May 17, 2023

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

Re: Enterprise Single-Family Social Bond Policy

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 on the Enterprise Single-Family Social Bond Policy.[2] We commend FHFA for seeking input on this important topic and we hope that our comments below will help inform FHFA's views.

Background

We will start with a brief background on Social Bonds.

Why are Social Bonds important?

Generally, there are at least two reasons why social bonds are important. First, there is a clear market demand for "ESG" investments. "ESG" stands for "environmental," "social" and "governance." More and more investors want to ensure that their money has a positive impact in one or more of these categories.[3] "Social Bonds" focus on the "S" in ESG and are commonly defined as "any type of bond instrument where the proceeds, or an equivalent amount, will be exclusively applied to finance or refinance in part or in full new and/or existing eligible Social Projects…and which are aligned with the four core components of the [Social Bond Principles]."[4]

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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 on the Enterprise Single-Family Social Bond Policy* (Feb. 2023), https://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/RFI-Enterprise-SF-Social-Bond-Policy.pdf.
[3] *See, e.g.,* Structured Finance Association, *ESG Market Sentiment Survey* at 6 (Feb. 2023), https://structuredfinance.org/wp-content/uploads/2023/02/SFA-ESG-2022.pdf (finding that "[g]lobal investor demand for ESG disclosure continued to rise across all facets of the capital markets during 2022").
[4] *See* International Capital Market Association, *Social Bond Principles* at 3 (June 2021) ("ICMA Social Bond Principles") (emphasis added),

Additionally, in this case, Social Bonds are particularly important because of the mission, legal obligations, and historical record of FHFA and the Government-Sponsored Enterprises ("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
- Promoting access to mortgage credit throughout the Nation (including central cities, rural areas, and underserved areas).[5]

Also, the GSEs must comply with the nation's fair lending laws, which include the Fair Housing Act,[6] the Equal Credit Opportunity Act,[7] and the Federal Housing Enterprises Financial Safety and Soundness Act.[8] Finally, 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.[9]

Despite their missions, the GSEs have not met their obligations 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,[10] the GSEs have

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https://www.icmagroup.org/assets/documents/Sustainable-finance/2022-updates/Social-Bond-Principles_June-2022v3-020822.pdf.

[5] 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.

[6] 42 U.S.C. § 3601 *et seq*.

[7] 15 U.S.C. § 1691 *et seq*.

[8] 12 U.S.C. § 4501 *et seq*.

[9] 42 U.S.C. § 3608(d).

[10] 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. Communities of color lost $1 trillion in wealth as a result of concentrated subprime mortgage foreclosures on nearby homes. *See* Debbie Gruenstein Bocian, Peter Smith and Wei Li, *Collateral Damage: The Spillover Costs of Foreclosures*, Center for Responsible Lending (Oct. 24, 2012), https://community-wealth.org/content/collateral-damage-spillover-costs-foreclosures. After a robust study of the causes of the Great Recession, the Financial Crisis Inquiry Commission concluded that the GSEs "contributed to the crisis but were not a primary cause." Financial Crisis Inquiry Commission, *Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States* at xxvii (2011), https://www.gpo.gov/fdsys/pkg/GPOFCIC/pdf/GPO-FCIC.pdf. Some have 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 is patently false. 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

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.[11]

What frameworks are used for transparency?

Next, we turn to the frameworks used for Social Bonds. It's important to first understand the concept of "social washing," which is the act of making false or misleading statements about the social benefits of a particular investment. To avoid "social washing" and provide transparency, many investors turn to widely-accepted international frameworks, including:

- The United Nations ("UN") Sustainable Development Goals and
- The International Capital Market Association ("ICMA") Social Bond Principles.

In 2015, all of the United Nations member states adopted the 2030 Agenda for Sustainable Development, which is centered on 17 Sustainable Development Goals.[12] For the purpose of housing-related Social Bonds, the most relevant are #10-Reduced Inequalities and #11-Sustainable Cities and Communities.

In addition, the ICMA's Social Bond Principles are also widely-used and accepted.[13] These are voluntary process guidelines for issuing social bonds. The GSEs currently use these principles for issuing their Green Bonds and Multi-family Social Bonds as do other large issuers. The Social Bond Principles begin with the list of sample Social Projects. For the purpose of housing-related Social Bonds, the most relevant are Affordable Housing and Socioeconomic Advancement and Empowerment.

The ICMA Social Bond Principles also consist of four core components:

1. The Use of Proceeds,
2. The Process for Project Evaluation and Selection,
3. The Management of Proceeds, and
4. Reporting.

Finally, the Principles also recommend issuing a Framework with a Social Objective and providing for External Review.

Oversight, to urge a halt to their program of purchasing Alt-A mortgages and subprime securities only to be told that the GSEs needed to purchased Alt-A and subprime MBS because they were hemorrhaging market share, becoming irrelevant, and losing profits.

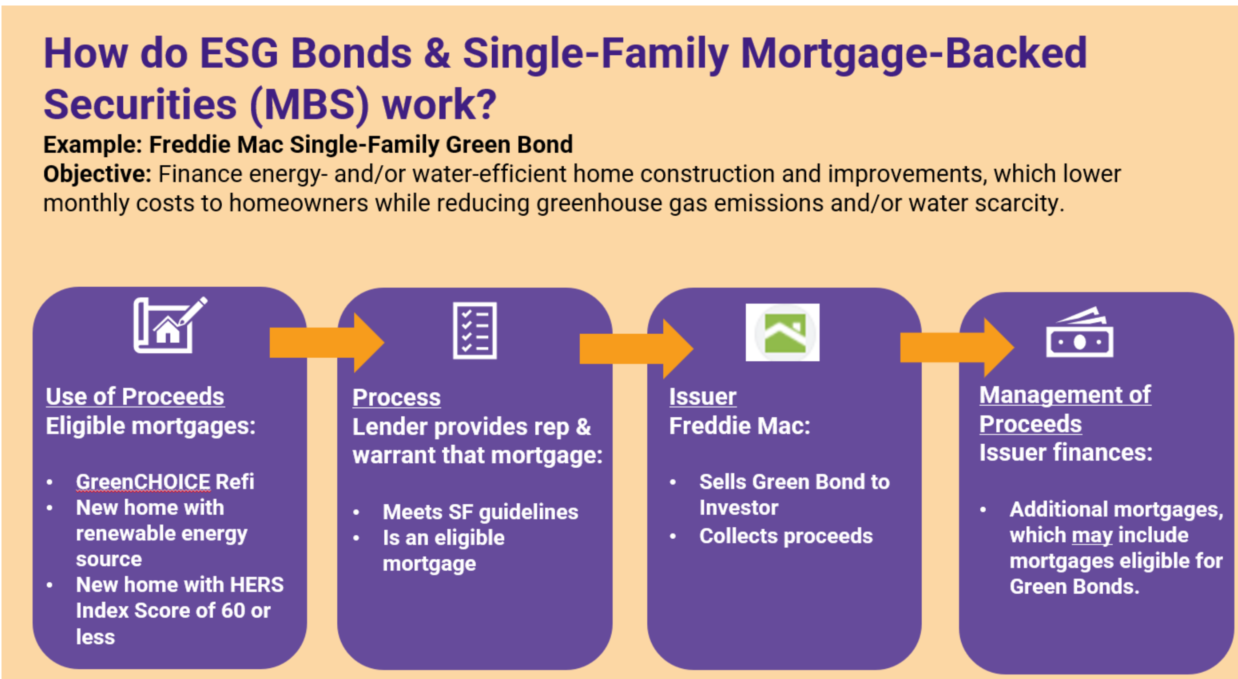
[11] FHFA, *Fair Lending Data,* https://www.fhfa.gov/DataTools/Downloads/Pages/Fair-Lending-Data.aspx.

[12] UN Department of Economic and Social Affairs, *17 Sustainable Development Goals*, https://sdgs.un.org/goals.

[13] ICMA Social Bond Principles.

How do ESG Bonds work with mortgage-backed securities?

There are several structures for ESG bonds. For many ESG bonds, the issuer obtains money from investors and then a specified committee or service provider decides which projects will fulfill the broad goals of the fund. However, for many ESG Bonds that consist of Mortgage-Backed Securities ("MBS"), the typical arrangement is for the issuer to designate in advance certain loans that will fulfill the Objective. Below is an example based on the framework for Freddie Mac's Single-Family Green Bond:[14]



- First, Freddie Mac has designated 3 types of mortgages as eligible for its Green Bond:
    - GreenCHOICE mortgages, which refinance consumer loans for solar panels;
    - Mortgages on new homes with a renewable energy source (such as solar power); and
    - Mortgages on new homes with a Home Energy Rating System ("HERS") Index Score of 60 or lower.
- Next, the lender must provide a representation and warranty to Freddie Mac that the mortgage meets Freddie's Single-Family Seller Guidelines and is one of these eligible mortgages.
- Then, Freddie Mac as the issuer sells the Green Bond to investors and collects the proceeds.

[14] Freddie Mac, *Single-Family Green Bond Framework* (Nov. 2021), https://capitalmarkets.freddiemac.com/mbs/docs/Freddie_Mac_SF_Green_Bond_Framework.pdf.

- Finally, Freddie Mac uses the proceeds to finance additional purchases of mortgages that meet the criteria described in the Seller Guide, including (but not limited to) additional purchases of mortgages eligible for Single-Family Green Bonds.

Now we'll turn to the recommendations for the Enterprise Single-Family Social Bonds Policy based on the ICMA Social Bond Principles.

Comments

Comments from NFHA and the undersigned organizations:

1. Social Objective: The Social Objective should be to create equity in homeownership and affordable housing opportunities.

America's long history of discriminatory housing policies[15] has created distinct advantages for White families, leading to wide and persistent racial and ethnic homeownership, credit, and wealth gaps. For example, the Black-White and Latino-White homeownership gaps are the same or greater than they were when the Fair Housing Act was passed in 1968. The Black-White homeownership gap today stands at a 29-point difference (44% of Black households compared to 73.3% of White households) and the Latino-White homeownership gap today is at a 23-point difference (50.6% of Latino households compared to 73.3% of White households).[16] The GSEs have a legal mandate to help remedy this issue.

For these reasons, we recommend that the GSEs issue Social Bonds with the Objective of **creating equity in homeownership and affordable housing opportunities**. This Objective would serve the following UN and ICMA Goals:

- The UN Goal of reduced inequality and the ICMA goal of socioeconomic advancement and empowerment; and
- The UN Goal of sustainable cities and communities and the ICMA goal of affordable housing.[17]

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[15] *See* Gregory Squires, *The Fight for Fair Housing: Causes, Consequences, and Future Implications of the 1968 Federal Fair Housing Act*, New York, NY, Rutledge (2018); Richard Rothstein, *The Color of Law: A Forgotten History of How Our Government Segregated America*, New York, NY, Liveright Publishing Corporation (2017).
[16] *See* U.S. Census American Community Survey Data, https://www.census.gov/programs-surveys/acs/news/data-releases/2021/release.html#oneyear. *See also*, National Association of Hispanic Real Estate Professionals, *2022 State of Hispanic Homeownership Report* (March 2023), https://nahrep.org/downloads/2022-state-of-hispanic-homeownership-report.pdf (showing the Latino homeownership rate at 48.6% based on the Current Population Survey/Housing Vacancy Survey data).
[17] *See* UN Department of Economic and Social Affairs, *17 Sustainable Development Goals*, https://sdgs.un.org/goals; ICMA Social Bond Principles.

Finally, we note that this Objective would not present heightened safety and soundness risk. Fair lending is safety and soundness.[18] Lenders must ensure that all mortgage loans - including mortgages to consumers and communities of color - take into account the borrower's ability to repay.[19] Moreover, lenders can improve their bottom line by reaching out to the millions of mortgage-ready Black and Latino consumers who represent the fastest-growing sector of the market.[20]

2. Use of Proceeds: The single-family mortgages in the Social Bonds should have features that promote equity in homeownership and affordable housing opportunities.

The ICMA describes the Use of Proceeds as follows:

> The cornerstone of a Social Bond is the utilization of the proceeds of the bond for eligible Social Projects which should be appropriately described in the legal documentation of the security. All designated eligible Social Projects should provide clear social benefits, which will be assessed and, where feasible, quantified by the issuer.[21]

To align with the Objective of creating equity in homeownership and affordable housing opportunities, the single-family mortgages in the Social Bonds:

- Should require:
    - Financial education and/or counseling, and

[18] *See, e.g.*, Michael Barr, Vice Chair of Supervision, Board of Governors of the Federal Reserve, *Remarks on the Banking and Financial Inclusion Conference* (Feb. 7, 2023), https://www.federalreserve.gov/newsevents/speech/barr20230207a.htm (stating that "[e]nsuring that all would-be borrowers are treated equally means more customers, more loans, and better returns for banks.").
[19] *See* Regulation Z, Ability to Repay Rule, 12 C.F.R. § 1026.43.
[20] *See* Laurie Goodman and Jun Zhu, *The Future of Headship and Homeownership*, Urban Institute (January 2021), https://www.urban.org/sites/default/files/publication/103501/the-future-of-headship-and-homeownership.pdf (estimating that between 2020 and 2040, there will be 6.9 million net new homeowners comprised of 4.8 million more Latino homeowners, 2.7 million more Asian and other homeowners, and 1.2 million more Black homeowners but 1.8 million fewer White homeowners).
[21] *See* ICMA Social Bond Principles at 3.

    - No Loan Level Price Adjustments;[22] and

- Should have one or more of the following features:
    - first-generation homebuyer programming,[23]
    - Special Purpose Credit Programs,[24]
    - small dollar mortgages, or
    - community land trusts.

Research has shown that these features are the most likely to reach and benefit underserved consumers and communities of color and advance affordable housing opportunities.[25]

Additionally, we recommend that if placed-based or property-based criteria are considered, protections against neighborhood gentrification are attached to those criteria.

Furthermore, FHFA should allow social bonds that are composed of loans based on borrower characteristics such as underserved communities of color. This level of specificity explicitly aligns with the Objective of creating equity and affordable housing opportunities for

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[22] Consumer and civil rights organizations have long advocated for the elimination of the LLPA increases and adverse market delivery fee increase that FHFA put in place in response to the 2008 financial crisis. *See* Housing Wire, *Fannie Mae Raises Fees, Changes Loan-Level Pricing* (Aug. 5, 2008) https://www.housingwire.com/articles/fannie-mae-raises-fees-changes-loan-level-pricing/. At this time, FHFA has eliminated that adverse market delivery fee increase and some LLPA increases, but some LLPA increases remain. *See, e.g.*, 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.

[23] Research has shown that first-generation homeownership programs can greatly strengthen equitable homeownership outcomes. There are roughly five million people in the United States who would qualify as first-generation homebuyers and are most likely to purchase a home. Of that number, 34% are Black, 29% are White, 26% are Latino, and 10% are Asian, Native American, and other. For more information, see Center for Responsible Lending and National Fair Housing Alliance, *First Generation: Criteria for a Targeted Down Payment Assistance Program* (2021) https://nationalfairhousing.org/wp-content/uploads/2021/06/crl-nfha-first-generation-jun21.pdf; and Center for Responsible Lending and National Fair Housing Alliance, *Adding Eligibility for First-Generation Homebuyers to the GSE Affordable Housing Programs* (2022) https://nationalfairhousing.org/wp-content/uploads/2022/04/First-Generation-for-GSE-Affordable-Programs-4-11.pdf .

[24] *See* Tim Lambert, *Using Special Purpose Credit Programs to Serve Unmet Credit Needs*, CFPB (July 19, 2022) https://www.consumerfinance.gov/about-us/blog/using-special-purpose-credit-programs-to-serve-unmet-credit-needs/; Lisa Rice, *Using Special Purpose Credit Programs to Expand Equality*, National Fair Housing Alliance (November 4, 2021) https://nationalfairhousing.org/using-special-purpose-credit-programs-to-expand-equality/.

[25] *See, e.g.*, NFHA and Advocates, *Comment Letter to FHFA re Enterprise 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.

communities who suffered from and are still suffering from underservice in the housing finance system.

In addition, we do not see a need for the Social Index as currently constructed by the GSEs.[26] The current format combines income, borrower, and property characteristics into a single score. Although this approach protects borrower privacy, it is not transparent enough to determine whether the use of proceeds will deploy the features most likely to help consumers and communities of color and to fulfill the Objective of creating equity in homeownership or affordable housing opportunities. Other organizations have raised concerns about the lack of transparency and about whether the Social Index will sufficiently incentivize investors looking for the features that decrease prepayment risk, such as the percentage of average median income, lower unpaid principal balances, lower credit scores, and higher debt-to-income ratios.[27]

Moreover, our position should not be construed as favoring an existing alternative. As our point above stresses, a format that focuses on well-fulfilling the Objective of creating equity in homeownership and affordable homeownership must be the goal.

3. <u>Process for Project Evaluation and Selection</u>: The process should be based on the lender's representation and warranties and testing.

According to the ICMA, the issuer should "clearly communicate to investors…the process by which the issuer determines how the projects fit within the eligible Social Project categories."[28] In this case, we agree with the GSEs' current process of having the lender provide representations and warranties that the mortgage meets the Single-Family Seller Guidelines as well as the Social Bond eligible mortgage criteria. Additionally, we recommend the GSEs test compliance.

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[26] Fannie Mae, *Single-Family Social Index* (Nov. 22, 2022), https://www.fanniemae.com/media/44446/display.

[27] *See, e.g.,* Structured Finance Association, Letter to Fannie Mae and Freddie Mac re Social Index for Single-Family MBS Pools (Jan. 5, 2023), https://structuredfinance.org/wp-content/uploads/2023/01/SFA-Letter-to-GSEs-on-Social-Index-website.pdf; Laurie Goodman, Janneke Ratcliffe, *Policy Thoughts about Single-Family Mortgage Social Bonds* Urban Institute (March 27, 2023), https://www.urban.org/sites/default/files/2023-03/Policy%20Thoughts%20about%20Single-Family%20Mortgage%20Social%20Bonds_0.pdf.

[28] *See* ICMA Social Bond Principles at 4.

4. **<u>Management of Proceeds</u>: The GSEs should ensure that the proceeds are exclusively dedicated to financing the purchase of mortgages that meet the eligibility criteria for Social Bonds.**

According to the ICMA, "[t]he net proceeds of the Social Bond, or an amount equal to these net proceeds, should be credited to a sub-account, moved to a sub-portfolio or otherwise tracked by the issuer in an appropriate manner, and attested to by the issuer in a formal internal process linked to the issuer's lending and investment operations for Social Projects."[29]

In this case, the GSEs should ensure that the proceeds from the sale of Single Family Social Bonds are <u>exclusively</u> dedicated to financing the purchase of mortgages that meet the eligibility criteria for the Social Bonds. It appears, with respect to ESG or Green Bonds, that in some cases, Fannie Mae and Freddie Mac have established frameworks that would allow proceeds to be used for the purchase of <u>any</u> type of mortgage that meets the requirements of their Seller/Servicer Guide, which may (or may not) include the mortgages eligible for the ESG Bond.[30] However, that approach is inconsistent with the ICMA definition of Social Bonds and the Management of Proceeds component. FHFA should ensure that any proceeds from the sale of Single-Family Social Bonds are used to finance the types of features and programs that create equity in homeownership.

5. **<u>Reporting</u>: The GSEs should report data in the most transparent manner possible while maintaining consumer privacy.**

According to the ICMA:

- Issuers should make, and keep, readily available up to date information on the use of proceeds to be renewed annually until full allocation, and on a timely basis in the case of material developments.
- This annual report should include a list of the projects to which Social Bond proceeds have been allocated, as well as a brief description of the projects, the amounts allocated, and their expected impact.
- Where confidentiality agreements, competitive considerations, or a large number of underlying projects limit the amount of detail that can be made available, the Social Bond Principles recommend that information is presented in generic terms or on an aggregated portfolio basis (e.g. percentage allocated to certain project categories).[31]

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[29] *See id.*
[30] *See, e.g.*, Freddie Mac, *Single-Family Green Bond Framework* (Nov. 2021), https://capitalmarkets.freddiemac.com/mbs/docs/Freddie_Mac_SF_Green_Bond_Framework.pdf (depicted above).
[31] *See* ICMA Social Bond Principles at 5.

The GSEs should report data in the most transparent manner possible to determine whether the Social Bond is achieving the Objective of creating equity in homeownership and affordable housing opportunities. For example, the GSEs should report:

- The number of borrowers receiving the loans, disaggregated by race, ethnicity, and income of the borrowers, and census tract of the property;
- The unpaid principal balance;
- The number of loans and the beneficiaries of first-generation homebuyer programs, Special Purpose Credit Programs, small dollar loans, and community land trust loans;
- The number of loans made where no LLPA was applied and the beneficiaries; and
- How the investments are likely to reduce racial homeownership and wealth gaps.

Reporting at the pool-level (rather than the loan-level) is sufficient for these purposes. Pool-level reporting also helps maintain borrower privacy and prevent re-identification. However, as systems evolve and technology allows, FHFA should consider ways of using more transparent data analyses and reports to demonstrate compliance with the Social Bond eligibility criteria while preserving borrower privacy.

6. External Review: The GSEs' Single Family Social Bonds should be reviewed by an external party.

According to the ICMA, issuers should:

- Pre-issuance: appoint an external review provider to assess the alignment of their Social Bond with the four components of the Social Bond Principles (i.e. Use of Proceeds, Process for Project Evaluation and Selection, Management of Proceeds and Reporting); and
- Post issuance: use an external auditor to verify the internal tracking and the allocation of funds from the Social Bond proceeds.[32]

Accordingly, we recommend that the GSEs' Single Family Social Bonds be reviewed by an external party at pre-issuance and post-issuance.

7. Additional Considerations: FHFA should also consider social disclosures.

In addition to Social Bonds, FHFA should consider the feasibility, efficiency, and effectiveness of social disclosures.[33] The goal of securing investor money for single-family mortgage Social

[32] *See id.* at 6.
[33] For more detailed analysis of alternatives, *see* Laurie Goodman, Janneke Ratcliffe, *Policy Thoughts about Single-Family Mortgage Social Bonds* Urban Institute (March 27, 2023),

Bonds is admirable, however FHFA should not consider the Social Bond framework as the only path for achieving goals that benefit the public. Moreover, while some investors may be motivated by the Social Objective alone, others may be more interested in features that reduce prepayment risk (and therefore increase the value to the investor).

For these reasons, FHFA can also help to achieve the Objective of creating equity in homeownership and affordable housing opportunities by encouraging the GSEs to use appropriate social disclosures. Disclosure of the features that indicate reduced prepayment risk as well as benefits to underserved consumers and communities of color may be efficient. In sum, we encourage FHFA to consider the most feasible, efficient, and effective means of encouraging the GSEs to create equity in homeownership and promote the use of Social Bonds that help reduce the racial wealth and homeownership gaps.

Thank you for considering our views.

Sincerely,

National Fair Housing Alliance
Americans for Financial Reform Education Fund
Center for Responsible Lending
National Consumer Law Center (on behalf of its low-income clients)
National Housing Resource Center
PolicyLink

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https://www.urban.org/sites/default/files/2023-03/Policy%20Thoughts%20about%20Single-Family%20Mortgage%20Social%20Bonds_0.pdf.