August 14, 2023

The Honorable Sandra L. Thompson
Director
Federal Housing Finance Agency
400 Seventh Street, SW
10th Floor
Washington, D.C. 20219

Re: Request For Input on Fannie Mae and Freddie Mac Single Family Mortgage Pricing Framework

Dear Director Thompson:

The Center for Responsible Lending (CRL) appreciates this opportunity to comment on the Federal Housing Finance Agency's Request for Input (RFI) on Fannie Mae and Freddie Mac's Single Family Mortgage Pricing Framework.[1]

Though the RFI contains two sets of questions, CRL believes that the first set is largely imponderable. Specifically, it is not possible to calculate what a "commercially reasonable" return on capital over the long term should be without first knowing what business structures the Enterprises will assume after conservatorship ends. The enterprises' final form, whether it be as quasi-government entities, utilities, or fully private corporations, will determine the level of risk that equity holders assume and the volatility of their earnings. As a result, the enterprises' business structures will dictate the return needed to attract capital over the long term. And, in the short term, while they remain in conservatorship and are effectively owned by the federal government, no benchmark exists to measure what rate of return is "reasonable" for the United States.

Given this, our input on the existing Single Family Mortgage Pricing Framework for Fannie Mae and Freddie Mac focuses on three key points:[2]

(1) The role that excessive capital requirements are playing in reducing homeownership affordability and access;
(2) The need for the pricing framework to empower the Enterprises to better serve the full scope of creditworthy borrowers by substantially increasing the purchase percentage of loans to families of color; and
(3) The need to develop a targeted relief strategy from upfront guarantee fees that focuses on first generation borrowers, single head of household borrowers, and smaller dollar mortgages.

[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. For 40 years, Self-Help has created asset-building opportunities for low-income individuals, rural communities, women, and families of color. In total, Self-Help has provided over $9 billion in financing to 172,000 homebuyers, small businesses, and nonprofit organizations and serves more than 160,000 mostly low-income families through 72 credit union branches in North Carolina, California, Florida, Illinois, South Carolina, Virginia, Washington, and Wisconsin.

[2] This comment letter interchangeably refers to Fannie Mae and Freddie Mac as both the "enterprises" or "GSEs".

1. **The GSEs Existing Capital Requirements are Excessive and, as a Result, Make Conventional Mortgage Credit Less Affordable Than It Should Be.**

The case for reconsidering the Enterprise Regulatory Capital Framework ("ERCF") is clear and compelling. At the time of the 2020 proposal, CRL–along with a number of consumer advocacy and civil rights organizations–identified the framework's multiple flaws.[3] We collectively noted that the framework was flawed due to: (1) its adoption of the Basel structure, which was developed for depository organizations with a very different business model and risk profile; (2) its overly pessimistic stress assumptions and multiple subjective buffers; and (3) its failure to count a portion of guarantee fee revenue as capital since in a stress scenario it would be normal to expect that revenue not needed to cover expenses and ordinary, expected losses would be available to cover extraordinary losses and would do so before capital was drawn down.[4] Others, including scholars from the Urban Institute[5] and the Joint Center for Housing Studies at Harvard University[6] and other mortgage experts[7]--voiced similar concerns.

Developments over the past two and a half years have made it even clearer that the ERCF is seriously flawed. The stress scenario on which the risk-based capital requirements were based assumed that the level of foreclosures experienced during the financial crisis would recur in a similarly severe economic downturn. But recent scholarship has proven that what drives foreclosures is not housing price deflation and underwater borrowers but rather financial shocks and financially distressed borrowers.[8] Yet, as a result of their experiences through the crisis and with the Home Affordable Mortgage Program, FHFA

---

[3] *See* "Comment on the Proposed Rule to Amend the Enterprise Regulatory Capital Framework," available at https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-comment-fhfa-amending-ercf-nov2021.pdf.

[4] The CRL comment was joined in by the organizations listed in .2 and also by the Consumer Federation of America, UnidosUS, National Association of Hispanic Real Estate Professionals, National Association for Latino Community Asset Builders, National Association of Real Estate Brokers, National Community Stabilization Trust, and National Housing Conference. https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-comment-gse-capital-rule-31aug20.pdf

[5] Edward Golding, Laurie Goodman, and Jun Zhu, *Analysis of the proposed 2020 FHA Rule on Enterprise Capital, https://www.urban.org/sites/default/files/publication/102779/analysis-of-the-proposed-2020-rule-on-enterprise-capital_0.pdf*

[6] Don Layton, *The New Proposed Capital Rule for Freddie Mac & Fannie Mae: Ten Quick Reactions, https://www.jchs.harvard.edu/blog/the-new-proposed-capital-rule-for-freddie-mac-fannie-mae-ten-quick-reactions*

[7] These include the former Vice Chairman and CFO of Freddie Mac, the former Vice President of Risk at Fannie Mae, the former Senior Advisor to the Director of FHFA in a comment filed jointly with the Chief Economist for Moody's Analytics, and one of the leading mortgage analytics firms, Comment of Timothy Howard, https://www.fhfa.gov/SupervisionRegulation/Rules/Pages/Comment-Detail.aspx?CommentId=15548; Comment on Michael Molesky, https://www.fhfa.gov/SupervisionRegulation/Rules/Pages/Comment-Detail.aspx?CommentId=15587; Comment of Jim Parrott, Bob Ryan, and Mark Zandi, https://www.fhfa.gov//SupervisionRegulation/Rules/Pages/Comment-Detail.aspx?CommentId=15577 , Comment of Andrew Davidson & Co., https://www.fhfa.gov//SupervisionRegulation/Rules/Pages/Comment-Detail.aspx?CommentId=15571

[8] The evidence is summarized in Alexandrov, Goodman & Tozer, *Normalizing Forbearance* (2022), https://www.urban.org/sites/default/files/2022-07/Normalizing%20Forbearance.pdf

and the GSEs have developed a set of loss mitigation tools, and loss mitigation processes, that enable many borrowers in distress to avoid foreclosure. Thus, a key assumption underlying the ERCF risk weightings—that the financial crisis provides the appropriate benchmark for projecting foreclosures—is deeply flawed.

Moreover, the loss mitigation tools available to the GSEs have become even more robust since 2020 as the result of the experience during the pandemic with forbearance followed by a payment deferral. As Director Thompson stated in March when FHFA announced that it was adding such options as a "key part of our standard loss mitigation toolkit," these tools enabled the GSES to "completed more than one million COVID-19 payment deferrals during the pandemic, helping borrowers nationwide to stay in their homes," and their addition to the loss mitigation toolkit "will promote sustainable homeownership and will further support the safety and soundness of the Enterprises".[9]

Perhaps the best proof of the excessiveness of the current capital requirements comes from the stress tests conducted by the GSEs to project outcomes in what FHFA describes as a "severely adverse" scenario marked by a "severe global recession." In the results announced in August, 2022, in which the Enterprises were instructed to assume, among other things, a 29% decline in home prices, 10% unemployment rate, and 3.5% decline in real GDP, Fannie Mae's stress test results showed that before creating a valuation allowance for deferred tax assets, it would have $10.8 billion in net income and after creating such an allowance its net income would drop to a small ($3.8 billion) negative position. Freddie fared even better, with positive income both before ($6.2 billion) and after ($1.8 billion) establishing the allowance.[10] And, in the most recent stress test, in which the Enterprises were instructed to assume an even more dramatic 38% decrease in home prices and 8.75% decline in real GDP, the Enterprises still had positive net income before establishing a valuation allowance on deferred tax assets ($6.0 billion for Fannie and $4.0 billion for Freddie); after establishing the valuation allowance the Enterprises showed modest losses ($7.8 billion for Fannie and $0.6 billion for Freddie).[11]

Commenting on last year's results, Donald Layton, a Senior Visiting Fellow at the NYU Furman Center and former CEO of Freddie Mac, wrote that these stress test results both confirm [a] major derisking success" and "showcas[e] the need for regulatory capital revision" as the stress tests revealed "a level of required capital…dramatically lower than the $312 billion of capital currently required" by the ERCF. Layton added:

> Notably, the question of how much capital the two GSEs are required to maintain is not just an academic one. If the regulatory requirement is too low, the safety and soundness of the GSEs will be inadequate, reducing the stability of the entire U.S. financial system. If it is too high, the economic equivalent of an unnecessary tax on homeownership will be created, which is

[9] "FHFA Annonces Enhanced Payment Deferral Policies for Borrowers Facing Financial Hardship," https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Announces-Enhanced-Payment-Deferral-Policies-for-Borrowers-Facing-Financial-Hardship.aspx

[10] https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/Final_2022-Public-Disclosures-FHFA_SA.pdf. The results for Fannie Mae summarized in the text comes from the revisions made by Fannie Mae. https://www.fanniemae.com/media/47816/display

[11] Dodd-Frank Act Stress Tests Results Severely Adverse Scenario (August 10, 2023), https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/Final_2023-Public-Disclosure_FHFA_SA.pdf?utm_medium=email&utm_source=govdelivery

contrary to the long-standing and bipartisan public policy goal of supporting sustainable homeownership. It is therefore incumbent upon the FHFA to find the "just right" Goldilocks level of capital requirement, i.e., enough for fully adequate safety and soundness, but not materially more.

***

Because the variance between the ERCF and the stress-based capital calculation developed herein is so large, it seems incumbent upon the FHFA to revisit the ERCF and the stress tests, together, and subsequently make the official changes needed to get them to produce reasonably comparable capital requirements.

The short of the matter, then, is this. There is much the GSEs can do and should do to expand homeownership opportunities for lower income, lower wealth households and close the homeownership gap. The ERCF stands as an obstacle to progress on these fronts. Given the stress test results, the developments since the adoption of the ERCF that have reduced the GSEs risks, and the multiple fallacies of the ERCF itself, FHFA should reconsider the amount of capital required by the ERCF and the ERCF's definition of what constitutes capital.

2. **The Pricing Framework Should Empower the Enterprises to Better Serve the Full Scope of Creditworthy Borrowers by Substantially Increasing the Purchase Percentage of Loans Made to Underserved Communities.**

The GSEs explicitly undertake vital public duties in exchange for Congressional charter and public support. They are to promote access to mortgage credit for underserved borrowers, including Black and Latino families, and serve countercyclical roles in the mortgage market. These public duties are in the GSEs' charters and the reason for their very existence.[12] Beyond that, they are statutorily required to support fair lending and report to Congress on how their practices "affect the purchase of mortgages for low- and moderate- income families, or … may yield disparate results based on the race of the borrower, including revisions thereto to promote affordable housing or fair lending."[13] FHFA, in turn, is tasked with assuring that the GSEs remain true to their mission of fostering "resilient national housing finance

[12] *See* 12 U.S.C. § 1716; 12 U.S.C. § 1451. The legislated purpose of the GSEs, as stated in their charters, is to:

1. provide stability in the secondary market for residential mortgages;1. respond appropriately to the private capital market;
2. provide ongoing assistance to the secondary market for residential mortgages (including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing;
3. 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;
4. manage and liquidate federally owned mortgage portfolios in an orderly manner, with a minimum of adverse effect upon the residential mortgage market and minimum loss to the Federal Government.

[13] *See* 12 U.S.C. § 1456(f)(2)(G).

markets (including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities)."[14]

FHFA took an important step forward last year in this regard by eliminating LLPAs for the GSEs' affordability products and for first-time homebuyers with income at or below 100% of the Area Median Income in most of the United States and below 120% of AMI in high-cost areas. Even so, the LLPAs continue to be a barrier to GSE financing for low-wealth homebuyers with incomes above AMI, notwithstanding recent research from the Joint Center for Housing Studies showing that the lowest hanging fruit in closing the racial and ethnic homeownership gap lies with such households.[15]

3. **The Single Family Pricing Framework Should Provide Relief from Upfront Guarantee Fees for First Generation Borrowers, Single Head-of-Household Borrowers, and Smaller Dollar Mortgages.**

Accordingly, we urge FHFA, as an initial matter, to build on the progress made last year by eliminating LLPAs for all first generation, first-time homebuyers. First generation homebuyers are least likely to have the benefit of intergenerational wealth to access in making a home purchase, and have a special need for assistance in becoming homeowners. Eliminating LLPAs for this population would be a logical next step in furthering the GSEs' mission. And importantly, but not surprisingly, precisely because it has been so difficult for Black and Hispanic families to obtain homes in the past and because of the large income gap between white families and families of color, the first-generation homebuying population is disproportionately composed of people of color.[16]

Beyond that, for borrowers who are able to obtain a GSE mortgage, the LLPAs continue to be a large contributor to pricing disparities, especially for lower wealth, lower-score consumers who face LLPAs of up to 2.25%.[17] It goes without saying that Black and Latino households disproportionately fall at the lower end of the income, wealth and credit score spectrums[18] and thus are disproportionately disadvantaged by the LLPAs.

---

[14] Id. 4513(a)(1)(B)(ii).

[15] McCue *et al., How Much Can Down Payment Assistance Close Homeownership Gaps for Black and Hispanic Households* (2023), https://www.jchs.harvard.edu/sites/default/files/research/files/harvard_jchs_downpayment_assistance_mccue_2023.pdf

[16] Center for Responsible Lending and National Fair Housing Alliance, *First Generation: Criteria for a Targeted Down Payment Assistance Program* (2021), https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-nfha-first-generation-jun21.pdf. This study is restricted to borrowers with incomes up to 120% of AMI but we believe the same analysis would hold true across the income spectrum.

[17] For example, the CFPB reported that in 2019 for conventional mortgages, the median interest rate for Black borrowers was 25 basis points higher than for White borrowers, and the median Black borrower paid $320 more in total loan costs. CFPB, *An Updated Review of the New and Revised Data Points in HMDA* (2020), https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/cfpb_data-points_updated-review-hmda_report.pdf

[18] *E.gBhutta et al., Disparities in Wealth by Race and Ethnicity in the 2019 Survey of Consumer Finance, https://www.federalreserve.gov/econres/notes/feds-notes/disparities-in-wealth-by-race-and-ethnicity-in-the-2019-survey-of-consumer-finances-20200928.html; Board of Governors of the Federal Reserve System, Report to*

Accordingly, we join with others in urging FHFA to cease requiring LLPAs on owner-occupied purchase mortgages for single head-of-household families and small dollar mortgages. Further, we urge FHFA to do so without increasing the ongoing guarantee fees as doing so would negate at least some of the benefit of ending these LLPAs.

We recognize, of course, that suspending LLPAs without increasing ongoing fees will, by definition, reduces the GSEs' revenue and hence their rates of return, but as we said at the outset, we view the "appropriate" rate of return as an artificial concept so long as the GSEs are in conservatorship. Moreover, as we explain above, whatever the appropriate rate of return, the rate of returns currently being calculated are artificially understated as they are pegged to capital requirements that are flawed both in terms of the amount of capital the GSEs are required to hold and in their overly cramped definition of what constitutes capital. **Accordingly, FHFA should reconsider the ERCF framework and requirements.**

When FHFA issued its original proposed ERCF in 2018, CRL, joined by several of its allies in the civil rights community, expressed concern that the proposal was based on an overly conservative stress scenario and added unnecessarily large buffers on top of the risk weightings, resulting in proposed requirements that would unduly burden working families and disserve the GSEs' mission.[19] Our concerns were magnified many times over when, in 2020, FHFA issued a new proposal the net effect of which would have been to increase the required capital as of September 30, 2019 by 77% over the original proposal, from $137 to $243 billion. In response, CRL—joined by an even broader coalition including not only our civil rights allies but also allies from the consumer advocacy and mortgage professional communities--submitted a detailed comment demonstrating the multiple fallacies in the 2020 proposal and warning that the proposal would "reduce mortgage credit availability, with an acute impact on low-to-moderate income families" and a "disproportionate impact on people of color."[20]

That remains true today. Even if FHFA were to eliminate LLPAs on all owner-occupied home purchase and mortgages, that would make only a small dent in closing the racial and ethnic homeownership chasm. In 2020 only 3% of the loans purchased by the Enterprises were for Black borrowers,[21] even though Black borrowers accounted for 7% of home purchase and 6% of refinance mortgages and an

---

Congress on Credit Scoring and Its Effect on the Availability and Affordability of Credit (2007) *https://www.federalreserve.gov/boarddocs/rptcongress/creditscore/creditscore.pdf*

[19] CRL's comment was joined in by the NAACP, Leadership Conference on Civil and Human Rights, National Coalition for Asian Pacific American Community Development, National Fair Housing Alliance, National Community Reinvestment Coalition, and the National Urban League. https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl_fhfa_capitalrequirements-nov2018.pdf

[20] The CRL comment was joined in by the organizations listed in .2 and also by the Consumer Federation of America, UnidosUS, National Association of Hispanic Real Estate Professionals, National Association for Latino Community Asset Builders, National Association of Real Estate Brokers, National Community Stabilization Trust, and National Housing Conference. https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-comment-gse-capital-rule-31aug20.pdf

[21] National Housing Resource Center, *Racial Equality and Fannie Mae and Freddie Mac Mortgages,* *https://www.hsgcenter.org/racial-equity-and-freddie-mac-and-fannie-mae/#:~:text=In%202020%2C%203.06%25%20of%20loans,and%206.77%25%20to%20Hispanic%20borrowers*.

even larger share of applications for new mortgages.[22] Latino borrowers are also underrepresented among loans purchased by the Enterprises but to a much lesser extent. So much more is needed to assure that the Enterprises serve borrowers of color, including, for example, expanding the GSE credit box through innovative underwriting techniques, providing secondary market support for mortgages originated through special purpose credit programs, outreach in the most impactful markets–including higher income Black renter households–and programs to get minority families into homeownership at earlier ages. In addition, the framework should also include addressing the needs of single head-of-household families and requiring lenders to market to their full communities and sell loans to the GSEs that reflect the communities from which those loans come. The GSEs can further increase continuing participation by families of color by structuring loans and servicing to account for the profound differences in personal and family wealth levels that result from extensive historic and continuing economic discriminatory policies and practices. The framework should also address the needs of single head-of-households and increase support for smaller dollar mortgages. Each of these initiatives will cost money. And, so long as the GSEs are expected to achieve a "reasonable rate of return" on an unreasonably large capital base–currently over $300 billion– it will be difficult, if not impossible, for the GSEs to pursue such initiatives at the scale needed to fulfill their mission.

Accordingly, additional LLPA changes must be carefully analyzed to ensure that they are structured in a way that does not inadvertently increase homeownership and equity disparities. That analysis will require an examination of not only what the impact would be on the existing pool of GSE borrowers, but also an estimate of the impact on the prospective pool, including the changes that reduced pricing might generate in that pool.

Thank you for your consideration of these comments.

Respectfully,

[22] CFPB, *Data Point: 2020 Mortgage Market Activity and Trends,* *https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/cfpb_2020-mortgage-market-activity-trends_report_2021-08.pdf*