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August 14, 2023

Ms. Sandra L. Thompson, Director
Federal Housing Finance Agency
Office of Capital Policy
400 7th Street SW, 9th Floor
Washington, DC 20219
Re: Request for Input on the Enterprises' Single-Family Mortgage Pricing Framework

Dear Ms. Thompson,

The Center for American Progress ("CAP") welcomes the opportunity to submit comments in response to the Federal Housing Finance Agency (FHFA)'s request for input (RFI) on the Enterprises' Single-Family Mortgage Pricing Framework. CAP is an independent, nonpartisan policy institute dedicated to improving the lives of Americans through bold, progressive ideas and action. As part of its core mission, CAP conducts research and develops policy ideas that help enhance the economic security of all Americans, boost their opportunities for advancement, and promote equality.

CAP commends FHFA's recent adjustments to risk-based loan pricing, particularly those to upfront guarantee fees for single-family home mortgage loans purchased by Fannie Mae and Freddie Mac. The proposed changes are consistent with the mission of the GSEs to always serve all markets and to support access to affordable homeownership in underserved low-income communities and communities of color. These changes have the potential to facilitate access to homeownership for first-time homebuyers, particularly low-income borrowers and borrowers of color. More steps, however, need to be taken to increase homeownership among underserved groups. Some recommendations on steps that the FHFA can take to contribute to racial equity in access to homeownership are listed after the background information provided below.

Background

Fannie Mae and Freddie Mac (the GSEs) acquire single-family loans from sellers and bundle these loans into mortgage-backed securities (MBS), which are then sold into the secondary market. The GSEs assume the credit risk on these loans and ensure that investors receive principal and interest payments. In exchange for this guarantee and to cover other administrative costs and the cost of holding capital, the GSEs charge a guarantee fee (G-fee). Guarantee fees come in two forms: ongoing and upfront. Both types of fees are passed on to the borrower by the lender as they are factored into a loan's interest rate paid by the borrower. While ongoing fees are paid monthly until the loan is paid off, upfront fees consist of one-time payments that sellers make to the GSEs upon loan delivery. Upfront fees are typically used to account for specific risk attributes. Both Fannie

Mae and Freddie Mac determine their own estimated costs of guaranteeing a loan based on a series of cost variables and on a target rate of return on capital. Cost variables include borrowers' credit scores and LTV ratios, which directly affect Fannie Mae's loan-level price adjustments (LLPAs) and Freddie Mac's Credit Fees in Price. The inclusion of these variables took effect in 2008, when the Great Recession and GSE conservatorship led to major changes in the structure and level of G-fees.

In 2021, the FHFA's Enterprise Regulatory Capital Framework (ERCF) became effective. Since 2022, the Enterprises have transitioned from Conservatorship Capital Framework (CCF) to the ERCF to measure capital requirements and buffers. The ERCF changes capital requirements across credit characteristics using base grids and the FHFA expects the Enterprises to set guarantee fees consistent with the amount of the regulatory capital requirements determined using the ERCF, which in the aggregate are higher than in the past.[1] Risk weights in the base grids are determined using loan-to-value (LTV) ratios and credit scores. The ERCF includes reduction to risk-based capital requirements for loans with LTV ratios above 80 percent. Importantly, the updated guarantee fee pricing framework increases support for low-income and low-wealth creditworthy borrowers with limited resources for downpayments. In October 2022, FHFA announced the elimination of upfront guarantee fees for mortgage loans made to many first-time homebuyers, low-income borrowers, and underserved communities and lower upfront fees for other groups. These changes are reflected in the recalibrated fee grids that were updated in May 2023. Based on the current adjustments, for loans with LTV ratios greater than 80 percent, a borrower with a credit score lower than 640 pays 1.875 percentage points more than a borrower with a credit score equal to or greater than 740 compared with 3 percentage points more before the adjustments were implemented.

The disparate impact of risk-based pricing through LLPAs on underserved homebuyers

Risk-based pricing through LLPAs has had a disparate impact on underserved borrowers, especially borrowers of color, since its introduction. Risk-based pricing has important racially disparate impacts because people of color, particularly Black Americans, are more likely than non-Hispanic white Americans to lack the financial resources needed to make large down-payments and are more likely to have lower credit scores due to generations of housing and labor market discrimination.[2] There are significant racial disparities in credit scores. In 2021, the average FICO score was 677 for Black people and 701 for

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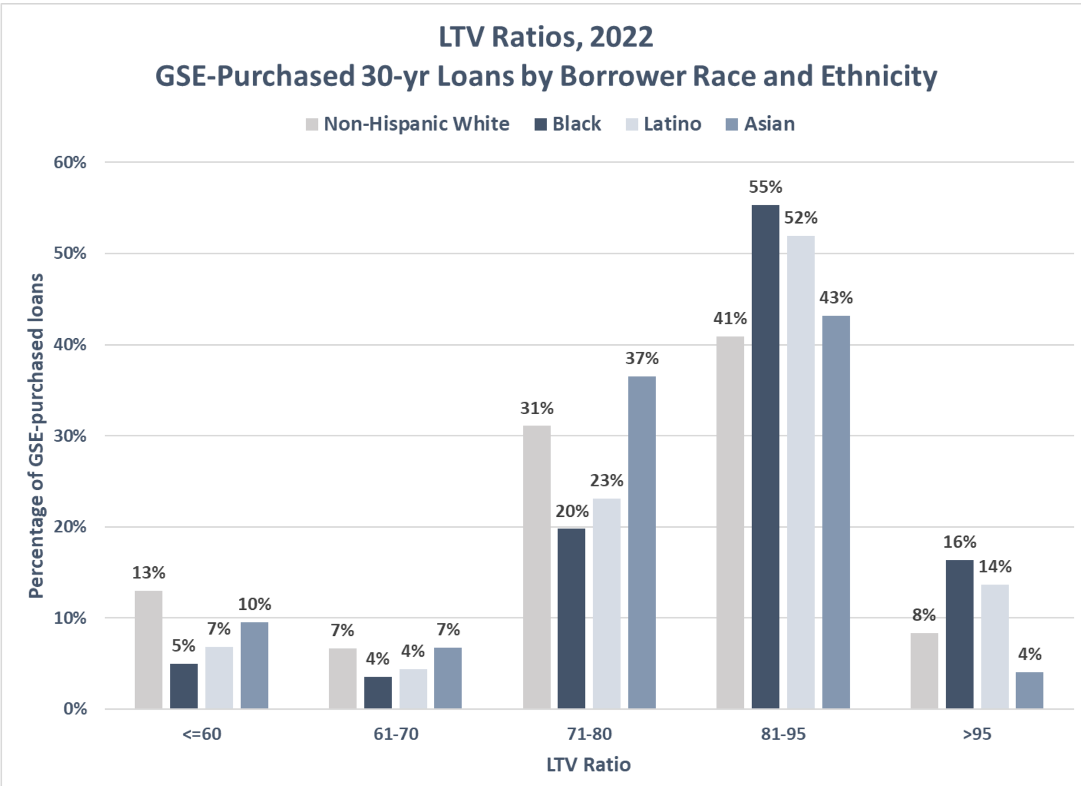
[1] https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/GFee-Report-2021.pdf

[2] Dan Immergluck, "Racial Justice and the Mortgage Market: Recommendations to the Biden Administration Regarding the Future of the GSEs," USI Publications 54, 2021, available at https://scholarworks.gse.edu/urban_studies_institute/54. See also Michelle Singletary, "Credit scores are supposed to be race neutral. That's impossible," The Washington Post, October 16, 2020; Adam Levitin, "How to Start Closing the Racial Wealth Gap," The American Prospect, June 17, 2020, available at https://prospect.org/economy/how-to-start-closing-the-racial-wealth-gap/. fees

Hispanic people compared with 734 for non-Hispanic white people.[3] Credit scores not only determine which applicants receive a loan but also the cost of that loan product.

In 2022, 55 percent and 52 percent of GSE-purchased 30-year loans to Black and Hispanic borrowers, respectively, had an LTV ratio greater than 80 compared with 41 percent of GSE-purchased loans to non-Hispanic white borrowers (Figure 1).

Figure 1

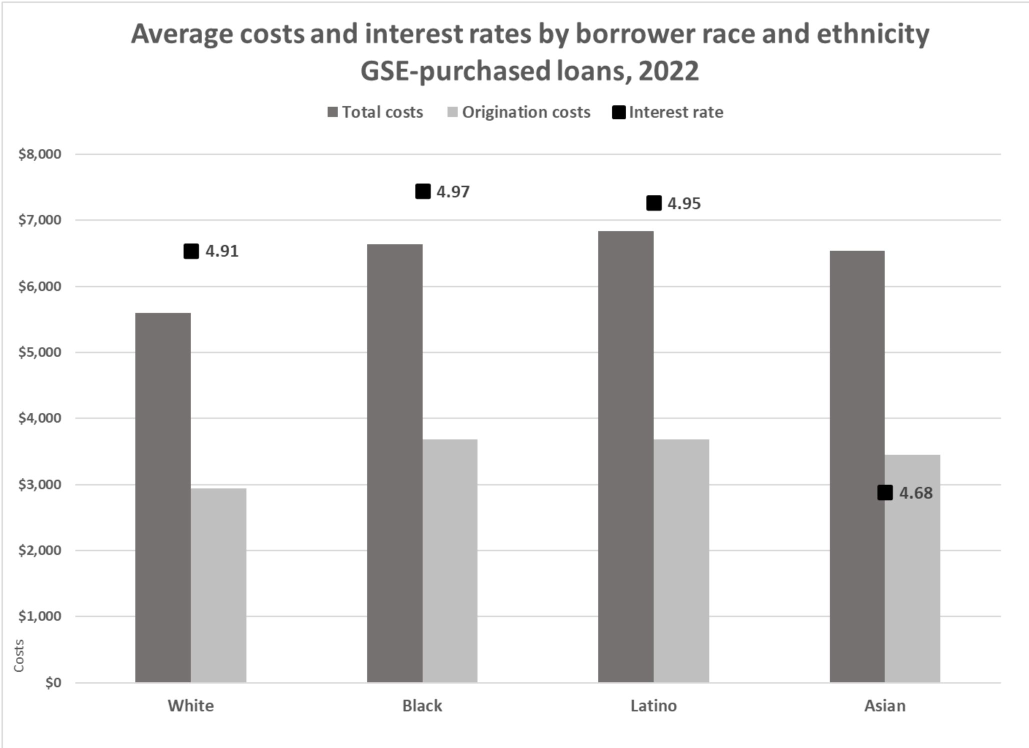


Source: CAP calculations of 2022 Home Mortgage Disclosure Act (HMDA) data.

CAP analysis of 2022 HMDA data indicates that total costs for loans purchased by the GSEs were an average of $6,638 for Black borrowers and $6,841 for Hispanic borrowers compared with an average of $5,595 for non-Hispanic white borrowers (Figure 2). Average interest rates charged to Black and Hispanic borrowers were also higher than those charged to non-Hispanic white and Asian borrowers.

[3] Kristen Broady, Mac McComas, and Amine Ouazad, "An analysis of financial institutions in Black-majority communities: Black borrowers and depositors face considerable challenges in accessing banking services." (Washington: Brookings, November 2021), available at https://www.brookings.edu/articles/an-analysis-of-financial-institutions-in-black-majority-communities-black-borrowers-and-depositors-face-considerable-challenges-in-accessing-banking-services/.

Figure 2



Source: CAP calculations of 2022 HMDA data.

Gaps in total costs and origination costs of GSE-purchased loans by race and ethnicity are consistent across different LTV brackets (Table 1). These results are consistent with the findings of a study conducted by Fannie Mae on closing costs for first-time borrowers and low-income homebuyers.[4] The study indicates that closing costs are disproportionally high for first-time, low-income, and minority borrowers relative to the home purchase price. In particular, the closing costs net of credits for Black and Hispanic borrowers are a larger share of sale price than for Asian and non-Hispanic white borrowers. Black and Hispanic borrowers also exhibit lower reserve levels.[5]

[4] Nuno Mota and Mark Palim, "Barriers to Entry: Closing Costs for First-Time and Low-Income Homebuyers," Fannie Mae, December 2021, available at https://www.fanniemae.com/media/42286/display; Robert Bartlett et al. "Consumer-lending discrimination in the FinTech Era," Journal of Financial Economics 143 (1) (2022): 30-56, available at https://www.sciencedirect.com/science/article/abs/pii/S0304405X21002403.

[5] Nuno Mota and Mark Palim, "Barriers to Entry: Closing Costs for First-Time and Low-Income Homebuyers."

Table 1

Distribution of average costs and interest rates by LTV ratio and borrower race/ethnicity
GSE-purchased 30 year-term loans, 2022

	Non-Hispanic White borrowers			Black borrowers		
LTV brackets	**Total costs**	**Origination costs**	**Interest rate**	**Total costs**	**Origination costs**	**Interest rate**
<=60	$4,833	$2,475	4.79	$5,355	$2,905	4.80
60-70	$5,773	$3,198	4.86	$6,611	$3,922	4.88
70-80	$5,890	$3,249	4.89	$7,194	$4,357	4.97
80-95	$5,757	$2,927	4.94	$6,939	$3,795	4.98
>95	$4,707	$2,276	5.04	$5,339	$2,663	4.99

	Latino borrowers			Asian borrowers		
LTV brackets	**Total costs**	**Origination costs**	**Interest rate**	**Total costs**	**Origination costs**	**Interest rate**
<=60	$5,677	$2,978	4.78	$5,882	$2,976	4.57
60-70	$7,001	$3,985	4.88	$6,959	$3,856	4.62
70-80	$7,321	$4,236	4.92	$6,738	$3,686	4.64
80-95	$7,078	$3,744	4.98	$6,512	$3,339	4.73
>95	$5,654	$2,779	5.01	$5,798	$2,947	4.89

Source: CAP calculations of 2022 HMDA data.

Recommendations

High mortgage costs, along with a shortage of affordable homes for sale, a legacy of racial discrimination in the housing market, and the related racial wealth gap continue to represent major barriers for people of color in accessing homeownership. As a result, people of color, especially Black and Hispanic people, continue to lag far behind non-Hispanic Whites in terms of homeownership rates. U.S. Census data indicate that at the end of 2022, the Black homeownership rate was 45 percent, and the Hispanic homeownership rate was 48.6 percent compared with a 74.4 percent rate for non-Hispanic whites (Figure 3). Closing the homeownership gap is an urgent policy priority across the entire housing eco-system. This includes an important role for the GSEs, which own or guarantee more than 60 percent of the nation's home mortgages, including more than half of single-family home mortgage loans.[6] According to HMDA data, in 2022 only 4 percent and 10 percent of GSE-purchased mortgages were loans to Black and Hispanic homebuyers, respectively, compared with 58 percent of GSE-purchased loans that went to non-Hispanic white borrowers.[7]

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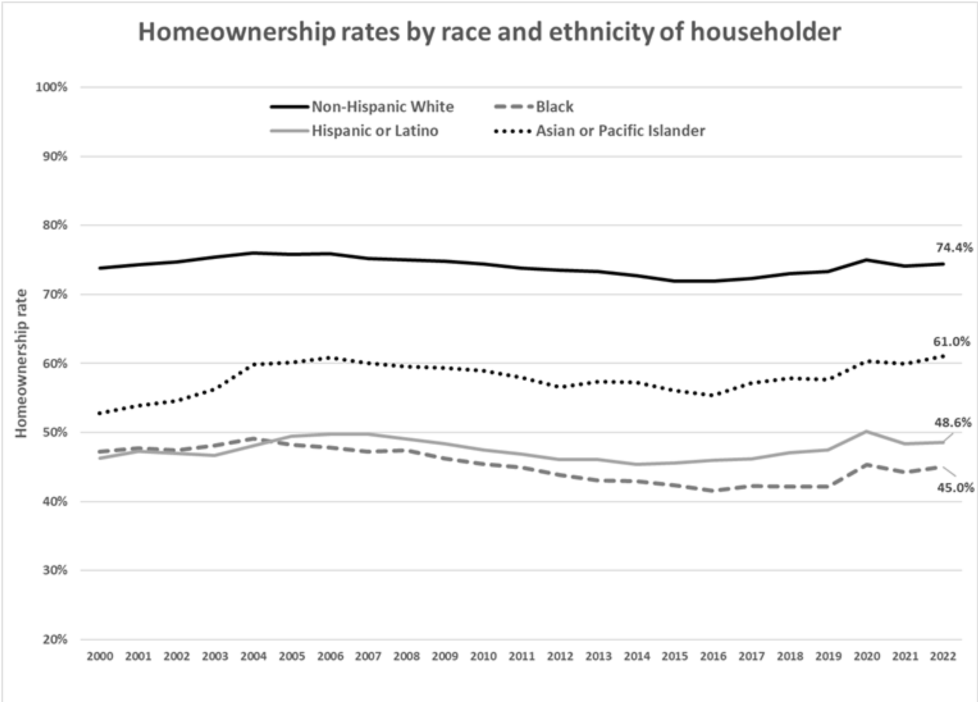
[6] Federal Housing Finance Agency, "What Types of Mortgages Do Fannie Mae and Freddie Mac Acquire?", April 14, 2021, available at https://www.fhfa.gov/Media/Blog/Pages/What-Types-of-Mortgages-Do-Fannie-Mae-and-Freddie-Mac-Acquire.aspx.

[7] CAP calculations of 2022 HMDA data.

Figure 3



Source: U.S. Census Bureau, Current Population Survey/Housing Vacancy Survey, March 15, 2023

To support the GSEs's goal of contributing to racial equity in access to homeownership, CAP offers the following recommendations in response to FHFA's RFI on single-family mortgage pricing.

1) <u>Eliminate LLPAs</u>.

   FHFA's recalibration of up-front fees represents a crucial step toward lowering mortgage closing costs for underserved borrowers, but it does not eliminate risk-based pricing. CAP recommends that FHFA eliminate up-front fees so that historically disadvantaged borrowers across the credit spectrum stop incurring unfairly and arbitrarily imposed closing costs.

2) <u>Allow the GSEs to accept lower returns from historically underserved borrowers</u>.

   FHFA should allow the GSEs to accept lower returns from low- and moderate-income and first-time homebuyers, particularly among borrowers of color, throughout the life of the loan to lower the total costs of mortgages for these groups and boost their access to homeownership. For example, FHFA should take steps to restructure ongoing guarantee fees, which are higher than up-front fees and vary by borrower risk factor, so that risk is pooled. This would allow pricing to be maintained leveled across credit categories rather than priced into individual loans based on credit risk.

3) Revisit FHFA's Private Mortgage Insurer Eligibility Requirements (PMIERs).

The GSEs require private mortgage insurance for all mortgages with downpayments of less than 20 percent. The mortgage insurance allows the GSEs to charge lower LLPAs. The borrower, however, still pays a fee for the insurance. This, in turn, is added to the total mortgage cost for borrowers. Private mortgage insurance is often a larger component of the total cost of mortgages for underserved borrowers. FHFA's PMIERs, which are risk-based by LTV and credit score, establish capital standards for mortgage insurance providers of GSE-purchased loans. FHFA should revise the standards for capital required of insurers and reduce differential mortgage insurance pricing across loans to reduce total costs for underserved borrowers.[8]

Thank you for the opportunity to submit comments in response to the RFI on the Enterprises' Single-Family Mortgage Pricing Framework. Any questions regarding this comment letter or related issues should be directed to Michela Zonta at mzonta@americanprogress.org.

Sincerely,

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Senior Policy Analyst, Housing Policy, Inclusive Economy, Center for American Progress

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[8] Janneke Ratcliffe, "Understanding the impact of recent changes to the Federal Housing Finance Agency's Loan-Level Price Adjustment." Statement before the Subcommittee on Housing and Insurance, Financial Services Committee, United States House of Representatives, May 17, 2023, available at https://docs.house.gov/meetings/BA/BA04/20230517/115954/HHRG-118-BA04-Wstate-RatcliffeJ-20230517.pdf; Jim Parrot and Janneke Ratcliffe, "Fannie Mae and Freddie Mac's New Pricing In Not Punishing Those with Better Credit: Follow the Numbers." (Washington: Urban Institute, April 2023), available at https://www.urban.org/urban-wire/fannie-mae-and-freddie-macs-new-pricing-not-punishing-those-better-credit-follow-numbers.