NCSHA

National Council *of*
State Housing Agencies

October 25, 2021

Sandra Thompson
Acting Director
Federal Housing Finance Agency
400 Seventh Street SW
10th Floor
Washington D.C. 20219

RE: Equitable Housing Finance Plans

Dear Ms. Thompson:

The National Council of State Housing Agencies (NCSHA),[1] on behalf of the nation's state housing finance agencies (HFAs), is pleased to submit recommendations for actions Fannie Mae and Freddie Mac (collectively, "the Enterprises") can take to "advance equity in housing finance," in response to your recent directive that they "prepare and implement three-year Equitable Housing Finance Plans."

We commend you for implementing this directive, which we believe sets the stage for substantive actions by the Enterprises to do much more to address racial and ethnic inequities in the housing system. We especially appreciate your sense of urgency for the Enterprises to act. The time is long past for more reports, task forces, and conferences. It is time for concrete actions that directly address the well-documented barriers to a more equitable housing system. Our recommendations detail specific steps the Enterprises can take, today, towards that goal by expanding existing partnerships with state HFAs.

FHFA is requiring the Enterprises to submit by December 31 plans that "include objectives, measurable goals, and planned meaningful actions for … reducing the racial or ethnic homeownership gap and [r]educing underinvestment or undervaluation in formerly redlined areas that remain racially or ethnically concentrated areas of poverty or otherwise underserved or undervalued."

We recommend two specific opportunities for Enterprise action on these fronts that can commence as soon as FHFA directs the Enterprises to undertake them with state HFAs. They are:

- Expanding Enterprise financing through HFA homeownership programs; and

[1] NCSHA is a nonprofit, nonpartisan organization. None of NCSHA's activities related to federal legislation or regulation are funded by organizations that are prohibited by law from engaging in lobbying or related activities.

- Piloting acquisition, development, and construction financing and small-dollar mortgage financing through HFAs.

Background: State HFAs' Service to Borrowers of Color

State HFAs are at the center of the nation's affordable housing system and are focused on meeting the affordable mortgage finance needs of the low- and moderate-income (LMI) homebuyers and renters in their states.

In 2020, state HFA programs provided more than $31.8 billion to an estimated 165,400 homebuyers. This includes an estimated $10.3 billion of Enterprise financing, which helped more than 51,000 homebuyers. Twenty-eight state HFAs are sellers and/or servicers for one or both of the Enterprises. HFAs have partnered with Fannie Mae and Freddie Mae to extend billions of dollars in credit to tens of thousands of homebuyers over the past several years. At the end of 2019, state HFA portfolios held more than $26 billion of Enterprise mortgage products.

Fully 75 percent of all state HFA-financed home loans in 2020 went to borrowers earning at or below area median income. The median borrower income for state HFA program loans in 2020 was $48,000, nearly 30 percent below the national median income. The national average purchase price of HFA-financed home was $188,000 – well below the conforming loan limit of that year.

On an annual basis, 25 – 30 percent of HFA program loans serve borrowers of color. The Enterprises have long recognized the HFA value proposition in this area. According to Freddie Mac: "HFA-funded home buyer education and [down payment assistance] undoubtedly play an important role in paving the way for households of color, as do HFAs' established role as a trusted advisor and provider of sustainable mortgage financing and extensive relationships with non-profit and faith-based organizations."

Even though state HFAs serve lower-income, higher-risk borrowers than most lenders, as a matter of mission, HFAs have a long track record in industry-leading loan performance and borrower sustainability. A review of 1 million loans to LMI buyers guaranteed by Fannie Mae between 2005 and 2014, of which roughly 10 percent were HFA-backed, found HFA loans were 20 percent less likely to experience a long-term default and 30 percent less likely to be foreclosed.

A 2020 study of the Hardest Hit Fund, administered by the HFAs of 18 states and the District of Columbia found the HFA-run program "leads to a 40 percent reduction in the probability of mortgage default and foreclosure through four years post assistance" and that "about one in four of these assisted homeowners would have ended their loan in severe default absent the HHF program, corresponding to an estimated $7.9 billion direct loss to lenders, investors and the secondary market."

Treasury Department data indicate roughly one-in-three households HFAs served through the HHF is minority. Based on their track record and performance in helping vulnerable households remain in their homes, state HFAs will serve as the primary administrators of the Homeowner Assistance Fund, created earlier this year in the American Rescue Plan to help homeowners impacted by the pandemic avoid displacement and foreclosure.

The statute prioritizes assistance for "socially disadvantaged individuals," which Treasury Department regulations suggest include "a member of a group that has been subjected to racial or ethnic prejudice or cultural bias within American society [or] resident of a majority-minority Census tract." The White House has identified the Homeowner Assistance Fund as a key tool in "Helping Black Americans Stay in Their Homes."

Barriers to Equity State HFAs Can Help the Enterprises Address

State HFAs are well positioned to assist the Enterprises in doing more to overcome several well-documented barriers to a more equitable housing system:

- **Unfair mortgage loan pricing**. Loan level price adjustments (LLPAs) instituted by the GSEs more than a decade ago, ostensibly to offset risks associated with lower credit profiles and smaller down payments, "disproportionately impact potential homebuyers of color and low-to-moderate income families, whose ability to save for down payments and credit profiles have been negatively impacted by discrimination and lack of opportunity in the mortgage market," according to the Center for Responsible Lending. *Recommendation 1 below addresses this barrier*.

- **Lack of savings for a down payment**. Minority households generally have lower incomes and savings, and less family wealth than white households, so many naturally struggle to afford a down payment. "Increasing the visibility of and access to down payment assistance will especially benefit young black homebuyers, who are less likely to receive parental support when purchasing a home than white young adults," according to the Urban Institute. *Recommendation 1 below addresses this barrier*.

- **Student loan debt burdens**. Black students are more likely than whites to take on student debt, borrow more, and have longer-running debt obligations. High student loan balances can increase debt-to-income ratios, reduce credit scores, and make it harder to amass savings for a down payment for borrowers generally. Blacks were more likely than other groups to delay purchasing a home because of student loan debt, according to the Education Data Initiative. *Recommendation 1 below addresses this barrier*.

- **Inadequate supply of affordable homes**. The country is facing the largest shortage of homes in a generation and the problem is rapidly worsening. The resulting increase in home prices is putting homeownership out of reach for millions, particularly households of color. "Land availability…is the most critical factor explaining the supply shortage, followed closely by the availability of [acquisition, development, and construction (ADC)] financing, "according to analysts Jim Parrott and Mark Zandi. They observe that Enterprise support for ADC loans, "would allow more capital to flow to the smaller businesses engaged in land development and construction." *Recommendation 2 below addresses this barrier*.

- **Disinvestment in communities of color**. Neighborhoods defined by higher-than-average population loss, poverty, and unemployment rates "tend to be overwhelmingly communities of color," according to the Center for American Progress. In addition, in majority Black neighborhoods "not only is the housing stock of lower quality…[s]chool performance is weaker, commute times are longer, and access to business amenities is more limited," according to researchers at the Brookings Institution. *Recommendation 2 below addresses this barrier*.

Recommendation 1: Expand Enterprise Financing Through HFA Homeownership Programs

Fannie Mae and Freddie Mac have long-standing partnerships with state HFAs through the HFA Preferred and HFA Advantage products, respectively. The products were created in the aftermath of the Great Recession to expand the Enterprises' efforts to serve low-income borrowers. They offer a more affordable fixed-rate mortgage than eligible borrowers could otherwise qualify for and also typically provide down payment assistance. The cost savings come mostly from two product features: a waiver of LLPAs and an allowance to purchase the "charter minimum" level of private mortgage insurance (PMI) of 18 percent.

The Enterprises' HFA loan products have helped more than 250,000 households, including many thousands of borrowers of color, purchase a home. The loans' strong performance was instrumental in FHFA allowing the Enterprises to expand its affordable, high loan-to-value (LTV) lending options, including Fannie Mae HomeReady and Freddie Mac Home Possible.

In 2019, Fannie and Freddie restricted the pricing benefits of their HFA products to borrowers earning 80 percent or less of area median income (AMI). They also increased the PMI coverage requirements for such borrowers. These changes greatly hindered HFAs' ability to help working families buy a home with conventional financing. The changes have been especially impactful to moderate-income minority households, who often do not have the same access to financial assistance from family or other resources to help pay for a down payment. Two-thirds of HFAs estimated in 2019 that the product changes would reduce the amount of program loans they could deliver to minority homebuyers.

One actual example illustrates the impact:

> Minnesota Housing was working in 2019 with a Hispanic family of five in St. Paul hoping to buy their first home. The couple earned a slightly above-average income and had an excellent history of making payments. They needed assistance with the down payment and, because they did not use credit cards, were unable to build up a credit record that reflected their history of financial responsibility. An HFA Preferred Mortgage with Minnesota HFA down payment assistance would have met their needs. But program changes in 2019 requiring them to pay an LLPA effectively increased their interest rate by .875 percent, which qualified their mortgage as a "high-cost" mortgage loan and priced them out of their dream.

In cases such as these, creditworthy and responsible borrowers are either forced to purchase a home that is less suited for their family and/or utilize a mortgage insured by the Federal Housing Administration (FHA) or other government insurance program. Many HFAs estimate that, after the 2019 product restrictions, the Enterprise share of their production declined anywhere from 10-30 percent, with many of the borrowers instead going to FHA. While FHA is an essential and effective resource, FHA loans often come with higher costs and are less competitive in the marketplace and, as the Center for Responsible Lending has observed, borrowers of color already are "vastly overrepresented in the FHA market."

We do not expect the Enterprises to eliminate LLPAs across the board or compete aggressively with FHA for the same pool of borrowers. By restoring HFA Preferred and HFA Advantage, they can, however, help more borrowers of color access conventional financing and in the process assess the impacts of scaling financing for them through additional channels in a risk-manageable manner. Since HFA Preferred and HFA Advantage already exist and work well, the impacts could be immediate.

Four-in-five HFAs report that expanding the pricing advantage and charter level PMI for more HFA Preferred borrowers would increase their ability to serve more borrowers of color.

Another ready opportunity for the Enterprises to deliver on racial equity is by investing in HFA tax-exempt Mortgage Revenue Bonds (MRBs). MRBs have been one of the primary tools for HFAs to expand affordable homeownership since the early 1970s.

Capital market sources are willing to accept lower yields on MRBs because the interest payments they receive are exempt from federal taxation. HFAs pass the interest savings to homebuyers through below-market interest rate mortgage loans that lower the costs of homeownership. MRB loans are tightly targeted by law in terms of borrower income and home purchase price amounts. Thirty percent of HFA MRB borrowers were households of color in 2020.

The Enterprises were previously investors in MRBs. Resuming their MRB purchases would create additional liquidity for the bonds, ultimately benefitting borrowers, and enable the Enterprises to link their racial equity commitments to their objectives in Environmental, Social, and Governance (ESG) investing. The state HFAs of Colorado, Florida, and Rhode Island have recently issued certified ESG bonds based in part on their targeted financing for borrowers of color.

Two-thirds of HFAs report that Enterprise investments in MRBs through an ESG framework would increase their ability to serve more borrowers of color.

The other benefit to restoring the HFA loan products and/or resuming MRB investments as an Enterprise Equity Plan pillar is generation of additional funding for down payment assistance through state HFA programs. HFAs provided DPA to more than 122,000 borrowers last year, at an average amount of $7,500 – a total of almost $1 billion in assistance. Almost all this funding was generated by the HFA loan program. Simply put, more HFA-backed loans lead to more down payment assistance.

A relatively small amount of Enterprise subsidy could augment HFA programs even more and enable them to address deeper financial barriers many borrowers of color face, such as student loan debt. One model is Illinois Housing Development Authority's (IHDA) SmartBuy program, which allows homebuyers purchasing a home with an IHDA loan the option to take out an unrecorded forgivable note worth up to 15 percent of the home purchase prices to pay off their student loan debt. The IHDA financing used for the student debt relief must extinguish all open student loans, or the borrower must contribute additional funds to ensure the same.

Three quarters of HFAs said an Enterprise-HFA program aimed at helping student loan debt-burdened borrowers afford a down payment would increase their ability to provide more financing for borrowers of color.

Recommendation 2: Pilot ADC and Small Dollar Mortgage Financing Through HFAs

A decade ago, roughly 20 percent of HFA-financed homebuyers purchased a new home. Today, less than 10 percent do, just one more indicator of the worsening shortfall of entry-level homes. The lack of supply also means would-be homebuyers utilizing an HFA program loan with down payment assistance face stiff competition from all-cash buyers and others who have the equity needed to put down a large down payment. Many HFAs are doing what they can to ease some of the pressure. For example:

- Michigan State Housing Development Authority offers financial incentives to local governments and nonprofits to help them acquire and place affordable modular homes in communities where they are needed.

- Tennessee Housing Development Authority and the Mortgage Bankers Association are working together to create a model for increasing Black homeownership in Memphis that increases efforts to expand the existing supply of affordable housing and promotes an equitable and accessible housing finance system to make investments.

- MassHousing's Commonwealth Builder Program is a $60 million fund intended to spur the construction of single-family homes and condominiums affordable to households with moderate incomes, particularly in communities of color.

- Virginia Housing has partnered with a public benefit corporation to build a factory in the state that builds affordable modular homes; one of the first units sold through this partnership went to a minority first-time homebuyer who purchased the home with a Virginia Housing program loan with down payment assistance.

These and similar creative efforts cannot overcome the need for larger-scale, national solutions. A recent Freddie Mac study found "the main driver of the housing shortage is the decline in construction of entry-level, single-family homes." Research by Andre Perry makes clear the connection between this general problem and the specific focus of Enterprise equity plans: "Because people of color are far more likely than white people to be first-time rather than repeat homebuyers, a mass of housing inventory weighted against attainable starter homes disproportionately favors households with higher concentrations of generational wealth to pay bigger down payments."

While the starter-home shortage cannot be resolved entirely with financing, the research cited above and regularly collected data from the National Association of Homebuilders strongly suggest that a financial product for ADC lending targeting entry-level homebuilding would benefit borrowers and communities of color. Such a product could support new homeownership opportunity in both highly resourced and disinvested areas.

Fully 85 percent of HFAs report that an Enterprise - HFA ADC loan product aimed at encouraging affordable entry-level home construction, with a focus on borrowers and communities of color, would enable them to accomplish more in this area.

Another area where the Enterprises have an opportunity to advance racial equity in partnership with HFAs is in testing and scaling small-dollar home mortgage loans, which can help expand homeownership in resource-rich areas and support community revitalization.

In many stable majority-minority neighborhoods, aspiring buyers cannot get mortgages because the needed principal amount is lower than conventional lenders will offer. The *New York Times* reported that, in 2019, mortgages for $100,000 fell to 10 percent of home purchase loans from 17 percent in 2014. "Addressing the small-dollar mortgage problem would open pathways to homeownership for many traditionally underserved groups, including LMI households and people of color, especially in low-cost geographies," according to the Urban Institute.

HFAs in recent years have explored offering small dollar mortgage loan options, both in rural areas and distressed urban neighborhoods. However, they faced obstacles due to lackluster lender interest and lack of a secondary market. An Enterprise pilot to purchase small dollar loans from HFAs, with competitive pricing, could help pave the way for such lending to flourish.

More than 80 percent of HFAs said an Enterprise - HFA small dollar loan product would enable them to provide more financing to households of color.

In closing, it is critical to note the often-overlooked rural dimensions of racial inequities in the housing system. Not only are "persistently high-poverty counties" disproportionally rural, according to the Institute for Research on Poverty, one in five rural Americans is a person of color, according to researchers Katy Backes Kozhimannil and Carrie Henning-Smith.

The Enterprises' housing equity plans should make special, specific commitments to address rural needs. The plans can link to and complement the Enterprises' Duty-to-Serve (DTS) responsibilities – which, per Recommendation 1 above, explicitly allow the Enterprises to receive credit for purchases of MRBs as well as tax-exempt multifamily housing bonds. State HFAs' statewide focus and capacities, and their deep historic commitment to rural areas make them essential Enterprise partners in this work.

Thank you again for your leadership in making systemic change to create a more equitable housing system. We look forward to working with the Enterprises to make more progress.

Sincerely,

Garth Rieman
Director, Housing Advocacy and Strategic Initiatives