

Mr. Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
Eighth Floor
400 Seventh St. SW
Washington, DC 20024

Re: 2018-2020 Enterprise Housing Goals, RIN 2590-AA81

Dear Mr. Pollard:

The Center for Responsible Lending¹ and the undersigned consumer, civil rights, and community organizations would like to thank you for the opportunity to submit comments on the Federal Housing Finance Agency's (FHFA) proposed rule setting the 2018-2020 Affordable Housing Goals for Fannie Mae and Freddie Mac ("Enterprises"). We appreciate FHFA's efforts to improve strategies to ensure those from lower wealth communities have access to the market and homeownership. While we support the FHFA's efforts, we believe that the tests proposed would set unnecessarily low goal standards and would not be effective at reaching higher percentages of groups seeking access to homeownership.

- First, we note that the affordable housing goals are part of the FHFA's clearly laid out mission to reach underserved communities and that increasing access to mortgage credit in these communities is essential to the housing recovery.
- Second, we recommend that the FHFA maintain the two-part test, and strongly urge that the FHFA set a higher benchmark standard and require that both standards be matched or surpassed.
- Third, we contend that how FHFA addresses findings of failure to meet a metric is critical and recommend the FHFA act more assertively to enforce procedures in the Housing and Economic Recovery Act when housing goals are not met. In recent years, the Enterprises have done a poor job of meeting their home purchase goals.
- Fourth, we recommend that FHFA establish higher benchmarks than those proposed, as warranted by prior historical performance. Specifically, we recommend setting the Low-Income Borrower Home Purchase Goal at 27%, the same level as the benchmark for 2010-2012.

¹ 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. Since 1980, Self-Help has provided over \$7 billion in financing to 131,000 families, individuals and businesses underserved 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 over 130,000 people in North Carolina, California, Chicago, Florida and Wisconsin and offers a full range of financial products and services.

- Fifth, we recommend that FHFA continue to monitor and analyze the way that the low-income areas purchase subgoal may contribute to gentrification and potential displacement of lower-income families and people of color.
- Sixth, we note that FHFA and the Enterprises’ pricing policies act as a barrier to the Enterprises’ ability to purchase loans to meet its affordable housing goals, and recommend the elimination of the loan-level price adjustments and excessive risk based pricing.

I. FHFA and the Enterprises Have a Clearly Laid out Mission that Includes the Duty to Reach Underserved Communities.

Under the Housing and Economic Recovery Act of 2008 (“HERA”), FHFA and the Enterprises have a duty to ensure that borrowers from traditionally underserved and/or excluded communities will have access to the mortgage market. The Enterprises’ single-family affordable housing goals – particularly the purchase of loans from low and very low-income borrowers – are essential to encourage affordable homeownership opportunities.

We note that the obligation of the Enterprises to serve the entire market and ensure that underserved borrowers (including those from rural, African-American, Latino, and Asian-American Pacific Islander communities, prospective first-time homeowners, millennials, and low and moderate-wealth households) have access to responsible forms of mortgage credit is critical. This is particularly important now as such borrowers have been particularly shut out from mortgage credit since the Great Recession. African-American borrowers received just 2.7% of conventional mortgages in 2015 and Latino borrowers received just 5.1%.²

FHFA and the Enterprises also have an explicit duty to broadly increase liquidity in the mortgage market. Not only is this obligation addressed by the Enterprises’ charters and statute, it is essential to the recovery of the housing market and the United States economy.³ FHFA should continue to invest as much effort as possible to ensuring access to responsible credit for more communities, as many of the groups described above will constitute the majority of the housing market in the near future.⁴ Homeownership is a critical component of family wealth, particularly for low-income families and people of color, and has been shown to explain much of the observed racial wealth gap.⁵

² CENTER FOR RESPONSIBLE LENDING, THE NATION’S HOUSING FINANCE SYSTEM REMAINS CLOSED TO AFRICAN AMERICAN AND LATINO CONSUMERS DESPITE STRONG ECONOMIC RECOVERY IN 2015, *available at* <http://www.responsiblelending.org/research-publication/nations-housing-finance-system-remains-closed-africanamerican-latino-and-low>.

³ 12 U.S.C. § 1716; 12 U.S.C. § 1451 note

⁴ JOINT CENTER FOR HOUSING STUDIES OF HARVARD UNIVERSITY, THE STATE OF THE NATION’S HOUSING 2017, *available at* http://www.jchs.harvard.edu/research/state_nations_housing.

⁵ THOMAS SHAPIRO, THE ROOTS OF THE WIDENING RACIAL WEALTH GAP: EXPLAINING THE BLACK WHITE DIVIDE, *available at* <http://iasp.brandeis.edu/pdfs/Author/shapiro-thomas-m/racialwealthgapbrief.pdf>; CHRISTOPHER HERBERT, DANIEL MCCUE, AND ROCIO SANCHEZ-MOYANO, IS HOMEOWNERSHIP STILL AN EFFECTIVE MEANS OF

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,⁶ the Equal Credit Opportunity Act,⁷ the federal charters of Fannie Mae and Freddie Mac,⁸ the Federal Housing Enterprises Financial Safety and Soundness Act⁹ and its implementing regulations, and several Executive Orders. Furthermore, where federal funding is involved, whether in the form of loans, insurance or -- as in the case at hand – 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.

Communities in underserved markets have been deeply harmed by irresponsible lending in the last decade. Today, rather than remediate the damage done by subprime lending and its disproportionate impact on communities of color, lenders and the Enterprises responded by closing off lending options for these communities. One reason the conventional market is struggling to serve communities of color and low to moderate-income families is that credit is now more unnecessarily constrained than it has been in a generation.

Since the financial crisis, many lenders and the Enterprises have limited lending and increased prices for borrowers with lower credit scores and/or lower down payments. Borrowers of color, low and moderate-income families, and first-time homebuyers tend to have both lower FICO scores and fewer resources to put towards a down payment due, in part, to generations of discrimination. Historically, federal housing policies provided credit access to whites and wealthier Americans while excluding others, preventing generational wealth building. More recently, predatory loan products were targeted to these communities,¹⁰ stripping wealth¹¹ and

BUILDING WEALTH FOR LOW-INCOME AND MINORITY HOUSEHOLDS (WAS IT EVER?), *available at* <http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/hbtl-06.pdf>.

⁶ 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.

⁷ 15 U.S.C. § 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).

⁸ 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 Enterprises 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.”

⁹ 12 U.S.C. § 4501 *et seq.*

¹⁰ CRL’s report LOST GROUND, 2011: DISPARITIES IN MORTGAGE LENDING AND FORECLOSURES (*available at* <http://www.responsiblelending.org/mortgage-lending/research-analysis/Lost-Ground-2011.pdf>) found that “African Americans and Latinos were consistently more likely to receive high-risk loan products, even after accounting for income and credit status.”

¹¹ CRL’s report 2013 UPDATE: THE SPILLOVER EFFECTS OF FORECLOSURES (*available at* <http://www.responsiblelending.org/mortgage-lending/research-analysis/2013-crl-research-update-foreclosurespillover-effects-final-aug-19-docx.pdf>) found that “Minority neighborhoods have lost or will lose \$1.1 trillion in home equity as a result of spillover from homes that have started the foreclosure process.”

depressing credit scores.¹² As a result, eligibility limits and pricing based on FICO scores and Loan-to-Value (“LTV”) ratios serve as barriers to homeownership for these borrowers.

Evidence of this can be seen in the increase in the median credit score for all new purchase originations which rose to over 750 in 2013 and remains more than 20 points higher than it was a decade ago at 733.¹³ Furthermore, less than 10% of loans were made to borrowers with FICO scores at 647, even though about 30% of the scored population has a credit score in this range.¹⁴ The Urban Institute calculated that, as result of tight restrictions based on credit score alone, 5.2 million fewer loans were made between 2009 and 2014 than would have been expected based on historically safe lending standards.¹⁵

II. FHFA Should Maintain the Dual Part Test, but Both Standards Must be Met and Enforced.

Two different metrics are considered to determine compliance with the goals: 1) the market metric, which analyzes whether the Enterprises meet the percentage of affordable lending in the overall relevant market; and 2) the benchmark metric, which analyzes whether the Enterprises meet a percentage of affordable loans that is set based on market projections, Enterprise credit policies, and other factors. **We recommend these components be designed to work together in the dual market test to carry out FHFA’s duty to serve low and moderate-income families.** We also recommend two other considerations for application of the tests. First, the test must be appropriate for the projected persistence of this highly atypical housing market over the next three years. Second, the test must consider the related issue of how FHFA responds to findings of noncompliance, after determining how the goals are structured and how compliance is determined.

A. A Market Metric Goal Alone is Necessary but not Sufficient.

The market metric measures how the Enterprises are performing compared to other conventional market entities. The Enterprises should be leading the market by meeting or exceeding this goal. However, the market metric alone may simply reflect the Enterprises activities due to their historically high percentage of the conventional market and predicted continued dominance of that market.

The Enterprises have an affirmative Duty to Serve all markets at all times, and are taxpayer supported, unlike the other players in the conventional market (bank portfolios and private label securities). Yet, the Enterprises have consistently failed to meet the market metric for the low-

¹² KENNETH BREVOORT AND CHERYL COOPER, FORECLOSURE’S WAKE: THE CREDIT EXPERIENCES OF INDIVIDUALS FOLLOWING FORECLOSURE, available at <http://www.federalreserve.gov/pubs/feds/2010/201059/index.html>.

¹³ URBAN INSTITUTE, HOUSING FINANCE AT A GLANCE: A MONTHLY CHART BOOK AUGUST 2017, at 14, available http://www.urban.org/sites/default/files/publication/92941/august_chartbook_final.pdf.

¹⁴ *Id.*, FICO BLOG, US AVERAGE FICO SCORE HITS 700: A MILESTONE FOR CONSUMERS, available at <http://www.fico.com/en/blogs/risk-compliance/us-average-fico-score-hits-700-a-milestone-for-consumers/>.

¹⁵ BING BAI, LAURIE GOODMAN, AND JUN ZHU, TIGHT CREDIT STANDARDS PREVENTED 5.2 MILLION MORTGAGES BETWEEN 2009 AND 2014, available at <http://www.urban.org/urban-wire/tight-credit-standards-prevented-52-million-mortgagesbetween-2009-and-2014>.

income home purchase goal. This is unacceptable. The Enterprises should be leading not lagging the market in providing access to affordable homeownership.

Figure 1: Enterprise Low Income Home Purchase Performance Compared to Market 2006-2016¹⁶

	Market	Fannie Mae Performance	Freddie Mac Performance
2006	24.20%	27.70%	22.10%
2007	26.10%	26.00%	24.60%
2008	25.50%	23.10%	24.30%
2009	29.60%	25.50%	25.40%
2010	27.20%	25.10%	26.80%
2011	26.50%	25.80%	23.30%
2012	26.60%	25.60%	24.40%
2013	24.00%	23.80%	21.80%
2014	22.80%	23.50%	21.00%
2015	23.60%	23.50%	22.30%
2016	N/A	22.90%	23.80%

Furthermore, as has been the case since the Great Recession, the Enterprises' book of business dominates the conventional market, and will likely continue to do so over the next three years. As a result, the market test alone is inherently circular; the bar is largely set by the Enterprises regardless of their progress or failure to provide reasonable access to affordable home loans. Figure 2 shows that since 2011, the Enterprise share of the market overall has consistently exceeded 50% and their share of the conventional market has been much higher, averaging 75% of non-government lending.

¹⁶ Percentages calculated by FHFA for 2006-2016. See Table 6 for 2006-2013 data *available at* https://www.fhfa.gov/SupervisionRegulation/Rules/RuleDocuments/Enterprise_Goals_Proposed_Rule_8-29-2014.pdf and Table 1 for 2014-2016 data *available at* <https://www.fhfa.gov/SupervisionRegulation/Rules/Pages/2018-2020-Enterprise-Housing-Goals-Proposed-Rule.aspx>. Highlighted cells indicate where Enterprise performance exceeded the market.

Figure 2: Enterprise Market Share 2011-2017¹⁷

	Enterprise Share Overall	Enterprise Share Conventional
2011	61%	78%
2012	62%	79%
2013	65%	84%
2014	53%	71%
2015	52%	72%
2016	46%	59%
2017	53%	72%

Given their dominance, the Enterprises should easily be able to meet and exceed the market metric with focused efforts to reach this market. As discussed further below, the Enterprises' meeting the market metric, and by how much, should be relevant factors in evaluating the Enterprises' performance. However, deeming the Enterprises to meet their affordable housing goals by merely meeting the market over the next three years would eviscerate the housing goals and their utility.

B. A Benchmark Metric Goal Alone is Also Insufficient.

The benchmark metric is essential in the Enterprises' lending policies. After the financial crisis, the FHFA and Enterprises' focus was understandably on restoring the financial stability of the Enterprises. As we discuss above, a consequence of this focus has been excruciatingly tight lending standards that have depressed affordable lending for the Enterprises and the whole market. However, the Enterprises have stabilized their finances and returned to profitability. Now it is time for them to fulfill their other statutory duty, to provide credit to the broad housing market with emphasis on the depressed affordable housing. Meeting an appropriate benchmark goal must be part of FHFA's oversight of the Enterprises.

FHFA has chosen to set the benchmark goal primarily based on a complicated model forecasting exercise. Limitations in the model will be discussed below, but apart from technical limitations the concept of relying heavily on a forecast model to measure the Enterprises' ability to serve the market is flawed. The forecasting effort attempts simply to predict the future based on the past. If FHFA compares the Enterprises only to a forecasted prediction, the point of the affordable housing goals is lost. The intent of the goals is not to accurately predict the future with the best model; the intent is to incentivize and hold the Enterprises accountable for serving the entire market. Given this understanding, a forecast model is helpful for providing a guideline but should not be the sole standard to which the Enterprises are held.

¹⁷ CRL Calculations. 2011-2015 numbers based on Graph 1 of the Proposed Rule. 2016-2017 estimated based on data from the Urban Institute Housing Finance at a Glance: Monthly Chartbook, June 2017 and February 2017, p. 8, available at <http://www.urban.org/policy-centers/housing-finance-policy-center/projects/housing-finance-glance-monthly-chartbooks>.

There have been various criticisms of a benchmark metric. We think that they in fact speak to how the goal should be administered and utilized in the evaluation of the Enterprises' affordable housing goal, not whether such a goal should be set and enforced. For example, it is argued that external conditions could change, making it harder to reach a benchmark goal. However, this is inherent in any goal setting, and FHFA is well equipped to respond fairly to that scenario through its authority to retroactively adjust the goal and/or to formulate any response to a failure to meet the goal. This same flexibility applies to and addresses the argument that FHFA could set the goal inappropriately high. Most important, for the benchmark metric to be effective it must be a required part of the evaluation of whether the Enterprises met their affordable goals, rather than an alternative to the market test, which is a lax standard for the expected market.

C. For Housing Goals to be Met, Both Metrics Must be Matched Under the Dual Test.

The key question is how the two metrics should interact. It is clear that if an Enterprise fails both metrics, then they have failed to meet their housing goals. It is likewise clear that if they pass both metrics, they have met their housing goals. The question is what results when an Enterprise passes one metric and fails the other. As shown in the discussion above, the market metric is inherently subject to being circular. This is particularly the case now, as the Enterprises enjoy a market share over 70% of the conventional market. For these reasons, to meet the housing goals, the Enterprises should have to meet *both* the market and benchmark metrics to pass the goal.

That said, the meeting of the market metric and by how much the Enterprises exceed the market should be a significant factor in evaluating the Enterprises' performance on the housing goal. For example, if the Enterprises are substantially above the market, that is strong evidence that they are striving to provide affordable housing. On the other hand, if they are one tenth of one percent above the market, this provides little evidence in the current environment that they are making substantial progress in returning reasonable accessibility to the market.

The Enterprises' meeting of the market metric, and by how much, should be an important consideration in the FHFA's evaluation of a failure to meet the benchmark goal and its determination of what remedial or enforcement steps, if any, are appropriate. This approach provides the FHFA the tools and flexibility to effectively and fairly evaluate the GSE's performance relative to the two metrics. This flexibility is inherent in the entire goals process. For example, if the Enterprises fail the benchmark badly without a good explanation, that should not be treated the same as missing the goal by a tenth of one percent with evidence of good effort. Again, FHFA would use its discretion to respond appropriately to the two very different scenarios. Conversely, the alternative approach of declaring any meeting of the market metric to be a meeting of the housing goals is unduly rigid, and it deprives the FHFA of the tools necessary to carry out its statutory duty of ensuring credit is available to qualified borrowers. If exceeding the market metric by any amount at all constitutes meeting the housing goals, it creates a bright line loophole for the Enterprises. This would nullify the benchmark metric for the coming years and render the housing goals a false promise for the tens of thousands of low and moderate-income families who have the potential to prosper from affordable homeownership opportunities provided by FHFA and the Enterprises.

III. FHFA Should More Robustly Exercise its Statutory Authority to Enforce the Goals.

The Enterprises have frequently failed to meet their single-family goals. In 2014, FHFA determined that Freddie Mac's performance fell short of the benchmark and market levels on the low-income and very low-income home purchase goals. FHFA determined that achieving the goals was feasible in 2014 and required Freddie Mac to submit a housing plan, which FHFA approved on March 31, 2016.¹⁸ Yet, Freddie Mac missed these two goals again in 2015, and submitted a revised housing plan for 2017-2018.¹⁹ FHFA continues to monitor Freddie Mac's progress toward meeting its goals, but it is unclear whether any improvements have been made, and whether Freddie Mac will miss its goals again in 2016.

In 2015, both Fannie Mae and Freddie Mac missed the low-income and the very low-income home purchase goals. FHFA determined that because this was the first year since 2013 that Fannie Mae did not achieve these goals and because Fannie Mae missed the goals by narrow amounts, FHFA would not require that Fannie Mae submit a formal housing plan. Still, in its recent housing activities report, Fannie Mae predicted it would miss three out of five single-family goals in 2016 – the low-income home purchase goal, the very low-income home purchase goal, and the low-income refinance goal.²⁰ According to predicted performance, Fannie Mae would miss these goals by much larger amounts than in 2015. It appears that the prospect of missing goals is not met with much consequence.

Moving forward, we recommend that FHFA more robustly enforce processes that will allow for detailed examination of failed or infeasible goals, and a detailed plan, where appropriate, for improvement for the following goals period. A critical examination will facilitate more efficient planning and responsible enforcement of future goals. FHFA has the statutory authority²¹ to enforce procedures and where necessary to impose civil and monetary penalties for when housing goals are not met. Funds from potential penalties are directed to the established Housing Trust Fund. FHFA should assertively enforce this policy to provide reasonable incentives to bolster the Enterprises' commitment to meet the goals, and to formulate action plans for improvement when goals are not met.

Thus, we recommend that the FHFA exercise its statutory authority to enforce housing goals and provide real action and consequences for when goals unjustifiably are not met. Follow up reporting and civil penalties (where necessary) will also help FHFA and the Enterprises to

¹⁸ Letter from Director Watt to CEO of Freddie Mac (Mar. 31, 2016), *available at* https://www.fhfa.gov/PolicyProgramsResearch/Programs/AffordableHousing/Documents/Fred_M_Goals/2016/3-31-16_ltr-to-FRE_Freddie-Affordable-Housing-Plan.pdf.

¹⁹ Letter from Director Watt to CEO of Freddie Mac (Apr. 3, 2017), *available at* https://www.fhfa.gov/PolicyProgramsResearch/Programs/AffordableHousing/Documents/Fred_M_Goals/2017/4-3-17_FRE_Affordable_Hsg_Plan_for_2017-18.pdf.

²⁰ Fannie Mae 2016 Annual Housing Activities Report and Annual Mortgage Report, p. 7, *available at* https://www.fhfa.gov/PolicyProgramsResearch/Programs/AffordableHousing/Documents/Fan_M_Goals/2017/Fannie-Mae-2016-AHAR-AMR-FINAL.pdf. Official performance on the 2016 housing goals will be determined by FHFA later this year.

²¹ P. Law 102-550, the Housing and Community Development Act of 1992, Secs. 1336-1349, P. Law. 110-289, the Housing and Economic Recovery Act of 2008, Sec. 1345.

improve future goal setting when failures receive proper examination. Directing civil penalties to the Housing Trust Fund will be an appropriate use of potential monetary penalties. An efficient housing goals enforcement system will help improve the Enterprises' performance, which will benefit the communities that these goals are meant to reach.

IV. Single Family Purchase Benchmark Levels Should be Higher.

FHFA proposes to keep the low-income purchase, very low-income purchase, and low-income refinance goals at the same benchmark level as in the 2015-2017 goal cycle (24 percent, 6 percent and 21 percent, respectively). FHFA proposes to increase the low-income areas home purchase subgoal by one percentage point, from 14 percent to 15 percent.

A review of the forecasting model and historical affordable lending levels shows that the proposed benchmark levels are too low and that FHFA should set higher benchmark metrics. We focus our analysis and recommendations on the first, and most comprehensive, goal – the Low-Income Borrower Home Purchase Goal. In determining the benchmark metric, it is critical to start with recognition of the current extraordinary circumstances in the housing market. As many have observed, the housing market recently experienced a hundred-year storm, unprecedented in our lifetimes. Some of the results of this have been the Enterprises' tightening credit to the most restrictive levels in a generation, with resulting suppression of affordable housing levels. As a result, the Enterprises have become not just the dominant, but virtually the only secondary market option for conventional loans. These once-in-a-lifetime circumstances have profound impacts on assessing the methodology used to set the benchmark metric and the resulting benchmark goal.

FHFA's proposed benchmark goal is determined based on a forecast model and consideration of three additional factors. However, the accuracy of the model's predictions is seriously compromised by the atypical conditions in the current and recent housing market. This results in goals that are unjustifiably low. In addition, historically, the Enterprises have maintained lending to low-income purchasers at levels above those that FHFA has proposed, and above the levels predicted by the model for 2018-2020. As shown below, a higher benchmark of goals is needed due to the limitations of the model and the evidence of the Enterprises' historic performance. Furthermore, consideration of the three statutory factors which are not incorporated into the forecast model justify FHFA setting a higher benchmark goal from within the model's predicted range.

We recommend setting the Low-Income Borrower Home Purchase Goal at 27%, the same level as the benchmark for 2010-2012.

A. Extraordinary Circumstances Substantially Limit the Usefulness of FHFA's Model in Setting Goals for the Next Three Years.

The FHFA's forecast model looks at numerous factors and fits a model that explains the level of affordable housing based on these factors for the period of 2004-2015. The model is then used to predict future levels of affordable housing based on predicted values of the underlying factors. However, the applicability of the model to the current goal setting is undermined by the grossly atypical outlier housing market, and by the fact that the model cannot account for important

exogenous factors. Finally, we show below that the fact that the model produces wide confidence intervals does not justify setting a lower benchmark goal.

a. The Base Data is not Representative of the Long-Term Housing Market.

In order to predict the level of affordable housing for the coming three years, FHFA's model looked at various factors over the past twelve years and built a model that explains the level of lending to low income borrowers based on those factors. A key assumption underlying this method is that the past decade reflected typical relationships between these factors and the level of lending to low income borrowers. The past twelve years, however, has been anything but a typical housing market.

The model used to set the level of the Low-Income Borrower Home Purchase Goal includes the following driver variables: household debt service ratio, per capita income, labor force participation rate, consumer confidence, consumer price index, housing affordability index, sale of existing homes, and the share of government insured or guaranteed mortgages. The model predicts the share of low income borrowers in 2018-2020 will closely match that of 2012-2016, increasing rise modestly and then fall again. In constructing this model, FHFA made many changes from their previous modeling. Yet, they continue to build their model on the same set of data and as a result continue the flawed assumption that the relationships between these factors and lending to low income borrowers over the past twelve years are predictive. However, this has been anything but the case. For example, the consumer confidence index reached a historic low in 2009 and the sale of existing homes rose and fell dramatically during the crisis. Additionally, lenders extended credit liberally during the subprime boom years included in the model (2004-2007) and tightened credit significantly in the years during and following the Great Recession also included in the model (2008-2015).

One of the most important past market conditions that distorts the model's prediction is the severe restriction of credit imposed by the Enterprises since 2008. Excessive risk-based pricing and the use of loan-level price adjustments (LLPAs) are partially to blame for this credit restriction. As a result, values for the model driver factors were correlated by the model with artificially low levels of lending to low income homebuyers. This model then in turn wrongly predicts that future affordable housing must remain well below historic levels despite predicted improvements in many of the driver factors, for example a rise in per capita disposable income. Instead of accurately correlating these factors with lending levels, the model assumes that the relationships in the past years were typical and will continue. Ultimately the model forecasts low and decreasing lending to low income borrowers despite predicting rising incomes, continued low interest rates and unemployment, and minimal inflation.

The relationships observed between these factors over these years will not be the same as the relationships between these same factors in more normal times. The impact of having such extraordinary periods in the base profoundly affects outcomes. For example, if one predicted October rainfall in New York City based on the last decade, which included the once in a century storm Sandy, one would get a very distorted and inaccurate prediction of future rainfall.

b. Exogenous Factors Limit the Predictive Power of the Forecast Model

Another assumption underlying a reliable predictive model is that there are not additional factors (exogenous factors) that will significantly affect the future but are left out of the model. This assumption does not hold. In particular, the model does not take into account any factors that explain the impact of Enterprise policies on the market that are likely to profoundly affect the market for low income borrower purchase loans over the next few years. Things like changes to Enterprise buyback and representations and warranties policies, Enterprise efforts under their Duty to Serve Underserved Market Plans and other outreach and product development by the Enterprises could have important impact on mortgage lending and yet are not able to be modeled under the econometric framework.

c. The 95 Percent Confidence Level Test Does Not Justify a Conservative Benchmark.

The model predictions include 95 percent confidence levels for the predictions and these show a wide range of possible levels of lending to low income borrowers, including as low as 15.6 percent. Some have suggested that is a reason to set conservative benchmark levels. This suggestion is unsupported. A 95 percent confidence level means that one would expect that the prediction to be within the stated range 19 out of 20 times. This means that the model has to take into account scenarios such as severe recessions, and one could occur in the next 20 years. However, this is not a reasonable standard for setting goals. For example, if one were setting goals for the next three years for a salesperson, one would not depress the goals simply because there was a one in twenty chance of a recession. Rather, one would set the goals based on the most likely level that can be met with substantial effort, and adjust them if significant outside conditions changed. FHFA should follow this same approach; it should set the goals based on the most likely level that can be met with substantial effort, using its authority to subsequently change the goals and utilize its wide discretion to decide what, if any, steps to take if the goals are not met.²²

B. Historic Performance Justifies Higher Benchmark Goals.

Evidence of the model's flaws can be seen in looking at the historic data on affordable housing purchase loan levels. Periods with economic factors similar or less favorable than those predicted for 2018-2020 resulted in much higher levels of affordable housing. It is noteworthy that some of the most important factors in the model predicting Low Income Borrower Home Purchases will still be at very favorable levels historically, and they will be at least as favorable or more favorable than the numerous years when affordable housing lending levels were much higher. Historic performance under a range of credit and business conditions shows that the Enterprises are able to meet higher goals under a variety of different housing market conditions. Figure 3

²² As discussed above, including the once in a lifetime data of the Great Recession produces a non-representative sample for the model. One consequence of this is that it substantially increases the size of the 95 percent range of predictions, just as including Sandy data in the base for rainfall predictions would dramatically increase the range of predictions of future rainfall.

shows that in nearly every year from 2001 to 2012, the lending of Fannie and Freddie exceeded the benchmark proposed by FHFA for 2018-2020 (24 percent).

Figure 3: Low Income Home Purchase Historical Performance 2001-2016²³

	Fannie Performance	Freddie Performance
2001	24.60%	24.30%
2002	27.00%	24.90%
2003	29.00%	24.90%
2004	29.10%	24.80%
2005	<i>Data unavailable</i>	
2006	27.70%	22.10%
2007	26.00%	24.60%
2008	23.10%	24.30%
2009	25.50%	25.40%
2010	25.10%	26.80%
2011	25.80%	23.30%
2012	25.60%	24.40%
2013	23.80%	21.80%
2014	23.50%	21.00%
2015	23.50%	22.30%
2016	22.90%	23.80%

A more reliable method for setting the goals would be to look at typical historic levels of affordable housing in economic markets that match the predictions for the future three years, rather than setting such levels based on a model that is based on the experience of an extraordinary period of the housing market. When this is done, the data supports a benchmark equal to that for 2010-2012 of 27 percent.

C. Other Factors, Which FHFA is Statutorily Required to Consider, Support Setting a Higher Benchmark Goal.

As FHFA discusses in the proposed rule, the statute outlines seven factors which must be considered in setting the benchmark goal. FHFA goes on to describe how four of the seven factors are incorporated into the forecast model. The other three are used by FHFA to select a point estimate within the range predicted using the model. These non-modeled factors are: historical performance and effort of the Enterprises toward achieving the housing goal; ability of

²³ Percentages calculated by FHFA for 2006-2016. See Table 6 for 2006-2013 data available at https://www.fhfa.gov/SupervisionRegulation/Rules/RuleDocuments/Enterprise_Goals_Proposed_Rule_8-29-2014.pdf and Table 1 for 2014-2016 data available at <https://www.fhfa.gov/SupervisionRegulation/Rules/Pages/2018-2020-Enterprise-Housing-Goals-Proposed-Rule.aspx>. CRL calculated percentages for 2001-2004 from data in Tables 5a and 5b available at https://www.huduser.gov/portal/datasets/GSE/profiles01_04.pdf. Highlighted cells exceed the proposed benchmark (24%).

the Enterprises to lead the industry in making mortgage credit available; and need to maintain the sound financial condition of the Enterprises.

As described above, the forecast model produces wide confidence intervals. For the low-income home purchase goal the model forecast is: 25.5% +/- 5.6% in 2018; 24.0% +/-6.6% in 2019; and 23.0% +/-7.4% in 2020. FHFA chose a benchmark goal of 24%, which falls squarely in the middle of these ranges and is below the midpoint of the range predicted for 2018. However, a review of the three factors not considered in the model justifies choosing a higher benchmark goal from within the range.

The Enterprises have successfully reached a higher level of lending in the past and are in a strong position to lead the market. Both of these points have been discussed in detail above and justify choosing a higher benchmark goal from within the forecasted ranges. Delinquency and default data highlight the fact that there can be more responsible lending to low to moderate-income borrowers without undue financial risk. A chart in Fannie Mae's 2016 Annual Housing Activities Report compares the relative 90-day delinquency and default rates between single-family loans serving low and moderate-income families and loans serving families with income about the median level, by year.²⁴ For loans originated since 2009, the difference is starkly minimal. Higher income borrowers had a default rate of 0.1 percent, while lower income borrowers had a default rate of 0.3 percent for 2010-2015. Moreover, the likelihood of delinquency and default among low income borrowers is historically low – approximately to that of high income loans originated in 2002-2004.

D. The Enterprises' Refinance Goal is Essential for Preserving Affordable Homeownership.

The Enterprises have generally been more successful at meeting the low-income refinance goal than the home purchase goals. While we believe the home purchase goals are the most important to create affordable homeownership opportunities, we also support the Enterprises in meeting their refinance goal. Responsible and affordable refinance loans are crucial 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.²⁵ Subprime lenders and brokers targeted lower-income borrowers, including the elderly and communities of color, for bad refinance loans. Given this history, the Enterprises must continue to encourage responsible and affordable refinance loans for low-income borrower to preserve homeownership.

²⁴ 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.

²⁵ 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>.

V. FHFA Should Continue to Monitor the Low-Income Areas Home Purchase Subgoal to Ensure Policy Objectives are Met.

The low-income areas home purchase subgoal is based on the percentage of all single-family, owner-occupied home purchase mortgages purchased by an Enterprise that are either: (1) for families in low-income areas, defined to include census tracts with median income less than or equal to 80 percent of AMI; or (2) for families with incomes less than or equal to AMI who reside in racial minority census tracts (defined as census tracts with a racial minority population of at least 30 percent and a tract median income of less than 100 percent of AMI).²⁶ Borrowers may qualify under either or both conditions. However, the data show that mortgages satisfying condition one vastly outweigh mortgages satisfying condition two.

In its proposed rule, FHFA notes that its analysis found that the mortgage market in both low-income areas and in high-racial minority census tracts has been moving towards borrowers with higher incomes in recent years. In addition, research shows that white and Asian borrowers are overrepresented in the underserved markets the Enterprises target.²⁷ FHFA further notes that while the presence of higher income borrowers in lower income and higher racial minority areas may be a sign of economic diversity and may be related to improving economic indicators for the community, there is still concern that such a trend would displace lower income households in these areas or that low income borrowers may not be able to access the credit they need to purchase homes in these areas. We share these concerns and encourage FHFA to monitor and further analyze the trend, considering whether this subgoal meets policy objectives. Furthermore, we urge FHFA to consider how the Enterprises' pricing policies put loans out of reach for low-income people, and how both the pricing policies and the subgoal operate together to facilitate gentrification and potential displacement of lower-income and racial minority families as well as limit opportunities for affordable homeownership.

VI. FHFA and the Enterprises Should Modify their Pricing Policies to Help Meet Housing Goals.

In addition to the recommendations above, we urge FHFA and the Enterprises to revisit their pricing policies and consider how the current structure is a barrier to the Enterprises' ability to purchase loans to meet its affordable housing goals. FHFA should eliminate the LLPAs and set g-fees in such a way as to pool risk and encourage wide access to responsible homeownership. FHFA should also consider the ways in which the PMIERS capital requirements have contributed to greater risk based pricing and differential pricing for private mortgage insurance.

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

²⁶ The low-income areas home purchase goal – as opposed to the subgoal – also includes moderate income families in designated disaster areas. FHFA first sets the benchmark level for the low-income areas subgoal, and then establishes an additional increment for mortgages to families located in federally-declared disaster areas with incomes less than or equal to AMI.

²⁷ MICHELA ZONTA, DO THE GSEs MEET THE CREDIT NEEDS OF UNDERSERVED COMMUNITIES OF COLOR?, *Cityscape: A Journal of Policy Development and Research*, Vol. 17, No. 3 (2015), available at <https://www.huduser.gov/portal/periodicals/cityscape/vol17num3/ch11.pdf>.

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, especially in today's mortgage market. For example, although Fannie Mae's guidelines allow the Enterprise to purchase loans with credit scores down to 620 and loan-to-value (LTV) ratios of up to 97%, very few loans purchased by the Enterprise have these characteristics. For example, just 4.1% of Fannie Mae's 2016 single-family loan purchases had credit scores below 660 and just 1.1% had a combination of a credit score under 660 and an LTV over 80%.²⁸ One reason is that excessive risk-based pricing by both the Enterprises 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%.²⁹ Thus, reducing differential pricing would likely further the Enterprises' loan purchases in underserved markets.

VII. Conclusion

We commend the FHFA for its continued work to ensure that the Enterprises increase liquidity in the mortgage market and ensure that borrowers from traditionally underserved and/or excluded communities have access to the mortgage market. Maintaining the two-part test and setting a higher benchmark standard is essential to the effectiveness of the affordable housing goals in meeting this responsibility. We also encourage the FHFA to use its statutory authority under HERA to enforce the goals in order to maintain the Enterprises' commitment to actually meet the goals or formulate an action plan when goals are not met. Communities in underserved markets have been deeply harmed by irresponsible lending in the last decade. The Enterprises have improved their financial conditions, and now it is time for them to fulfill their other statutory duty, to provide credit to the broad housing market with emphasis on the depressed affordable housing. Ensuring the Enterprises are meeting a robust benchmark goal and leading the market must be part of FHFA's oversight of the Enterprises. Such an improvement will be good not only for the families who have more access to affordable and responsible credit, but will also further the more general housing recovery.

Sincerely,

Americans for Financial Reform
Center for Responsible Lending
Consumer Action
Empire Justice Center
Esperanza

²⁸ See p. 6 of 2017 First Quarter Credit Supplement, Fannie Mae, May 5, 2017, *available at* http://www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2017/q12017_credit_summary.pdf.

²⁹ $350/4+225=312.5$ 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.

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