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August 28, 2020

The Honorable Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
400 Seventh Street SW
Eigth Floor
Washington, DC 20219
Submitted via Regulations.gov / RegComments@fhfa.gov

RE: Comments/RIN 2590–AA95

To Whom It May Concern:

On behalf of Minnesota Housing, we appreciate the opportunity to comment on the Advanced Notice of Proposed Rulemaking regarding the new regulatory capital framework for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac).

Minnesota Housing is a state Housing Finance Agency (HFA). In 2019, we financed homeownership mortgages for nearly 5,300 low and moderate income households in Minnesota. A strategic priority of our agency is to address the persistent racial disparities in homeownership. Thirty four percent of mortgage loans financed by Minnesota Housing programs went to people of color and indigenous communities (POCI)in 2019, this compares to just 16% in the marketplace as a whole.

We are concerned the proposed risk multipliers will disproportionately increase the borrowing costs for low and moderate income borrowers and POCI, and consequently reduce their ability to achieve sustainable homeownership. The proposed risk multipliers do not factor in the comparatively good performance of HFA loans despite having many of the characterisitics the framework associates with risk, and as a result the framework would leave very little space for state HFAs to affordably serve this already underserved market. This disproportionate impact goes directly against FHFA's stated value of promoting diversity in its' business practices and those of its regulated entities, and would force Fannie Mae and Freddie Mac to abandon their missisons to provide access to affordable mortgage financing in all markets.

Increasing the cost of these mortgage loans to Fannie Mae and Freddie Mac (the GSEs) is expected to cause them to raise guaranty fees to state HFAs who will raise interest rates to mortgage borrowers in order to maintain sustainable margins. Simply put, for every 10 basis points of increase in GSE guaranty fees, HFAs will need to increase mortgage rates to the borrower by 10 basis points, reducing affordability. We would expect a shift in the lower-income market share to the Federal Housing Administration (FHA), which may not be sustainable to FHA's insurance fund and likely would ultimately increase mortgage costs and further reduce homeownership opportunities to underserved populations.

We examined how the proposed risk multipliers would impact our Minnesota Housing borrowers, and over the last 12 months the vast majority of our borrowers would have received significantly worse pricing under the proposed framework, which may have priced them out of the market.

- 92% of Minnesota Housing conventional borrowers would have been subject to the "subordination" risk multiplier because the borrower receives a second mortgage loan to assist with downpayment and closing costs. This subordinate financing is vital to expanding homeownership opportunities to credit-worthy borrowers who can afford a monthly mortgage payment but have struggled to save up enough money to cover the upfront costs of purchasing a home

- The vast majority of Minnesota Housing conventional borrowers had loan to value ratios over 95%, which would have triggered a higher risk rating. The proposed framework overstates the risk of higher loan to value loans because it states that it "included MTMLTV buckets beyond 95 percent to account for adverse changes in home prices subject to origination, as well as to account for the inclusion of streamlined refinance loans in the single-family segment," which overlooks Fannie Mae and Freddie Mac's state HFA products that are designed to serve borrowers with loan to value ratios up to 97%.

- Approximately 40% of Minnesota Housing conventional borrowers would be subject to the credit risk multiplier for debt-to-income ratios above 40%.

- Approximately 60% of Minnesota Housing conventional borrowers would be subject to a much less significant credit enhancement multiplier because they are getting a 30 year amortizing loan with charter-level mortgage insurance coverage instead of the guide-level coverage. A borrower's income level is the only factor that determines whether a borrower must pay the guide-level coverage or charter-level coverage, so this proposed structure inherently penalizes lower-income borrowers.

Fannie Mae and Freddie Mac have historically valued working with state HFAs to offer products that expand homeownership opportunities to low and moderate income communities in a sustainable way, and the strong performance track-record of Minnesota Housing loans starkly contrasts the risk assumptions that undergird the proposed risk multipliers. In fact, research commissioned by Fannie Mae in 2018 examined over 1 million low and moderate income homebuyers and found "the risk of ever experiencing a 90-day default is about 20 percent lower for borrowers with loans originated through HFAs, and the risk of foreclosure is about 30 percent lower. The relative likelihood of prepayment is also about 30 percent lower" (Moulton, Record, & Hembre, 2018)[1]. The study used a match sample of loans originated between 2005 and 2014 to compare HFA and non-HFA loans with similar characteristics (e.g. geography, loan terms, income, credit score, and loan-to-value ratio) and found that HFA loans performed better than non-HFA loans even during the great recession and foreclosure crisis. The researchers pointed to several reasons for the comparatively better performance of HFA loans:

- "As HFA mortgages are more likely to have full documentation, be originated in the retail channel, and include community seconds (typically associated with better credit performance than other sources of subordinate financing), all factors that improve the relative credit profile

[1]Moulton, S., Record, M., & Hembre, E. (2018). *Low Income Homeownership and the Role of State Subsidies: A Comparative Analysis of Mortgage Outcomes.* Fannie Mae.

of HFA loans, including these factors can explain some but not all of the historically observed better credit performance of HFA loans."[2]

- "The results indicate that loans originated by HFAs with direct servicing or with homeownership counseling are less likely to experience default or foreclosure, with no observed effects of direct lending."[3]

- "Further, there is some evidence that preventative servicing practices (e.g., prompt contact with the borrower when a payment is missed) may contribute to the observed HFA performance gap, as loans originated by HFAs servicing their own mortgages perform better in this sample."[4]

In conclusion, we believe the proposed framework should include flexibility and space for state HFAs to continue their proven track-record of providing sustainable homeownership opportunities to low and moderate income and POCI borrowers through access to affordable conventional loans. Failure to provide sufficient access to affordable conventional mortgages for buyers on the lower end of the housing market will not simply shift those borrowers to FHA, but instead is likely to overwhelm FHA's capacity, resulting in FHA pricing increases that would price many borrowers out of the market. This stagnation of would-be first-time homebuyers could reverberate through the rest of the real estate and rental housing markets, as potential first-time homebuyers are unable to free up much needed rental units and move-up buyers find fewer buyers for their homes.

Thank you again for the opportunity to comment. If there are any questions about these comments, please contact me at 651-297-3120 or by email at jessica.deegan@state.mn.us.

Sincerely,

Jessica Deegan

Director of Federal Affairs

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[2] Moulton, S., & Fout, H. (2018, May 17). *Low Income Homeownership and the Role of State Affordable Mortgage Programs*. Summary, Retrieved August 25, 2020, from Fannie Mae: https://www.fanniemae.com/portal/research-insights/perspectives/low-income-homeownership-state-affordable-programs-moulton-fout-051718.html

[3] Ibid.

[4] Ibid.