-lending/research-analysis/2013-crl-research-update-foreclosurespillover-effects-final-aug-19-docx.pdf) found that "Minority neighborhoods have lost or will lose $1.1 trillion in home equity as a result of spillover from homes that have started the foreclosure process."

[9] BREVOORT, K. AND COOPER, C., FORECLOSURE'S WAKE: THE CREDIT EXPERIENCES OF INDIVIDUALS FOLLOWING FORECLOSURE available at: http://www.federalreserve.gov/pubs/feds/2010/201059/index.html.

[10] URBAN INSTITUTE, HOUSING FINANCE AT A GLANCE: A MONTHLY CHART BOOK MAY 2017 at 14, available at http://edit.urban.org/research/publication/housing-finance-glance-monthly-chartbook-may-2017.

[11] *Id*., JIM PARROTT AND MARK ZANDI, OPENING THE CREDIT BOX, available at http://www.urban.org/publications/412910.html.

[12] LAURIE GOODMAN ET. AL. TIGHT CREDIT STANDARDS PREVENTED 5.2 MILLION MORTGAGES BETWEEN 2009 AND 2014, available at http://www.urban.org/urban-wire/tight-credit-standards-prevented-52-million-mortgages between-2009-and-2014.

capital available for residential mortgage financing."[13] The Enterprises also have a statutory duty to fulfill affordable housing goals.[14] These accountability measures – duty to serve and the housing goals – do not stand on their own, but work together to support a process that prioritizes expanding access to homeownership for low and moderate income communities. Both measures are necessary and important.

Assessing the Plans

FHFA's evaluation guidance assesses the Enterprises' plans against three distinct but related goals: progress, impact and effort/implementation. The current scoring system addresses each of these goals in the scoring process. However, the two-step quantitative and qualitative approach separates assessments of these goals and elevates one of the three (progress). An Enterprise can only fail under the proposed scoring system if it fails to make progress, since the assessment of impact and effort are made only after a pass/fail determination. This raises significant concerns, including:

- What guards against Enterprises putting only low impact objectives in the plan?
- What incentives do Enterprises have to score highly (above minimally passing)?
- What guards against only proposing easily achievable objectives?

The evaluation guidance presupposes that the plan objectives are meaningful. Under the rule, the determination that the objectives are meaningful is not made through the evaluation guidance but through FHFA's issuance of non-objection to the plans, which comes after public comment. If the plans are meaningful, then the scoring system's sole emphasis on evaluating progress to determine compliance is reasonable. However, if the Enterprises offer plans full of low impact objectives, then the scoring approach in the guidance rewards the Enterprises for aiming low or for accomplishing objectives that are not meaningful.

The issuance of a non-objection is clearly an important component of evaluating the plans: it is the step in the process that ensures the proposed objectives are meaningful. Since this step is so consequential, FHFA should take care to make the process of issuing a non-objection transparent and provide the public with information about the value of the objectives in the plan as well as the Enterprises' and FHFA's assessment of the meaningfulness of the proposed objectives. We recommend that the plans and the issuance of a non-objection come with justification from the Enterprises and FHFA as to why each objective and the set of objectives will result in meaningful change. For instance, FHFA could release a narrative summary of FHFA's analysis of each plan. In that analysis, FHFA could also provide potential scoring for each objective if completed successfully.

CRL also recommends that FHFA require the Enterprises to provide baselines for all objectives, not only the loan purchase objectives. With regard to outreach objectives, the Enterprises

[13] 12 U.S.C. § 1716; 12 U.S.C. § 1451 note.
[14] 12 U.S.C. § 4561(a).

should state what their efforts have been historically. This will ensure that the outreach objectives are meaningful. The Enterprises should not receive duty to serve credit for completing objectives they would have completed anyway, as the goal is to *increase* Enterprise activity in underserved areas.

Furthermore, some changes to the rule could allow for a more meaningful scoring process. As described above, compliance should be determined based on all three goals: progress, impact and effort. The quantitative scoring, as proposed, only measures progress and is used to assess compliance. This allows the Enterprises to potentially comply only by meeting relatively low effort objectives. One suggested change would be to require a combination of a quantitative and qualitative score to determine compliance. For example, allow plans to Fail at Step 1, but not Pass at Step 1. To comply, a plan would have to meet a threshold Step 2 score as well as a threshold Step 1 score (for example a score of 26, proposed for “minimally passing”). This would guard against the case of an Enterprise fully achieving all the goals (passing with a score of 7 or more on Step 1), but not making a meaningful impact or effort.

Scoring Methodology Changes

We also recommend FHFA develop more rigorous evaluation of the loan product and loan purchase objectives in particular. These objectives are the heart of the Enterprises’ activities, and provide the needed credit for these underserved areas. Also, the qualitative scoring approach is confusing and could be simplified.

Performance on loan objectives should be measured against number ranges and percentage of the market ranges, which could be done using HMDA data. As it stands, evaluation is based only on the Enterprises’ projections of their loan purchase volume. Market conditions may change, however, through the course of evaluating the plans. HMDA data provides a ready source of information about lending in these underserved markets that FHFA could use to situate the Enterprises’ projections within the market context. FHFA should use this market data in the quantitative scoring step.

Additionally, the loans purchased by the Enterprises need to be responsible loans that borrowers can repay. FHFA should assess loan product changes and the loans purchased under the loan purchase objectives to ensure that the loans do not have features that have been found to be associated with borrower distress.

The proposed Step 2 qualitative scoring measures two goals: impact and implementation. This is confusing as it is possible for an objective to be impactful but not efficiently implemented, or efficiently implemented but not impactful. FHFA needs to clarify how it will reconcile the qualitative scores if the impact and implementation would independently receive different scores. We recommend the impact score be more highly valued if the impact and implementation scores would be different if independently assessed. A poorly executed, but impactful objective is more meaningful to the underserved community than a well-executed, but not impactful objective.

Also, the effort/implementation score is helpful, but could be duplicative with progress. FHFA needs to clarify what they are trying to measure with this score and its importance relative to the other factors. As discussed above, we suggest impact and progress are more important than effort/implementation.

Extra Credit

Extra credit should only be awarded for truly "extra" effort and impact. Thus, we think that it is appropriate for FHFA to use percent increases, as this rewards higher impact activities. The evaluation guidance proposes to award an extra credit adjustment if an individual objective achieves a score of 40 or more. The extra credit score is then assessed on the total qualitative score. Instead, we recommend that an extra credit adjustment be permitted for an individual objective score of 30 or more. According to the chart in Appendix B, a score of 30 represents meaningful impact in addressing an underserved market area or a meaningful attempt to lay the foundation for future impact, and the Enterprise is deemed to have implemented effectively the actions associated with the objective. Activities that promote residential economic diversity, for instance, are of immense significance and should be encouraged and rewarded. Economic diversity is linked to fair housing goals, including combatting residential segregation. Consequently, we believe that meaningful impact plus economic diversity should receive extra credit.

Public Input and Transparency

A robust public comment process is necessary to properly assess the Enterprises' lengthy and complex plans. We appreciate FHFA increasing the period for public input on the plans from 45 days to 60 days. We recommend that FHFA also include a required comment period for significant plan modifications. Currently, the rule and evaluation guidance states that FHFA and an Enterprise may seek public input on a modification if FHFA determines that public input would assist its consideration of the proposed modification. Although we agree that minor revisions would not need public review, we believe that meaningful changes to the plan should be subject to a public comment period, as public input would assist FHFA's consideration of the proposed modification. We recommend FHFA add a requirement to the evaluation guidance that significant revisions, including any revision to an objective, be subject to a 30-day public comment period before being approved by FHFA. We also suggest that FHFA provide notice when significant modifications are approved, detailing the approved changes and reasoning behind FHFA's approval.

Additionally, there should be more transparency in declaring an objective infeasible. The draft evaluation guidance states that an Enterprise may ask FHFA to declare an objective in its plan to be infeasible due to economic or other events beyond the Enterprises' control. We recommend that the public be permitted to comment on any Enterprise request to declare one or more objectives infeasible. This is important to prevent an Enterprise from declaring an objective infeasible simply because the Enterprise is failing to meet the objective. It also encourages FHFA to subject the Enterprises' request to adequate scrutiny.

We appreciate FHFA's recognition that informed public input on a proposed plan is important to the development, review, and evaluation process, and we recognize that some Enterprise data will be deemed confidential or proprietary. However, we encourage as much information to be made public as possible. The evaluation guidance states that any plan content that the Enterprise believes requires confidential or proprietary treatment should be clearly identified and the Enterprise should explain why the information should be afforded confidential or proprietary treatment. FHFA should consider providing examples of the types of information FHFA would likely determine to be confidential or proprietary to help the Enterprises and the public navigate this process.

Conclusion

We urge FHFA to implement changes to the evaluation guidance that will foster transparency, encourage the Enterprises to propose meaningful and high impact objectives, and hold the Enterprises accountable in achieving their objectives. Thank you for consideration of our comments.