November 26, 2012

Mr. Patrick Lawler
Office of Policy Analysis and Research
Federal Housing Finance Agency
400 7th Street, SW
Washington, D.C. 20024
gfeeinput@fhfa.gov

RE: Federal Register Notice No. 2012-N-13, "State-Level Guarantee Fee Pricing"

Dear Mr. Lawler:

Thank you for the opportunity to comment on the Federal Housing Finance Agency's plan for state-level guarantee fee pricing at Fannie Mae and Freddie Mac.

This comment is submitted by the Center for American Progress (CAP) and joined by the undersigned organizations and individuals. CAP is a progressive, nonpartisan think tank dedicated to improving the lives of Americans through ideas and action. CAP's housing team aims to preserve access to credit for all communities, prevent foreclosures, stabilize neighborhoods, and provide access to affordable, safe, and energy efficient rental housing. CAP also convenes the Mortgage Finance Working Group, which brings together experienced housing finance experts, affordable housing advocates, and leading academics to collaborate on policies related to the future of the U.S. mortgage finance system.

General Comments on the Proposed State-Level Fee

We appreciate the importance and complexity of FHFA's mandate to preserve the assets of Fannie Mae and Freddie Mac, protect taxpayers from excessive losses, and promote a liquid and resilient U.S. housing market. Setting a financially responsible guarantee fee is one of many critical responsibilities of the agency.

In addition, we recognize that foreclosure timelines extending long beyond the time periods required by state law can have a harmful impact not only on investors, but also on neighborhoods and families. Unnecessary foreclosure delays can postpone the disposition of abandoned homes or homes that are not properly maintained, which contributes to neighborhood blight, the spillover costs associated with such blight, and the unavailability of housing stock for new families.

At the same time, a rush to foreclosure without an opportunity or effort to engage in loss mitigation also damages investors (such as the Enterprises), neighborhoods, and families. In many cases, a homeowner will prove eligible for a loan modification that has a positive net present value for the investor. Even when a loan modification is not possible, other foreclosure alternatives, including short sales and deeds-in-lieu, result in a greater recovery by the investor

than a foreclosure sale and require no subsequent REO-related expenditures. What's more, increasing costs to new homebuyers and making home-buying unaffordable may well derail a housing recovery that will help investors, neighborhoods, and families.

While we agree that addressing these unnecessarily elongated timelines is important, we do not think a state-level g-fee premium is the correct solution. First, the proposal does not target the real causes of the delays, much of which are due to servicer or attorney behavior.

Second, the proposal represents a potentially unlimited expansion of risk-based pricing that could undermine the primary function of the Enterprises, which is to provide a national mortgage market that pools and covers the risks posed by individual geographic markets.

Third, the proposal fails to calculate accurately the costs to the Enterprises of the delays. Doing so would require a much more holistic view at the costs and benefits of state foreclosure laws, REO carrying costs, and other external costs imposed by foreclosures.

Finally, FHFA does not demonstrate that the agency has balanced its commitment to conserving and preserving Enterprise assets against its stated conservatorship goal to "maintain foreclosure prevention activities and credit availability for new and refinanced mortgages."[1] Instead, it appears to punish states for their efforts to protect homeowners from unnecessary or illegal foreclosure and attempt to roll back those protections.

For these reasons, we oppose the implementation of the proposal and strongly suggest that it be withdrawn. Alternatively, if FHFA does not withdraw the proposal, we suggest that the agency significantly revise the methodology for assessing the cost of delays and for identifying the states in which a premium would be added.

Below, we lay out our concerns in more detail.

1. **The proposal targets the wrong problem and penalizes the wrong actors.**

The justification for a state-based g-fee appears to rest on the assumption that state laws are primarily to blame for excessive foreclosure timelines. For example, the proposal suggests that "if those states were to adjust their laws and requirements to move their foreclosure timelines and costs more in line with the national average, the state-level, risk-based fees … would be lowered or eliminated."

However, there are many contributors to delay, chief among them servicer-related delays. Some servicer delays are deliberate, some relate to lack of servicer capacity and/or competence, and some relate to servicer inability or unwillingness to follow legal requirements, as demonstrated by the fraudulent papers submitted to courts under the practice now known as "robosigning." Another contributor to the delay is the sheer volume of foreclosures being filed as a result of last decade's unwise and predatory lending practices.

To illustrate the impact that external factors have on state timelines, it is useful to compare the FHFA timelines with the USFN timelines. USFN, a trade group of mortgage banking attorneys, publishes a state-by-state analysis of the amount of time it would take to complete an uncontested foreclosure while observing all state laws but in the absence of other delays. As the table below demonstrates, foreclosures are actually taking much longer than state laws require.

Note: the figures used in this table cover the time that the foreclosure is initiated by the servicer until the actual sale date. Since state-mandated redemption periods are not required in all states and add the same number of days to each column, we have excluded them from this table, although they would relate to carrying cost calculations.

State	USFN timeline	FHFA timeline
Connecticut	250	690
Florida	150	660
Illinois	315	540
New Jersey	560	750
New York	420	820

Sources: UNFN Foreclosure Timelines Matrix (2012), FHFA proposal

Consider New York as an example. USFN estimates that it should take 420 days to complete a foreclosure in New York. Yet foreclosures are actually taking approximately twice that amount of time, according to FHFA's data. In New York, a servicer's attorney must file an affirmation that the facts underlying the foreclosure are accurate. But servicers are having trouble finding attorneys that are willing to sign off, which is clogging the foreclosure pipeline.[2]

Similarly, when a well-known law firm in New York that handled an enormous volume of Enterprise foreclosure cases was terminated by the Enterprises for misconduct, the transfer of files from that firm to other attorneys delayed foreclosures significantly.[3]

Neither of these problems is due to the existence of a particular law; they are due to the failure to comply with those laws.

FHFA is already targeting servicer behavior through the Servicing Alignment Initiative, under which the GSEs charge servicers "compensatory fees" for exceeding prescribed foreclosure timelines. If these fees are proving inadequate to change servicer behavior, FHFA might want to think about increasing them or changing the way they are imposed.

However, if FHFA insists on charging homebuyers more to recoup these losses, it would be more appropriate and effective to target loans originated by companies with particularly bad servicing records. Alternatively, the Enterprises could bar servicers that cannot comply with reasonable expectations. Either option would likely have a greater impact on reducing foreclosure timelines than levying a premium on loans made in particular states.

2. **The proposal ventures into dangerous waters by pricing for risk posed by completely exogenous factors.**

It is well known that the Enterprises make distinctions among products and borrower characteristics for the purposes of pricing. There continues to be debate about the appropriate extent of such risk-based-pricing. Placing too much emphasis on risk-based pricing – what could be called "micro-risk-based pricing" -- could have severe implications for the housing market and access to credit. It could lead to such high levels of customization and variability in mortgage products that consumers will no longer be able to shop around and compare rates.

These risks are heightened when the risks being priced for are unrelated to and not under the control of the individual loan or borrower, as in the case of this proposal. Further, the proposal articulates no limiting principle for when to price for such factors, naturally raising the questions of how FHFA chose to select this one factor out of all other potential risk factors and how it will make such determinations in the future.

For example, high unemployment is widely considered to drive an increase in foreclosure activity. Will FHFA impose additional premiums on loans made in states with high unemployment rates? Should g-fees be raised or lowered for other state laws and regulations? If state-level premiums are appropriate, what about county-level or census-tract level? The slope is a very slippery one.

Consideration of the full range of factors that potentially impact risk strongly suggests that FHFA's decision to select foreclosure timelines alone for additional premiums is arbitrary. It is equally clear that attempting to account for all external factors is simply impossible.

The Enterprises dipped their toes into policies related to exogenous factors at the start of the housing crisis by instituting "declining market" policies that increased down-payment requirements for loans in markets where price declines appeared likely. As in today's proposal, these policies were an attempt to deal with a genuine problem, but were imposed hastily and without full consideration of the implications. Upon greater consideration, the Enterprises concluded that it made more sense to address the issue at the individual loan level through their automated underwriting systems rather than to place a blanket requirement on a particular geographical area. Just as it did in that instance, it makes more sense for FHFA to allow the Enterprises to fulfill their mission of diversifying risks nationally and refrain from charging different g-fees depending on state-based factors.

Additionally, basing future g-fees on the discontinuous experience of the last five years in these states punishes future buyers whose foreclosure experience is likely to be far different than that of the immediate past. The Enterprises' new books of business are, according to FHFA's own reports, composed of very high quality loans with a much lower risk profile than even the pre-2000 book at both companies.[4] If this is the case, there is weak justification for higher g-fees because of the current backlog of foreclosures caused by the market and regulatory failures of the boom years.

3. The proposal's methodology for identifying the states to penalize is fundamentally flawed and double-charges for the costs imposed by lengthy timelines.

FHFA's proposal is grounded on the assumption that longer foreclosure timelines cause bigger losses for Fannie Mae and Freddie Mac. But FHFA's methodology fails to account for numerous other variables that influence the ultimate cost to the Enterprises – even while FHFA likely has access to more data related to these variables than most other market participants or observers -- and therefore does not provide support for this proposition. What's more, there is no analysis at all to demonstrate that state laws are causing the delays rather than servicer behavior or volume, nor that the costs incurred during a "normal" market would justify the proposed increases.

First, the FHFA calculation assumes that loans originated in each state will default at the national average default rate. It is difficult to understand why FHFA would rely on a national average when setting a state-based policy, given that default rates actually vary quite widely among states, as do loss severities, and that there is ready access both to default rates and to cure rates. While we oppose the state-level fees, if they are to be imposed, the calculations should use state-level inputs.

Second, the methodology fails to consider whether certain state laws actually save money for the Enterprises. In states with better consumer protection laws, borrowers who default are more likely to end up with loan modifications, short sales, or other foreclosure alternatives, which have a much lower loss severity than foreclosures.[5] Thus, to the extent that state laws reduce foreclosures, they can potentially save Fannie and Freddie significantly more than the timelines cost.

Third, the formula only accounts for pre-foreclosure carrying costs, and it does not take into account the additional losses incurred as a result of REO carrying costs or resale losses. Similarly, it does not at all include the costs incurred as the results of the "spillover effect" whereby foreclosures push down the values of surrounding homes and communities, which itself increases the risk of future default or foreclosure in the surrounding homes.[6]

Fourth, the formula does not account for other state laws that reduce the risk of default. For example, FHFA does not provide credit to states with strong anti-predatory lending laws, which

have been shown to reduce default rates by reducing the origination of poorly underwritten mortgages.[7]

Finally, as noted above, the Enterprises already charge servicers compensatory fees for exceeding prescribed foreclosure timelines. These fees are specifically designed to help offset the additional costs incurred due to foreclosure delays. Therefore, any premiums based on a calculation of cost to the Enterprises needs to take these fees into account and back them out of the equation – otherwise, the new fees imposed on homebuyers are essentially double-charging for the same problem.

Answers to Specific Questions in the Notice

FHFA requested comments on three specific aspects of the proposal. Our answers are below.

Is standard deviation a reasonable basis for identifying those states that are significantly more costly than the national average?

While standard deviation is an appropriate mechanism for identifying outliers in a group, it is meaningless to use it in this instance because the formula on which the calculations are based is fatally flawed (see analysis above). To identify states that are more costly than the national average due to their foreclosure timelines, FHFA must develop a formula that can measure the actual costs directly attributed to long foreclosure timelines (after accounting for net savings from avoided foreclosures), not the mere existence of a long timeline. Thus, we do not believe that FHFA should charge an additional premium solely based on the state in which a mortgage is made.

Should finer distinctions be made between states than the approach described here?

No, because we do not believe these distinctions should be made.

Should an upfront fee or an upfront credit be assessed on every state based on its relationship to the national average total carrying cost, such that the net revenue effect on the Enterprises is zero?

No, because charging different premiums in all fifty states based on some relationship to an average cost fundamentally subverts the essential mission and purposes of a national secondary market.

Conclusion

We believe it would be a mistake for FHFA to impose state-level guarantee fees unrelated to the risks posed by individual loans, and we do not think the agency has demonstrated an adequate nexus between the problem it has identified and the solution it proposes. Furthermore, the

selection of foreclosure timelines as the one exogenous factor included in pricing appears arbitrary. We therefore believe it would be appropriate for the agency to withdraw its proposal.

However, if FHFA does proceed to charge premiums to borrowers in states with long foreclosure timelines, the agency should be required to perform a much more detailed analysis of actual costs of the timelines in each state and account for compensatory fees received under the Servicing Alignment Initiative.

Thank you again for the opportunity to comment on this notice. If you have any questions or would like to discuss anything in this letter in more detail, please contact John Griffith, Policy Analyst, Center for American Progress, at 202-481-8158 or jgriffith@americanprogress.org.

Sincerely yours,

Center for American Progress
Center for Responsible Lending
Conrad Egan, Affordable Housing Institute*
Consumer Federation of America
Ellen Seidman
Enterprise Community Partners
Janneke Ratcliffe, UNC Center for Community Capital*
Mark Willis, NYU Furman Center for Real Estate and Urban Policy*
Mortgage Finance Working Group
National Association of Consumer Advocates
National Community Reinvestment Coalition
National Fair Housing Alliance
National Housing Conference
National People's Action
Sarah Rosen Wartell, Urban Institute*
Susan Wachter, Richard B. Worley Professor of Financial Management, The Wharton School, University of Pennsylvania*

** Affiliations listed for identification purposes only*

ENDNOTES

[1] Federal Housing Finance Agency, "Preparing a Foundation for a More Efficient and Effective Housing Finance System (Strategic Plan for Fiscal Years 2013-2017)," *available at* http://www.fhfa.gov/webfiles/24576/FinalFHFAStrategicPlan10912F.pdf.

[2] MFY Legal Services, Inc., "Justice Deceived: How Large Foreclosure Firms Subvert State Regulations Protecting Homeowners," *available at* http://www.mfy.org/wp-content/uploads/MFY-White-Paper-JUSTICE-DECEIVED.pdf

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[3] Thom Weidlich, *Baum Foreclosure Firm Settles with New York for 4 Million*, Bloomberg, Mar. 22, 2012 (Baum firm handled upward of 100,000 foreclosure files from 2008 – 2010), *available at* http://www.bloomberg.com/news/2012-03-22/baum-foreclosure-firm-settles-with-new-york-for-4-million-1-.html).

[4] Federal Housing Finance Agency, "Conservator's Report on the Enterprises' Financial Performance, Second Quarter 2012," available at http://www.fhfa.gov/webfiles/24549/ConservatorsReport2Q2012.pdf.

[5] Collins, J. Michael, Herbert, Christopher E. and Lam, Ken, "State Mortgage Foreclosure Policies and Lender Interventions: Impacts on Borrower Behavior in Default" (October 2010) (judicial processes and state foreclosure prevention initiatives are associated with increases in loan modifications.), *available at* http://ssrn.com/abstract=1475505.

[6] Debbie Gruenstein Bocian, Peter Smith and Wei Li, "Collateral Damage: The Spillover Costs of Foreclosures," Center for Responsible Lending (2012), *available at* http://responsiblelending.org/mortgage-lending/research-analysis/collateral-damage.pdf; see also "Written Testimony of Mark Ladov and Meghna Philip to the Task Force to Expand Access to Civil Legal Services in New York," Brennan Center for Justice at NYU School of Law (October 4, 2012) (citing Empire Justice Center estimate that state foreclosure prevention programs "saved New Yorkers at least $3.4 billion by preventing families from slipping into homelessness, shoring up property values in struggling communities and preserving our state's property tax base"), *available at* http://www.brennancenter.org/content/resource/testimony_to_the_task_force_to_expand_access_to_civil_legal_services_in_new/

[7] Carolina Reid et. al., *The Impact of State Anti-Predatory Lending Laws on the Foreclosure Crisis*, 21 Cornell Journal of Law & Public Policy 247 (2012) (State anti-predatory lending laws strongly reduce incidence of default and foreclosure, and also reduce origination of riskier loans like option ARMs).