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Committee on Financial Services

A Failure to Act: How a Decade without GSE Reform Has Once Again Put Taxpayers at Risk

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I. Introduction

Good morning Chairman Hensarling, Ranking Member Waters, and Members of the House Committee on Financial Services. Thank you for the opportunity to testify regarding our nation's housing finance system during the 50th year commemoration of the federal Fair Housing Act, which promises all Americans an opportunity to live in thriving communities free of housing discrimination including in the sale, financing, and securitization of mortgage loans. Housing is an issue that profoundly impacts American families as all Americans deserve a safe and decent place to live. Housing accounts for nearly 20 percent of the national economy as homeownership is the engine that drives the economy by creating jobs that stabilize communities across the nation. Homeownership is also one of the most important tools for building and passing on wealth for most middle-class families in America.

I am Executive Vice President of the Center for Responsible Lending (CRL), a nonprofit, nonpartisan 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, a community economic development lender headquartered in Durham, NC. Since 1980, Self-Help has provided more than $7 billion in financing to 131,000 families, individuals, and businesses under-served by traditional financial institutions. It helps drive economic development and strengthen communities by financing hundreds of homebuyers each year, as well as nonprofits, child care centers, community health facilities, public charter schools and residential and commercial real estate projects. Through its credit union network, Self-Help's two credit unions serve more than 130,000 people in North Carolina, California, Illinois, Florida and Wisconsin and offers a full range of financial products and services. Learn more at www.self-help.org and www.self-helpfcu.org.

This important hearing provides an opportunity to look back over the last decade where significant reform occurred in the secondary market and offer a pathway for continued improvement by moving to a utility model that regulates rates of return, and that can be achieved through administrative action. Such action will lead us toward creating a more equitable housing finance system rooted in access to safe and responsible mortgage credit for all credit-worthy consumers on affordable terms. The prior approach of extreme caution must continue as we build on initial repairs so as not to disrupt the delicate recovery that the system is experiencing. The foundations offered by the Housing and Economic Recovery Act of 2008 (HERA) and the new rules created by the Dodd-Frank Act and the Consumer Financial Protection Bureau (CFPB) deliver important safety and soundness regulation that the prior system lacked. Our end goal must be to better protect taxpayers from systemic catastrophic risk and incorporate important market segments--people of color, low-to-moderate income families, and rural residents – that a well-functioning future system depends. Successful reform produces a system that serves the full universe of credit worthy borrowers, and provides equal treatment for small lenders, including community banks and credit unions, which often are the only sources of mortgage credit in underserved communities across the nation.

Today's testimony draws extensively from our October 25, 2017 remarks delivered before the House Financial Services Committee Subcommittee on Housing and Insurance.[1]

II. The GSEs and Ginnie Mae Provide Important Access to Mortgage Credit in Underserved Communities

Both the GSEs and Ginnie Mae continue to provide critical mortgage capital to underserved communities. The GSEs purchased more than two million homes and refinance mortgage loans in 2015, including almost half a million loans to low- and moderate-income borrowers, nearly 400,000 loans to borrowers of color and over 300,000 loans to borrowers living in rural areas. At the same time, smaller financial institutions (those with assets less than $10 billion) originated and sold loans to the GSEs in order to meet the credit needs of nearly 400,000 borrowers seeking mortgage credit in rural communities, relying on the GSEs for critical capital. Loans backed by Ginnie Mae also continue to play a significant role in serving borrowers whose credit may warrant additional enhancement or who have limited resources for a down payment. However, government-backed lending cannot and should not be the sole source of mortgage lending in these communities.

To better understand the GSE market share among low- and moderate-income borrowers, borrowers of color, rural borrowers and among community banks and credit unions, CRL analyzed over six million home purchase and refinance mortgages for first-lien, owner-occupied, 1-4 family homes (including manufactured homes) reported under the Home Mortgage Disclosure Act in 2015 (referred to as purchase lending and refinance lending going forward). Of these loans, 34.2 percent were sold to Fannie Mae, Freddie Mac or Farmer Mac (collectively, the GSEs) and 16.2 percent were loans guaranteed through Ginnie Mae (see Figure 1).

Figure 1. 2015 purchase and refinance loans by purchaser

	All loans		**Loans to LMI borrowers**		**Loans to borrowers of color**	
	#	%	#	%	#	%
GSEs	2,065,978	34.2%	457,450	31.3%	374,133	30.0%
Ginnie Mae	976,119	16.2%	235,514	16.1%	262,773	21.1%
Not sold in 2015	1,245,698	20.6%	275,054	18.8%	225,453	18.1%
Other	1,752,868	29.0%	493,318	33.8%	382,781	30.7%
Total	**6,040,663**		**1,461,336**		**1,245,140**	

[1] Sustainable Housing Finance: Private Sector Perspectives on Housing Finance Reform, Hearing before the Subcommittee on Housing and Insurance of the House Financial Services Subcommittee, 115th Congress. 1-26 (2017) (Testimony of Nikitra Bailey), *available at* https://financialservices.house.gov/uploadedfiles/hhrg-115-ba04-wstate-nbailey-20171025.pdf.

Source: CRL analysis of 2015 Home Mortgage Disclosure Act data, home purchase and refinance mortgages for first-lien, owner-occupied, 1-4 family homes, including manufactured homes. GSEs refers to all loans sold to Fannie Mae, Freddie Mac or Farmer Mac in 2015 calendar year. Other category includes loans acquired by an affiliate institution, commercial bank, savings bank, savings association, life insurance company, credit union, mortgage bank, finance company or private securitization.

A. The GSEs and Ginnie Mae Provide Important Credit Access for Low- and Moderate-Income Borrowers and Borrowers of Color

In 2015, GSEs purchased 457,450 purchase and refinance loans made to low- and moderate-income (LMI) borrowers, making up 31.3 percent of purchase and refinance mortgage lending to LMI borrowers, or borrowers with incomes less than 80 percent of the area median income. Likewise, Ginnie Mae guaranteed 235,514 purchase and refinance loans to LMI borrowers, making up 16.1 percent of all purchase and refinance lending to low- and moderate-income borrowers (Figure 1).

During the same year, the GSEs purchased 374,133 loans to borrowers of color, or 30.0 percent of all loans to these borrowers and Ginnie Mae guaranteed 262,773 FHA loans to borrowers of color—a 21.1 percent market share.

B. GSE Market Share Exceeds Ginnie Mae Market Share in Rural Communities

While conventional financing and the GSEs remain a critical component of the mortgage market in low- and moderate-income communities of color, the GSEs also provide an important source of mortgage capital in rural communities.[2] According to research by CRL and released by Brookings Institution, the GSEs purchased nearly one out of every three new mortgages in rural communities in 2016. In 2016, lenders made over 1.2 million purchase and refinance loans in rural areas.[3] The GSEs also purchased 80,680 purchase and refinance loans to LMI borrowers in rural areas and 24,132 loans to rural borrowers of color, a 26.7 percent and 21.9 percent market share, respectively (Figure 2).

In comparison, Ginnie Mae guaranteed 244,573 FHA loans in rural areas, including 59,455 (19.7 percent) to rural LMI borrowers and 30,308 loans (27.6 percent) to rural borrowers of color.

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[2] Calhoun, Michael, Tom Feltner, and Peter Smith. Supporting Mortgage Lending in Rural Communities. Brookings Institution, (January 2018). https://www.brookings.edu/wp-content/uploads/2018/01/es_2018_01_10_rural_housing_report.pdf.

[3] Census tracts, which were classified as either urban or rural areas based on the 2017 definition of rural area at 12 CFR 1282.1, and *available at* https://www.fhfa.gov/DataTools/Downloads/Pages/Duty-to-Serve-Data.aspx.

Figure 2. 2016 purchase and refinance loans by purchaser in rural areas

	All loans		All rural loans		Loans to rural LMI borrowers		Loans to rural borrowers of color	
	#	%	#	%	#	%	#	%
GSEs	**2,427,505**	**35.2**	**364,719**	**30.3**	**80,680**	**26.7**	**24,132**	**21.9**
Ginnie Mae	1,191,979	17.3	244,573	20.3	59,455	19.7	30,308	27.6
Not sold in 2016 CY	1,346,756	19.5	283,722	23.5	74,531	24.7	24,926	22.7
Other	1,932,929	28.0	311,900	25.9	87,058	28.8	30,643	27.9
Total	**6,899,169**		**1,204,914**		**301,724**		**110,009**	

Source: Center for Responsible Lending analysis of 2016 HMDA data

The GSEs also provide a critical source of mortgage capital for smaller lenders, those with assets of less than $10 billion in 2016. The GSEs purchased 100,151 purchase and refinance loans from smaller lenders lending in rural areas, or 26.8 percent of the market. Ginnie Mae guaranteed just 9,119 purchase and refinance loans made by small lenders in rural areas that same year—a 2.4 percent market share (Figure 3).

Figure 3. 2016 purchase and refinance loans originated by small lenders by purchaser in rural areas

	Purchase		Refinance		Total	
	#	%	#	%	#	%
GSEs	50,334	24.6%	49,817	29.6%	100,151	26.8%
Ginnie Mae	7,450	3.6%	1,669	1.0%	9,119	2.4%
Not sold in 2016 CY	78,691	38.4%	79,975	47.4%	158,666	42.5%
Other	68,252	33.3%	37,123	22.0%	105,375	28.2%
Total	**204,727**		**168,584**		**373,311**	

Source: CRL analysis of 2016 Home Mortgage Disclosure Act data

In addition to support for homeownership, the GSEs also play a vital role in supporting affordable rental housing, which is essential for many working families. These programs have performed well, even through the recent financial crisis, and should be continued going forward.

III. FHA is a Critical Component of the Housing Finance System and Along with the GSEs Saved the Market from Total Collapse. To Remain Effective and Achieve its Goal of Promoting Homeownership, it Must be Reformed and Modernized.

A. When Considering Reform Changes to the Housing Finance System, it is Crucial to Start by Recognizing the Central Role that the GSEs and FHA Play in the Nation's Housing Market Recovery

The GSEs and FHA ensured that stable and affordable mortgage credit was available across the country throughout the economic downturn and are still essential to the market today. Currently, they hold mortgages worth $6.17 trillion with Fannie Mae at 44.2 percent, Freddie Mac at 27.5 percent, and Ginnie Mae at 28.3 percent.[4] The GSEs were created by Congress in the 1930s to provide stability to the capital markets and to increase the availability of mortgage credit throughout the United States following periods of significant economic instability. The GSEs have a mandate to serve all credit markets at all times, which guarantees broad credit availability in all regions of the nation. The charters of the GSEs state that they must "promote access to mortgage credit throughout the nation (including central cities, rural areas, and underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing."[5] By

[4] Laurie Goodman et.al., Housing Finance at a Glance: A Monthly Chartbook, at 6-7 (May 2017), *available at* http://edit.urban.org/sites/default/files/publication/90451/may_chartbook.pdf.
[5] Fannie Mae's charter is in Title III of the National Housing Act, 12 U.S. Code § 1716 et. seq. Freddie Mac's charter is in 12 U.S.C. §1451 et. seq.

pooling and securitizing mortgages, backed by an implied federal government guarantee, the GSEs have ensured the flow of credit to all parts of the nation. We now have a national mortgage market, investor confidence, increased loan volume, and widespread use of the 30-year fixed rate mortgage.

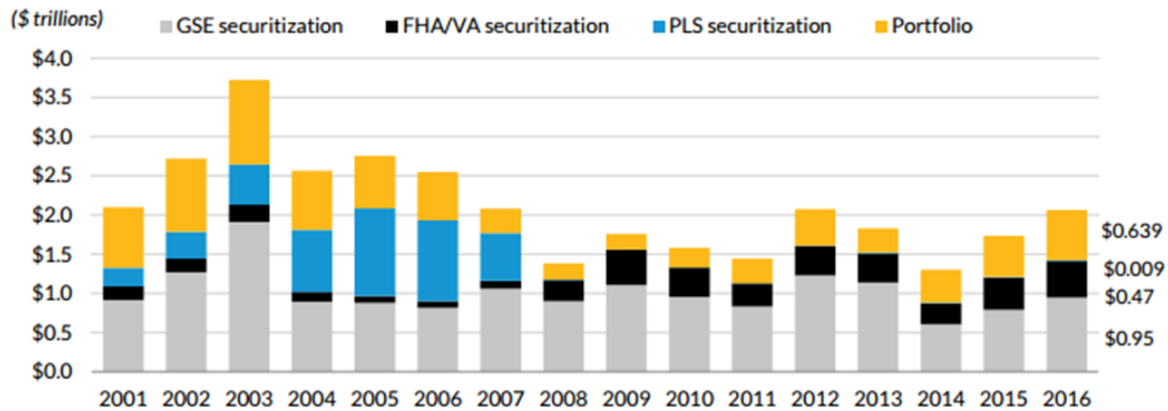
B. Following the Financial Crash, GSE and FHA Lending Saved the Market from Complete Shutdown

Private capital withdrew from the market during the housing crash. The countercyclical nature of the GSEs and FHA insured mortgage credit sustained the market during this time. Private label lending peaked in 2006 with approximately 40 percent of all mortgage originations.[6] It began to decline in 2007 and virtually stopped by 2008.[7] With record levels of defaults and foreclosures occurring alongside sharp declining prices nationwide, overall mortgage lending quickly dried up.

Credit would not have been available for most mortgagees if not for government support during the financial crisis. Backed by government guarantees, the GSEs, under Federal Housing Finance Administration conservatorship beginning in September 2008, and FHA continued to ensure the availability of credit. GSE lending jumped to over 65 percent of all mortgage originations in 2008.[8] FHA lending also played a key role as its involvement increasing rapidly.[9] Since then, FHA purchase loans have dropped steadily and returned closer to the normal levels of the early 2000s (Figure 9).[10] Moody's estimated that FHA's contribution prevented a second collapse in the housing market, which could have sent the U.S. economy into a double-dip recession and caused the economy to shed another three million jobs and the unemployment rate to rise an additional 1.6 percent.[11]

[6] Laurie Goodman et.al., Housing Finance at a Glance: A Monthly Chartbook, at 8 (May 2017), *available at* http://edit.urban.org/sites/default/files/publication/90451/may_chartbook.pdf.
[7] *Id.*
[8] *Id.*
[9] John Griffith, "The Federal Housing Administration Saved the Housing Market" (Washington: Center for American Progress, 2012), *available at* https://www.americanprogress. org/issues/housing/report/2012/10/11/40824/the-federalhousing-administration-saved-the-housing-market/. This report cites data estimates from Moody's Analytics in October 2010.
[10] US Department of Housing and Urban Development, Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund Fiscal Year 2010, at 2 (November 2010), *available at* https://portal.hud.gov/hudportal/documents/huddoc?id=report_to_congress.pdf; See also US Department of Housing and Urban Development, Federal Housing Administration Annual Report to Congress, The Financial Status Of the FHA Mutual Mortgage Insurance Fund Fiscal Year 2016, at 8 (November 2016), *available at* https://portal.hud.gov/hudportal/documents/huddoc?id=2016fhaannualreport1.pdf.
[11] John Griffith, "The Federal Housing Administration Saved the Housing Market" (Washington: Center for American Progress, 2012), *available at* https://www.americanprogress. org/issues/housing/report/2012/10/11/40824/the-federalhousing-administration-saved-the-housing-market/. This report cites data estimates from Moody's Analytics in October 2010.

Figure 9. First lien origination volume



Source: Inside Mortgage Finance and Urban Institute, last updated February 2017

C. Modernizing the FHA is Critical to Ensure It Carries Out its Mission to Promote Homeownership and Ensure Access to Credit

The FHA is one of the main pillars of the nation's housing finance system. The program creates an entry point for millions of first-time home buyers. As noted above, FHA was central to the nation's economic recovery after the financial crash by continuing to insure mortgage loans when private capital dried up. However, the program would benefit tremendously from both funding and statutory reform.

i. The False Claims Act

Lender liability under the False Claims Act has been the subject of a variety of proposed reforms. There is a recognized need to clarify what types of errors can trigger liability under the Act. The statute imposes treble damages against anyone who submits a false claim to the government, including FHA insurance payments. Because these treble penalties can cost a far greater amount than the loan itself, this has the potential to decrease the appetite for making FHA insured loans that have only a modest risk of defaulting.[12] This has potential negative effects on access to mortgage credit, especially for those borrowers that rely on FHA to secure mortgage loans. The False Claims Act can be a strong tool to curb fraud in the mortgage lending space and should be reformed to clarify the liability provisions so it can bolster access to credit.

ii. *Program Funding*

FHA loan volume plummeted during the subprime mortgage lending boom. In 2015, FHA lending slightly recovered, but while the increase in lending volume has bolstered FHAs capital levels it has

[12] See, *The Federal Housing Administration Can Do More With More*, April 2017, *available at* https://www.brookings.edu/research/the-federal-housing-administration-can-do-more-with-more/.

counterintuitively negatively impacted FHA's operations.[13] Under statute the entirety of FHA's revenue is sent to the Mutual Mortgage Insurance Fund (MMIF) and cannot be used for FHA's operations, regardless if that funding could significantly improve operational or program efficiency. For example, FHA attempted to address the False Claims Act ambiguity by establishing which errors would and would not trigger liability, but this effort was abandoned due to lack of funding.[14] Additionally, FHA loan servicing for modifications for troubled loans is expensive and risky, so servicers will be constrained in their ability to provide payment relief for borrowers without programmatic changes.

FHA has made attempts to secure additional funding to address these (and more) complications but has been met with resistance. One of these proposals was legislation authorizing a 4 basis point ongoing fee on FHA loans. Additionally, HERA authorized $25 million a year for five years out of a "negative credit subsidy", proceeds from the MMIF, to target system upgrades and quality control.[15] These upgrades would advance FHA's role in the housing market, protect taxpayers, and support the overall economy.

III. Access to Safe and Responsible Credit on Affordable Terms Must Be Central in the Future of the Housing Finance System

Despite historical inequities in access to mortgage credit, the future of the market depends on often-excluded borrowers including people of color and LMI families, the fastest growing segment of potential future homebuyers. These borrowers have less wealth, which has translated into lower credit profiles and an inability to make large down payments on mortgage loans.[16] Therefore, a future well-functioning system that serves all credit-worthy borrowers would not only fulfill the GSE's mission, but enable the mortgage market to thrive—for example, making it easier for families to sell their homes to new buyers.

A. Serve All Credit-Worthy Borrowers

Rural borrowers, new emerging households, LMI borrowers and borrowers of color all face obstacles to receiving competitive and affordable mortgage loans. Current statutory provisions governing the

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[13] See, *The Federal Housing Administration Can Do More With More*, April 2017, *available at* https://www.brookings.edu/research/the-federal-housing-administration-can-do-more-with-more/.

[14] See *The Federal Housing Administration Can Do More With More*, April 2017, *available at* https://www.brookings.edu/research/the-federal-housing-administration-can-do-more-with-more/.

[15] 12 U.S.C. § 4501 et. seq.; Section 2126 authorized $25m negative subsidy (This funding was dependent on FHA's meeting its statutory capital ratio, and FHA has been below this standard for several years before present day, so this provision was never implemented.)

[16] See The State of the Nation's Housing, Joint Center for Housing Studies, at 3 (2013) (stating that "[m]inorities—and particularly younger adults—will also contribute significantly to household growth in 2013–23, accounting for seven out of ten net new households. An important implication of this trend is that minorities will make up an ever-larger share of potential first-time homebuyers. But these households have relatively few resources to draw on to make down payments. For example, among renters aged 25–34 in 2010, the median net wealth was only $1,400 for blacks and $4,400 for Hispanics, compared with $6,500 for whites. Even higher-income minority renters have relatively little net wealth, with both blacks and Hispanics in the top income quartile having less than half the average net wealth of whites. Proposed limits on low-down payment mortgages would thus pose a substantial obstacle for many of tomorrow's potential homebuyers.")

GSEs include important measures to further service of these markets: the mandate to serve the broad market, even at a lower rate of return; affordable housing goals; the duty to serve under-reached markets; and the affordable housing funds. These were all included in or reaffirmed by HERA, which passed with strong bipartisan support. These bipartisan compromises, worked out over nearly a decade, must be preserved and expanded in order to meet needs of the current and future mortgage market, which will include large proportions of these borrowers. Equally important, credit risk transfers must continue to be done by the GSEs through mechanisms that do not price these borrowers or small lenders out of the market. This means credit risk transfers must be executed through reinsurance structures that permit pooling of loans and risk, and not through deeper upfront risk transfers.

B. Pricing Practices Should Expand Mortgage Access

The GSEs and FHA today have an affirmative duty to serve all markets which incentivizes them to set prices in a way that balances risk and access.[17] These participants in today's housing finance system are incentivized to pool risk and price credit risk on a pooled basis. Unfortunately, recent proposals for legislative housing finance reform share a common feature that undermines this pricing approach. Deep upfront credit risk transferred to private capital would incentivize actors to segment, rather than pool, credit risk and prices. Segmented pricing puts mortgage credit out of reach for too many credit-worthy borrowers by making mortgage debt more expensive.

The total amount borrowers pay to cover credit risk is a function of modeled losses, capital standards and the required rate of return on capital.[18] Modeled losses are largely independent of system structures.[19] Capital requirements and required rates of return on capital are dependent on the structure of a future system, and function to increase or decrease the overall total amount to be held to guard against losses.

It is the policies of participants in the housing finance system that translate predicted credit losses into borrower prices and distribute prices for borrowers with different characteristics. Importantly, the degree to which costs are pooled or distributed is determined by the structure of the housing finance system. For example, FHA charges the same insurance premium to borrowers regardless of credit score,[20] whereas private mortgage insurers charge widely different fees to borrowers with different credit scores and/or levels of down payment (Figure 4).

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[17] CRL continues to work with FHFA to encourage changes which could further open up access to credit. For example, eliminating the loan level price adjustments (LLPAs) that were put in place after the crisis.

[18] For a more detailed discussion of the levers that affect pricing and the distribution of pricing for credit risk see Calhoun, M. and Wolff, S. Who Will Receive Home Loans, and How Much Will They Pay?, 2016, *available at* http://www.urban.org/policy-centers/housing-finance-policy-center/projects/housing-finance-reform-incubator/mike-calhoun-and-sarah-wolff-who-will-receive-home-loans-and-how-much-will-they-pay .

[19] System structure could introduce new risks. For example, if a future system made it very difficult or costly for first-time homebuyers to purchase a home, then existing homeowners would have a difficult time selling their homes. This could depress housing prices or limit liquidity in the housing system overall, which could result in a downturn and create losses in the system above what would be predicted by current models.

[20] FHA premium rates *available at* https://portal.hud.gov/hudportal/documents/huddoc?id=17-07ml.pdf.

Figure 4. Private mortgage insurance pricing, 2017

	97-95.01% LTV 35% Coverage	95-90.01% LTV 30% Coverage	90-85.01% LTV 25% Coverage	85% LTV and under 12% Coverage
>=760	55	41	30	19
740-759	75	59	41	20
720-739	95	73	50	23
700-719	115	87	60	27
680-699	140	108	73	32
660-679	190	142	100	41
640-659	205	150	105	43
620-639	225	161	110	45

From online published rate sheets for Borrower Paid Mortgage Insurance from private mortgage insurers Genworth (https://mortgageinsurance.genworth.com/pdfs/Rates/11370775.Monthly_Natl.FIXED.0616.pdf) and Radian (http://www.radian.biz/sfc/servlet.shepherd/version/download/068C0000002osy9IAA)

Underwriting structures determine if borrowers are credit-worthy, but pricing structures have a significant impact on whether a credit-worthy borrower can afford a mortgage. Differential pricing creates an additional barrier to mortgage credit by increasing the price, sometimes significantly, for some borrowers relative to others. There is evidence of price acting as a barrier even in today's mortgage market. For example, although Fannie Mae's guidelines allow the GSEs to purchase loans with credit scores down to 620 and loan-to-value (LTV) ratios of up to 97 percent, very few loans purchased by the GSEs have these characteristics.[21] One reason is that risk-based pricing by both the GSEs and private mortgage insurers add significantly to the cost of loans for borrowers with lower scores and less wealth for a down payment. For example, the combination of loan-level price adjustments (LLPAs) and mortgage insurance (MI) premiums adds over 300 basis points to the cost of a mortgage for a borrower with a credit score of 620 and an LTV of 97 percent.[22]

The GSEs, though, currently set prices based on a more consolidated set of borrower characteristics than private actors like private mortgage insurers. They lay off credit risk largely through back-end credit risk transfer mechanisms which allows for pooling of loans and risk. Ultimately, these policies limit the degree to which loan pricing is highly segmented.[23]

[21] See p. 6 of *2017 First Quarter Credit Supplement*, Fannie Mae, May 5, 201, *available at* http://www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2017/q12017_credit_summary.pdf.
[22] 350/4+225=312.5 basis points. Fannie's Mae's LLPA for this combination of credit score and LTV is a one-time fee of 350 basis points (see page 2: https://www.fanniemae.com/content/pricing/llpa-matrix.pdf), we assumed a LLPA multiple of 4 to convert this upfront fee to an ongoing cost comparable to the MI premium. Borrower paid MI from Genworth for this combination of credit score and LTV is a continuing fee of 225 basis points (see: https://mortgageinsurance.genworth.com/pdfs/Rates/11370775.Monthly_Natl.FIXED.0616.pdf).
[23] Through the LLPAs the GSEs also have differential pricing, which limits their reach to underserved borrowers.

Comparing the GSE guarantee fee structure to the MI pricing structure reveals the private market's tendency to create finely defined bands. GSE guarantee fee pricing[24] breaks up credit scores into three bands: >=740, 700-739, and 620-699. From December 2013 to April 2016, MI companies broke up this same range into four bands: >=760, 720-759, 680-719, and 620-679. Recent MI pricing, released in April 2016, breaks this same range of credit scores into eight different bands: >=760, 740-759, 720-739, 700-719, 680-699, 660-679, 640-659, and 620-639 (Figure 5).

Finely defined pricing frameworks produce more extreme pricing. Figure 5 below shows the change in basis points borrowers with a given credit score experienced when PMI pricing changes were implemented in April 2016. Some borrowers, those with credit scores above 740, enjoyed a reduction in fees whereas others, almost all borrowers with scores below 680, experienced increases. The cells highlighted in dark green saw a decrease of more than 30 basis points. The cells highlighted in dark green saw a decrease of more than 30 basis points. The cells highlighted in dark orange saw an increase of more than 30 basis points (Figure 5).

Figure 5. Change in MI pricing by credit score and LTV December 2013 to April 2016

	97-95.01% LTV 35% Coverage	95-90.01% LTV 30% Coverage	90-85.01% LTV 25% Coverage	85% LTV and under 12% Coverage
>=760	-50	-13	-9	-4
740-759	-35	-3	-3	-7
720-739	-15	11	6	-4
700-719	-16	-2	3	-6
680-699	9	19	16	-1
660-679	42	27	29	2
640-659	57	35	34	4
620-639	77	46	39	6

From online published rate sheets for Borrower Paid Mortgage Insurance from private mortgage insurers Genworth and Radian for December 2013 and April 2016.

Proposed housing finance systems that rely on deep, upfront private capital to cover credit risk do not provide a countervailing pressure to market incentives to finely and differentially price credit risk. Even in the current system, in which the GSEs have incentives for risk and price pooling, troubling pricing differences prevent credit worthy borrowers from getting mortgages. Unfortunately, the legislative proposals further erode incentives for pooling and are likely to result in even greater differential pricing. This will make it even harder and costlier for credit-worthy borrowers of modest means to afford a mortgage.

[24] As described in *Fannie Mae and Freddie Mac Guarantee Fees: Request for Input*, FHFA, 2015*, available at* https://www.fhfa.gov/policyprogramsresearch/policy/documents/gfeerfi060514f.pdf

IV. Build on the Extensive Changes Already Made with the HERA, Dodd Frank Act's Ability-to-Repay and QM Rules with a Utility Model

Congress has already substantially reformed the housing finance system. It can now allow for continued changes through the administrative process because the FHFA is a more effective, stronger regulator for the GSEs that enjoys key enforcement tools to help rein in the abuses of the past. Moving the system to a utility model will build on the substantial reforms of the HERA and the reasonable protections provided through the Dodd-Frank Act's Ability-to-Repay Standard and QM rules.

A. A Utility Model Will Rein in Risky Profit Seeking Activity

The structure of the GSEs created a conflict that has been noted by many. While they had public purposes and goals, their structures made them accountable to shareholders who expected maximum returns. This created an incentive for the GSEs to take on more risks to increase returns. It also encouraged the GSEs to focus on the most lucrative segments of the market, underserving small lenders, rural communities, and LMI borrowers. To counteract this conflict, the GSEs should be restructured to operate as a utility that have a regulated rate of return and require the approval of new products and services. The Duty to Serve and Affordable Housing Goals would be maintained as well.

A new utility structure preserves the efficiencies and the key countercyclical role that the GSES play while protecting private entities from unfair competition. Under this structure, investors are provided a lower, but less volatile, rate of return. Additional advantages include closer oversight of the entities, including regulation of fees, as has been done in conservatorship of the GSEs. This change in structure would prevent the present conflict of interest created by the GSEs' structures.

1. Additional Reforms Must Include Prohibitions on Political Activities and Lobbying, Vertical Integration, and Portfolio Arbitrage

Other reforms that would also better align the GSEs with their important public goals include making permanent the ban on their political and lobby activities and continuing the prohibition on any vertical integration of their activities into the retail mortgage market.

It is accurate to say that the GSEs had exploited their implicit government backstop to borrow at advantaged interest rates and used this funding to arbitrage the purchase and holding of an outsized mortgage portfolio. Doing so produced much higher rates of return than just guaranteeing loans that they securitized. However, this action placed additional risk on the books of the GSEs. Such arbitrage should be prohibited, and the GSEs have dramatically reduced the size of their portfolios in recent years under pressure from the FHFA and Congress. However, some portfolio is necessary for the aggregation of TBA loans, the modification of distressed loans and the holding of specialized loans. Borrowing for these limited purposes should continue to be permitted and should be protected in times of stress. Otherwise, when the need for these services is greatest for the benefit of the overall economy, funding will be unavailable or unaffordable.

2. FHFA Requires the GSEs to be Well Capitalized and Participate in Credit Risk Transfer Programs

The FHFA has decreased taxpayer risk by requiring that the GSEs enter into credit risk transfers on most of their loans. This action decreases the amount of risk that the GSEs hold and has already increased private capital in the housing finance system. However, as stated above in the pricing section, front end credit risk transfers promote pricing segmentation and make mortgages less affordable. FHFA should direct the GSEs more towards back end credit risk transfers that will continue to allow them to pool risk.

3. The Boards of the GSEs Should Have Designated Public Positions

To ensure more accountability to the public mission of the GSEs, the boards should have designated public positions. This action will protect the public interest and could include seats for taxpayers, borrowers, and lenders, including community banks and credit unions.

V. Current Legislative Proposals to Reform the GSEs will Produce Less Access to Safe and Responsible Credit and Drive Up Cost

Since the Housing Crash of 2008, there have been various proposals to reform the GSEs. There is broad consensus that any future reforms must make the government backstop explicit and fully paid for, and that access to safe and responsible credit for all credit-worthy borrowers must be a central purpose of a future system. However, how to achieve those goals remains a point of major contention. Existing proposals fall far short of advancing the types of reforms needed to produce a more inclusive housing finance system and as drafted will increase cost for all borrowers by scrapping the system's current affordability mechanisms.

A. Preserve Duty-to-Serve and Affordability for All Market Participants

The statutorily defined duty-to-serve requirements ensure broad availability of mortgage credit throughout the business cycle, which ensures that no region of the nation is left out of the housing finance system. Congress created the obligation within the actual charters of the government sponsored enterprises (GSEs), and they state that the GSEs must "promote access to mortgage credit throughout the nation (including central cities, rural areas, and underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing".[25] These obligations continue through the Fair Housing Act of 1968, which Congress passed immediately following the death of Dr. Martin Luther King, Jr. who spent a crucial portion of his life working to address housing discrimination.[26] They are carried forward in the Equal Credit Opportunity Act of 1974 (ECOA), and are implemented through the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (FHEFSSA) and Housing and Economic Recovery Act of 2008 (HERA).[27] They represent Congress' long-term view that all secondary mortgage market participants have an affirmative duty to further fair lending.

Congress also created the Affordable Housing Goals in 1992 with FHEFSSA and carried them forward in 2008 with HERA to help expand credit access for underserved groups, ensure liquidity in the financial markets, and further fair lending goals.[28] Originally, the goals advanced lending opportunities to low-income families in underserved areas, which resulted in mortgage originators making more affordable

[25] 12 U.S.C. § 1716; 12 U.S.C. § 1451 note.
[26] 42 U.S.C. § 3601 et seq.
[27] 15 U.S.C. § 1691 et seq; 12 U.S.C. 4501 et seq; Pub. L. 110-289 (July 30, 2008).
[28] 12 U.S.C. § 4562 (single-family housing goals)

loans. The affordable housing goals made a tremendous impact on helping credit-worthy borrowers purchase homes. From 2003 through 2012, the National Community Reinvestment Coalition reported that more than 25 million hard-working families nationwide were able to become homeowners due to the goals.[29] Now, they are a metric for accountability by the GSEs' conservator, the Federal Housing Finance Agency, to address underservice to important, and often excluded, market segments such as LMI families, rural communities, and people of color.

Thus, the goals must be strengthened and fully enforced to ensure that their true purpose is realized. They can be a tool for helping to strengthen household wealth in a safe and sound manner while also shoring up economic growth. Further, Congress should continue to require that all participants within the secondary mortgage market be subject to the duty-to-serve mandate and affordable housing goals.

B. Proposals that Abandon the Public Interest Mandate Will Increase Cost Harming Lower Wealth Families and Smaller Lenders

Most proposals to reform the GSEs seek an explicit and fully paid for government guarantee for systemic catastrophic loss. Such a public risk requires the granting of an equal public benefit. Yet, most proposals offer untested alternatives to the current system's longstanding affordability provisions that are the result of the incentives that the GSEs must pool risk and price credit risk on a pooled basis. Unfortunately, recent proposals for legislative housing finance reform share a common feature that undermines this pricing approach. Deep upfront credit risk transferred to private capital would incentivize actors to segment, rather than pool, credit risk and prices. Segmented pricing puts mortgage credit out of reach for too many credit-worthy borrowers. Further, the proposals ignore the reality that the broad liquidity provided by the GSEs create the ability for the current system to offer lower costs to all borrowers through the existence of the 30-year fixed rate mortgage which allows for predictable monthly borrower payments.

1. Corker-Warner Is A Blow to Affordable Housing and Harmful to the Overall Economy

The most recent draft of the Corker-Warner proposal would jettison the very foundation blocks of the obligations of companies using government backing to promote the public interest, including serving a national market, including rural and urban areas; serving all lenders equitably; including community banks and credit unions.[30] It also undermines fair housing and the ability to increase access to affordable mortgage credit for underserved borrowers.[31] Finally, it repeals and replaces the current system's affordable housing goals and enforcement provisions with unenforceable aspirations and an

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[29] National Community Reinvestment Coalition, Nationwide Benefits from the Affordable Housing Goals, a*vailable at* http://www.ncrc.org/images/PDFs/ahg/nationwide%20ahg.pdf.

[30] CRL's President Mike Calhoun provides a more in depth analysis on the weaknesses with the Corker-Warner proposal along with the President & CEO of the National Urban League Marc Morial, and mortgage default risk and insurance regulation expert Mike Molesky in Senate GSE Reform Proposal: A Blow to Affordable Housing and Harmful to the Overall Market, *available at* https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-nul-senate-gse-reform-proposal_march2018.pdf.

[31] *Id.*

even explicit prohibition on interfering with the "business judgment" of those receiving and profiting from government backing.[32]

Moreover, the assumptions used in its affordability provisions use narrow scenarios and unreasonable assumptions that tilt the numbers erroneously towards the proposal, while a more neutral analysis shows that those promises are unattainable.[33] When one looks behind the promises, it is clear that this proposal would be a historic setback for affordable housing and harm the overall market.[34]

Central to the Corker-Warner proposal is the notion that the proposed affordability mechanism will result in an additional $1 billion cross subsidy towards affordable housing through the implementation of the Market Access Fund. To achieve this goal, the fund would collect fees each month from payments of all borrowers, who would, in turn, use them to pay a portion of targeted mortgage payments.[35] This action introduces unnecessary complexity and is unlikely to receive broad bi-partisan support. Further, once the calculations are closely examined it is clear that this formula when applied to current 2016 loan distribution would produce a much smaller outcome.[36] It should be noted that the 2016 distribution has low levels of targeted loans.[37]

The GSEs currently provide $4 billion of cross subsidy. Moreover, in a more typical and inclusive mortgage market it would be greater.[38] The current system provides nearly twice the amount of subsidy for underserved borrowers than the proposed system.[39]

2. Proposed Ginnie Models are Untested and Will Lead to Higher Costs

While proposals for Ginnie Mae models for reform try to strike a public-private hybrid balance, they fail to consider the substantial cost increases of this move. Ginnie Mae is the third GSE. It guarantees the servicing performance of the issuer and not the underlying collateral. It has a full government wrap on the loans that it insures. Extending this wrap is likely to drive up fees as the market will respond to the increased number of participants in the Ginnie program with anxiety.

Further, smaller lenders are disadvantaged with this model as Ginnie has inherent operational complexities that could deter smaller lenders from becoming issuers.

The servicing within the Ginnie program is also far more complex than the existing system and puts enormous financial pressure on servicers, especially in times of economic distress. Ginnie servicers are required to advance missed payments to investors for an unlimited amount of time until the loan is resolved or buy it out of the pool using the servicer's resources. This buyback scenario requires servicer financing in times of economic distress when loan defaults are heightened. Ginnie already faces difficulty suitably overseeing its large roster of issuers and servicers, which are mostly nonbanks.

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[32] *Id.*
[33] *Id.*
[34] *Id.*
[35] *Id at 4-5.*
[36] *Id at 5.*
[37] *Id.*
[38] *Id.*
[39] *Id at 5-9.*

A recent HUD Inspector General report details these concerns and found that Ginnie was not prepared for the rise in nonbank lending and did not respond to the changes in its lender base. Further, Ginnie does not currently evaluate credit risk. Currently, Ginnie relies on FHA, VA, and Rural Housing to determine that that program underwriting standards are met. With the new model, it would take on the role of determining underwriting and risk on privately guaranteed mortgages along with having to determine and manage the counterparts risk of the many issuers (it has a limited amount of risk today on VA loans, which do not have 100% insurance, but the counterparty risk is small).

In the Ginnie proposals the goal is to absorb Fannie and Freddie to utilize their expertise to fulfill this requirement. However, the Bright-DeMarco proposal would require that this function continue to be performed under the regulatory authority of the FHFA. This action creates uncertainty.

Finally, a Ginnie model will isolate all affordable mortgage lending to the FHA, VA, and other government insured programs. This action places a higher burden of risk in those programs as they struggle with needed technology and staffing updates. It will also potentially raise cost for nearly all borrowers with the brunt of the weight felt by borrowers with lower credit scores and down payments.

C. Ensure Equal Access for Smaller Lenders Including Community Banks in the Housing Finance Reform

Community banks, credit unions and other small lenders play a critical role in providing mortgages and other financial services on a local basis to American families, and they must be supported by the housing finance system. The current system has many provisions to do this, and these should be continued and expanded. Some proposals for changes in housing finance, though, would strongly tilt the system against these institutions.

Community banks, credit unions, and other small financial institutions deliver mortgages to their customers, along with other essential financial services, in the communities where they are located. As has been noted by many, these institutions have a different business model than larger institutions, often serving local markets and having close relationships with their customers. In rural areas, these institutions play a particularly important role. In many rural communities, community banks and credit unions are the only financial institutions providing retail branches and services in the community. These institutions also focus on traditional banking services and do not engage in many of the complex lines of business that larger institutions do, such as securities issuance, credit default swaps, or proprietary trading.[40] Disruptions to the traditional banking services, such as mortgages, cannot be offset with other products and lines of service. As a result, stress on community banks and their mortgage lending would be felt elsewhere. For example, community banks provide almost half of small business lending, and that is dependent on the overall sustainability of the institutions.

The GSEs provide a number of features that are essential for community banks. First is the GSEs' cash window, which provides lenders the option of selling individual loans. This means that smaller institutions do not have to trade their loans for securities or sell their loans to other large banks. Although many larger lenders trade their loans for GSE securities, this is difficult for small lenders. The

[40] These distinctions have been recognized by the CFPB, which created a number of special provisions for these lenders in the mortgage regulations, exempting smaller lenders from many requirements and providing additional flexibility for underwriting and servicing of loans.

securities carry the interest rate risk of the underlying loans and, as a result, can change in value if market interest rates change. An increase in market interest rates would significantly reduce the value of the securities and create a loss for the bank holding the security. Larger institutions can purchase interest rate swaps to hedge this risk, but this is much harder for small lenders to do.

Another advantage of the current cash window is that the GSEs purchase these loans without requiring the transfer of the servicing of the loans to a third party. This enables the community banks and credit unions to continue the relationship with the customer during the life of the loan rather than having the loan serviced by a third party or even a competitor. Private loan purchasers and aggregators often require the seller to transfer the loan servicing to the purchaser. Keeping loan servicing in the hands of the community based financial institutions usually results in better consumer outcomes in terms of customer service and loan performance.

The current cash window also provides comparable pricing to trading for securities. This is critical, as options such as the cash window are viable only if the pricing is at a level that permits community banks to be competitive in the mortgage market. Overall, the mortgage market favors larger lenders and larger transactions, particularly for securities. Sales of large pools of loans are more attractive to buyers of the loans and buyers of the securities backed by the loans. Absent safeguards, large lenders can leverage the government support to use these structural advantages to squeeze community banks and other small lenders out of the market. These important features of the cash window option, which are not available for FHA loans, are a reason that the FHA program, while vitally important, is not a substitute for community banks having access to conventional lending for their full spectrum of customers.

Given the importance of these provisions in the current housing finance system, they should be continued and expanded. However, some of the proposals for housing reform have provisions that would tilt the government supported mortgage market heavily against community banks. While most options preserve some form of a cash window, they do not have the supporting protections that make it workable. Most important is pricing parity with the securities option. If securities trade at a better price, it greatly diminishes the value of the cash window. This is true even if there is a provision that prohibits volume pricing or discounts. If all cash transactions are disfavored to securities, the lack of discounts in either market are of little consolation to community banks who are disproportionately dependent on the cash window transactions. To provide this pricing parity, the guarantor/issuer must have the ability to pool costs across the market. This makes it essential that guarantor/issuers serve a national market and have a duty to equitably serve all lenders. Otherwise, if some guarantors/issuers can choose to cream the market, serving only the large lenders and the most lucrative markets, the remaining guarantors will not have sufficient loans from the full market to be able to provide pricing parity to small lenders and still compete in the overall market. In order to provide this parity, the guarantor/issuers also must be able to pool the credit risk that they hold and reinsure. If all but the catastrophic credit risk is transferred before the loans are purchased by the guarantor/issuers, there is insufficient revenue remaining for the guarantors/issuers to pool the costs and provide viable pricing to small lenders. If substantially all of the credit risk is sold and priced before the loans are acquired by the guarantor/issuer, then these other parties control the access and pricing and they will favor the larger lender transactions, which will be more profitable.

Provisions for a small lender security or issuer are offered in some plans to address this problem, but they are inadequate. Securities resulting from small groups of loans from many lenders will be measurably more expensive to assemble. They would also still lack the size to create enough loans to provide the large volume of securities for the economies of scale and liquidity that investors in securities desire, and would also reduce the price community banks received for the mortgages.

Other aspects of the mortgage market already have headwinds for community lenders. Many components of the production of mortgages favor large lenders due to their market size. These larger lenders can demand lower prices for many of the third-party services provided to lenders, and overall, they have the advantage of economies of scale over smaller lenders. These conditions make it all the more important that the government elements of the mortgage provide a level playing field and not contribute to the squeezing out of community bank mortgage lending.

VI. Today's Housing Finance System is Rooted in a Legacy of Discrimination and Exclusion

In an address to Howard University titled "To Fulfill These Rights," President Lyndon B. Johnson offered the following remarks on June 4, 1965:

> You do not wipe away the scars of centuries by saying: Now you are free to go where you want, and do as you desire, and choose the leaders as you please.
>
> You do not take a person who, for years, has been hobbled by chains and liberate him, bring him up to the starting line of a race and then say, "you are free to compete with others," and still justly believe that you have been completely fair.
>
> Thus is it not enough just to open the gates of opportunity. All our citizens must have the ability to walk through those gates.[41]

Regrettably, President Johnson's recommendation did not occur within the nation's housing finance system. Race matters in mortgage lending. Federal housing policies created in the twentieth century in response to the Great Depression explicitly discriminated against families of color and denied them access to federally insured mortgage programs. These federal programs helped white families, mostly former immigrant families with European backgrounds, enter homeownership and build a solid foundation to help establish the American middle class. These federal policies granted whites the ability to build wealth through homeownership while denying equal opportunities for families of color to build similar home equity over the same period. As a result, whites built an economic advantage over families of color that has been passed on to future generations through intergenerational wealth transfers. According to a report by Demos, if homeownership rates were the same for whites and people of color we would see a decrease in the racial wealth gap by 31 percent for African-Americans and 28 percent for Latinos.[42] The current mortgage market was built on discriminatory federal housing policies and has yet to offer an equitable solution forward.

A. Homeownership is Critical to Reducing the Persistent and Growing Racial Wealth Gap

[41] Lyndon B. Johnson: Commencement Address at Howard University: 'To Fulfill These Rights.' Accessed October 23, 2017. http://www.presidency.ucsb.edu/ws/?pid=27021.

[42] Tanvi Misra, Why America's Racial Wealth Gap is Really a Homeownership Gap, Demos, March 12, 2015, *available at* http://www.demos.org/news/why-americas-racial-wealth-gap-really-homeownership-gap.

Homeownership is the foundation of the American Dream and is still the primary way that most middle-class families build wealth and achieve economic stability. Wide access to credit is critical for building family wealth, closing the racial wealth gap, and for sustaining the housing market overall—which in turn, contributes significantly to our overall economy. Today, the opportunity to purchase, maintain and refinance a home has not reached significant portions of low-to-moderate income families and people of color. As a result, these families lag far behind wealthier and white communities that received a head start due to historic lending discrimination supported by our federal government's mortgage policies. These well-documented policies began in 1933 with the underwriting guidelines of the Home Owners Loan Corporation (HOLC) and allowed redlining of African-American and other communities of color, denying them access to mainstream banking services.[43] Examples of the impact of this inequity include the reality that only 2% of FHA insured mortgage loans went to homebuyers of color during the first 35 years of the program due to redlining.[44] Further, the administration of the GI Bill loan programs enacted by Congress in 1944 continued this discrimination.[45] In the state of Mississippi alone, just 2 out of 3,229 VA insured mortgages went to African-Americans servicemembers seeking to finance a home or business in the first three years of the program.[46]

Likewise, the lasting impacts of the Great Recession have eroded the modest increase in homeownership rates that African-American and Latino families enjoyed since the passage of the Fair Housing Act in 1968. Evidence from data provided by the Home Mortgage Disclosure Act suggest that communities of color continue to be underserved by the conventional mortgage market and are more likely than white borrowers to receive FHA loans.[47] At the same time, while FHA remains an important part of the mortgage market, lending backed by Fannie Mae and Freddie Mac is also a critical part of the housing finance system in low-wealth communities, rural communities and communities of color.

The Great Recession exacerbated inequality in wealth distributions. According to the Pew Research Center, in 2012 whites had 13 times the wealth of African-Americans and 10 times the wealth of

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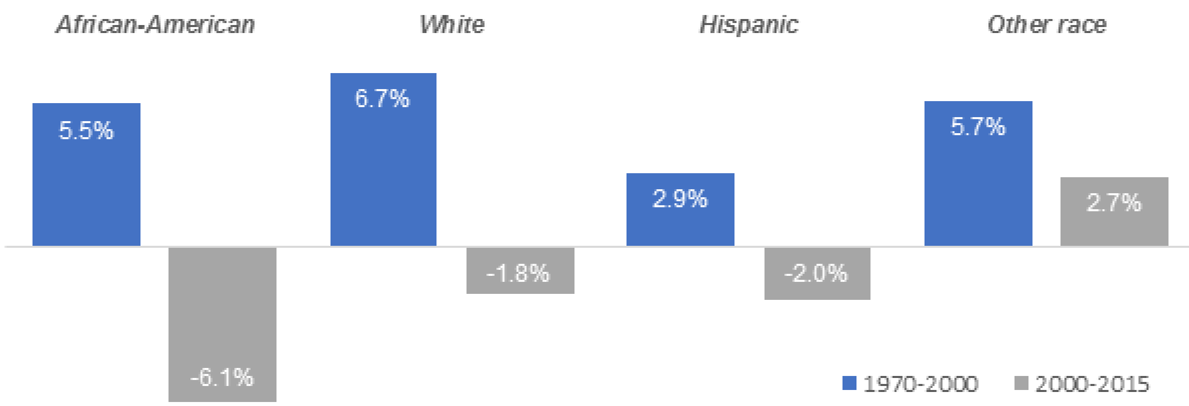
[43] For a more robust discussion of how federal housing policies benefitted whites while disadvantaging African-Americans and other people of color, see Ta-Nehisi Coates, The Case for Reparations, The Atlantic, June 2014, *available at* http://www.theatlantic.com/features/archive/2014/05/the-case-for-reparations/361631/; Bob Herbert, Against All Odds: The Fight for the Black Middle Class, Bob Herbert and Public Square Media, Inc (2016), *available at* http://www.pbs.org/wnet/chasing-the-dream/films/against-all-odds/;
James Carr and Nandinee Kutty, Segregation: The Rise Costs for America, Routledge (2008); Ira Katznelson, When Affirmative Action Was White: An Untold History of Racial Inequality in Twentieth-Century America, W. W. Norton & Company (2005); Thomas M. Shapiro, The Hidden Cost of Being African American: How Wealth Perpetuates Inequality, Oxford University Press (2004); Melvin L. Oliver and Thomas M. Shapiro, Black Wealth/White Wealth: A New Perspective on Racial Inequality, Routledge (1997).
[44] Dedrick Asante-Muhammad, et. al, The Road to Zero Wealth: How the Racial Wealth Divide is Hallowing Out America's Middle Class; p. 15, September 2017, *available at* https://prosperitynow.org/files/PDFs/road_to_zero_wealth.pdf.
[45] *Id* at. 16.
[46] *Id.*
[47] Center for Responsible Lending, New HMDA Data Show Despite Growing Market, African-Americans and Latinos Remain Underserved (September 2017) *available at* http://www.responsiblelending.org/research-publication/new-hmda-data-show-despite-growing-market-african-americans-and-latinos-remain.

Hispanics.[48] Specifically, whites had a median wealth of $141,900 compared to $13,700 and $11,000 for non-Hispanic whites and African-Americans respectively.[49] Also, the St. Louis Federal Reserve reports that one in nine whites have less than $1,000 in wealth compared to one in four for Latinos and one in three for African-Americans.[50] Home equity plays a great role in determining a families' wealth and is the furthermost contributor to the racial wealth gap between whites and people of color.[51]

Unfortunately, the decline in homeownership that followed the Great Recession wiped out thirty years of homeownership gains among African-Americans and substantially reduced the homeownership rate among Hispanics (Figure 6). Between 1970 and 2000, African-American homeownership rate increased 5.5% and the Hispanic homeownership rate increased 2.9%. Since 2000, the homeownership rate decreased 6.1% among African-Americans and 1.8% among Hispanics.[52]

Figure 6. All gains in African-American homeownership since the Fair Housing Act have been erased since 2000



Source: Urban Institute. Other race includes Asian Americans, Pacific Islanders, American Indians and Alaska Natives, people who identify as "other," and (starting 2000) people who chose more than one racial identity. Hispanics can be of any race; all other categories are non-Hispanic.

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[48] Rakesh Kochhar and Richard Fry, Wealth inequality has widened along racial, ethnic lines since end of Great Recession, Pew Research Center, December 12, 2014, *available at* http://www.pewresearch.org/fact-tank/2014/12/12/racial-wealth-gaps-great-recession/.

[49] *Id.*

[50] Ray Boshara and William Emmons, Stark Disparities in Wealth Are Key in Discussions on Race in the United States, Washington Post, December 30, 2014, *available at* https://www.washingtonpost.com/opinions/policies-that-can-bootstrap-the-poor-out-of-the-wealth-gap/2014/12/30/3bf972a6-8f87-11e4-a412-4b735edc7175_story.html?utm_term=.bfc010a14313.

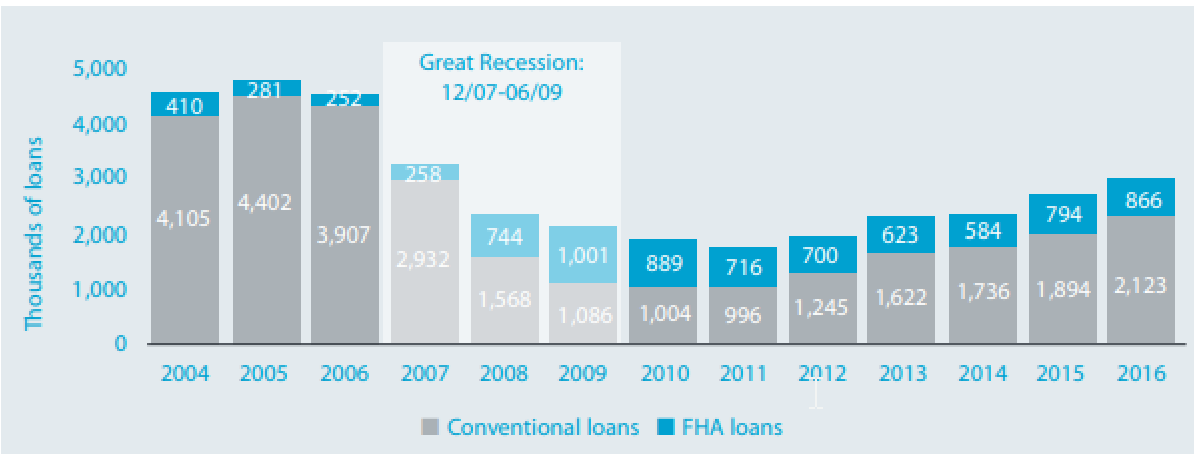
[51] See Shapiro et al., The Roots of the Widening Racial Wealth Gap: Explaining the Black-White Economic Divide, Institute on Assets and Social Policy, (February 2013).

[52] Goodman, Laurie, Jun Zhu, and Rolf Pendall, Are Gains in Black Homeownership History? Urban Institute, February 14, 2017. https://www.urban.org/urban-wire/are-gains-black-homeownership-history.

B. Evidence From 2016 HMDA Data Suggests that the Current Housing Finance System is Underserving Important Market Segments

As the housing bubble burst between 2008 and 2012, access to conventional loans decreased dramatically for low- and moderate-income borrowers and borrowers of color. At the same time, FHA stepped in to maintain access to mortgage credit for many underserved homebuyers, as well as ensure toxic subprime loans could be refinanced into more sustainable FHA loans (Figure 7).[53] FHA's loan volume grew quickly following the financial crisis, and this growth helped prevent more foreclosures and even steeper declines in home prices.[54] According to estimates from Moody's Analytics, home prices would have fallen another 25% nationally if FHA had not stepped in.[55] While FHA played a crucial countercyclical role following the crisis and preserved access to credit for underserved borrowers, the conventional market has tightened credit standards and shut out over 6 million creditworthy borrowers between 2009 and 2015.[56]

Figure 7: Conventional and FHA purchase loans by year, 2004–2016



Source: CRL calculations of 2004–2016 HMDA purchase loan data

During the recession, as credit standards tightened in the conventional market, the FHA took on a much broader role than it had previously. This was a necessary countercyclical influence in the fallout from the era of subprime mortgages, but it marked changes within both markets. While FHA has historically provided access to credit to lower-income borrowers and first-time homebuyers, it has emerged and remained the mortgage credit source for over 40% of the low-income home purchase market (Figure 8).

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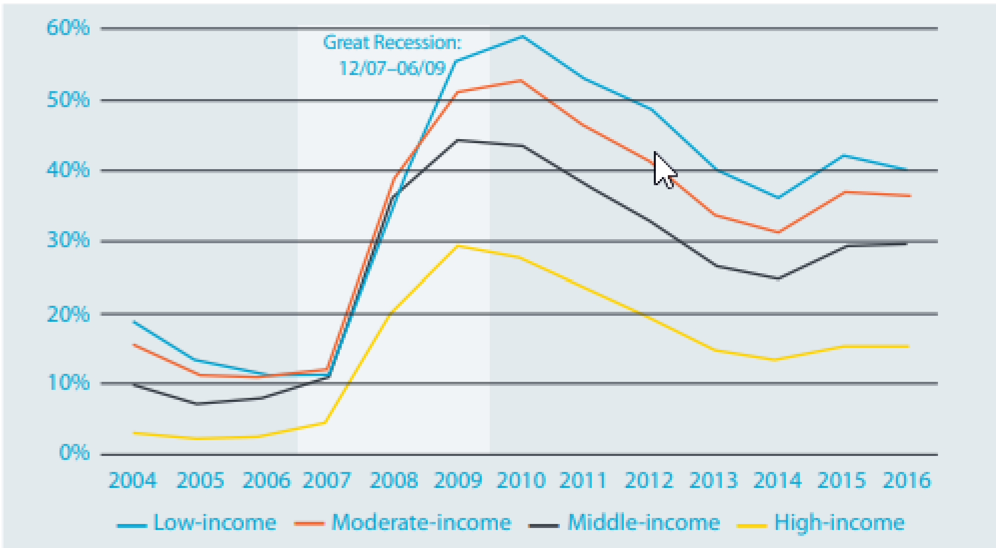
[53] Jared Bernstein, The FHA's Countercyclical Contribution, N.Y. Times, Dec. 16, 2013, https://economix.blogs.nytimes. com/2013/12/16/the-f-h-a-s-countercyclical-contribution/.

[54] John Griffith, The Federal Housing Administration Saved the Housing Market, Center for American Progress (Oct. 11, 2012), available at https://www.americanprogress.org/issues/economy/reports/2012/10/11/40824/the-federal-housingadministration-saved-the-housing-market/.

[55] Mark Zandi and Cris deRitis, What If There Were No FHA, Moody's Analytics (Oct. 2010), available at https:// www.economy.com/mark-zandi/documents/2010-10-01-What-If-There-Were-No-FHA.pdf.

[56] Laurie Goodman, Jun Zhu, and Bing Bai, Overly Tight Credit Killed 1.1 Million Mortgages in 2015, Urban Institute (Nov. 21, 2016), available at https://www.urban.org/urban-wire/overly-tight-credit-killed-11-million-mortgages-2015 (stating that lenders would have issued 6.3 million additional mortgages between 2009 and 2015 if lending standards had been more reasonable).

Figure 8: FHA share of all purchase loans made by income category, by year, 2004–2016

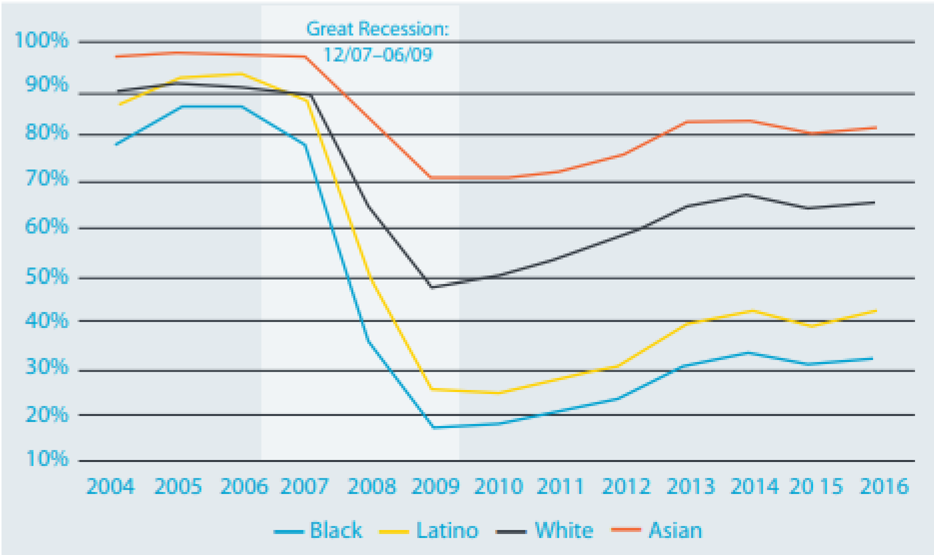


Source: CRL calculations of 2004–2016 HMDA purchase loan data

Since the Great Recession, the share of conventional loans made to borrowers of color has declined precipitously and failed to recover at the same rate it has for white borrowers.   In 2006, Black, Asian, Latino, and white borrowers each received more than 85% of their purchase loans from the conventional market. By 2009, conventional lending market share among Black borrowers had declined dramatically, with Black borrowers receiving just 18.2% of their loans from the conventional market—less than half the rate of conventional lending to white borrowers. While the 2006 conventional market included some of the most problematic subprime loans,[57] this cannot explain the post-recession difference in conventional lending between white borrowers and borrowers of color (Figure 9).

[57] Marshall Lux and Robert Greene, What's Behind the Non-Bank Mortgage Boom?, Harvard Kennedy School Mossavar Rahmani Center for Business and Government (June 2015), at 2, *available at* https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/working.papers/42_Nonbank_Boom_Lux_Greene.pdf.

Figure 9: Conventional share of all purchase loans by race/ethnicity category, by year, 2004–2016

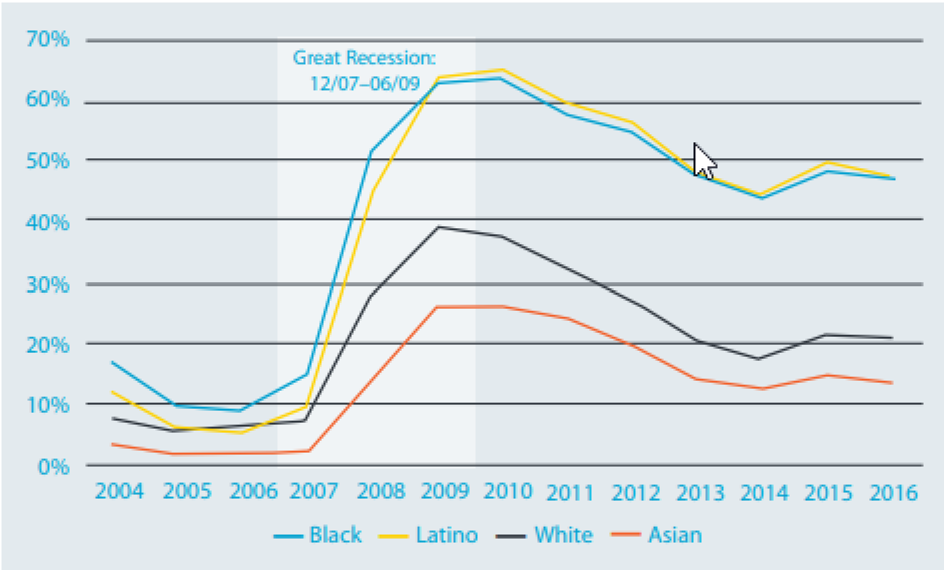


Source: CRL calculations of 2004–2016 HMDA purchase loan data

As conventional lending to borrowers of color steeply declined between 2006 and 2009, the FHA share of lending to borrowers of color increased and remains high. While the share of FHA purchase lending made to Black and Latino borrowers has exceeded the share of FHA purchase lending to white borrowers since 2004, the FHA share to borrowers of color also grew at a faster rate during the recession and has remained persistently high.[58] In 2016, Black and Latino borrowers received nearly half their purchase mortgage loans from FHA, while white borrowers received less than a quarter of theirs and Asian borrowers received under 14% (Figure 10).

[58] The only exception was the 2005–06 FHA, which made a higher percentage of white borrowers' loans than those of Latino borrowers.

Figure 10: FHA share of all purchase loans by race/ethnicity category, by year, 2004–2016



Source: CRL calculations of 2004–2016 HMDA purchase loan data

As historically FHA-reliant low- and moderate-income borrowers continue to rely on FHA lending for access to purchase mortgage credit, there are similar FHA lending patterns among borrowers of color. In 2006, Black, Asian, Latino, and white borrowers each received more than 85% of their purchase loans from the conventional market. By 2009, conventional lending market share among Black borrowers had declined dramatically, with Black borrowers receiving just 18.2% of their loans from the conventional market—less than half the rate of conventional lending to white borrowers.

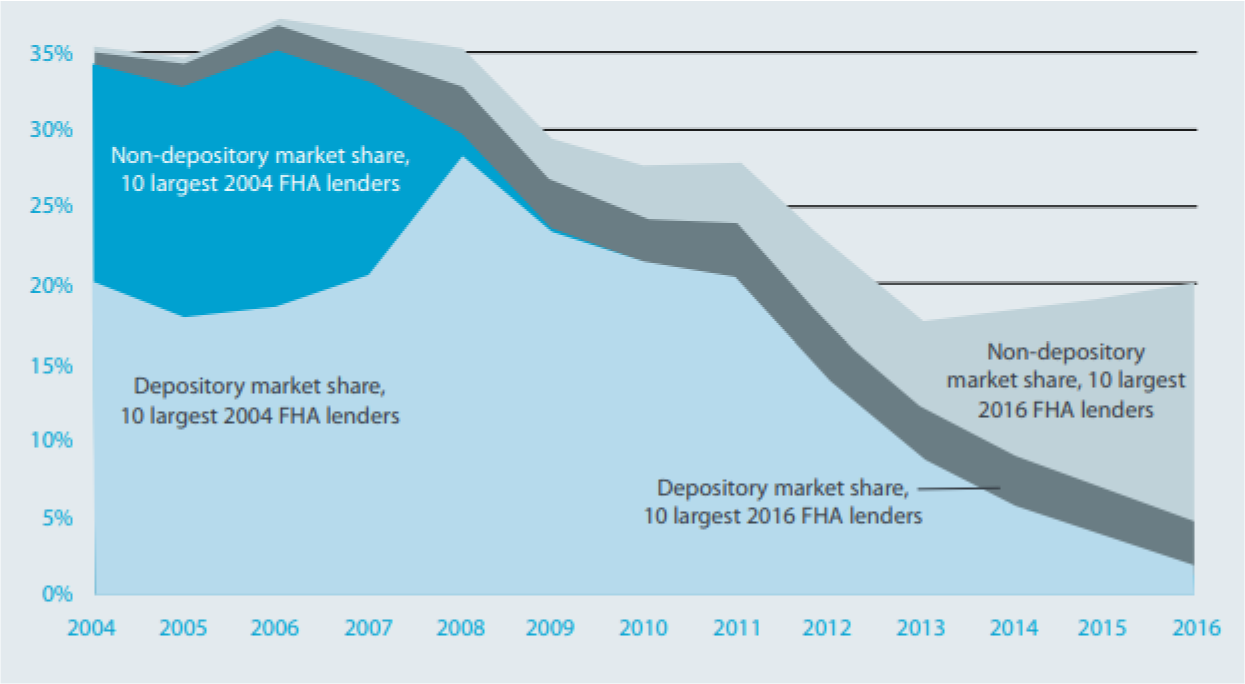
While the overall market share for these programs continues to decline as the market improves, the rate at which people of color rely on these programs has not diminished. Government-insured loans, such as FHA, have clearly been an important source of credit post-crisis. FHA mortgages are a primary source of credit for African-Americans and Latino home purchasers. However, compared to conventional loans these loans can be costlier over the life of the loan. Further, increasingly, lenders have also been less willing to make these loans.

As banks have exited the FHA market or reduced their FHA lending, the market share of the 10 largest lenders has declined, and nonbank lenders have become the dominant market segment.[59] In 2004, the top 10 FHA lenders held a 34% share of the total FHA home purchase market, and by 2016 the market share of the largest lenders declined to just over 18%. Of the 10 largest FHA home purchase lenders in

[59] Michele Lerner, The Mortgage Market is Now Dominated by Non-Bank Lenders, Washington Post, Feb. 23, 2017, https://www.washingtonpost.com/realestate/the-mortgage-market-is-now-dominated-by-nonbanklenders/2017/02/22/9c6bf5fc-d1f5-11e6-a783-cd3fa950f2fd_story.html?utm_term=.577814ac35f5.

2004, no lender remained in the top 10 by 2016 (Figure 11). At the same time, the share of non-depositories increased dramatically.[60]

Figure 11. FHA purchase lending of the top 10 largest FHA purchase lenders in 2004 and 2016, before and after the financial crisis



Source: CRL calculations of 2004–2016 HMDA purchase loan data

While FHA cannot be the major source of mortgage credit for borrowers of color, these programs are critical and deserve ongoing federal support. The FHA program must be adequately funded and modernized to ensure its viability. However, these data also underscore the urgent need for federal regulators to better enforce fair lending requirements to ensure a more robust conventional mortgage market that serves borrowers of color.

Market indicators highlight how tight lending standards have become, especially for conventional mortgages. These trends help explain the remarkably low levels of conventional loans that made to African-American and Latino borrowers in 2016. As noted, last year only 3.1% of conventional loans were made to African-American borrowers, and only 5.8% were made to Hispanic white borrowers. By contrast, non-Hispanic white borrowers received 70.2% of the conventional loans.

[60] For a further discussion of the market participants in the FHA market, see Stegman, Melissa, and Peter Smith. Repairing a Two-Tiered System: The Crucial but Complex Role of FHA. Center for Responsible Lending (May 2018). https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-repairing-two-tiered-system-fha-may2018.pdf.

In 2016 the average credit score for all new loan originations fell from its high of 750 in 2013 to stand at 732 in December of 2016. However, the average score remained about 33 pts above the average score a decade before.[61] At the same time, market-level credit availability indices continue to show that lenders have a very low tolerance for taking reasonable risk for new loans.[62] Recent vintages of new mortgages (loans originated from 2011-2015) have had near zero rates of default.[63]

These tight credit standards are preventing homeownership opportunity for credit-worthy borrowers of color and low- to moderate-income borrowers. Recent data released by Fannie Mae show that loans to low-income borrowers originated from 2010-2015 had a default rate of just 0.3 percent, approximately equal to that of loans to high-income borrowers originated from 2002-2004.[64] There is ample opportunity in the mortgage market to expand lending to borrowers while still offering responsible loans that borrowers can successfully repay.

VII. Housing Finance Reform Must Address Prior Discrimination in the System

Discrimination within the nation's housing finance system is well documented and a significant contributor to the current racial wealth gap that plagues our nation today. This discrimination harms the market by curtailing credit-worthy borrowers from accessing loans in a marketplace that is safer; has historically low interest rates; and relatively lower housing costs than the times leading up to the Great Recession. Action is needed now to reduce unnecessary restrictions on mortgage credit access such as excessive risk-based pricing. Thus, the FHFA's loan level price adjustments (LLPAs) must be eliminated.

A. The Future of the Market Depends on Mortgage Providers Meeting Their Duty-to-Serve Obligations

Existing homeowners, especially older Americans, will need buyers when they want to sell, and new families need access to affordable mortgage credit to buy their homes. In the future, homebuyers will be more racially and ethnically diverse than they have been in the past. Harvard's Joint Center for Housing Studies found that non-whites accounted for 60 percent of household growth from 1995-2015 and predicted that half of millennial households by 2035 will be non-white.[65] The mortgage market will need

[61] Laurie Goodman et.al., Housing Finance at a Glance: A Monthly Chartbook (March 2017), *available at* https://www.urban.org/research/publication/housing-finance-glance-monthly-chartbook-march-2017/view/full_report.

[62] *Id.*; Mortgage Bankers Association, Mortgage Credit Availability Index (2017), *available at* https://www.mba.org/newsresearch-and-resources/research-and-economics/single-family-research/mortgage-credit-availability-index.

[63] Laurie Goodman, Squeaky Clean Loans Lead to Near-Zero Borrower Defaults – And That is Not a Good Thing, Urban Institute (Aug. 31, 2016), *available at* http://www.urban.org/urban-wire/squeaky-clean-loans-lead-near-zero-borrower-defaults-and-not-good-thing.

[64] Fannie Mae 2016 Annual Housing Activities Report and Annual Mortgage Report, chart at page 19, *available at* https://www.fhfa.gov/PolicyProgramsResearch/Programs/AffordableHousing/Documents/Fan_M_Goals/2017/Fannie-Mae-2016-AHAR-AMR-FINAL.pdf.

[65] Joint Center for Housing Studies of Harvard University, State of the Nation's Housing 2017, June 2017, *available at* http://www.jchs.harvard.edu/research/state_nations_housing.

to find ways to serve borrowers of color and lower-wealth borrowers to sustain a robust market in the coming years.

Responsible and affordable refinance loans are also crucial to allowing borrowers to preserve homeownership. Recent history shows this to be the case, as toxic refinance loans helped spur the housing crisis. In fact, 90 percent of borrowers who took out subprime loans from 1998 to 2006 were already homeowners.[66] Yet, discrepancies persist in access to refinance mortgages as well as purchase mortgages. In fact, while very modest gains were made in 2016 in the access of borrowers of color to purchase mortgages, these gains did not carry over for African-American and Hispanic white borrowers, relative to the growing refinance market. In addition to making loans broadly available for home purchase, responsible and affordable refinance mortgages need to be broadly available to support sustained homeownership.

B. The Federal Housing Finance Agency Must Eliminate Loan Level Price Adjustments

Following the mortgage crisis of 2008, which was found to be caused by Wall Street's appetite for excessive profits, market overcorrections emerged that led to excessive pricing of risk in the system. FHFA instituted LLPAs to offset risk from borrowers with lower credit profiles and smaller down payments, despite compelling evidence that when provided with safe and affordable mortgage loans, these borrowers perform well. Further, these increased fees disproportionately impact potential homebuyers of color and low-to-moderate income families whose ability to save for down payments and credit profiles have been negatively impacted by discrimination and lack of opportunity in the mortgage market that has been previously been discussed.[67]

Moreover, families of color and LMI communities have been deeply harmed by irresponsible lending in the last decade. Predatory mortgage lending dominated formerly redlined communities and, the brunt of the impact was experienced in communities of color across the nation. The Center for Responsible Lending's research on the effects of subprime lending found that a disproportionate number of foreclosures occurred in communities of color — even when these borrowers qualified for less expensive and sustainable mortgage loans.[68] Core Logic reports that 7.8 million foreclosures have been completed.[69] The post foreclosure spillover costs within communities of color totaled $1 trillion

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[66] Maura Reynolds, Refinancing spurred subprime crisis, Los-Angeles Times (July 5, 2008), available at http://articles.latimes.com/2008/jul/05/business/fi-refi5; Amir Khandani, Andrew Lo, and Robert Merton, Systemic Risk and the Refinancing Ratchet Effect, National Bureau of Economic Research Working Paper No. 15362 (Sept. 2009), available at http://www.nber.org/papers/w15362

[67] For a more detail discussion of how discrimination contributes to lower credit scores for borrowers of color see, Racial Justice Project of the National Consumer Law Center, Past Imperfect: How Credit Scores and Other Analytics "Bake In" and Perpetuate Past Discrimination, May 2016 *available at* https://www.nclc.org/images/pdf/credit_discrimination/Past_Imperfect050616.pdf.

[68] Debbie Gruenstein Bocian, Wei Li, and Keith S. Ernst, Foreclosures by Race and Ethnicity: The Demographics of a Crisis, June 18, 2010*, available at http://www.responsiblelending.org/mortgage-lending/research-analysis/foreclosures-by-race-and-ethnicity.pdf*

[69] http://www.corelogic.com/about-us/news/corelogic-issues-us-residential-foreclosure-crisis-decade-in-review.aspx.

dollars.[70] These losses were not to homeowners who actually suffered a foreclosure but to their neighbors who lived in close proximity to homes that had been foreclosed upon.

Today, rather than remediate the damage done by abusive subprime lending and its disproportionate impact on communities of color, lenders and FHFA responded by closing off lending options for these communities. The Urban Institute reports that from 2009-2014 there were 5.2 million mortgage loans missing from the secondary market system due to unnecessarily overly tight credit restrictions put in place by the GSEs.[71]

C. Maintain Flexibility in Determining Down Payments and Creating Initiatives to Fuel Lending

Removing regulator flexibility in establishing down payments in housing finance reform and mandating down payments would unnecessarily restrict access to credit for lower-wealth families. As an initial matter, these mandates overlook the fact that borrowers must also save for closing costs – roughly 3 percent of the loan amount – on top of any down payment required. And, the mandates would increase the number of years that borrowers would need to save for a down payment. An analysis by the Center for Responsible Lending demonstrates that it would take the typical family 17 years to save for a 10 percent down payment and 11 years to save for a 5 percent down payment.[72] This time frame is greatly expanded for African-American and Latino borrowers. Considering that many of these households have limited wealth, down payment mandates could significantly reduce the number of future first-time homebuyers.[73] This reduced pool of buyers could lead to lower home prices, more difficulty selling an existing home, and even some existing borrowers defaulting on their mortgage.

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[70] Debbie Gruenstein Bocian, Peter Smith and Wei Li, Collateral Damage: The Spillover Costs of Foreclosures, October 24, 2012, *available at* http://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/collateral-damage.pdf.

[71] Bing Bai, Laurie Goodman, Jun Zhu, Tight credit standards prevented 5.2 million mortgages between 2009 and 2014, Urban Institute, January 28, 2016, *available at* https://www.urban.org/urban-wire/tight-credit-standards-prevented-52-million-mortgages-between-2009-and-2014.

[72] CRL years-to-save calculations are based on purchase of a 2011 median priced house ($173,600) by borrower with median income in 2011 ($50,502). Assumes an annual savings rate dedicated for down payment of 2.6%. Median income for 2011 is from American Community Survey. Savings rate assumption is derived from the Bureau of Economic Analysis's (the 1-year average of the BEA's personal savings rate from July 2012-July 2013 is 4.9 percent; the 20-year average was 5.0 percent). However, the BEA's the BEA's rate is based on take home, not gross, income, and therefore, a 5.0 personal savings rate translates to a 3.6 percent rate for gross income, assuming a combined federal, state and local tax rate of 28 percent (see effective tax burden for the middle http://www.nytimes.com/2012/11/30/us/most-americans-facelower-tax-burden-than-in-the-80s.html?pagewanted=all&_r=2&). Assumes that, of this 3.6 percent, 1 percentage point must be used by families for retirement, college, and emergencies, leaving 2.6% available for homeownership savings.

[73] See The State of the Nation's Housing, Joint Center for Housing Studies, at 3 (2013) (stating that "[m]inorities—and particularly younger adults—will also contribute significantly to household growth in 2013–23, accounting for seven out of ten net new households. An important implication of this trend is that minorities will make up an ever-larger share of potential first-time homebuyers. But these households have relatively few resources to draw on to make downpayments. For example, among renters aged 25–34 in 2010, the median net wealth was only $1,400 for blacks and $4,400 for Hispanics, compared with $6,500 for whites. Even higher-income minority renters have relatively little net wealth, with both blacks and Hispanics in the top income quartile having less than half the

Not only is there a huge cost to legislatively mandating down payments, but there is also a limited benefit in terms of reducing default rates. When looking at loans that already meet the product requirements for a Qualified Mortgage, a UNC Center for Community Capital and CRL study shows that these requirements cut the overall default rate by almost half compared with loans that did not.[74] Layering on a down payment requirement on top of these protections produces a marginal benefit.[75] This makes sense, because risky product features and poor lending practices caused the crisis by pushing borrowers into default, and the Dodd-Frank Act reforms address these abuses. The Qualified Mortgage and Ability to Repay reforms restrict risky features such as high fees, interest-only payments, prepayment penalties, yield-spread premiums paid to mortgage brokers, lack of escrows for taxes and insurance for higher priced mortgage loans, teaser rates that spiked to unaffordable levels even with constant interest rates and outlawing no-doc loans. These reforms address the unaffordable and abusive loan products that caused the crisis.[76]

D. The U.S. Commission on Civil Rights Should Convene Hearings to Investigate the Impact of Mortgage Discrimination Within the Nation's Housing Finance System on Families of Color

Throughout these remarks, the federal government's role in furthering housing discrimination within the mortgage market has been described. Now, is the appropriate time to fully investigate the impact of those discriminatory practices on the ability of families of color to build wealth through homeownership in an equitable manner with whites. According to recent research by Prosperity Now, it will take 228 years for the average African-American family to reach the level of wealth white families own today.[77] For the average Latino family, matching the wealth of white families will take 84 years.[78] The U.S. Commission on Civil Rights should convene hearings to probe and complete an official record of this discrimination similar to work done by the Financial Crisis Inquiry Commission following the Housing Crash of 2008. Once an official record is completed, Congress should request that the Congressional

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average net wealth of whites. Proposed limits on low-downpayment mortgages would thus pose a substantial obstacle for many of tomorrow's potential homebuyers.").

[74] Roberto G. Quercia, Lei Ding, Carolina Reid, Balancing Risk and Access: Underwriting Standards for Qualified Residential Mortgages, Center for Responsible Lending and UNC Center for Community Capital (Revised March 5, 2012) (stating that "[l]oans consistent with the QM product features—which include both prime and subprime loans—have fared extremely well, with just 5.8 percent of loans either 90+ days delinquent, in the foreclosure process, or foreclosed upon as of February 2011. In comparison, the default rate for prime conventional loans in our sample was 7.7 percent, nearly two percentage points higher…[T]he rates for the subprime and Alt-A market segments [were] 32.3 and 22.3 percent, respectively.") (*available at* http://www.responsiblelending.org/mortgage-lending/researchanalysis/Underwriting-Standards-for-Qualified-Residential-Mortgages.pdf).

[75] *Id.* at 18.

[76] See Debbie Gruenstein Bocian, Wei Li, Carolina Reid, and Roberto G. Quercia, Lost Ground, 2011: Disparities in Mortgage Lending and Foreclosures, Center for Responsible Lending and UNC Center for Community Capital (November 2011), *available at* http://www.responsiblelending.org/mortgagelending/research-analysis/Lost-Ground-2011.pdf).

[77] Dedrick Asante-Muhammad, et.al., The Road to Zero Wealth: How the Racial Wealth Divide is Hollowing Out America's Middle Class, Prosperity Now, p. 5, September 2017, *available at* https://prosperitynow.org/files/PDFs/road_to_zero_wealth.pdf.

[78] *Id.*

Budget Office issue a report on the economic impact of the discrimination and offer legislative action that directly addresses this discrimination.

VIII. Conclusion

This year, our nation celebrates 50 years of the passage of the federal Fair Housing Act of 1968. Many of the promises of that important legislation have yet to be realized, especially within the nation's housing finance system. Congress has a unique opportunity to reform the secondary mortgage market in a more equitable manner. Such action will allow far more American citizens the opportunity to thrive and keep smaller lenders on equal footing with large national banks. Congress must also act with extreme care and build upon existing reforms that have stabilized the marketplace and made it safe for consumers and lenders alike.