Credit Score Request for Input

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To: **Federal Housing Finance Agency (FHFA)**
From: **Rocky Mountain Institute (RMI)**
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INTRODUCTION

RMI appreciates the opportunity to provide comments and recommendations to FHFA on its Credit Score Request for Input (RFI). RMI previously provided comments and recommendations to FHFA in 2017 regarding the Enterprises' Duty to Serve Action Plans, focusing specifically on lending and underwriting interventions that can promote energy efficiency for affordable housing preservation. RMI has had productive dialogues and relationships with both Enterprises and looks forward to continuing to collaborate and support their goals under Duty to Serve.

We urge FHFA to consider how any change to credit score requirements aligns or fails to align with the Enterprises' Duty to Serve goals to address the concerns of low- to moderate-income (LMI) households and to improve their services for those households. FHFA is considering an update to credit score requirements with the goal of better predicting and ultimately reducing mortgage default risk. However, FHFA acknowledges in the RFI that the Enterprises' own empirical findings revealed only marginal benefits to requiring a credit score other than Classic FICO, and that each Enterprise's automated underwriting system more precisely predicted mortgage defaults than third party credit scores alone because of their more holistic scope. To that end, RMI views the currently contemplated updates as an opportunity to dovetail efforts with Duty to Serve commitments by incorporating energy costs into underwriting processes and thereby addressing their material hidden risks and benefits.

BACKGROUND

According to FICO's website, more than **50 million** American adults do not have a FICO score. A significant portion of this "credit invisible" market is likely made up of LMI consumers and those who have suffered economic difficulties, in addition to students, recent immigrants, and other demographics. Both Enterprises are committed to better serving these consumers through various improvements over the next few years, yet all four options for updating credit score requirements described in the RFI would fail to address the needs of this substantial portion of the population.

Based on 2016 data from the U.S. Bureau of Labor Statistics, consumers earning less than $50,000 per year spend **10.1%** of their gross income on utilities—more than on property taxes (4.8%) and insurance (4.3%) *combined*. Across all income categories nationwide, these proportions are 3.3%, 2.6%, and 1.9%, respectively[1]. Additionally, a 2017 white paper by ATTOM Data Solutions, curator of the nation's largest multi-sourced property database, and UtilityScore, a software provider focused on residential utilities, shows that utility costs (electricity, natural gas, water and sewer) add **25%** to monthly housing costs for all homeowners nationwide based on zip code level research. Nonetheless, existing mortgage underwriting processes account only for proposed property taxes and insurance—not utilities. Utility costs represent a significant burden to homeowners,

[1] U.S. Bureau of Labor Statistics 2016 Consumer Expenditure Survey; utilities category includes electricity, fuels, and water; insurance figures also include maintenance costs.

LMI consumers in particular, and present a growing risk to lenders if left unaddressed. Another study by UNC's Center for Community Capital and IMT found **32%** lower mortgage default risks in energy efficient homes.

Other mortgage actors do consider utilities. For example, the Veterans Administration's loan analysis input fields include a $0.14 per square foot assumption for utilities (and maintenance) costs nationwide. In the United Kingdom, 90% of mortgage lenders use implied energy costs based on data from the Office of National Statistics. It is of note that the Enterprises' own Loan Modification practices include the utilization of a family budget when determining a troubled borrower's ability to pay; this budget explicitly includes utility costs, which are in many cases a large proportion of their fixed monthly expenses. But this information can be accounted for upfront and not just during times of distress. Given the growing pool of home energy data available in the U.S. and the increasing use of home energy audits and automated algorithm-based estimates, the Enterprises have an opportunity to do it better. **Solving this will address the foundational issue underneath seeking improved credit scores: to more accurately assess borrowers' ability to pay their mortgage.**

OUR COMMITMENT

RMI supports FHFA's goal to foster innovation in credit scoring. But we believe that accounting for energy cost risks in underwriting for LMI and non-LMI borrowers alike would have more meaningful and wider spread risk mitigation impacts than marginal improvements in credit score requirements. RMI is developing a proposed framework for the Enterprises to leverage available home energy data sources and seamlessly integrate this information into their automated underwriting systems. We would welcome the opportunity to discuss this approach directly with the FHFA and Enterprises in order to engage in more targeted research and innovation that would result in the most useful and impactful outcomes.

As always, RMI would like to extend its technical expertise, stakeholder facilitation, and other skillsets to support FHFA and the Enterprises in their efforts to continue improving processes and product offerings, both under Duty to Serve and more broadly. Please contact Jacob Corvidae at jcorvidae@rmi.org if you would like to discuss the contents of this letter or our offer to support your efforts further.

Our three comments and associated recommendations below address specific questions laid out in the RFI.

Comment 1

Question A1.6: Do you have a recommendation on which option FHFA should adopt?

Overall Comment:

Of the four options presented in the RFI, none account for the material risk posed by energy or utility costs. This risk should be integrated into the Enterprises' automated underwriting systems separately with potentially wider spread risk mitigation benefits than updating credit score requirements for the portion of the borrower universe that has credit history. The Enterprises' underwriting systems already account for non-credit score based issues around a borrower's ability to pay, which may explain why they are able to more precisely predict mortgage payment success. As such, incorporating utility data there would further improve that functionality. It would also begin to address the lack of inclusion of rent, utilities, and telecommunications payment information in the existing credit scores.

In the event FHFA moves forward with updating credit score requirements, Option 1 may be simplest (although we leave that determination to FHFA), but only if utility information is incorporated into the underwriting process. Otherwise, Option 4 (waterfall) with FICO XD (not currently in consideration) should be considered for the secondary credit score in order to best address the needs of "credit invisible" consumers. As mentioned in the RFI, FICO XD pulls data from the National Consumer Telecom & Utilities Exchange (NCTUE) to produce reliable FICO scores for borrowers based on their payment histories for utilities, cable, phone, and other services. NCTUE has 90 members including electric, gas, and water utilities, in addition to cable, home security, internet, phone, and satellite TV companies. FICO XD seems to address the needs of FHFA and the Enterprises while also providing coverage and protection to LMI and other "credit invisible" consumers under Duty to Serve.

RMI Recommendations:

- Incorporate utility information into the Enterprises' automated underwriting software to improve the accuracy of predicting mortgage performance under any of the proposed options—especially as an alternative path for the "credit invisible" who have no credit score, but in most cases do have utility payment history.
- If utility information is not incorporated into the Enterprises' underwriting software, then we would recommend Option 4 with FICO XD as the secondary credit score option to ensure a better model to address LMI households and the "credit invisible" and to align with the goals of Duty to Serve.
- Contact RMI to discuss a potential framework under development for the Enterprises to incorporate energy costs into underwriting by integrating available data sources into their automated systems; further discussion with FHFA and the Enterprises can refine RMI's efforts to this end.

Comment 2

Question A1.7: Do you have additional concerns with or insights to share on the Enterprises updating their credit score requirements?
Overall Comment: The Enterprises' own Loan Modification practices include the utilization of a family budget when determining a troubled borrower's ability to pay; this budget explicitly includes utility costs, which are in many cases a large proportion of their fixed monthly expenses. But this information can now be accounted for upfront and not reserved for periods of borrower distress. The FHFA expresses a priority in the RFI for fostering innovation in credit scoring, but it appears to be advancing a "closed system" with two FICO scores and a VantageScore that are all closely related. The Veterans Administration loans performed significantly better than conventional loans in the recent post-recession period; some have attributed this to the inclusion of operating and utility costs in their underwriting process. The growth of data availability and assessments to create customer profiles suggests that new approaches from other companies may be able to create viable innovation competition that better addresses the "credit invisibility" gap. Given that the challenges of introducing a system that allows for more than one credit score to be used are sufficient to warrant keeping the focus on a single credit score, other approaches to allow innovators access to the market may need to be considered. These could include mechanisms for piloting other approaches in interested markets, or by setting standards of better results that would warrant initiating the use of the other scores.
RMI Recommendations: • Research the relationship between underwriting data and data used by the Enterprises to determine ability to pay in a Loan Modification. • Foster greater innovation by evaluating the use of FICO XD and considering other significant credit variables such as utilities, or by creating more specific pathways that innovators who better address the "credit invisibility" gap can enter the market. • Research Veterans Administration loan performance to better understand the significance of operating and utility costs in their underwriting.

Comment 3

Question A2.7: What impact would any of the credit score options have on a need for consumer education? What impact would the multiple credit score options (options 2-4) have on consumers? Are there steps that FHFA, the Enterprises, or stakeholders could take that would mitigate any confusion about multiple credit score options?
Overall Comment: Many LMI consumers and first-time home buyers do not fully understand the credit scoring process. They need to better understand how their behavior translates into their credit score. A new reliance by the Enterprises' on multiple credit scores from very similar methodologies may add further confusion for consumers and does not offer them another viable option that better reflects their true credit standing. Among credit score options, LMI and other "credit invisible" consumer considerations seem to be only addressed through FICO XD.
RMI Recommendations: • Develop and market free and easy-to-use online tutorials for consumers to add their credit information (or elements of it) to understand how they may impact their overall credit score and to address practical questions (e.g. is it better to pay cash for many small purchases to keep my overall credit usage as a lower percentage of my monthly income; how do student loans impact my score; etc). • Develop an outreach strategy to expand the coverage and utilization of FICO XD or new entrants to the industry that better account for "credit invisibility". • Develop and finance a curriculum with the national consumer counseling agencies to help consumers build an acceptable FICO score or gather the information to populate a nontraditional score beyond current practices that rely primarily on rental payments.