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Comments on FHFA Strategic Plans Fiscal Years 2022-2026

Submitted to the Federal Housing Finance Agency

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March 10, 2022

We are deeply concerned about addressing racial and ethnic disparities in loans underwritten and purchased by Fannie Mae and Freddie Mac. This critical area should be addressed as part of your strategic Goal 2: Foster housing finance markets that promote equitable access to affordable and sustainable housing.

Our organization advocates for housing counseling agencies and housing consumers. We support your efforts to improve equitable access to affordable and sustainable housing. Despite the enactment of the Fair Housing Act of 1968, communities of color are less likely to be homeowners than their white counterparts and Black homeownership levels in particular are unacceptably low. We understand that access to capital impacts racial equity. We believe that the Federal Housing Finance Administration (FHFA) could improve the current performance for Fannie Mae and Freddie Mac for Black and Brown borrowers.

In 2020, 3.06% of loans purchased by Fannie Mae were for Black borrowers and 8.03% were Hispanic borrowers. In comparison, 65.61 % were for white borrowers[1]. For Freddie Mac in 2020, 3.28% of loans purchased were to Black borrowers and 6.77% to Hispanic borrowers. Compare that to 64.62% of loans were for white borrowers[2]. This gap between Black and Hispanic borrowers and their white counterparts reflects a systemic failure to meet market opportunity. Compare these numbers with FHA insured mortgages, where in 2020, 12.74% of FHA loans went to Black borrowers, 17.29% of loans went to Hispanic borrowers and 50.11% went to white borrowers[3].

[1] Annual Mortgage Report – Fannie Mae 2020
[2] Annual Mortgage Report – Freddie Mac 2020
[3] FHA Single Family Production Report

We understand that Fannie Mae and Freddie Mac do not accept the same levels of risk that FHA will among applicants. However, there is a gap among borrowers seeking financing from both Government Sponsored Enterprises (GSE) and the FHA. We request that as part of *Strategic Goal 2: Foster housing finance markets that promote equitable access to affordable and sustainable housing* that Fannie Mae and Freddie Mac address the low levels of Black and Brown loans. Risk should be managed better to reflect this strategic goal.

Furthermore, we request enhancement of the lending practices for people with smaller down payments and low credit scores in Fannie Mae and Freddie Mac, as part of your strategic *Objective 2.2 to advance equity in housing finance*, including through compliance with fair lending laws, and regulations. Borrowers of color from lower-income communities are not able to save as much capital for a down payment. Their families are often low-wealth and they have less opportunity to gift down payment assistance to help with the purchase. Black and Brown consumers are also more likely to be rent-burdened, paying a higher proportion of their income for rent. Consequently, they have difficulty saving down payment funds, especially with record-breaking inflation.

In the housing finance industry, the GSEs have very high credit score averages among applicants. The average credit score in the Fannie Mae portfolio is 751.[1] Similarly, Freddie Mac's average credit score is 759. [1] In contrast, the national average credit score of Black households is 677, and the average credit score of Hispanic households is 701. In comparison, the average credit score for White households is 734.[1] Borrowers from lower wealth communities tend to have low credit scores.

In the current market, Fannie Mae and Freddie Mac's automated underwriting programs treat lower downpayment borrowers with low credit scores as layered risk and higher risk.[2] These automated systems put Black and Brown borrowers at disadvantage compared to White borrowers. The credit-scoring algorithmic bias partly explains the low percentages of the Black and Brown borrowers in the Fannie Mae and Freddie Mac portfolios.

One reason for the low levels of Black and Brown loans covered by the GSEs is the assumption in underwriting systems that low downpayment loans are high risk and require very high credit scores as compensation. In practice, borrowers with good credit scores and good payment histories but not top credit scores are more likely to be rejected. This practice means that Black and Brown borrowers are not well served by the underwriting assumptions because many of them are entering the homebuying process with lower downpayments. The Strategic Plan should address this issue with the goal of identifying low downpayment borrowers that will perform well without having the highest credit score. The review should also examine if there are other unnecessary underwriting barriers triggered by a lower downpayment which disadvantage these borrowers.

Housing Counseling agencies conduct extensive reviews of credit reports for consumers seeking their first home. Housing counselors observe that there are reasons that consumers who are low-moderate income, and people of color have lower credit scores on average and some of these have nothing to do with timely payment. Other reasons for lower credit scores are 1) credit reporting errors, 2) a reluctance to increase credit capacity, which means they are not aware of the counterintuitive value of having plenty of unused credit capacity to improve the credit score, 3) use of subprime credit sources where timely payment is not as valuable as with prime credit sources in credit scoring, 4) some institutions only report late credit payment but not timely payment, 5) personal preferences to use cash over credit, and 6) recent immigrant credit histories where the country of origin do not routinely transfer and it takes time to comprehend and access the United States systems.

Furthermore, we agree with your Objective 2.2 to publish data and analysis on fair lending, fair housing, and equity topics. This information could indicate any changes in lending, housing, and equity patterns overtime to ensure accountability.

Primarily, to target this issue, we believe the GSEs should equitably serve low down payment borrowers to significantly increase Black and Brown portions of their portfolios. Higher risk is necessary to promote racial equity in their portfolios.

Second, as part of Objective 2.3: serve as a reliable source of information and analysis on the state of the housing finance market and related, the GSEs should work closely with HUD approved housing counseling agencies to identify the needs of borrowers in the 650 -700 credit score bands that can be low risk and capable of making timely payment.

Housing counselors create robust credit profiles through documentation and evaluation of rent, utility, furniture, and childcare payments. Successful completion of a high quality housing counseling program could be a compensating factor for lower downpayment borrowers. The GSEs should analyze the trends of program participants with lower credit scores who complete housing counseling programs. This information could provide insight into funding needs among underserved communities and allow Fannie Mae and Freddie Mac to go lower on credit score for low downpayment borrowers.

Further, to accomplish Objective 2.3, FHFA should require the collection of the housing counseling data fields and language preference in the Uniform Residential Loan Application or some other mechanism at origination. The inability of the lending community to track and utilize language preference means that lenders and servicers cannot communicate with a portion of their borrowers who can not understand communications in English. Integrating the language preference data field into mortgage origination, requiring that the language preference transfers at closing with the mortgage information to the servicer, and maintaining the information available if servicing is sold, will mean that the lender and servicer could communicate succinctly in language at any point in the relationship. Similarly, restoring the housing counseling data fields would allow housing counseling work to be tracked, in the future investors may evaluate counseled loans as lower risk, and servicers can refer delinquent borrowers back to the agency with which they had worked. The restoration of this data field and language preference could be collected by your agency for further analyses on the state of the housing finance markets, as part of Objective 2.3.

While we support your objective 2.5: Support leveraging of technology and data to further promote efficiency and cost savings in the mortgage process, we are concerned about the algorithmic bias that tends to increase racial bias. Machine-learning algorithms based on a history of racially biased lending patterns have the potential to replicate these patterns. Some oversight will be necessary to ensure that the algorithms do not worsen racial disparities.

We appreciate your efforts to mitigate the racial disparities in the current market. We believe that addressing Goal 2: Foster housing finance markets that promote equitable access to affordable and sustainable housing with our recommendations represents an opportunity to serve communities equitably.

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