Housing Finance & Regulatory Affairs
Jessica R. Lynch
Vice President, Housing Finance
jlynch@nahb.org

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The Honorable Sandra Thompson
Director
Federal Housing Finance Agency
Office of the Director
400 7th Street, S.W.
10th Floor
Washington, D.C. 20219

Re: Fannie Mae and Freddie Mac Single-Family Mortgage Pricing Framework
Request for Input

Submitted via email to: https://www.fhfa.gov/AboutUs/Contact/Pages/Request-for-Information-Form.aspx

Dear Director Thompson:

On behalf of the National Association of Home Builders of the United States (NAHB), I welcome the opportunity to respond to the Federal Housing Finance Agency's (FHFA) request for input on the Fannie Mae and Freddie Mac single-family mortgage pricing framework. As conservator and regulator of Fannie Mae and Freddie Mac (the Enterprises), FHFA's important role of ensuring the Enterprises fulfill their mission to serve as a reliable source of liquidity and funding for housing requires the agency to oversee the Enterprises' pricing framework. We appreciate that FHFA is seeking industry input on establishing the Enterprises' single-family upfront guarantee fees and their appropriate return on capital. We are encouraged this is a step toward increased transparency in the pricing policy and guarantee fee-setting process.

NAHB is a Washington, D.C.-based trade association representing more than 140,000 members involved in the development and construction of for-sale single-family homes, including homes for first-time and low- and moderate-income home buyers, as well as the construction, ownership and management of multifamily rental housing, including affordable rental housing. The ability of the home building industry to meet the demand for housing, including addressing affordable housing needs, and contribute significantly to the nation's economic growth is dependent on an efficiently operating housing finance system. The nation's housing finance system must offer home buyers in all geographic areas access to affordable mortgage financing at reasonable interest rates through all economic conditions and provide financing for multifamily housing development to support affordable rental opportunities.

Background

Guarantee Fees

The Enterprises always have required a guarantee fee on the loans they acquire from lenders. The ongoing guarantee fee for the life of the loan is a component of the mortgage interest rate charged by the lender to the borrower on every mortgage loan. The fee is retained by the Enterprises for guaranteeing the timely payment of principal and interest to investors in the agency mortgage-backed securities (MBS) they issue and covers

projected credit losses from borrower defaults over the life of the loans, administrative costs, and a return on capital. The ongoing guarantee fee may differ between Fannie Mae and Freddie Mac and also by product type, i.e. 30-year versus 15-year fixed rate mortgage and adjustable rate mortgages. Ongoing guarantee fees are negotiated between the Enterprises and their lender customers and do not reflect any borrower characteristics. Before the Great Recession, large lenders often benefitted by negotiating volume-based discounts on their guarantee fees or discounts based on other terms. After the Great Recession, mortgage market reform advocates called for a level playing field on mortgage pricing. In 2019, then-FHFA director, Mark Calabria directed the Enterprises to end volume-based ongoing guarantee fee discounts for loans delivered through the Enterprises' cash windows to ensure smaller lenders would not be disadvantaged when selling their loans through the cash window.

Loan-level guarantee fees were first implemented by Fannie Mae and Freddie Mac in March 2008 as the Enterprises were struggling to remain solvent in the wake of the mortgage market meltdown. Loan-level guarantee fees are risk-based and based on individual borrowers' loan-to-value (LTV) and credit score. The decision to implement risk-based pricing at the loan level was made in reaction to the determination the Enterprises had not been charging high enough guarantee fees to cover their credit risk fully and therefore contributed to their insolvency. The loan-level risk-based fees are paid upfront when the loans are delivered to the Enterprises, but often are assessed by the lender to the borrower in the form of a higher interest rate on the mortgage loan.

Recently, the loan-level risk-based pricing framework is further differentiated by FHFA's determination of the "mission" value of the mortgage. The current pricing framework includes adjustments on pricing depending on whether a mortgage loan is classified as "mission-driven," "mission-remote," or a "core" loan.

Core loans are conforming, conventional mortgage loans for the purchase or limited cash-out refinance of owner-occupied properties; mission-remote loans are cash-out refinances, high balance mortgage loans and mortgage loans on second homes and investment properties. Mission-driven loans generally are those that qualify for duty-to-serve credit, loans to first-time homebuyers with income less than or equal to 100 percent of area median income or 120 percent of area median income in high-cost areas, and loans to borrowers using the Enterprises' affordable products. Whether a mortgage loan is classified as a core loan, mission-remote loan or a mission-driven loan is not relevant to the credit risk posed by the borrower.

Enterprise Capital

In July 2008, Congress passed the Housing and Economic Recovery Act (HERA) 2008 that created FHFA. HERA gave FHFA a broader range of supervisory authority than was permitted of the previous regulator, the Office of Federal Housing Enterprise Oversight. By regulation, HERA required FHFA to prescribe risk-based capital requirements for the Enterprises "to ensure that the Enterprises operate in a safe and sound manner, maintaining sufficient capital and reserves to support the risks that arise in the operations and management of the enterprises."

When the Enterprises were declared insolvent in September 2008, FHFA placed them in conservatorship, as allowed per its expanded authority, and named itself their conservator. As conservator, FHFA is granted the powers of the management, boards, and shareholders of Fannie Mae and Freddie Mac and required to "take such action as may be: (i) necessary to put the regulated entity in a sound and solvent condition; and (ii)

appropriate to carry on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity."[1] Also in its capacity as conservator, FHFA provides oversight of the Enterprises' guaranty fee pricing for single-family mortgage loan acquisitions.

In 2017, FHFA directed Fannie Mae and Freddie Mac to implement a conservatorship capital framework (CCF), to ensure they were making prudent business decisions. FHFA used the CCF to assess the Enterprises' guarantee fees, activities, and operations and to guard against the Enterprises making competitive decisions that could adversely impact safety and soundness. The CCF required Fannie Mae and Freddie Mac meet a specified minimum return on capital effective with February 2018 loan deliveries. The Enterprises could set different profit margins for different types of loans as long as they met their overall target rate of return on capital over their entire portfolio of loans.

Enterprise Regulatory Capital Framework

After notice and comment, FHFA adopted the Enterprise Regulatory Capital Framework (ERCF) for determining capital requirements and buffers in December 2020 and transitioned the Enterprises from the CCF to the ERCF in 2022. Per FHFA, the ERCF is "risk-sensitive," although FHFA has incorporated several requirements that are not related to the risk of the loans acquired by the Enterprises yet contributes to a substantially higher aggregate amount of capital required by the Enterprises compared to the capital required per the CCF. The aggregate increase reflects the following components of ERCF that are not risk-based: (i) a risk-weight floor minimum requirement for single-family mortgage exposures, (ii) a countercyclical adjustment to single-family credit risk capital requirements that elevates single-family requirements when real single-family house prices are significantly above their long-run trend, and (iii) capital buffers, which include capital buffers for stability and stress.

According to FHFA, the risk-insensitive components of the ERCF result in the ERCF having a relatively flat risk gradient across credit characteristics and this results in loans with less credit risk having more significant capital increases than loans with more credit risk characteristics than was the case in other capital proposals. Therefore, FHFA's recalibration of the Enterprises' pricing matrices earlier this year to align pricing with the ERCF caused certain low risk loans to have upfront guarantee fees increased while some higher risk loans had upfront guarantee fees reduced.

That said, only FHFA has the detailed data and models to explain fully how the Enterprises' current loan-level risk-based pricing aligns loan-level risk with the ERCF.

NAHB Comments

NAHB appreciates FHFA requesting input on the single-family mortgage pricing framework. Earlier this year, our members expressed concern regarding the revision of loan-level risk-based fees charged by Fannie Mae and Freddie Mac that went into effect on May 1, 2023. NAHB members were particularly troubled by the increased fees on mortgage loans to home buyers with high credit scores and making significant down payments.

[1] History of Fannie Mae and Freddie Mac Conservatorships.

Loan-level Risk-based Pricing

FHFA has the duty to promote safety and soundness of the Enterprises and foster liquid, efficient, competitive and resilient national housing finance markets. It is in pursuit of these goals that the ERCF was finalized. Achieving these goals includes overseeing the Enterprises' single-family mortgage guarantee pricing and ensuring the Enterprises are pricing their credit risk appropriately to meet the capital requirements per the ERCF. Some stakeholders have raised the concern that the risk-insensitive components of the ERCF contribute to an unnecessarily high level of required capital and therefore tying loan-level risk-based guarantee fees to the ERCF would cause the guarantee fees to be unnecessarily high relative to the loan-level risk. However, as the Enterprises are complying with the ERCF, it is reasonable for FHFA to link upfront guarantee fees to the ERCF, using the ERCF as a basis for pricing credit risk at the borrower/loan level.

Holding capital comes at a cost. As capital requirements have increased significantly with the implementation of the ERCF, the Enterprises have increased fees to generate the required capital, pay for the cost of holding increased capital and meet their targeted rate of return on capital. NAHB generally supports loan level risk-based pricing to allow the Enterprises to meet their costs associated with the ERCF as well as their statutory duties to promote housing affordability and stability and support low- and moderate-income borrowers while remaining safe and sound. NAHB fears that eliminating loan-level risk-based upfront guarantee fees and reverting back to a one-size-fits-all ongoing guarantee fee would cause a corresponding increase in the ongoing guarantee fees for all borrowers in order to meet the capital requirements and targeted rate of return per the ERCF.

NAHB does have a concern as to how the market is to know whether the upfront guarantee fees are "priced accurately for risk." We urge FHFA to provide transparency in the data and decision making that determines the pricing across the loan-level risk categories relative to the ERCF capital standards.

Mission-remote loans are charged an additional upfront fee above the loan-level risk-based upfront fee charged based on the borrower's credit score and LTV. FHFA representatives have indicated this additional fee on mission-remote loans allows the Enterprises to charge a lower fee or even no fee on many creditworthy mission-driven loans. The charters of both Fannie Mae and Freddie Mac stipulate they are authorized "to provide 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)…"

However, it is not clear that the Enterprises use only the additional upfront fee on mission-remote loans to pay for the elimination of fees on all or most mission-driven loans. Again, we urge FHFA to provide transparency on whether the additional upfront fee on mission-remote loans does compensate for the elimination of fees on the mission-driven loans or if the fees on core loans also are subsidizing mission loans. While this subsidy on mission loans currently is factored into the loan level price matrices of the Enterprises, NAHB believes before any additional price increases would accrue to core loans or mission-remote loans, FHFA should reconsider whether all mission loans should be exempt from upfront loan-level risk-based guarantee fees. Pricing credit risk appropriately requires charging higher guarantee fees for loans that have lower credit scores and low downpayments than for loans with higher credit scores and larger downpayments.

Return on Capital

Although the Enterprises have a target return on capital that informs pricing decisions, this target rate of return is not transparent. FHFA has stated that categories of loans will have varying rates of return as long as the Enterprises meet the overall target rate of return on all acquisitions. FHFA's annual g-fee report to Congress does not inform stakeholders whether the guarantee fees on categories of loans have generated a loss or profit relative to a target rate of return. FHFA should provide stakeholders transparency on expectations for the profitability of certain loans and therefore transparency on the decision of fees to charge.

Going forward, FHFA and the Enterprises may periodically assess their loan-level risk-based upfront guarantee fees on the different segments of their loan acquisitions to ensure they are meeting targeted rates of return. FHFA should allow NAHB and other housing industry stakeholders to provide feedback when these assessments may cause FHFA and the Enterprises to contemplate fee and program changes that will impact home buyers and home owners. Further, prior to changes being announced that will impact home builders and new home buyers, we ask that NAHB be given some advance notice of these actions so we can anticipate possible concerns and prepare to mitigate potential negative reactions.

Conclusion

NAHB appreciates the significant value the Enterprises bring to the housing market. This is particularly important at a time when housing affordability continues to be a challenge. All borrowers have faced the same recent volatility and uncertainty in interest rates over the last year that have raised mortgage payments and reduced affordability of new home purchases. NAHB urges caution before FHFA considers further changes and additional increases to guarantee fees. Now is not the time to make housing even more unaffordable for any borrowers. If FHFA finds that pricing is not adequately covering risk or meeting the ERCF, FHFA may need to reconsider some level of risk-based pricing on mission loans, while looking at additional avenues to support borrowers limited by income or by wealth, or reconsider whether FHFA should continue to tie loan-level risk-based guarantee fees to the ERCF.

Sincerely,

Jessica R. Lynch