



# Institute for Policy Integrity

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*new york university school of law*

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VIA ELECTRONIC COMMUNICATION

FHFA OPAR  
400 Seventh Street SW  
Ninth Floor  
Washington, DC 20024

Re: Comments on Proposed Increases to State-Level Guarantee Fee Pricing, 77 Fed. Reg. 58,991 (Sept. 25, 2012) [Notice No. 2012-N-13]

Dear FHFA OPAR:

The Institute for Policy Integrity submits the following comments on the Federal Housing Finance Agency's ("FHFA") State-Level Guarantee Fee Pricing notice.<sup>1</sup>

The Institute for Policy Integrity at New York University School of Law is a non-partisan think tank dedicated to improving the quality of government decisionmaking through advocacy and scholarship in the fields of administrative law, economics, and public policy.

FHFA plans to increase the guarantee fees that the Federal Home Loan Mortgage Corporation ("Freddie Mac") and the Federal National Mortgage Association ("Fannie Mae") (collectively "the Enterprises") charge for single-family mortgages in the states with the highest default-related costs.<sup>2</sup> In practice, this means that the costs charged to homeowners for mortgages will be higher in those states with the strongest judicial and regulatory protections against foreclosure.<sup>3</sup>

As government-sponsored enterprises, Freddie Mac and Fannie Mae do not function solely to maximize private profit, but instead are designed by the government to facilitate a secondary market for residential mortgages, in turn supporting mortgage origination.<sup>4</sup> As such, it is inappropriate for FHFA to approach guarantee-fee pricing as if Freddie Mac and Fannie Mae were purely private entities. Instead, FHFA should consider the public interest and attempt to maximize net social benefits in deciding whether to institute a fee increase based upon foreclosure costs.

In particular, FHFA should conduct a more robust cost-benefit analysis of the proposed policy: to that end, the agency should clearly define the goal of its policy, specifically taking the public interest into account; and the agency should assess and quantify the potential social benefits from increased foreclosure protections to the extent feasible and determine the extent to which any increase in guarantee fees will disincentivize states from adopting those protections.

## **I. Background**

FHFA plans to increase Freddie Mac and Fannie Mae's guarantee fees for single-family mortgages in the states with the longest current average time between default and a final foreclosure sale, which

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<sup>1</sup> State-Level Guarantee Fee Pricing, 77 Fed. Reg. 58,991 (Sept. 25, 2012).

<sup>2</sup> *Id.*

<sup>3</sup> *See id.*

<sup>4</sup> *See* Fannie Mae and Freddie Mac Charter Acts, 12 U.S.C. §§ 1716 *et seq.* and 12 U.S.C. §§ 1451 *et seq.*

FHFA identifies as the states with the highest default-related costs for the Enterprises. Freddie Mac and Fannie Mae charge lenders guarantee fees (which are, in turn, passed along to consumers) in order to “compensate for the credit risks that the Enterprises undertake when they own or guarantee mortgages.”<sup>5</sup> In order to assess the implications of this proposed policy change, it is first necessary to understand the nature and purpose of Freddie Mac and Fannie Mae, as well as how they relate to FHFA.

Freddie Mac and Fannie Mae are so-called “government-sponsored enterprises” that buy mortgages, guarantee them, and package and sell them as mortgage-backed securities.<sup>6</sup> The government created Fannie Mae in 1938 and Freddie Mac in 1970 to support the mortgage lending market.<sup>7</sup> Under Fannie Mae’s Charter Act, its purpose is “to establish secondary market facilities for residential mortgages,” with goals including “provid[ing] stability” and “assistance” to the secondary market (including mortgages for low and moderate income families), “promot[ing] access to mortgage credit,” and “manag[ing]” federally owned mortgage portfolios with minimum adverse effects to federal spending.<sup>8</sup> Freddie Mac’s purposes under its Charter Act are nearly identical to those of Fannie Mae.<sup>9</sup>

The Enterprises are not formally backed by government guarantees, but there is an implicit guarantee that the government will support them during a downturn—and indeed, the government stepped in through a conservatorship during the most recent recession.<sup>10</sup>

In particular, with the Housing and Economic Recovery Act of 2008,<sup>11</sup> the federal government created FHFA, which placed Freddie Mac and Fannie Mae in conservatorship to stabilize the mortgage market. FHFA’s principal duties are “to oversee the . . . operations” of Freddie Mac and Fannie Mae and to confirm that they operate with adequate capital and safeguards, while fostering effective housing finance markets in compliance with the law. The statute instructs FHFA to ensure that “the activities of each regulated entity and the manner in which such regulated entity is operated are *consistent with the public interest*.”<sup>12</sup> Thus, FHFA must ensure that Freddie Mac and Fannie Mae operate with the public interest in mind. To effectively accomplish this goal, FHFA should attempt to maximize net social benefits through a thoughtfully conducted cost-benefit analysis of proposed policies.

## **II. FHFA should conduct a comprehensive cost-benefit analysis of the proposed increase in guarantee fees, making sure to fully account for social benefits stemming from enhanced foreclosure protections**

FHFA should conduct a comprehensive cost-benefit analysis to determine whether charging higher guarantee fees for mortgages in states with longer default-related timelines will maximize net social benefits. Though FHFA is an independent agency<sup>13</sup> and so is not strictly required to perform a regulatory impact analysis under Executive Orders 12,866 and 13,563, conducting such an analysis is considered best practices for regulatory decisionmaking. Additionally, Executive Order 13,579 advises independent agencies to carefully analyze likely consequences and to consider the

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<sup>5</sup> 77 Fed. Reg. at 58,991.

<sup>6</sup> MARK JICKLING, CONGRESSIONAL RESEARCH SERVICE, FANNIE MAE AND FREDDIE MAC IN CONSERVATORSHIP (2008).

<sup>7</sup> They were created in 1938 and 1970, respectively, and were converted to for-profit shareholder-owned corporations in 1968 and 1989, respectively. UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE, FANNIE MAE AND FREDDIE MAC: ANALYSIS OF OPTIONS FOR REVISING THE HOUSING ENTERPRISES’ LONG-TERM STRUCTURES 2 (2009).

<sup>8</sup> 12 U.S.C. § 1716.

<sup>9</sup> 12 U.S.C. § 1451.

<sup>10</sup> MARK JICKLING, CONGRESSIONAL RESEARCH SERVICE, FANNIE MAE AND FREDDIE MAC IN CONSERVATORSHIP (2008).

<sup>11</sup> Pub. L. No. 110-289, 122 Stat. 2654 (2008).

<sup>12</sup> 12 U.S.C. § 4513.

<sup>13</sup> 44 U.S.C. § 3502(5).

costs and benefits of regulatory decisions (to the extent permitted by law).<sup>14</sup> Moreover, as discussed above, FHFA has a statutory obligation<sup>15</sup> to have the Enterprises operate consistent with the public interest, which requires a careful analysis of what the public interest is and whether a particular policy is optimal for the public. Thus, FHFA should follow the best practices for conducting a regulatory impact analysis laid out in White House guidance, particularly the Office of Management & Budget's Circular A-4.<sup>16</sup>

The Circular A-4 lays out the steps of a cost-benefit analysis, namely: "(1) a statement of the need for the proposed action, (2) an examination of alternative approaches, and (3) an evaluation of the benefits and costs—quantitative and qualitative—of the proposed action and the main alternatives identified by the analysis."<sup>17</sup> In its Federal Register notice, FHFA has done an incomplete job of defining its goals and examining alternatives and has not evaluated the costs and benefits of its plan at all. FHFA should follow the best practices for regulatory decisionmaking laid out in the Circular A-4, and so should articulate the regulatory goals and account for social benefits.

***FHFA should clearly define the goals of its proposal, incorporating the public interest into these goals***

The most fundamental step in regulatory decisionmaking required by Executive Order 12,866 is to define regulatory goals: agencies must identify the problem to be addressed, assess the significance of the problem, and explain why regulation is necessary to address that problem. Defining goals initially is crucial to all subsequent steps in rational rulemaking, such as evaluating the effectiveness of different policy alternatives in meeting those goals, and assessing the actual performance of the rule on an ongoing basis. Only by defining regulatory goals can the agency determine which regulatory structure will be the "best . . . tool[] for achieving regulatory ends."<sup>18</sup> In the Federal Register notice, FHFA states that the goal of the proposed fee increase is "to recover a portion of the exceptionally high costs that the Enterprises incur in cases of mortgage default in those states."<sup>19</sup> If consumers impose more costs on a service provider, charging them extra generally makes business sense. However, even if the FHFA is correct that the Enterprises' costs are higher in these states, compensating for private costs cannot be the entire goal because FHFA must consider the public interest in its policymaking.<sup>20</sup> FHFA should explain how its policy maximizes net social benefits.

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<sup>14</sup> Executive Order No. 13,579, § 1, 76 Fed. Reg. 41,587, 41,587 (July 14, 2011).

<sup>15</sup> Congress has given FHFA other directives over time. In a 2011 statute, Congress instructed FHFA to increase guarantee fees by at least an average of 10 basis points and consider the cost of private capital and the risk of loss in setting guarantee fees. Temporary Payroll Tax Cut Continuation Act of 2011, Pub. L. No. 112-78, 125 Stat. 1280, 1287 (to be codified at 12 U.S.C. § 4547). This suggests that Congress supports the use of risk in setting guarantee fees. However, this particular fee increase has already occurred, so this statutory provision is not directly binding. See Clea Benson, *Fannie Mae, Freddie Mac Guarantee Fees Boosted by Regulator*, BLOOMBERG BUSINESSWEEK, Sept. 1, 2011, available at <http://www.businessweek.com/news/2012-08-31/fannie-mae-freddie-mac-guarantee-fees-increased-by-regulator>.

<sup>16</sup> OFFICE OF MANAGEMENT & BUDGET, CIRCULAR A-4 (2003), available at <http://www.whitehouse.gov/sites/default/files/omb/assets/omb/circulars/a004/a-4.pdf> [hereinafter "CIRCULAR A-4"] Executive Order 12.866 tasks the Office of Information and Regulatory Affairs ("OIRA")—an agency within the Office of Management and Budget—with reviewing all significant proposed regulations to ensure that they comply with the Executive Order and all applicable laws and policies. The Circular A-4 is the most comprehensive set of guidance for agencies on how to conduct an effective cost-benefit analysis.

<sup>17</sup> CIRCULAR A-4 at 2.

<sup>18</sup> Exec. Order No. 13,563, § 1 at 1.

<sup>19</sup> 77 Fed. Reg. at 58,991.

<sup>20</sup> FHFA states that it considers the public interest in its guarantee-fee-setting process in its annual report to Congress, but there is no explanation of how the public interest was incorporated into this proposal. See FEDERAL HOUSING FINANCE AGENCY, FANNIE MAE AND FREDDIE MAC SINGLE-FAMILY GUARANTEE FEES IN 2010 AND 2011, at 14-19 (2012).

***FHFA should ensure that it accounts for social benefits in its analysis, balancing these benefits against costs***

Foreclosure protections may provide social benefits, even while they may impose direct costs on Freddie Mac and Fannie Mae. In order to conduct a robust cost-benefit analysis that will allow the agency to maximize net social benefits, FHFA must account for these social benefits. The increased foreclosure protections in certain states—for which FHFA proposes to charge more fees—may provide a number of social benefits. Several studies have found that foreclosures impose externalities on neighboring property values (through, for example, abandoned properties due to default)<sup>21</sup> as well as on a local community as a whole (such as through increased police costs needed to monitor abandoned properties and educational instability when children are forced to relocate schools).<sup>22</sup> Foreclosure protections may help minimize those externalities by allowing homeowners more time to modify or cure their default, which could result in fewer foreclosures.<sup>23</sup> The additional foreclosure procedure may also help to ensure that errors are not made in the foreclosure process, preventing homeowners who have complied with their mortgage obligations from losing their homes.<sup>24</sup>

If this proposal goes forward, states may feel compelled to reduce foreclosure protections that would otherwise have a net social benefit, out of concern that their citizens will be unable to afford

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<sup>21</sup> See, e.g., Jenny Schuetz, et al., *Neighborhood Effects of Concentrated Mortgage Foreclosures*, 17 J. OF HOUSING ECON. 306 (2008) (finding a relationship between foreclosures and lower neighboring property values); Zhengu Lin, Eric Rosenblatt & Vincent W. Yao, *Spillover Effects of Foreclosures on Neighborhood Property Values*, 38 J. REAL EST. FIN. & ECON. 387 (2009) (discussing spillover effects such as disinvestment and vandalism that lower neighborhood property values after foreclosure).

<sup>22</sup> See, e.g., Vicki Been, et al., *Does Losing Your Home Mean Losing Your School?: Effects of Foreclosures on the School Mobility of Children*, 41 REG'L SCI. & URBAN ECON. 407 (2011) (finding that the foreclosure crisis caused students to switch schools more often than they otherwise would have toward schools that were, on average, academically weaker); Dan Immergluck & Geoff Smith, *The Impact of Single-Family Mortgage Foreclosures on Neighborhood Crime*, 21 HOUSING STUD. 851 (2006) (finding foreclosed properties contribute to violent crime and arson); WILLIAM C. APGAR & MARK DUDA, HOMEOWNERSHIP PRESERVATION FOUNDATION, COLLATERAL DAMAGE: THE MUNICIPAL IMPACT OF TODAY'S MORTGAGE FORECLOSURE BOOM (2005), available at [http://www.995hope.org/wp-content/uploads/2011/07/Apgar\\_Duda\\_Study\\_Short\\_Version.pdf](http://www.995hope.org/wp-content/uploads/2011/07/Apgar_Duda_Study_Short_Version.pdf) (discussing the externalities on municipalities from foreclosures, such as administrative costs and increased crime and fire prevention required); INGRID GOULD ELLEN, ET AL., DO FORECLOSURES CAUSE CRIME? (2012), available at [http://furmancenter.org/files/publications/Ellen\\_Lacoe\\_Sharygin\\_ForeclosuresCrime\\_aug31\\_Furman\\_Copy\\_1.pdf](http://furmancenter.org/files/publications/Ellen_Lacoe_Sharygin_ForeclosuresCrime_aug31_Furman_Copy_1.pdf) (finding that foreclosures lead to additional crime in neighborhoods).

<sup>23</sup> A number of factors affect the likelihood of modification after default, including characteristics of the neighborhood, the particular loan, the borrower, and the servicers. SEWIN CHAN, ET AL., FURMAN CENTER FOR REAL ESTATE AND URBAN POLICY, PATHWAYS AFTER DEFAULT: WHAT HAPPENS TO DISTRESSED MORTGAGE BORROWERS AND THEIR HOMES? (2012), available at [http://furmancenter.org/files/publications/Pathways\\_After\\_Default\\_June\\_2012.pdf](http://furmancenter.org/files/publications/Pathways_After_Default_June_2012.pdf); VICKI BEEN, ET AL., DETERMINANTS OF THE INCIDENCE OF LOAN MODIFICATIONS (2011), available at [http://furmancenter.org/files/publications/Determinants\\_of\\_Mods\\_October\\_2011\\_Final\\_1.pdf](http://furmancenter.org/files/publications/Determinants_of_Mods_October_2011_Final_1.pdf). There is an active debate about whether additional foreclosure protections make borrowers more likely to cure defaults. Studies have found that additional time and judicial protections (such as required mediation) have increased the likelihood of cure and loan modification. J. Michael Collins et al., *State Mortgage Foreclosure Polices & Lender Interventions: Impacts on Borrower Behavior in Default* (SSRN, Working Paper, 2010), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1475505&download=yes](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1475505&download=yes); GEOFF WALSH, NATIONAL CONSUMER LAW CENTER, REBUILDING AMERICA: HOW STATES CAN SAVE MILLIONS OF HOMES THROUGH FORECLOSURE MEDIATION (2012), available at [http://www.nclc.org/images/pdf/foreclosure\\_mortgage/mediation/report-foreclosure-mediation.pdf](http://www.nclc.org/images/pdf/foreclosure_mortgage/mediation/report-foreclosure-mediation.pdf). Another study has found, however, that additional time in the foreclosure process did not make borrowers more likely to cure defaults. Kristopher Gerardi, et al., *Do Borrower Rights Improve Borrower Outcomes? Evidence from the Foreclosure Process* (Fed. Res. Bank of Atlanta, Working Paper No. 2011-16a, 2012).

<sup>24</sup> Evidence shows that some homeowners who have complied with their mortgage obligations have nonetheless been forced into foreclosure proceedings. See, e.g., Paul Kiel, *Disorganization at Banks Causing Mistaken Foreclosures*, PROPUBLICA, May 4, 2010, available at <http://www.propublica.org/article/disorganization-at-banks-causing-mistaken-foreclosures-050410>.

mortgages with the increased fees.<sup>25</sup> Before potentially inducing a chilling effect on foreclosure regulations, FHFA should at least examine whether the potential social benefits from these protections—as outlined above—outweigh the direct costs to Freddie Mac and Fannie Mae.

After qualitatively assessing the potential social benefits from the heightened foreclosure protections, FHFA should attempt to quantify these benefits where possible. FHFA should then incorporate these values into a cost-benefit analysis that assesses these social benefits in addition to the direct costs and benefits.

### **III. Conclusion**

Because it has a mandate to act in the public interest, FHFA should conduct a robust cost-benefit analysis where it clearly defines the goals of the policy and analyzes the optimal way to reach those goals. In conducting this analysis FHFA should ensure that it describes—and, to the extent possible quantifies—the social benefits that increased foreclosure protections may create.

Sincerely,

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Jason A. Schwartz

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<sup>25</sup> In theory, states could subsidize their own citizens' mortgages if they thought this was warranted, but subsidization might prove difficult in this period of major state deficits. And, indeed, the proposal encourages states to reduce their foreclosure costs. 77 Fed. Reg. at 58,994 (“This approach would allow for variation in practice among the states and impose upfront fees only on those states that are statistical outliers from the rest of the country. If those states were to adjust their laws and requirements sufficiently to move their foreclosure timelines and costs more in line with the national average, the state-level, risk-based fees imposed under the planned approach would be lowered or eliminated.”)