September 8, 2014

The Honorable Mel Watt
Director, Federal Housing Finance Agency
4000 7th Street, SW Ninth Floor
Washington, DC 20024

Re: Guarantee Fees-Request for Input

Dear Director Watt:

Thank you for the opportunity to submit input regarding the Federal Housing Finance Agency's (FHFA) proposal concerning guarantee fee (g-fees) and risk based pricing.

The Center for Responsible Lending (CRL) is a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, one of the nation's largest nonprofit community development financial institutions. Self-Help has provided $6 billion in financing to 70,000 homebuyers, small businesses, and nonprofits and serves more than 80,000 mostly low-income families through 30 retail credit union branches in North Carolina, California, and Chicago.

The input submitted below addresses FHFA's request for input on the proposal to raise g-fees by 10 basis points across the board and increase loan level pricing adjustments (LLPAs). First, CRL applauds and thanks FHFA for its recognition of its need to protect the taxpayers from risk and ensure that those from lower wealth communities have access to the market. CRL finds that the increases proposed would create unnecessary barriers to homeownership for borrowers, particularly those from underserved communities. In addition, CRL finds the FHFA models used to explain the need for g-fee increases (including LLPAs) are based on overly conservative capital modeling. Furthermore, we believe it is best to observe the analysis of the performance of mortgage loans made under the Qualified Mortgage ("QM") rule and Ability-to-Repay standard before assessing risk-based costs. Finally, we also strongly urge FHFA to avoid increasing fees for lower wealth borrowers on two fronts by both increasing g-fees and raising mortgage insurance ("MI") capital requirements.

Rather than implement the proposed increases, we believe that FHFA should consider lowering the g-fees. Alternative modeling suggests that current g-fees more than cover conservatively modeled risk scenarios. Recent housing market trends indicate many borrowers are unable to access affordable mortgage credit even at these levels. *FHFA should consider areas where they could reduce fees to promote greater access to the housing market.*

I. FHFA has a clearly laid out mission that includes the duty to reach underserved communities in addition to protecting the taxpayers from risk.

In Question 1 in FHFA's Request for Input, FHFA asks what other factors should be considered in setting G-Fees. As the FHFA and Director Watt have noted, under the Housing and Economic

Recovery Act of 2008 ("HERA"), FHFA and the GSEs have a duty to ensure that borrowers from traditionally underserved and/or excluded communities will have access to the mortgage market. CRL is concerned that increased g-fee costs will prevent borrowers from underserved markets from having access to the housing market.

CRL recognizes that FHFA has both a duty to ensure that underserved communities[1] have access to the mortgage market, and obligations to ensure the safety and soundness of the GSEs. We also acknowledge the need for g-fees as appropriate cost coverage for projected losses and operating expenses, and that such fees should deliver an appropriate return on capital for the GSEs overall book of business given the current uncertainty of the housing market.

As CRL and others have noted, however, the obligation of the GSEs to serve the entire market and ensure that underserved borrowers, including those from rural, African-American and Latino communities, prospective first time homeowners, millennials, and low and moderate-wealth households have access to responsible forms of mortgage credit is equally critical.[2] FHFA and the GSEs have an explicit duty to broadly increase liquidity in the mortgage market and ensure that borrowers from traditionally underserved and/or excluded communities will have access to the mortgage market. Not only is this obligation addressed by statute, it is essential to the recovery of the housing market and US economy. FHFA should continue to invest as much effort as possible to ensuring access to credit for more communities, as many of the groups described above will constitute the majority of the housing market in the near future.[3]

In addition to HERA, a series of federal laws, regulations and executive orders form a strong regulatory framework aimed at ensuring non-discrimination in the housing and mortgage markets. These include the Fair Housing Act,[4] the Equal Credit Opportunity Act,[5] the federal charters of Fannie Mae and Freddie Mac[6], the Federal Housing Enterprises Financial Safety and Soundness Act and its implementing regulations, and several Executive Orders. Further, where federal funding is involved, whether in the form of loans, insurance or - as in the case at hand -

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[1] Housing and Economic Recovery Act of 2008, P. Law 110-289, Section 1229(a)(1)
" Duty to Serve Underserved Markets-
(1) Duty—To increase the liquidity of mortgage investments and improve the distribution of investment capital available for mortgage financing for underserved markets, each enterprise shall provide leadership to the market in developing loan products and flexible underwriting guidelines to facilitate a secondary market for mortgages for very low-, low-, and moderate-income families….."

[2] Stated in a coalition letter to the Senate Banking Committee, *available at* http://www.responsiblelending.org/mortgage-lending/policy-legislation/2014-Civil-Rights-Groups-Comments-to-Senate-Banking-Comm-on-Housing-Finance-Reform-Bill-Feb-24.pdf

[3] JOINT CENTER FOR HOUSING STUDIES OF HARVARD UNIVERSITY, THE STATE OF THE NATION'S HOUSING 2014, *available at* http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/sonhr14-color-full.pdf (Hereinafter "Harvard Study.")

[4] 42 U.S.C. 3608(d). The Fair Housing Act makes it clear that all federal agencies that have programs or activities that relate to housing and community development have an affirmative obligation to promote fair housing.

[5] 15 U.S.C. Sec. 1691 et seq. Prohibits discrimination in any credit transaction based on, among other things, race, color, religion, national origin, sex or marital status, age (provided the applicant has the capacity to contract).

[6] See Sec. 301(n)(2)(G) of the Fannie Mae charter and Sec. 307((f)(2)(G) of the Freddie Mac charter. According to their charters, the GSEs are also required to "assess underwriting standards, business practices, repurchase requirements, pricing, fees, and procedures, that affect the purchase of mortgages for low- and moderate-income families, or that may yield disparate results based on the race of the borrower, including revisions thereto to promote affordable housing or fair lending."

guarantees, any federal agency administering such funds has an obligation to take affirmative steps to further fair housing. This framework underscores the priority that Congress has placed upon fair access to housing, including mortgage lending.

Access to credit and risk management are not mutually exclusive goals. As Director Watt has consistently acknowledged, the GSEs under HERA are not required to generate the same returns on loans from underserved communities.[7] Rather than penalize lower wealth borrowers or those with lower FICO scores, the GSEs should accept lower returns in accordance with its mission of expanding liquidity and access in the mortgage market, and manage some risk across its full mortgage business. FHFA has the ability to succeed in its obligation to mitigate risk and perform its duty to underserved communities. The GSEs are in a significant position to pool large amounts of mortgages across all geographic locations over time, and may through this provide a greater degree of liquidity to the nation's mortgage finance system while also mitigating risk. This allows FHFA to both manage its capital management responsibilities and reach the greater market.

Communities in underserved markets have been deeply harmed by irresponsible lending in the last decade. In the lead up to the economic and housing crisis, racial minorities were more likely than similarly situated whites to receive mortgages with toxic features, even when also eligible for safer loans.[8] Households from underserved communities suffered massive loss of generational wealth due to reckless and irresponsible lending and the resulting housing crisis.[9] Policymakers responded by putting in place new rules that prevented high-cost, poorly underwritten mortgages from being made in the future, and removed incentives that led lenders to target people of color and lower wealth families for predatory mortgages. However, they have not been able to undo the damage from past loans and many borrowers still face significant and unnecessary barriers to homeownership.[10]

CRL also discourages FHFA from increasing LLPAs for borrowers in either the low FICO score and/or the low down payment categories. In fact, CRL finds that the GSEs have enough capital to decrease LLPAs without putting the taxpayers at risk. Furthermore, research shows that

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[7] 12 USC 1716 (3) [Fannie]; Section 301(b)(3), Pub L 91-351, as amended [Freddie]. In addition, GSEs' charters explicitly state that they are to engage in "activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities."

[8] For example, African-American and Latino borrowers with FICO scores above 660 were three times as likely to have a higher interest rate mortgage as white borrowers in the same credit range. In addition, based upon 2012 Home Mortgage Disclosure Act ("HMDA") data, only 25% of purchased loans to African Americans and 33% of purchased loans to Latinos were conventional loans, compared to 58% of non-Hispanic Whites. In addition, of the 1.14 million conventional purchase loans, only 2.6% went to African-Americans and 6.0% to Latinos, *available at* http://www.federalreserve.gov/pubs/bulletin/2013/pdf/2012_HMDA.pdf

[9] See Allison Freeman and Janneke Ratcliffe, *Setting the Record Straight on Affordable Homeownership* (May 2012) at 4- 8; see also Christopher Herbert, Daniel McCue, and Rocio Sanchez-Moyano, *Is Homeownership Still an Effective Means of Building Wealth for Low-income and Minority Households? (Was it Ever?)*, Joint Center for Housing Studies, Harvard University at 48 (September 2013), (stating that "[o]verall, owning a home is consistently found to be associated with increases of roughly $9,000-$10,000 in net wealth for each year a home is owned. . . . ") *available at* http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/hbtl-06_0.pdf

[10] See Harvard Study at note 3. The average guarantee fee increased from 22 basis points in 2009 to 38 basis points by 2012 and this did not include broad-based utilization of LLPAs, additional upfront fees based on a borrower's credit score, LTV, and other risk factors that could add as much as 325 upfront basis points for moderate income and lower wealth borrowers.

borrowers with lower credit scores with well-underwritten loans can succeed, even with mortgages with lower down payment amounts. For example, Laurie Goodman of the Urban Institute ("UI") points out, for example, that even a hard 5 percent down payment cutoff is not the best way to address default risk, since compensating underwriting factors are often more important.[11] A high down payment requirement places additional costs and pressure on borrowers[12], and serves as an often unnecessary barrier for many communities to have access to credit and homeownership.

II. CRL Encourages FHFA to Consider Alternative Capital Modeling Suggestions.

In response to Question 9, the grid presupposes that every cell should pay for itself. That is a value assumption that we think is inappropriate when there is a public good at stake like homeownership for low and moderate-income families, particularly in distressed neighborhoods.

In this section, we primarily focus on Question 3, which asks what FHFA should consider in setting target return on capital and amount of capital required. As FHFA has shown in the analysis presented in the Request for Input, the target return on capital and the amount of capital drive the g-fees calculation. However, there are many assumptions underlying these two factors that merit careful consideration. Unfortunately, the data presented in the Request for Input does not fully elaborate on the many assumptions underlying these critical data points. Despite the lack of public information about these critical calculations, CRL's analysis indicates that FHFA's analysis is overly conservative and thus the setting of both the target return on capital and the amount of capital required are far too high.

We recommend FHFA alter the risk models to:

1) Model a less catastrophic stressed scenario, reflecting safeguards put in place by recent regulations and reflecting the GSEs' ability to pool risk across a portfolio of loans.
2) Incorporate revenue from g-fees on existing business in the capital calculation.
3) Include retained earnings from all business activities in the capital calculation.

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[11] See Laurie Goodman and Taz George, *Fannie Mae reduces its max LTV to 95: Does the data support the move?*, The Urban Institute, MetroTrends Blog (September 24, 2013) *available at* http://blog.metrotrends.org/2013/09/fannie-mae-reduces-max-ltv-95-data-support-move). *See also* See Quercia, Freeman and Ratcliffe, *Regaining the Dream: How to Renew the Promise of Homeownership for America's Working Families*, Self-Help and UNC Center for Community Capital (2011); *See also* CENTER FOR COMMUNITY CAPITAL, BALANCING RISK AND ACCESS, UNDERWRITING STANDARDS AND QUALIFIED RESIDENTIAL MORTGAGES 15 *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/Underwriting-Standards-for-Qualified-Residential-Mortgages.pdf. This paper is an analysis of the Self-Help Community Advantage Program. CRL's affiliate Self-Help has operated a national secondary market home loan program that has purchased 52,000 mortgages worth $4.7 billion. Seventy-two percent of borrowers of these mortgages made less than a 5 percent down payment. In addition, 41 percent were female-headed households, 40 percent were from minority households and median income was $30,792. These loans have performed well: they have a median annualized net return on borrower equity of 24 percent and have increased borrower equity by $18,000 through the crisis. Self-Help's cumulative loss rate has been approximately 3 percent, which demonstrates large successes with lower wealth borrowers. We note that these positive performances include the time period of the historic recession and housing crash.

[12] Such as borrowers from African-American, Latino, and rural communities who cannot afford high down payments, or prospective first time home buyers and millennials who cannot afford high down payments due to other financial issues such as student loan debt.

4) Reduce the target rate of return to a rate more appropriate for entities in conservatorship with public support and mission.

We focus our analysis on g-fee calculations for borrowers with FICO scores from 620-699 and loans with Loan-to-Value ("LTV") between 81-97% (the bottom right square in Figure 3 of the Request for Input). *As we have stated, this combination of FICO and LTV includes a high percentage of borrowers from African-American and Latino families, lower wealth households, and first time homebuyers, who tend to have both lower FICO scores and fewer resources to put towards a down payment.*

As FHFA outlines in the Request for Input, the estimated cost is made up of three components: the costs of 1) expected losses, 2) operating expenses, and 3) the amount of capital required to be held for unexpected losses and target return on that capital. FHFA has defined operating expense costs to be 17 bps – 7 bps for administration and 10 bps that go back to the Department of the Treasury ("Treasury").[13] The calculation of expected losses should also be fairly straightforward. FHFA has access to a wealth of data about historic loan performance. Expected losses should be calculated from historic performance data taking into account recent changes in underwriting that we discuss in Section III of this input.

Table 1 below shows the default and severity assumptions, and the calculated g-fee needed to cover expected losses. When we add in the operating expense cost given in the Request for Input (17 bps), the g-fee required for these loans is 42bps. We agree with the authors of *Guarantee Fees—An Art, Not a Science* report from the UI report by Goodman et. al. ("UI Report")[14] that this estimate is reasonable and even slightly conservative.

Table 1: Calculating the G-Fee Based on Expected Losses for Borrowers with FICO 620 - 699 and LTV (81-97)

Normal Default Rate (%)	4.60%	Performance of 2001 loans
Normal Severity (%)	15%	Performance of 2001 loans (includes charter level MI)
Normal Losses (bps)	69	Calculation (default x severity)
Stressed Default Rate (%)	28.50%	Performance of 2007 loans
Stressed Severity (%)	25%	Performance of 2007 loans (includes charter level MI)
Stressed Losses (bps)	712	Calculation (default x severity)
Expected Annual Losses (bps)	25	Calculation (95% normal losses + 5% stressed losses) / 4 year duration

Source: Goodman, et. al. (2014)[15]

The third component of the estimated cost, the cost resulting from holding the amount of capital required for unexpected credit losses, is based on the amount of capital required and the target return on that capital. We first focus on the calculation of the amount of capital required and then turn to the target return on capital.

[13] This is required by the Temporary Payroll Tax Cut Continuation Act of 2011.
[14] LAURIE GOODMAN ET. AL., GUARANTEE FEES—AN ART, NOT A SCIENCE (2014), *available at http://www.urban.org/UploadedPDF/413202-Guarantee-Fees-an-Art-Not-a-Science.pdf*
[15] Id.

A. Calculating the Amount of Capital Required for Unexpected Losses:

Calculating the amount of capital required for unexpected losses requires assumptions about both the experience and likelihood of a stress scenario. Predictive models, while based on historic experience should also be sensitive to wider economic conditions and factors like Housing Price Index and unemployment and household formation rates. As we cannot present a model based on those factors for the purpose of this analysis, we follow from model projections discussed in the UI Report. The UI Report's methodology assumes that the performance of the 2007 book of loans represents an extreme case of stress performance (see Table 1 above for default, severity and loss estimates). The results of the UI model closely approximate the numbers in the Request for Input, so we conclude that the modeling done by FHFA rests on similar assumptions.[16]

Although we present this extreme case, CRL does not recommend that FHFA model unexpected losses solely on the performance of loans originated in 2007. We believe the following factors should be taken into consideration when FHFA models a stress scenario:

1) Loan performance should be based only on loans that would meet the QM and Ability-to-Repay requirements outlined in The Dodd–Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").[17]
2) Loan performance should be based on more than a single origination year.

FHFA should have sufficient data to modify their stress case assumptions for these two factors. First, the model should be altered to reflect the fundamental underwriting changes that have been made as a result of the housing crisis. We note below that the QM and Ability-to-Repay provisions in Dodd-Frank eliminate the riskiest loans from the marketplace and it is unreasonable to model future defaults on loans that are no longer a part of the marketplace.

Second, the GSEs business model pools risk and pooled risk should be reflected in the risk modeling. The 2007 book of loans experienced the most severe losses. However, these were not the only loans on the GSEs books during the crisis. Loans originated in earlier years also experienced losses, though none to the extent of the 2007 book. The model should take a portfolio approach and model overall defaults for a range of origination years at the time of the stress scenario. We suggest this could be done very conservatively by using the overall default rate of loans originated from 2002-2011 (rather than 2007 defaults alone). This would still model a stressed scenario, but would provide a reasonable proxy for the portfolio of loans that the GSEs might have in a stressed case.

In addition, FHFA should incorporate to some degree the probability of a particular stress case scenario. Incorrectly allocating capital needs based upon 2007 stress scenarios for all loans is grossly overestimating unexpected losses. As a result, we find that the g-fees estimation based upon the FHFA model is overpriced. Adding in an assumption of the probability of a stress-scenario has a dramatic effect on the calculated amount of capital required, as shown in Table 2.

[16] Id.
[17] Pub.L. 111–203.

This again models only the scenario for borrowers with 620-699 credit scores and 81-97 LTV loans.

Table 2: Capital Allocated to Unexpected Losses (bps)

100% probability of stressed scenario	712
75% probability of stressed scenario	534
50% probability of stressed scenario	356
25% probability of stressed scenario	178

Note: The losses in a stressed scenario are shown in Table 1 and based only on 2007 performance.

As the g-fees calculation already includes estimates for expected losses, it is reasonable that the unexpected loss calculation should be discounted in some way for the probability of experiencing a stressed scenario. *Failing to factor this into the model effectively assumes that every new loan faces the 2007 probability of default.*

Another modeling assumption that is not discussed in the Request for Input but has a dramatic impact on the g-fee calculations is how the model incorporates g-fee income in the capital calculations as discussed in the UI Report. We believe that FHFA should model the required capital by including expected revenue from g-fees. Incorporating expected g-fees into the model accounts for the reality that the GSEs will be able to pay for losses both out of the capital set aside and from the premiums they will collect from loans. Including this revenue in the calculations is consistent with the way that banks are regulated and do business. **For borrowers with FICO scores between 620-699 and loans with LTVs between 81-97%, the UI Report shows how including expected returns from g-fees reduces the capital required in a stressed scenario by nearly 40% from 712 to 429 bps.** The GSEs also have other sources of income beyond the per loan g-fees, such as pair off fees, buy up and buy down fees, float and investment income. The Enterprises should use their retained earnings from all activities to reduce the capital requirements. This change will have a significant impact on capital requirements.

B. <u>CRL Urges FHFA to Model Future Capital Needs by Choosing a Reasonable and Appropriate Rate of Return on Capital.</u>

The final component of the g-fees calculation is to choose a reasonable and appropriate rate of return on capital to apply to the capital. The Request for Input suggests two rates – 9% and 15%. We believe that both rates are higher than is reasonable and that FHFA should choose a lower rate of return, especially for underserved borrowers and communities. The GSEs are operating under conservatorship with public support and not as private entities. As such, a market rate of return on capital is not an appropriate assumption. Again, the UI Report shows the extent of the effect that this assumption has on the final calculation of g-fees. Table 3 below summarizes the effect varying some of the assumptions we've discussed in responding to this question including varying the rate of return. The final row shows g-fees for a very conservative estimate of stress, yet the resulting g-fee is below the 80bps that is currently charged to these borrowers.

Table 3: Varying assumptions in calculating the g-fee for borrowers with FICO 620-699 and LTV 81-97%

	Capital Required	G-Fee
Expected Losses and Operating Costs Only		42
Expected Losses and Operating Cost Plus Capital for Unexpected Losses as: 100% probability of a stressed scenario, 10% rate of return on capital, no credit for g-fees	712	138
Expected Losses and Operating Cost Plus Capital for Unexpected Losses as: 100% probability of a stressed scenario, 10% rate of return on capital, credit for g-fees	429	100
Expected Losses and Operating Cost Plus Capital for Unexpected Losses as: 100% probability of a stressed scenario, 5% rate of return on capital, credit for g-fees	523[18]	72

Source: Goodman, et.al. (2014)[19]

In sum, CRL is concerned about the modeling and assumptions used to generate the g-fees described in the Request for Input. In Question 8 of the Request for Input, FHFA asks what alternatives should be considered in balancing increased used of risk based pricing with HERA mission requirements. Based upon our findings discussed above, CRL is concerned that justifying such an increase in pricing with the models FHFA presents will harm the housing recovery and prevent credit worthy borrowers from attaining successful homeownership. In addition, we question FHFA pricing arguments, particularly with low FICO and high LTV loans, on these models presented in the FHFA Request for Input alone. We (and FHFA) have noted that HERA allows FHFA to accept lower returns for the social good of housing for low and moderate income families. *Accepting a reduced return on capital for loans that fulfill statutorily mandated and social need is well within the mission of the GSEs.*

As mentioned above, low and moderate income borrowers tend to fall in FICO 620-699 and LTV 81-97% square. We strongly encourage FHFA to target a return on equity ("ROE") half the standard level for LMI borrowers and all borrowers. As an example, we have shown above returns and capital levels with 5% ROE. Based upon our findings discussed above, CRL is concerned that justifying such an increase in pricing with the models FHFA presents will harm the housing recovery and our economy, while preventing credit worthy borrowers from attaining successful homeownership.

III. FHFA's proposal should take into account the impacts of Dodd-Frank's mortgage reforms.

In Question 12 of its Request for Input, FHFA asks what interactions with the QM rule FHFA should consider in determining g- fee changes. The reforms put in place by Dodd-Frank, chiefly the Ability-to-Repay standard and the QM rule, have fundamentally changed the mortgage

[18] Since the expected g-fee income is an input in the calculation of the amount of capital required, the capital required is higher under a 5% rate of return than under a 10% rate of return.
[19] Id.

market, reducing the risk of default and foreclosure and pushing the market towards superior quality. FHFA's risk modeling and setting of g-fees must take into consideration that the current and future mortgage market will be shaped by these rules.

We discussed in Section II what we find to be appropriate future stress and capital modeling in light of these changes. First, we urge FHFA to limit the stress losses used in the model to the performance of loans that would meet today's requirements. Doing so would rightly eliminate subprime, Alt-A, no-doc and other toxic loans with risky features. These loans cannot be made under the new rules and should not be part of any models used to predict future losses. Second, we believe FHFA should apply a probability factor in calculating the capital required to account for unexpected losses.

Finally, we urge that the model be adjusted to account for major reforms to mortgage lending that have recently been implemented. The US housing market is beginning to emerge from the worst housing crisis since the Great Depression. Massive foreclosures have undercut the economic progress and security of families across the country. Importantly, the damage has not been limited to those families who have been directly displaced from their homes and neighborhoods. Rather, the devastation has spread throughout communities, destabilizing neighborhoods with vacant and vandalized houses, reducing the home equity wealth of neighbors and starving municipalities of property tax revenue.

The housing crisis was not merely caused by a drop in housing values; it was also fundamentally caused by reckless and poorly regulated mortgage lending. The QM rule and Ability-to-Repay standard set much higher and safer standards for lending, thus significantly reducing the likelihood of the nation experiencing a similar crisis. In other words, a housing crisis analogous to the one that resulted in the Great Recession is much less likely given the primary causes of the housing crisis have been largely addressed by legislative and regulatory reforms.

At its core, the foreclosure crisis was caused by harmful mortgage features and lending practices that pervaded the pre-crisis mortgage market. In 2006, a CRL report estimated that predatory subprime lending would lead to approximately 2.2 million foreclosures.[20] At the time, this report was denounced by the mortgage industry as overly pessimistic. As we all now know, the system was actually loaded with far more risk and the 2006 estimates were actually extremely conservative. A 2011 CRL report, *Lost Ground: Disparities in Mortgage Lending and Foreclosures* highlighted the link between risky mortgage features and foreclosure rates.[21] For mortgages originated between 2004 and 2008, this report showed that loans originated by a mortgage broker, containing hybrid or option adjustable rate mortgages ("ARMs"), having prepayment penalties, and featuring high interest rates (i.e. subprime loans) had much higher foreclosure rates than loans without these features.

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[20] Ellen Schloemer, Wei Li, Keith Ernst and Kathleen Keest. *Losing Ground: Foreclosures in the Subprime Market and their Cost to Homeowners*, December 2006. *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/foreclosure-paper-report-2-17.pdf

[21] Debbie Gruenstein Bocian, Wei Li, Carolina Reid and Roberto Quercia. *Lost Ground, 2011: Disparities in Mortgage Lending and Foreclosures*, (2011) *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/Lost-Ground-2011.pdf

Lost Ground also demonstrated that, while the majority of foreclosures have affected white borrowers, African Americans and Latinos have suffered foreclosures rates roughly twice that of whites, likely reflecting the fact that borrowers of color were much more likely to receive loans with risky loan features, even after controlling for credit score.[22] All of these links were confirmed by the Department of Housing and Urban Development (HUD) in its final report to Congress on the causes of the foreclosure crisis, which found that, while softening housing prices were clearly a triggering factor, the foreclosure crisis itself was "fundamentally the result of rapid growth in loans with a high risk of default—due both to the terms of these loans and to loosening underwriting controls and standards."[23]

Recognizing that the housing crisis was caused by irresponsible terms and practices, Congress drafted the Dodd-Frank Act to contain several layers of protections against these abuses and strategies for preventing new abuses from arising in the future. These include: (1) explicit bans or restrictions on specific risky loan features and lending practices; (2) an Ability-to-Repay standard that all loans must meet, in addition to incentives for lenders to originate "qualified mortgages"; and (3) risk retention for mortgage securitizers.

Since the foreclosure crisis, the GSEs have also adopted new standards that ensure that they do not buy or invest in risky loans. The Consumer Financial Protection Bureau (CFPB) promulgated regulations that established four pathways to QM status. This results in a definition that provides consumer protections while also ensuring broad access to credit. The CFPB's QM provisions went into effect for lenders on January 10, 2014. With a few narrow exceptions for certain agencies and small lenders, loans will only meet QM criteria if they: 1) are fully amortizing i.e., no interest-only or negatively amortizing loans, 2) have points and fees that do not exceed 3% of total loan amount, 3) do not exceed 30 years, and 4) are fixed rate or contain adjustable-rate loans that have been underwritten to the maximum rate permitted during the first five years. Finally, when a loan gains status as QM, it carries with it a legal presumption of complying with the Ability-to-Repay requirements. The CFPB's final rule creates two different kinds of legal presumption: a safe harbor and a rebuttable presumption. Under a safe harbor, a borrower is unable to challenge whether the lender met its Ability-to-Repay obligations. Under a rebuttable presumption, the borrower has the ability to raise a legal challenge but must overcome the legal presumption that the lender complied with this obligation.

The CFPB also established the Ability-to-Repay provision, which requires lenders to determine whether a borrower can afford a mortgage. Lenders are deemed to have complied with the Ability-to-Repay provision if they originate loans that meet the QM definition. This provision will prevent features such as no documentation loans that allowed for reckless lending and resulted in a myriad of defaults and foreclosures.

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[22] For example, African-American and Latino borrowers with FICO scores above 660 were three times as likely to have a higher interest rate mortgage than white borrowers in the same credit range. See also RISKY BORROWERS OR RISKY MORTGAGES? INNOVATIVE FINANCIAL SERVICES FOR THE UNDERSERVED: OPPORTUNITIES AND OUTCOMES 2009 COMMUNITY AFFAIRS RESEARCH CONFERENCE, CENTER FOR COMMUNITY CAPITAL, *available at* http://ccc.sites.unc.edu/files/2013/06/RiskyBorrowersRiskyMortgages.pdf

[23] U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, OFFICE OF POLICY DEVELOPMENT AND RESEARCH REPORT TO CONGRESS ON THE ROOT CAUSES OF THE FORECLOSURE CRISIS, 29 (2010) *available at* http://www.huduser.org/Publications/PDF/Foreclosure_09.pdf

Given that these harmful loan features and lax underwriting standards are no longer a major threat to the GSEs, modeling future risk based upon nearly extinct loan practices and their resulting defaults/loss of capital should not play a part in GSE capital modeling in a post Dodd-Frank/CFPB market. For example, loans that were classified as Alt-A, which the GSE's increasingly insured before entering conservatorship, required little to no documentation even for higher credit scored borrowers. High defaults on these Alt-A loans caused great losses for Fannie Mae and Freddie Mac, but are not likely to have any additional impact to the GSEs now that the QM rule and Ability-to-Repay standard is in effect.

Studies have shown that taking into account that the worst types of loans are mostly no longer in use, the GSEs have enough capital to cover losses without subsidy function even in the event of another recession. The Urban Institute for example conducted a study on the amount of capital required to keep the GSEs running, and modeled its stress scenarios based upon the 2005-2008 time period, which as we know was a disastrous time for the US housing market. The results of the study showed that given the recently implemented g-fee increases, the GSEs would have enough capital to withstand another recession that mirrored the 2005-2008 period losses.[24] The study itself is very conservative considering that, like the FHFA, the UI modeled its stress and default calculations from 2007.

Finally, the Board of Governors of the Federal Reserve System ("the Federal Reserve") conducted a study this year of catastrophic loss projections for GSEs and determined that in light of a catastrophic economic scenario, the GSEs would lose up to a projected $190 billion, which is less than what Fannie Mae and Freddie Mac currently have in their PSPA's with Treasury.[25] Regardless of this finding, the reforms of Dodd-Frank have cleansed the housing market of many of the types of loans that would result in such a loss in the first place, leaving the chances of such a loss to be drastically less than before the implementation of housing and lending reform.

Given the most recent implementation of the QM rule in January of this year, the most appropriate data to determine the next steps will not be available for some time. We urge the FHFA to proceed carefully in light of this important reform to the mortgage market and modify its model with the assumption that the risk of toxic loans and the impact they had on the overall market is considerably reduced.

IV. <u>CRL Urges FHFA to Keep the GSEs Involved in Maintaining a Broad Competitive Market for Borrowers.</u>

In Question 6 in its request for input, FHFA asks if higher g-fees imposed on low credit score/high LTV categories is desirable if this results in more borrowers moving to FHA/Ginnie

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[24] Based upon models assuming capital levels from the 2005-2008 era, Laurie Goodman's Research the current level of g-fees is sustainable. http://www.urban.org/UploadedPDF/412935-The-GSE-Reform-Debate-How-Much-Capital-Is-Enough.pdf At 2, 10 (citing Mark Zandi).

[25] Under Current Conditions, the $190 Billion loss is less than 4 percent of the size of Fannie and Freddie and would amount to two percent losses on their actual credit portfolio, and would still leave Fannie and Freddie with tens of billions more dollars on its government funding commitment, *available at* http://www.fhfa.gov/AboutUs/Reports/ReportDocuments/GSEFinProj2014FINAL.pdf at 6 (2014) (citing DFAST http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20140320a1.pdf)

Mae. Again, CRL encourages FHFA to enhance access to credit from underserved communities in order to avoid a dual market. As it stands, the Federal Housing Administration ("FHA") already manages a great deal of loans coming from low-wealth communities and communities of color. CRL discourages fees and practices that will further drive underserved communities directly to the FHA. While CRL applauds the various government agencies, sponsored programs, and initiatives to promote homeownership, we do not want to force entire segments of the population to a singular recourse of homeownership, simply due to the current status of wealth. A dual market approach is also not desirable given the GSEs have an explicit duty to reach the very communities at risk of being driven away from the GSEs due to unreasonable fee increases.

A dual market approach has never served the country well. For example, a dual market existed during the recent mortgage boom, when half of all African-American families were steered into high-cost, abusive subprime mortgages, while most white borrowers received prime loans. Going forward, lower-wealth families and communities should not be pushed into FHA as a sole housing reform solution. Rather, families able to succeed in a mainstream mortgage should be able to access the mainstream market and have more choices in their borrowing options. The GSEs are in a position to cover more of the market than currently served. Additionally, the option to choose conventional credit will create market competition which could help lower costs in mortgage lending for underserved borrowers.

<u>Increasing G-Fees Will Not Necessarily Result in Greater Private Label Securities ("PLS") Investor Participation.</u>

Questions 4 and 5 of the Request for Input ask about g-fee levels' impact on private-label security (PLS) investors, lenders holding loans on portfolio, and loan originations. Lenders are currently holding loans on their own balance sheets instead of selling to the GSEs. PLS investors, on the other hand, have shown very little interest in reentering the market.[26] G fees should be set at appropriate levels to cover responsible risk and meet the duty to serve outlined in HERA. Taxpayers and homeowners should not be punished by artificially raising g fees in order to try to shrink the Enterprises by enticing the PLS market to reenter.

Private capital has not been involved in the mortgage market, even as the market has entered recovery. An increase in g-fees would not lead to an increase in private capital into the marketplace, but instead would make homeownership inaccessible for borrowers who would be shut out as the market became more expensive.

In terms of question 7 of the Request for Input, it is not desirable for the Enterprises to charge higher g fees on high credit score/low LTV loans if it causes these loans to be insured/securitized through PLS or held on depository balance sheets. As long as the capital charges are shared equitably, it is a benefit to consumers to have these credit profile borrowers guaranteed by the Enterprises.

[26] See HOUSING AT A GLANCE, THE URBAN MONTHLY CHARTBOOK, 8 (2014), *available at* http://www.urban.org/UploadedPDF/413206-Housing-Finance-At-A-Glance-A-Monthly-Chartbook-August2014.pdf

V. Other Concerns

CRL Urges FHFA to Refrain from Imposing Fees on Judicial States.

In addition, CRL discourages fees directed at judicial states that have longer processes in the foreclosure process, which FHFA addresses in question 11 in its Request for Input. These delays are much more due to poor documentation by lenders and lack of capacity by servicers than the underlying state foreclosure laws, most of which have been in effect for decades without substantial impact. Furthermore, states that have additional procedures have the impact of protecting homeowners, particularly in this economic crisis from immediately losing their homes. Struggling homeowners, many of whom are victims of poor loans and servicing that led to the crisis in the first place, and states with laws that protect them should not be penalized with additional fees. FHFA should encourage processes that promote mitigation and avoid foreclosure wherever feasible.

CRL Urges FHFA to Mitigate the Impact of Increases in G-Fees and MI Eligibility Requirements on the Same Borrowers.

In light of FHFA's request for input regarding private MI eligibility requirements, CRL once again strongly urges FHFA to proceed with caution. Borrowers, especially those in the low FICO range, are in danger of facing unreasonable and overwhelming fees associated with homeownership given this proposal and the recently released MI proposal. Not only are the current risk models based upon the disastrous aftermath of now defunct types of loans, but the additional MI proposal threatens to deliver two-tiered dose of fees to moderate income and lower wealth borrowers to address related concerns. In order to facilitate a healthy housing market for lenders and consumers alike, FHFA should work with the most accurate and current data to determine the appropriate next steps. If rules and policies are enacted in advance of the most relevant data being available, there is a grave risk of missing a key issue or creating a consequential loophole that will hurt both consumers and the industry.

Conclusion

CRL applauds the efforts of FHFA as we rebound from a devastating housing and economic crisis. FHFA has an enormous responsibility both to minimize risk and protect and foster an open and inclusive housing market. We commend FHFA for striving to find a balance between the two and for opening up these important issues to public comment. After reviewing the issues, we ultimately conclude that the g-fee increases as proposed should not be adopted, that FHFA should reassess the models used to justify calculate g-fees and consider lowering fees. Analysis presented in our comment and by others strongly suggests that the models FHFA presented in the Request for Input are too conservative. Furthermore, the costs these increases would impose, particularly on borrowers with lower FICO scores and lower down payment needs, construct additional and unnecessary barriers to homeownership for first time homebuyers, lower wealth families and minority communities who are already struggling to achieve homeownership today. Rather than implement these changes, we believe that FHFA should consider lowering the g-fees. Alternative modeling suggests that current g-fees more than cover conservatively modeled risk scenarios. Recent housing market trends indicate many borrowers are unable to access affordable mortgage credit even at these levels. *FHFA should consider areas where they could* *reduce fees to promote greater access to the housing market.* We thank FHFA once again for the opportunity to submit input on this very critical subject.