Housing Policy Council
1750 K Street NW Suite 300
Washington, DC 20006
202-589-1923
www.housingpolicycouncil.org

October 25, 2021

Sandra Thompson
Acting Director
Federal Housing Finance Agency
Office of the Director
10th Floor, 400 Seventh Street, SW
Washington, DC 20219

RE: Enterprise Equitable Housing Finance Plans RFI

Dear Ms. Thompson:

The Housing Policy Council[1] (HPC) appreciates the opportunity to comment on the Federal Housing Finance Agency's (FHFA) Request for Input (RFI) on the Enterprise Equitable Housing Finance Plans. Our members support both the letter and spirit of the Fair Housing Act (including the Affirmatively Furthering Fair Housing provision) and the Equal Credit Opportunity Act as well as Enterprise efforts to promote these critical pieces of legislation. Additionally, our member companies devote substantial resources on an ongoing basis to ensure that credit decisions for all loan applicants are made without regard to race or other prohibited bases.

Given the importance of equitable housing opportunities to the success and stability of the housing finance system, it is discouraging that only about 42 percent of Black households own a home compared with 72 percent for Whites, a gap that hasn't shown sustained improvement in nearly 50 years.[2] The gap indicates that efforts to-date have been unsuccessful, and it is time to consider alternative approaches. To make the Enterprise Equitable Housing Finance Plans as effective as possible, we offer the following recommendations.

Specific Comments and Recommendations

Initiate Enterprise Review of Loan Pricing

FHFA should evaluate whether the upfront fees that the Enterprises charge (Fannie Mae loan level price adjustments, Freddie Mac delivery fees) are appropriately calibrated to compensate the GSEs for expected GSE credit losses from borrower defaults, without unintended, disparate

[1] The Housing Policy Council is a trade association comprised of the leading national mortgage lenders and servicers, mortgage and title insurers, and technology and data companies. HPC advocates for the mortgage and housing marketplace interests of its members in legislative, regulatory, and judicial forums. Our interest is in the safety and soundness of the housing finance system, the equitable and consistent regulatory treatment of all market participants, and the promotion of lending practices that create sustainable homeownership opportunities in support of vibrant communities and long-term wealth-building for families. For more information, visit www.housingpolicycouncil.org

[2] https://www.census.gov/housing/hvs/files/currenthvspress.pdf

impacts on protected classes. To be effective, this arrangement should rely on a routine assessment to determine that upfront fees are accurately calibrated. To accomplish this, we recommend that each Enterprise periodically evaluate loan-level pricing adjustments, to reflect any changes in the mortgage market. Regular review and recalibration would minimize undercharging or overcharging for the expected cost of a mortgage default.

An additional way to achieve more balance between risk and access in loan pricing may be to add other loan attributes to the pricing matrix. We would encourage exploration of additional factors such as small-dollar mortgages (those with an unpaid principal balance of less than $150,000) loans in certain geographies (including historically redlined areas, areas of concentrated poverty, high opportunity areas, or rural areas), and low downpayment mortgages that have 3rd party credit enhancements.[3] It is possible that loans with these characteristics are potentially being mis-priced due to their slower prepayment rates as well as their lower loss severities (particularly due to the increase in home prices for entry level properties). A study of this issue could uncover excess pricing for some of the most vulnerable borrowers and contributing to inequitable housing outcomes.

The GSEs' pricing framework would benefit from transparency regarding the overall GSE cross-subsidization methodology. The current upfront fee structure redistributes fee revenue to generate subsidies for higher-risk loans. For example, the GSEs overcharge investment properties and second homes based on their loss given default expectations and discount the fees for loans with high loan-to value ratios (LTVs) and low credit scores. This loan pricing policy was designed to support the Enterprise mission obligations. However, this policy could be enhanced if there were more transparency regarding the size and impact of the adjustments. Stakeholders have expressed concern that the upfront fees penalize borrowers of color and low-and-moderate-income borrowers, but this impact is not immediately discernable from existing reports issued by the GSEs or FHFA. If FHFA were more transparent about how the cross-subsidy in the upfront fees works (through a white paper, annual report, or other mechanism), stakeholders could better understand the impact of a flat pricing system; uniform pricing could potentially increase the fees charged for high LTV lending and lower credit score borrowers and reduce the costs for investor and second home loans. At the very least, greater levels of transparency would allow stakeholders to have a realistic conversation about what sort of expected losses, if any, are appropriate for the Enterprises to bear to meet their mission obligations and how best to compensate the GSEs for those losses.

Explore Updates to the GSE Automated Underwriting Systems (AUS)

The GSE AUSs have shaped the operations of the entire housing finance ecosystem. Many lenders process all prospective borrowers through a GSE AUS, even if those loans are to be insured by the USDA, VA, or FHA. Thus, when the GSEs make significant changes to their AUSs, such as the recent Fannie Mae announcement to incorporate borrower rental payments, those changes may have impacts far beyond the GSE instituting the change. In recognition of

[3] The current LLPA framework potentially does not fully account for the enhanced strength of GSE counterparties, including private MIs due to robust capital and operational standard under the GSE-created Private Mortgage Insurer Eligibility Requirements and updated Master Policies.

this enormous market power and responsibility, HPC members encourage the GSEs to build on the recent incorporation of rental history data and explore whether and how to incorporate other alternative sources of data into the AUS tools.

A promising alternative data set that is worthy of attention and analysis is bank account information, which reflects monthly cash-flow based on a borrower's income and expenses. This data has the potential to present a more reliable assessment of a borrower's ability to satisfy housing expenses and other obligations, such as monthly telecommunications, healthcare, childcare, or other reoccurring bills. This approach comes closest to the laudable, but operationally difficult residual income analysis used for VA loans and may prove to be more reliable than existing underwriting standards, which rely on misleading gross income calculations. Further, a cash-flow methodology could also position the Enterprises (and thus the rest of the housing finance ecosystem) to serve the borrowers of the future, who are more reliant on irregular non-W-2 income sources of income, but who nonetheless responsibly manage their obligations.

An even more challenging feature of mortgage underwriting today is the income variability of many borrowers. Household income is far less stable than in the past.[4] This tendency for income to go up and down adds a new risk dimension in mortgage lending that is not captured in AUS systems today. Since the goal of equity plans is not just to get more families into home ownership but to make sure they are successful, updates to AUS should explore ways to capture income variability.

In sum, HPC members believe that incorporating additional data sources into the GSE AUSs not only has the promise to improve the reliability of the credit models, but also to serve a wider swath of the population and reduce racial disparities in loan acceptance rates.

Consider Instituting a Competitive Enterprise Grant Program

By Charter, the GSEs are not set up to construct or rehabilitate affordable housing, so one efficient way to address critical supply constraints may be to provide direct subsidies to the actual creators of housing. Although FHFA previously directed the Enterprises to refrain from making grants in conservatorship,[5] the financial position of the Enterprises has improved significantly since the ban was issued and we believe it is time for this policy to be revisited.

Specifically, we recommend that the Enterprises be permitted to fund the equitable housing activities of for- and not-for-profit developers, community organizations, units of government, public housing authorities, and tribal governments. As a condition of this authorization, HPC recommends that FHFA only allow the GSE to provide access to grant dollars through publicized competitions, like the Federal Home Loan Bank Affordable Housing Program (AHP). This program has effectively distributed money to high-performing organizations and made an impact

[4] Jonathan Morduch and Rachel Schneider, *The Financial Diaries: How American Families Cope in a World of Uncertainty* (Princeton, NJ: Princeton University Press, 2017). See also Michael Barr, *No Slack: The Financial Lives of Low-Income Americans* (Washington, DC: Brookings Institution Press, 2012) and J. M. Collins, ed., *A Fragile Balance: Emergency Savings and Liquid Resources for Low-Income Consumers* (London: Palgrave Macmillan, 2015).
[5] 12 CFR Part 1282

in assisting affordable housing development. The AHP program also has established applications, scoring rubrics, and other assessment tools that are familiar to potential candidates for Enterprise grants and could be quickly adapted to stand up a program and distribute funds efficiently in the first year or two of an Equitable Housing Plan. Our members believe that a competitive and transparent grant making program that is targeted to high-capacity organizations would be an efficient and effective way for the Enterprises to support equitable housing outcomes.

Engage in Research and Share Data

For the Equitable Housing Plans to meet their potential, the GSEs and FHFA must make progress in clearly identifying the reasons for disparate outcomes in the current system. HPC members believe that an essential first step to better understand and address any discrimination in the appraisal and homebuying process is data transparency and evidence-based analysis.

Published research conducted by FHFA and the GSEs on valuation discrepancies and possible bias – both the scope and scale of variations and the root causes for disparities – could facilitate broader public understanding. We ask that FHFA and the GSEs perform such analysis, and also share the wealth of GSE property data (the Uniform Appraisal Dataset /UAD) with other stakeholders. In relation to the Equitable Housing Plans, such information and analysis could shed light on whether any aspect of the appraisal process or other factors may produce valuation disparities and/or contribute to intentional or unintentional discrimination against borrowers of color.

Another key area of research is whether, and to what extent, bias might affect the credit underwriting process. Recent research by the economists from the Federal Reserve Board[6] has been helpful in quantifying the issue, but both FHFA and the GSEs have access to significantly more data than those researchers (the financial regulator version of HMDA, NMDB, and the entire single family data warehouse), which could reveal different challenges and/or policy-making opportunities.

To effectively answer the questions posed above as well as other relevant questions, HPC recommends that FHFA make these subjects a research priority for both the GSEs and FHFA's Division of Research and Statistics, in close coordination with the Office of Fair Lending Oversight. Overall, our members strongly believe that the GSEs must show leadership in conducting research and publishing data to advance equitable and sustainable housing opportunities.

Establish Clear Measures of Success, Transparent Reporting, and Regular Stakeholder Engagement

For the Equitable Housing Plans to achieve a more equitable housing finance system, there must be clearly defined targets that will allow FHFA and outside stakeholders to assess whether progress is being made. These goals should be clearly laid out in the Equitable Housing Plans,

[6] See "How Much Does Racial Bias Affect Mortgage Lending? Evidence from Human and Algorithmic Credit Decisions", July 2021, by Neil Bhutta, Aurel Hizmo, and Danie Ringo.

and be specific, strategic (meeting the needs of the underserved market segment), measurable, and achievable within the three-year plan.

Another key element of a transparent evaluation process is to release the outcomes of the Equitable Housing Plans on an annual basis. We would like to see FHFA build on the recent data release by the Office of Fair Lending Oversight,[7] to document the progress/or lack of progress made by the equitable housing plans. In addition, we recommend that FHFA include a write-up on the Equitable Housing Plans in either the FHFA Annual Housing Report or the Annual Report to Congress, that evaluates the effectiveness of the Plans. As part of these annual reports, we recommend that FHFA highlight a few key examples of successful GSE efforts, as well as those that haven't worked out. This simple accountability measure would ensure that the Enterprises proceed in implementing the plans with an expectation that any failures be recognized and adjustments made, as necessary.

Another way that the Equitable Housing Plan development process can be enhanced is by providing opportunities for stakeholder feedback. The timeline for the current process is inadequate. With public comments due on October 25th, 2021 and plans required for execution by January 1st, 2022, there is little time for the Enterprises to perform thorough research on issues and work with stakeholders, including primary market lenders, to develop specific commitments that are needed but also achievable. This mistake should be remedied by creating a research and engagement period during the first year and incorporating this type of activity into future planning cycles.

Additionally, FHFA needs to ensure that the public has an opportunity to weigh in on the progress the Enterprises are making in executing their Equitable Housing Plans. Without a public input process, FHFA will be almost entirely reliant on Enterprise input only, to determine what is possible and effective. It would be appropriate for the FHFA to build into the process a mechanism for independent policy review and discussion to counterbalance the possibility of Enterprise self-interested assessments.

Conclusion

Thank you for your consideration of these recommendations. If you have any questions or would like to discuss these comments, please contact Meg Burns, EVP for the Housing Policy Council, at 202-589-1926.

Yours truly,

Edward J. DeMarco

Edward J. DeMarco
President
Housing Policy Council

[7] See "FHFA Releases Additional Data on Enterprise Fair Lending and Housing Goals", September 8, 2021.