

**THE CURRENT MORTGAGE MARKET:
UNDERMINING HOUSING
AFFORDABILITY WITH POLITICS**

HEARING
BEFORE THE
SUBCOMMITTEE ON HOUSING
AND INSURANCE
OF THE
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THE CURRENT MORTGAGE MARKET: UNDERMINING HOUSING AFFORDABILITY WITH POLITICS

Wednesday, May 17, 2023

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON HOUSING
AND INSURANCE,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2 p.m., in room 2220, Rayburn House Office Building, Hon. Warren Davidson [chairman of the subcommittee] presiding.

Members present: Representatives Davidson, Posey, Norman, Fitzgerald, Garbarino, Flood, Lawler, De La Cruz, Houchin; Cleaver, Tlaib, Pressley, Garcia, Williams of Georgia, Horsford, and Pettersen.

Ex officio present: Representative Waters.

Chairman DAVIDSON. The Subcommittee on Housing and Insurance will come to order.

Without objection, the Chair is authorized to declare a recess of the subcommittee at any time.

Today's hearing is entitled, "The Current Mortgage Market: Undermining Housing Affordability with Politics."

I now recognize myself for 5 minutes to give an opening statement.

Today, we will receive testimony from experts in the housing industry to discuss recent actions taken by the Federal Housing Finance Agency (FHFA). Housing affordability is crucial to giving Americans the opportunity to build wealth through homeownership. Homeownership, in turn, paves the way for success in many other aspects of life. In essence, housing affordability is a cornerstone for pursuing the American Dream.

The importance of maintaining a fair and undistorted mortgage market cannot be overstated. Currently, residential consumer mortgage debt accounts for approximately \$12 trillion, which is spread across over 80 million mortgages. Of this \$12 trillion, Fannie Mae and Freddie Mac, collectively known as the Enterprises, guarantee approximately 70 percent of the market. The FHFA, the entity charged with supervising the Enterprises and acting as their conservator, must be immune to political agendas, regardless of how much any Administration pressures this Agency. The FHFA, therefore, retains an exceptional degree of authority to impose rules that shape the entire mortgage market. It is this au-

thority that brings us here today in light of recent proposals to change the loan-level pricing adjustments (LLPAs) set forth by FHFA to be implemented by the Enterprises.

When created in 2008, loan-level price adjustments (LLPAs), also known as guarantee fees, were put in place to allow the Enterprises to charge for the credit risk associated with mortgages which they were guaranteeing. These fees are designed to cover the risk of standing behind the mortgages and to protect the solvency of the Enterprises. The recent changes to these fees that went into effect on May 1st, however, are alarming because they disproportionately increase fees for borrowers who have higher credit scores. Any way you slice it, prices will go up for consumers who have credit scores above 680, and even for some of those with down payments of more than 30 percent of the loan. In other words, this pricing scheme would shift most of the cost burden to more-creditworthy borrowers.

The FHFA contends that the loan-level price changes are attributed to higher capital standards that need to be imposed on the Enterprises. While this could justify some change in LLPAs, the change we saw imposed on May 1st clearly targeted new homebuyers with average credit scores and above. And we have also heard that the FHFA contends that interpreting the new LLPA chart must be coupled with mortgage insurance coverage, so as to paint a full picture for consumers. And while those with lower credit scores and low down payments are certainly likely to pay more for mortgage insurance given the risks they present, this is an entirely different credit product whose fees cover the cost of the insurance itself, and go to an entirely separate entity. Mortgage insurance payments do not help the Enterprises to build capital or to actually protect the taxpayers from risk.

Make no mistake, these changes to the LLPAs ultimately hurt housing affordability for the majority of homebuyers. Even if it is a relatively small cost for some, it is inappropriate to place the burden on Americans simply because there is a misguided notion that, "they can afford it," especially with the high cost of inflation that is plaguing our economy. Now, to be fair, we have already seen the FHFA reverse course on some components of the LLPA changes, while also issuing a request for input on its method for determining LLPAs. These are positive but small steps in the right direction, and while we welcome these changes, they are insufficient.

This committee will ensure that we have appropriate risk-based pricing and an efficient mortgage market. The witnesses here today will be critical to providing insight into how we can get that done. So, I thank our witnesses for their testimony today, and I look forward to the conversation.

The Chair now recognizes the ranking member of the subcommittee, the gentleman from Missouri, Ranking Member Cleaver, for 5 minutes for an opening statement.

Mr. CLEAVER. Thank you, Mr. Chairman, and I thank you for calling the hearing.

Let me first start by acknowledging that Government-Sponsored Enterprises (GSEs) pricing frameworks are not the most-digestible set of information. Housing finance is complex. The complexity then lends itself to misunderstandings and sometimes to deliberate

misinformation. I read a Fox News article last month entitled, “Real Estate Expert Shreds Biden Rule Punishing Homebuyers with Good Credit.” The argument was presented that pricing changes were a punishment for homebuyers with good credit, and designed to subsidize loans to higher-risk borrowers, and the expert, by the way, was a former media host. I have since seen these claims repeated in several other media outlets. The Washington Examiner, for example, called it, “Biden’s socialist housing scheme.”

Reasonable minds can disagree resolutely about how to implement a complex pricing framework, and I appreciate the request for input released by FHFA Director Thompson earlier this week. But I fervently disagree with the way in which individuals have taken the liberty with the motivations of FHFA or have mischaracterized the FHFA’s actions. We will hopefully get to the bottom of these claims during the hearing.

Last year, I called on the FHFA to do a holistic review of upfront fees. The old FHFA pricing framework was extremely unfair. The GSEs were unfairly overcharging borrowers with lower down payments who had the added protection of private mortgage insurance, and undercharging others. The new pricing framework was a recalibration that was warranted, given the implications of a new capital regime in 2020. The new framework is not perfect, but it is more fair.

Under both frameworks, no one is rewarded for having a lower credit score or making a lower down payment. Borrowers with lower credit scores and lower down payments continue to pay more than borrowers with higher credit scores and higher down payments, despite the adjustment made. These borrowers are some of the highest-credit borrowers in this country. The average credit score of a borrower in one of the Government-Sponsored Enterprises’ (GSE’s) flagship affordable mortgage programs is 743. These are prime-credit Americans who simply don’t have a great amount of wealth; they just want a reasonable chance for their family to own a home. In urban America, in suburban America, and in thousands of rural communities around this country, the average borrower with an Enterprise-backed mortgage is expected to receive a minimal increase of 4 basis points, or 0.5 percent, on their interest rate with these changes. Yet, the undersupply of housing has driven a nearly 300 basis point mortgage rate increase.

Mr. Chairman, I appreciate the opportunity for us to discuss this important issue. The country needs Congress to get past these narratives that turn Americans against each other. Thank you.

Chairman DAVIDSON. I thank the ranking member.

We now welcome the testimony of our witnesses.

First, Mr. Edward J. DeMarco. Mr. DeMarco is the president of the Housing Policy Council (HPC). Prior to joining HPC in June of 2017, he was a senior fellow in residence at the Milken Institute’s Center for Financial Markets. And from 2009 to 2014, Mr. DeMarco was the Acting Director of the Federal Housing Finance Agency, where he served as the conservator for Fannie Mae and Freddie Mac, and as regulator of those companies and the Federal Home Loan Banks.

Second, Mr. Kenny Parcell. Mr. Parcell is the 2023 president of the National Association of REALTORS (NAR), and the broker-owner of Equity Real Estate Utah. At the national level, Mr. Parcell served as NAR's vice president of government affairs in 2018, and in 2021, REALTOR Magazine named him as one of its 30 under 30.

Third, Dr. Clifford Rossi. Dr. Rossi is an executive-in-residence and professor-of-the-practice at the Robert H. Smith School of Business at the University of Maryland. Prior to entering academia, Dr. Rossi had nearly 25 years of experience in banking and government. His most recent position was as managing director and chief risk officer for Citigroup's consumer lending group, where he was responsible for overseeing the risk of a \$300-plus billion global portfolio of mortgage and home equity loans, student loans, and auto loans, with 700 employees under his direction.

Fourth, Ms. Janneke Ratcliffe. Ms. Ratcliffe is vice president for housing finance policy and leads the Housing Finance Policy Center at the Urban Institute. Ms. Ratcliffe came to the Urban Institute from the Consumer Financial Protection Bureau (CFPB), where she served as an Assistant Director, leading its Office of Financial Education. Ms. Ratcliffe serves on the Consumer Affairs Advisory Council of the Mortgage Bankers Association, and she is a member of the National Community Stabilization Trust Board of Managers.

We thank you all for taking the time to be here. You will each be recognized for 5 minutes to give an oral presentation of your testimony. And without objection, your written statements will be made a part of the record.

Mr. DeMarco, you are now recognized for 5 minutes to give your oral remarks.

STATEMENT OF EDWARD J. DeMARCO, PRESIDENT, HOUSING POLICY COUNCIL (HPC)

Mr. DEMARCO. Thank you, Mr. Chairman. Chairman Davidson, Ranking Member Cleaver, and members of the subcommittee, thank you for the invitation to participate in today's hearing. I am here on behalf of the Housing Policy Council (HPC), a trade association comprised of the leading national mortgage lenders and servicers; mortgage, property, and title insurers; and technology and data companies. My written statement provides HPC's views on today's topic and offers HPC's perspective on the relationship between pricing, capital, safety and soundness, and expanding homeownership opportunities.

The statutory purposes of Fannie Mae and Freddie Mac combined with FHFA's statutory responsibilities indicate that Congress expects the two companies to advance the stability and availability of mortgage credit while operating in a safe and sound manner. In other words, Fannie and Freddie have a mandate to facilitate and support the liquidity of the secondary mortgage market. Accomplishing this purpose directly enhances the availability of mortgage credit throughout the country and lowers the cost of such credit to homebuyers.

Congress went a step further and instructed that Fannie Mae and Freddie Mac take steps to meet specific goals to expand mort-

gage credit availability in identified geographies and for low- and moderate-income families. For purposes of today's discussion, I will divide FHFA's most recently announced pricing changes into two buckets: first, FHFA introduced and then rescinded a new up-front fee adjuster based on the borrower's debt-to-income ratio; and second, FHFA made adjustments to the pricing grids that establish up-front fees calibrated to Fannie's and Freddie's risk in a particular transaction, the risk to Fannie and Freddie.

HPC and others quickly recognized the challenges of the debt-to-income pricing element, and we asked FHFA for an implementation delay, which FHFA granted. After additional evaluation, HPC concluded that the proposed pricing element simply was not workable. We sent a detailed letter to FHFA on April 28th outlining our reasons for this conclusion. And on May 10th, FHFA announced it was rescinding the DTI pricing element, and HPC is grateful for this reconsideration.

As for the recent changes to the up-front grids, they appear to be reasonably aligned with credit risk after accounting for the new capital framework, the cost of private mortgage insurance, and historical default and loss data. That said, only FHFA has the detailed data and models to fully explain how the grids align with risk and the recently-finalized risk-based capital framework. This opacity may have contributed to the confusion and misreporting regarding the January announcement. HPC and its members believe the solution is to have greater transparency regarding the pricing across risk categories relative to these capital standards. My statement elaborates on this point.

I would like to specifically address HPC's views on expanding sustainable homeownership. HPC and its members do not believe that either subsidized pricing or more-lenient underwriting, both of which increase risk and the cost of losses, is the way to go. Rather than ignoring risk or trying to compensate for it by charging all borrowers more, the government would better achieve sustainable expansion in homeownership with forms of assistance that lower borrower risk. I have testified on this issue before in front of this committee, and my written statement also elaborates on this point.

HPC and its members would also like to point out that this entire discussion of g-fees reflects how poorly targeted the pricing framework is for accomplishing the GSE's housing mission. Congress established GSE housing mission goals to advance certain affordable housing priorities. It is unknown how much the goals actually benefit the targeted households, rather than simply being absorbed by other parties to the transaction, creating leakage of the intended cross-subsidization benefit to the consumer. There would be far greater transparency of how much financial support actually reaches low- and moderate-income families and communities if the subsidy were directly allocated to those borrowers, not embedded in the price between the lender and the GSE.

Thank you again for having me here.

[The prepared statement of Mr. DeMarco can be found on page 34 of the appendix.]

Chairman DAVIDSON. Thank you, Mr. DeMarco.

Mr. Parcell, you are now recognized for 5 minutes to give your oral remarks.

STATEMENT OF KENNY PARCELL, BROKER-OWNER, EQUITY REAL ESTATE UTAH, AND 2023 PRESIDENT, NATIONAL ASSOCIATION OF REALTORS (NAR)

Mr. PARCELL. Chairman Davidson, Ranking Member Cleaver, and members of the Housing and Insurance Subcommittee, thank you for your service, and, most importantly, thank you for your time. My name is Kenny Parcell, and I am a broker-owner of Equity Real Estate Utah. I have been a REALTOR member for over 27 years and I am now president of the National Association of REALTORS (NAR).

Today, I am here on behalf of our 1.5 million members who live and work in every ZIP Code in America. We are the nation's largest trade organization. Thank you for the opportunity to share our perspective on the housing market and the recent pricing changes announced by the Federal Housing Finance Agency.

It is no secret that today's market poses many obstacles for homebuyers. Typically, first-time buyers make up 40 percent of all buyers, but it is now at an all-time low of 26 percent. This is a very concerning statistic. Interest rates have risen nearly 3 percentage points over the last year. In March of 2022, if you had a loan of \$400,000 at a 3-percent interest rate on a 30-year mortgage, your principal and interest payment would have been \$1,682. Now, that same loan amount at 6 percent would put your payment at \$2,398. That is a 42-percent increase.

With the cost of inflation, and additional fees, we have a real concern. Housing affordability and availability remain extremely restricted. Our members navigate these issues every day, which is why it's crucial for buyers and sellers to have a REALTOR on their side.

I learned a hard lesson by not using a REALTOR when I purchased my first home going into my sophomore year in college. I was a young student-athlete, and all I wanted to be was a homeowner. I had 3 years left on my football scholarship, and I didn't want to rent. I had a dream of being a homeowner. Although it wasn't easy—when I closed on my first home, the seller removed the working white refrigerator and replaced it with a lime green one that didn't work, the kitchen cabinets were taken, and the AC and the garage door were removed. For the first 6 months, I lived out of a camping cooler. I would take the ice from the training room and bring it back to restock my cooler at home. It was a proud day when I eventually saved up enough money to buy a used refrigerator. I still own that home today, and it has increased in value by over \$300,000. This experience led me into real estate, and later, NAR leadership.

Our members abide by the code of ethics and have consumers' best interests at heart. REALTORS are committed to making the American Dream accessible to more people, whether by helping them navigate a difficult transaction like my family faced, or finding a solution to the supply and affordability crisis facing homebuyers nationwide.

A recent report from NAR found that we are at a 5-million unit shortfall. Underbuilding, high interest rates, and rapid price increases are eroding housing affordability. Homeownership is still viewed as a vital part of the American Dream, but it is becoming

increasingly out of reach for many. The average net worth of a renter is \$8,000. The average net worth of a homeowner is over \$320,000. The percentage of homeownership for Whites is 74.4 percent, 45.8 percent for Blacks, 61.6 percent for Asians, and 49.7 percent for Hispanics. We must and should improve the statistics for minorities. We believe any fee increase right now is not good for anyone wanting to purchase a home.

This brings me to FHFA's recent loan-level pricing adjustments or LLPA's. NAR believes this pricing was a missed opportunity to help Americans who are already struggling to afford homes. NAR has worked with FHFA on this issue for years and raised concerns about the fees in January. Given the sharp rise in interest rates over the past year, we knew these changes would harm borrowers in an already-tight housing market. Additionally, with economic concerns mounting as Congress debates the debt limit, these fees only serve to further de-incentivize potential buyers.

We are grateful to FHFA for listening to the concerns like these across the industry and announcing it would rescind its up-front fee on borrowers whose debt-to-income ratio is greater than 40 percent, which was set to take effect on August 1st. NAR will continue to work with FHFA and Congress to find a solution to lower barriers to homeownership while minimizing the risk to taxpayers.

It is like we are all in the same boat, but there is a hole in one side, and the people on the other side yell out, "Thank God the hole is not on my side." We need everyone's help on this important issue. It will take a bipartisan approach to address the housing affordability crisis in our country. Thank you for the opportunity to testify. We appreciate your time, and I look forward to your questions. Thank you.

[The prepared statement of Mr. Parcell can be found on page 53 of the appendix.]

Chairman DAVIDSON. Thank you, Mr. Parcell.

Dr. Rossi, you are now recognized for 5 minutes to give your oral remarks.

STATEMENT OF CLIFFORD V. ROSSI, PROFESSOR-OF-THE-PRACTICE AND EXECUTIVE-IN-RESIDENCE, ROBERT H. SMITH SCHOOL OF BUSINESS, UNIVERSITY OF MARYLAND

Mr. ROSSI. Thank you, Chairman Davidson, Ranking Member Cleaver, and members of the subcommittee. My name is Clifford Rossi, and I am professor-of-the-practice and executive-in-residence at the Robert H. Smith School of Business at the University of Maryland. I offer a unique perspective on this issue, having worked for 23 years in the financial services industry in a variety of C-level risk management positions, including 10 years at both Fannie and Freddie, where I actually helped design and work on the analytical methodologies that we are here to talk about today, using pricing, Enterprise guarantee fees, and risk-based underwriting matrices.

There remains much confusion over the process employed to price credit risk by the Enterprises. Like much of the housing finance system, that credit pricing process is based on a legacy structure that, in a perfect world, would likely never have been designed the way it is today. Of critical importance to this hearing is the issue of cross-subsidies among mortgage borrowers.

Changes in the LLPA grids that went into effect on May 1st sparked enormous controversy over the extent to which high-credit-quality borrowers are subsidizing low-credit-quality borrowers. I, too, in opinion pieces, raised concern over the appearance that fees on some high-credit-quality borrowers would rise, while reducing fees on a number of low-credit-quality borrowers. Those are immutable facts. The current and previous LLPA grids incorporate elements of risk-based pricing, although the current grids flatten that relationship between key risk attributes and credit default.

Another fact is that the cross-subsidy and credit pricing has been in place for decades by way of average guarantee fee pricing used by both Enterprises. Effectively, then, what we see is a hybrid form of credit pricing that features flat or average pricing for the ongoing or guarantee phase and quasi-risk based pricing. I don't actually call it risk-based pricing for up-front fees or LLPAs.

About the time of the financial crisis, as both GSEs came under increasing stress from accelerating credit losses, they turned to a new device to raise funds to staunch those losses: LLPAs. The LLPAs are essentially an artifact of a last-ditch effort by the GSEs to save themselves rather than as a well-thought-out credit pricing structure. The seminal question here is whether such a pricing scheme is the best structure to achieve the FHFA's objectives, cited earlier.

So, when designing an optimal mortgage credit pricing structure for the Enterprises, I have a set of criteria that are essential in guiding that, and these principles are as follows. One, any credit pricing structure must achieve the FHFA's goal of ensuring the safety and soundness of the Enterprises. I think we would all agree about that. Credit pricing must be transparent and straightforward to understand. Credit pricing must be empirically-based, reflecting a through-the-cycle view of loan performance, taking key risk attributes into account. Credit pricing should be operationally-tractable and designed to minimize implementation burden for the Enterprises and mortgage originators. And finally, credit pricing must seek to reduce and/or eliminate perverse incentives that may pose risks to borrowers or the GSEs.

How do the current LLPAs actually comport with these criteria? Use of the Enterprise regulatory capital framework, the ERCF, along with the modeling approach for generating guarantee phase aligns generally with the first and third criteria, but the introduction of LLPAs violates the second, fourth, and fifth. So, while on the surface it can be argued that the LLPAs are transparent by virtue of pricing by risk attribute, the exact mechanics are murkier, thus setting the stage for second-guessing the new LLPA grids and the need for a new approach.

I actually proposed eliminating the current FICO, LTV, and LLPA grids altogether, and updating the guarantee fees consistent with achieving a target rate of return, taking into account the ERCF, that is the regulatory capital requirements. My proposal meets all of the stated criteria of mortgage credit pricing laid out earlier. And a precedent has already been set, as we said earlier, with the FHFA's announcement of rescinding the LLPA fee for debt-to-income ratio.

So instead of imposing LLPA fees for FICOs and LTVs, what I suggest is that a part of the guarantee fee would be determined by the FHFA to use as a legislatively-capped rebate account of sorts to borrowers who are income- and/or wealth-challenged. There is ample precedent for these kinds of guarantee fees for various reasons, such as the FHFA's requirement over the years to add 10 basis points to guarantee fees, to provide additional coverage for credit exposure, and let us not forget the 10 basis points adjustment for TCCA.

The proposal decouples safety and soundness objectives from affordable housing and credit pricing, and that is important. We need to decouple credit pricing from these other policy objectives, and thus, it provides transparency in credit pricing, reduces operational burden, reduces risk to borrowers and the Enterprises, and supports the goal of affordable housing. Thank you very much.

[The prepared statement of Dr. Rossi can be found on page 71 of the appendix.]

Chairman DAVIDSON. Thank you, Dr. Rossi.

Ms. Ratcliffe, you are now recognized for 5 minutes to give your oral remarks.

**STATEMENT OF JANNEKE RATCLIFFE, VICE PRESIDENT,
HOUSING FINANCE POLICY, URBAN INSTITUTE**

Ms. RATCLIFFE. Thank you. Chairman Davidson, Ranking Member Cleaver, and members of the subcommittee, thank you for the opportunity to testify today.

I would like to start by mentioning that what I present today is based on my own views and should not be attributed to the Urban Institute, its trustees, or funders. I have been invited to discuss pricing decisions with regard to the loan-level price adjustments. This complex topic has generated concern and confusion, and I hope that analysis by me and my Urban Institute colleagues will help make things clearer. In my written testimony, I provide additional context around LLPAs, which were first introduced in 2008.

First, I want to emphasize that the recent adjustments to the LLPAs do not in any way compromise the safety and soundness of the GSEs. All Enterprise loans today are underwritten according to strict risk criteria and present low risk by historical standards. Indeed, even those falling in the lower-right quadrant of the pricing grid, with down payments less than 20 percent and credit scores between 620 and 680, have low projected losses. We estimate less than 1 percent. Moreover, these made up less than 3 percent of Fannie Mae's 30-year, fixed-rate purchased, single-family-owner-occupied mortgages in 2022, so a relatively small share.

Second, rather than thinking about these adjustments as new cross-subsidies, they should be viewed in light of a series of changes made by the Director to better align pricing with the capital requirements established by the prior Director under the Enterprise regulatory capital framework (ERCF). The GSEs exist to support sustainable and affordable homeownership across communities and across cycles.

GSE pricing is primarily structured so that they can meet their capital requirements and their overall target return on capital. They can set different profit margins for different types of loans,

which is a standard business practice in order to maintain safety and soundness, serve their public mission and meet their overall return target. For example, they charge the same fees for loans in all States, even though some States have higher default rates than others, and are thus less-profitable. They also have different margins on some products based on competitive pressures.

Within the current pricing structure, it is helpful to recognize three categories the GSEs do price differentially. First, mission-remote loans like second homes, investment properties, million-dollar loans, and cash-out refinances, which are seen as less-appropriate for deep public support and less-central to the basic homeownership mission. For these loans, they charge as much as they can, while still providing enough benefit to retain that business. These higher returns offset lower-return targets on a second category, mission loans, which include mortgages to people with lower incomes, in rural markets, manufactured homes, and a few other categories. For this category, the aim is to price as low a margin as possible while still meeting profit targets, a practice that inherently makes these loans less risky.

Then, we come to the third category, the bulk of the loans. These are purchase and rate-term refinances for all other owner-occupied homes, which are priced to hit capital requirements and target return on equity. The May 1st adjustments applied to the core loans. The May 1st pricing adjustment is the last in a series of steps taken over the past year, each to address different objectives. This has led to some confusion because these steps are being conflated, leading some to conclude that these changes are supporting mission business at the expense of the core business, but that is not correct.

The May 1st changes result in a flatter grid across the core business. They give more credit where it is due for private mortgage insurance, and they split up some of the prior groups into smaller groups. The May 1st additions are relatively small, adding at most \$40 per month to the median mortgage, and this adjustment applies to less than 1.5 percent of the core borrowers. Groups within the grid are all still priced to cover losses and make a profit.

Finally, in the core business, which is the vast majority of their lending, those who pose more risk pay more, in some cases a lot more, than borrowers who pose less risk. Borrowers with low down payments or high loan-to-value (LTV) have to buy private mortgage insurance. Private mortgage insurance reduces losses to the GSEs and also raises costs for borrowers with LTV over 80 percent, who were likely overcharged in the prior grid, especially those with lower credit scores.

With the May 1st changes, on a \$300,000 mortgage, a borrower with a credit score of 660 and 5 percent down will still pay around \$500 more per month—\$500, I just want to emphasize that—in LLPAs and PMI than a borrower with a credit score of 700 and a 25-percent down payment. Ultimately, the May 1st changes have little to nothing to do with cross-subsidy. They better align the core business, LLPAs, with the capital requirements and losses, and they address previous overcharges among high-LTV borrowers by accounting for mortgage insurance.

Thank you, and I look forward to your questions.

[The prepared statement of Ms. Ratcliffe can be found on page 58 of the appendix.]

Chairman DAVIDSON. Thank you, Ms. Ratcliffe.

We will now turn to Member questions, and the Chair now recognizes himself for 5 minutes for questions.

Regarding FHFA's LLPA changes instituted on May 1st, first, the pricing changes announced, both the LLPA and the DTI, did not sit well with many, a bit of an understatement. But second, the process, such as there was one, that FHFA used to convey these changes through a couple of press releases was neither formal nor inclusive. Third, FHFA can, and in the case of DTI, did make changes to its pricing plans when they fell flat. So, their argument that they had to do it this way doesn't really add up. And fourth, the data FHFA says justifies the changes has either been not available or at least not transparently presented, so it stoked a lot of opposition.

It is really FHFA's burden to explain its own work, and FHFA fell far short of those standards, which is why we are having this hearing. It is also why we have attached a discussion draft of a bill to this hearing to have FHFA revert back to the old LLPA pricing for now, and to have GAO do a study of the process so that we can study what they did do to get to this point, and then require FHFA to use a transparent process if future changes are, in fact, merited. Quite simply, we ought to ensure fairness, oversight, and accountability when it comes to matters affecting the mortgage market.

Does anyone on the panel disagree with that?

[No response.]

Chairman DAVIDSON. I don't see anyone. Does anyone claim that it would cause harm to do it this way?

[No response.]

Chairman DAVIDSON. That is the basic goal, and I appreciate the quiet affirmation of that, and I just want to highlight a couple of things that were out there.

Mr. DeMarco, if the 2023 price changes were actually about capital rule compliance, now that FHFA has rescinded its proposed DTI fee that folks like Ms. Ratcliffe have noted, "penalizes lower-income borrowers," doesn't that mean that the GSEs will now have some level of capital shortfall since they are not going to implement the DTI rule? Would you support FHFA further revising LLPAs to raise fees again on GSE borrowers to backfill the missing revenue stream, or what are they going to do to hit the higher capital requirement they said they were going to try to hit?

Mr. DEMARCO. I think FHFA itself, both in its guarantee fee (g-fee) study published last November, and in particular, they made it even more clear in the request for input that they published this week, that in fact, the current g-fee, the new g-fee framework, is not going to produce the target rate of return given the increased capital requirements that were finalized in 2020 and became effective in 2022. I think this is really a root issue in this whole discussion, right?

What was done under Director Calabria in terms of a material increase in the capital requirements for Fannie and Freddie included in those increases, not just a very granular approach to pricing mortgage credit risk, but also ensuring that there was a base

amount of capital across all mortgages. So, even lower-risk mortgages, through the way the capital rules put together, would have a substantial capital requirement, additional capital requirements. It is not surprising then that if one comes along afterwards and is trying to align g-fees to this new capital framework, that one would see the sort of pricing changes that were done. I think this really was done to align with the framework, but because capital is so much higher, I am not going to be surprised if there are additional capital raises that take place over time.

Chairman DAVIDSON. Yes.

Mr. DEMARCO. I'm sorry, g-fee raises that take place over time.

Chairman DAVIDSON. They may not be done yet, and to the point, say, well, it is no big deal. Ms. Ratcliffe illustrated on page 12 of her testimony that about half of all GSE loans, 46 percent, are facing higher LLPA costs, so that less than a third can wind up with lower costs, and that is on the new assessment. I understand it is not lower in the aggregate, but it is this assessment. So, there is kind of this bonus round where we are going to assess it to try to get higher capital standards.

Mr. Rossi, does it strike you as something that would sit well with regular Americans trying to buy a home? Do you see why many constituents would regard this shift in the balance as unfair?

Mr. ROSSI. Absolutely, and I don't personally like the—

Chairman DAVIDSON. Sorry. I gave you no time to answer. I am going to run a little tighter gavel, and I would love to get your answer in writing when you get a chance.

I now recognize the ranking member of the subcommittee, Mr. Cleaver, for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman. Ms. Ratcliffe, leading civil rights agencies and organizations like the Urban League and many of the housing advocate organizations have, as long as I have been on this committee, called for the elimination of LLPAs altogether. The argument that is being made is that the LLPA pricing framework has had a disproportionate impact on borrowers of color, and has been inherently unfair, as it placed the burden of the Enterprises' financial recovery and future catastrophic risk on borrowers of color, even though they were the victims of the financial crisis, not the cause. And I am a card-carrying opponent of the tendency to blame the victim.

My question is, regardless of what Congress does, there will always be an argument that something could be done differently or that there is a different and preferred way to analyze risk. Should the FHFA do away with LLPAs altogether, as suggested by some organizations? Do you see the value for perfecting the current framework, which has been worked on over the course of several FHFA Directors?

Ms. RATCLIFFE. Thank you for the question. I agree that LLPAs and private mortgage insurance costs will tend to fall heavier on borrowers with low down payments and those who haven't had the chance to build as robust a credit history. And I just want to remind everybody that all GSE loans today represent fully-underwritten loans with ability to repay, so these are not bad-credit borrowers by any means. But in any case, borrowers of color are less likely to have savings, and especially less intergenerational wealth

than White borrowers, so they are more likely to need high-LTV loans, and thus pay higher LLPAs and pay for private mortgage insurance.

So, I think that there is a good case to be made for doing away with LLPAs and just having everybody pay the same for access to the same benefit. All borrowers who access the GSE loans are getting a government benefit effectively that our research estimates amounts to about \$6 billion a year. So, it is not really a tax so much as it is just a question of, how do we give people access to this benefit?

There has been an argument here today for doing away with LLPAs, and I agree with that. I just want to say it is complex because right now, because of the higher LLPAs on the mission remote loans—the second homes, vacation homes, investor properties, cash-out refis, and high-balance loans—those are actually creating the potential to be able to reduce the LLPAs while still making the loans profitable for some of the more real mission-oriented loans, so there is a baby in the bathwater of the LLPAs as well. But other than those cross-subsidies, I would agree with Dr. Rossi on doing away with the LLPAs.

Mr. CLEAVER. Mr. DeMarco, I am interested in your response to that question.

Mr. DEMARCO. I have a different position. I believe that risk-based pricing is an important element of operating a safe and sound financial institution. Fannie Mae and Freddie Mac are two enormous financial institutions that are integral to our country's housing finance system and to our financial system. And I believe that the capital required and then the pricing of a financial guarantee needs to be done on the prospect of risk.

But, Mr. Cleaver, you raise a very important question about how we go about providing support to those segments of our country that Congress has designated as, for whatever historical or other reasons, warranting support. And what I go through in my testimony is providing a mortgage rate subsidy to these homebuyers so that instead of paying $6\frac{1}{2}$ percent—they are paying $6\frac{1}{2}$ percent or $6\frac{1}{8}$ —that I don't believe is going to get us where we want to go, instead, you think about the money that is being used to subsidize those rates. If that money was available and provided directly to the targeted borrowers, then we can work on enhancing their down payment, improving their credit position, and providing them with rainy day reserves so that they are going to be more sustainable when in their mortgage.

I think these are the sort of steps that we can take rather than subsidizing the rate. Let's provide that money directly to these families, and let's make sure we identify which families we are providing it to.

Mr. CLEAVER. Thank you.

Chairman DAVIDSON. I thank the gentlemen. The Chair now recognizes the gentleman from Florida, Mr. Posey, for 5 minutes.

Mr. POSEY. Thank you, Chairman Davidson. When I first read the proposal that we are going to charge people with good credit more, and we are going to charge people with poor credit less, I thought it was a bad joke. How that could possibly pass anybody's straight-face test is a mystery to me. Dr. Rossi, explain the prin-

ciple of risk-based pricing mortgage lending, and should we preserve such principles?

Mr. ROSSI. I am a big believer, just to say at the beginning, in risk-based pricing in general. Basically, what happens is that every loan that comes through that the GSEs purchase will go through their pricing engine. It will take into account all of the usual variables, such as FICO score, loan or credit score, loan-to-value ratio, debt-to-income ratio, and probably another 10 or 15 of those variables that you see in this LLPA grid. So, we are already pricing for it in the ongoing g-fee.

And I want to be clear here, there is the ongoing g-fee, and there is the up-front loan-level pricing adjustment, so risk-based pricing is inherently good. We all do it every day with auto insurance, right? We see that we each pay based on our driving habits and everything else, but it is different in the GSE world because we have this other dimension to it. So, it is not the case that I personally believe risk-based pricing has a purpose. I think it should be risk-based price into the g-fee. Every loan should be risk-based price, but then we average it at the end just like we do today. And 45 basis points, I think, is the average guarantee fee.

Mr. POSEY. Mr. Parcell, what are the views of the REALTORS across the nation on this?

Mr. PARCELL. Thank you, Congressman. We are against any increase in fee, period.

Mr. POSEY. In each of your written testimonies, you have offered some solutions, but, to me, it is so simple. Do we all agree that inflation drives the price up? Do we all agree that inflation makes it harder for low-income people to purchase homes? Do we agree that inflation makes it harder for them just to pay their bills every month, much less qualify for a home loan? All hands, I am sure we are unanimous on that.

So, why won't the Administration do something to fix that? The Administration is raising rates to try and stop the inflation that it caused because it is trying to kill the fossil fuel industry. Nothing in this room does not have a fossil fuel industry component to it. The Federal Government is causing these problems and then asking people to come in and help solve it when the Federal Government could solve the problem relatively quickly.

A housing shortage for everyone to have a home is nothing new. That has been around since the beginning, and we have tried to do everything possible, I think, the government, to make that, as some consider it, the American Dream, possible for every family. We know every generation is better off until possibly this one than the generation before because ownership of the rock has expanded, and we really want to do that. But it really seems that we are trying to solve a problem that could easily have been solved. It could easily be solved with almost a snap of a finger. We could bring prices down. We could bring affordability down. Does anybody want to dispute that on this panel?

Mr. DEMARCO. No, Congressman. More houses would certainly help.

Mr. PARCELL. Congressman, there are a few things that could help immediately, including the capital gains exemption for your primary residence, a law that was passed in 1997. It was \$250,000

if you are filing separately, and \$500,000 if you are filing jointly. There are people who are in their homes and would like to downsize, but they do not want to take the capital gains hit. Things have changed since 1997, so you all could help with that. There is also commercial office space that is not being utilized with COVID. There are people not coming in, and we could use some of that commercial space for conversion to homeownership. So, those are things that we would all welcome your help with, for sure. Thank you.

Mr. POSEY. Anybody else?

Mr. ROSSI. I have one. I would say if we eliminated the 10-basis points on top of guarantee fees today for payroll tax, that would go a long way, too.

Mr. POSEY. Thank you. Mr. Chairman, my time is about to expire, so I yield back. Thank you.

Chairman DAVIDSON. Thank you, Mr. Posey. The gentlewoman from Texas, Ms. Garcia, is now recognized for 5 minutes.

Ms. GARCIA. Thank you, Mr. Chairman, and thank you to all of the witnesses for being here today.

I would like to begin by expressing my concern that this is the first hearing that we have had on housing in this subcommittee, the Housing and Insurance Subcommittee, in this Congress. Our nation is facing a housing crisis, and this committee did constant work on this issue under the leadership of then-Chairwoman Waters. Now, however, the Republican Majority has chosen to ignore this very important housing issue and focus on one political and highly-technical issue. In fact, as I have been listening to some of your testimony, I think even I may have gotten a little confused there for a minute.

My first question is about this issue that Republicans have decided to focus on and why it can actually be an effective tool. Ms. Ratcliffe, according to the National Fair Housing Alliance and the National Consumer Law Center, credit scoring has a history of discrimination. Today's median FICO score is 742, which is much higher than individuals' credit scores throughout the nation, particularly in the South. Borrowers in my home State of Texas, and States like Georgia, Mississippi, Louisiana, Arkansas, and Oklahoma had average credit scores of less than 720. Do you believe that FHFA's recent pricing changes will help first-time homebuyers in these States access homeownership through conventional loans?

Ms. RATCLIFFE. Thank you for your question. And I do want to clarify that LLPAs went down for many borrowers with lower credit scores and many borrowers with higher loan-to-value compared to where they were in the previous grid.

Ms. GARCIA. When you say, "many," it is not all.

Ms. RATCLIFFE. Certainly, it is not all of them.

Ms. GARCIA. So, how many, less than half, one-third, 20 percent?

Ms. RATCLIFFE. I can work out the numbers while we are sitting here, but not right off the top of my head. But I am just emphasizing that when people say people are paying more, it is not that higher-credit-score borrowers are paying more than lower-credit-score borrowers. It is that higher-credit-score borrowers are going to pay a little more than if they had gotten their mortgage before May 1st, and lower-credit-score borrowers would be paying less

than they did before May 1st, but they are still paying substantially more than borrowers with high credit scores. So, I just want to clarify that.

For sure, because of the weight of the fees and the slight reduction for people with lower credit scores, this should be more helpful in areas where more borrowers have lower credit scores. Again, to emphasize, all GSE loans are carefully underwritten. These are good-quality borrowers, all of whom are expected to be successful in homeownership.

Ms. GARCIA. So, you think it would help first-time homebuyers?

Ms. RATCLIFFE. Marginally, yes, it would.

Ms. GARCIA. Okay. I tend to agree with you, and I believe that supporting first-time homeownership is not only essential but, in fact, the responsibility of this subcommittee and all of us to encourage.

I would like to take this opportunity to use the expertise of these witnesses to focus on other issues that have been ignored by the Republicans. I would like to discuss how Congress can support homeownership, particularly for low-income borrowers of color. My district is 77-percent Latino, and Latinos are on track to become the largest group of homebuyers in the nation very soon. Ms. Ratcliffe, how best can we support homeownership as potential buyers face high down payments, lack of generational wealth, a housing shortage, and high interest rates? Easy question.

Ms. RATCLIFFE. And I think there are many good answers here on the panel today. I will say there is no single silver bullet. I feel like it takes a bipartisan, coherent, across-the-board effort at the national and local level. The biggest issue right now is lack of housing supply. I think we have already heard that, both for rental housing and homeownership, and this is driving up prices. So, it is really important to focus on supply. There are many ways in which the Federal Government can find ways to subsidize the building of affordable housing, both for rental and homeownership. I won't go through the whole list.

I just want to say that at the same time that we are looking at the supply side, we also need to be sure to empower the borrowers, the homeowners of the future, the generations of the future to become homeowners. And that can be done through things like down payment assistance, perhaps interest rate, buy-down subsidies, things like that to support first-time homebuyers, as well as to help certain types of housing supply, like better loan options for manufactured housing, for purchase rehab lending, perhaps for condominiums as well. So, across-the-board, these solutions could work together.

Ms. GARCIA. Mr. Rossi, you were nodding. Did you want to—

Mr. ROSSI. I am nodding because that was very eloquently stated, and I am not sure that I have much more to say other than I think that, as she said, there are many ways to get at this. And one of the ways is to be able to think about separating credit pricing as part of the mission of FHFA from the mission.

Ms. GARCIA. Okay. Thank you, and I yield back.

Chairman DAVIDSON. The gentlelady's time has expired. The Chair now recognizes the gentleman from New York, Mr. Garbarino, for 5 minutes.

Mr. GARBARINO. Thank you, Mr. Chairman, and I am going to yield briefly to my colleague from South Carolina, Mr. Norman.

Mr. NORMAN. Thank you, Mr. Garbarino. I have a press conference to go to. This is the stupidest idea, raising these rates, what they are doing, charging those with good credit. I have been a REALTOR for 40 years. I built a lot of houses. The supply shortage is because of what this Administration is doing with our energy policies. There are no battery-operated dump trucks, and I don't know what affordable is for housing, I have no idea, but to penalize people for a good credit report is a joke.

And also, the credit cards. Try getting a credit card when you don't pay your bills. You pay a higher rate, and you should. This isn't a racial issue of Black/White. This is a common-sense issue. It is a backward way to do things. I yield back.

Mr. GARBARINO. Thank you. I have a couple of questions. Mr. Parcell, I want to start with you. Prior to getting here, I was a private practice attorney, and I did hundreds of closings. I know that the spring is usually the best time for the housing market. Right now, we have seen the Federal Reserve approve its 10th interest rate increase in just over a year. Can you describe what you and your members are seeing in today's housing market? How has it changed? Are we seeing fewer or more people purchasing homes right now?

Mr. PARCELL. Thank you, Congressman. We are seeing fewer people due to the affordability factor. It will break your heart when you see that single mom, mother of three children, with the rent increase, and for them just trying to get into a home. You are always trying to educate on rural housing loans, FHA loans, and there are some community grant programs. Many States are giving down payment assistance grant programs where you pay that back. But it is a huge issue, and that is why we are very much against any rate or fee increase at this time. This is not the time for it.

Mr. GARBARINO. Which is why I question why the FHFA is coming out with this policy change now. Can you tell us who would mostly be affected by this change?

Mr. PARCELL. It affects all buyers. It is going to affect all of them, and some people you hear say, well, it is only \$30 or \$40, but \$30 or \$40 is a significant amount for that single mom, or the military vet who is just trying to make it, or the school teacher who is on a fixed income. They don't have that extra \$30 to \$40.

Mr. GARBARINO. Absolutely. And I think you mentioned it briefly in your testimony, but can you say again how much more the average borrower is paying for a mortgage now versus in May of 2021?

Mr. PARCELL. Correct. It was \$1,682, and it is now nearly \$2,400 just on that interest rate alone.

Mr. GARBARINO. Yes, it is insane. I know a lot of people are paying 6 percent at closing right now. Six percent a long time ago, people would have loved, but what we have seen, it is just raising rates. I am also the lead of the SALT Deductibility Repeal Act, and I know the REALTORS are very supportive of that, and that will also help. If we get that deduction back, I think that will help homeowners as well.

Mr. DeMarco, I have a question for you. This hearing is entitled, "The Current Mortgage Market: Undermining Housing Afford-

ability with Politics,” and mortgages are the biggest—usually, the cost and availability of mortgages for middle-class people allows them to buy what is probably the biggest asset of their life, but it is not the only cost. Title insurance is a cost that people face, and I have seen having title insurance policies save homeowners from possible mistakes. And the committee has heard a lot about a proposed pilot where Fannie would waive title insurance requirements and act essentially as the title insurer to a lender originating a mortgage. How does such a program or activity fit into Fannie’s statutory mission, in your opinion?

Mr. DEMARCO. Title insurance is a primary market function. It is a critical element of protecting both the lender and the homeowner. And while there seems to be a lot of murkiness about what is going on with some potential pilot, from what I have heard, it certainly is disturbing to think that Fannie Mae or Freddie Mac might displace title insurance by taking on this insurance itself.

And I would trust that any such discussions are undergoing careful scrutiny at FHFA, and would be subject to the new product rule at FHFA, and, frankly, the GSEs simply do not belong in the primary market. We have seen attempts by them in the past to get into private mortgage insurance, hazard insurance and so forth, and I would caution against that. They have a big enough job keeping the secondary market working.

Mr. GARBARINO. Absolutely. As I said, I was a practicing attorney, and I did closings back in 2008 before the crash or during the crash. And I feel like both the rule that we are talking about today and this possible title insurance rule is going to be the start of maybe another downturn.

Mr. Chairman, I yield back. Thank you.

Chairman DAVIDSON. Thanks, Mr. Garbarino. The Chair now recognizes the gentleman from Nevada, Mr. Horsford, for 5 minutes.

Mr. HORSFORD. I thank the chairman and the ranking member for the hearing, and I want to thank our witnesses for your insight. I represent southern Nevada, Nevada’s 4th District. It covers 50,000 square miles in the State of Nevada, both rural and urban areas. We were one of the hardest-hit States and regions after the last housing crisis, and housing affordability continues to be the most important issue that my constituents are concerned about. In fact, just last week, I had the opportunity to host, with our Southern Nevada Regional Housing Authority, a regional housing summit with representatives from the Congressional Hispanic and Asian Caucuses. I currently serve as the Chair of the Black Caucus, and I was fortunate to have the ranking member, Ms. Waters, there as well.

I just find it interesting that the framing of this with some of my colleagues is that somehow people with good credit are overrepresenting and subsidizing in some way the impact to people with low credit scores. First of all, the credit score is a joke. We need to reform the credit rating system because it is biased, and it is inherently flawed in its methodology. It is not transparent. And I know under the leadership of the ranking member, this was a priority, and I hope that under this Congress, it can be as well.

Now, the underlying issue with this LLPA, notwithstanding it is a factor, but it is not the only factor, as I heard several of you say.

I did want to ask Ms. Ratcliffe if you could expand more on the historically-underserved communities who are fighting to keep a roof over their heads. And I agree with you that the May 1st statement, the LLPA adjustments are modest in nature and better align the balance and policy and market requirements that GSEs must consider. In your testimony, you note that while the number of significant variations is small, the recent pricing changes will result in some borrowers facing higher LLPAs and others will pay less. So, can you elaborate further on which borrowers are in which buckets, please?

Ms. RATCLIFFE. That is a great question. Thank you. And again, I want to emphasize that some will pay higher LLPAs than they would have paid before May 1st, and some will pay lower than they would have paid before May 1st, but the traditional relationship between higher credit score and lower credit score borrowers in the grid still remains.

I will just give you some examples. These are some numbers from page four of my written testimony, but I have three loans I picked fairly randomly off the grid. Consider a borrower with a 700 credit score, which is towards the high end of the credit score distribution in the grid, and a 75 percent LTV or 25 percent down. Before May 1st, they would have paid an LLPA that would have converted to a monthly payment of \$50, and after the changes, that is going to go down to \$44. That is on top of a mortgage payment—this is on a \$300,000 loan—of about \$1,877 to begin with. So, the mortgage payment is \$1,877. The LLPA used to be \$50. It will now be \$44.

Now, I will take another borrower who has a 720 credit score, even a little better, but has an 80-percent LTV, so they are putting a little bit less down, 20 percent. They used to pay \$38 per month on that same loan. Now, they will be paying \$63 if they close their loan after May 1st, so that is a little less than a \$30 increase a month.

Finally, we will look at a borrower who has a credit score of 630 and just 5 percent down, which is pretty far into the lower right-hand quadrant of the grid. On top of the \$1,800 mortgage payment, they used to pay \$175 a month in LLPAs, and that is going to go down to \$88 a month, which is still higher than anybody else's, but they are seeing the biggest decrease, and that is to take into account mortgage insurance. And I just want to add this: The mortgage insurance premium on top of that is \$465—\$465—in mortgage insurance.

Mr. HORSFORD. Thank you. I do think we need to look at this comprehensively. I wanted Mr. Parcell to know that I noted that the REALTORS were pleased with the adjustment that was made on the LLPAs' up-front fee on borrowers with debt-to-income ratios greater than 40 percent. That was slated to go into effect on August 1st, and I just wanted to give you an opportunity to elaborate on that.

Mr. PARCELL. Thank you, Congressman. Why that is so important is, if you can put yourself in a mortgage broker's situation, the loan process comes in, they send it to underwriting, and the buyers waive their earnest money because it is going through the underwriting process. That underwriter may flag that buyer and say,

look, we don't like the over time, we don't like the bonus structure, so you no longer qualify. Now, it puts you over that 40 percent, and then that buyer is in a real pickle, and the mortgage broker can't honor that interest rate. Thank you.

Chairman DAVIDSON. I thank the gentleman. The gentlewoman from Texas, Ms. De La Cruz, is now recognized for 5 minutes.

Ms. DE LA CRUZ. Thank you, Chairman Davidson, for holding this hearing today. And I appreciate all of our witnesses being here today. My district is an unique community down in deep South Texas. My district is over 80-percent Hispanic, and I am really concerned about any increases, whether we say the increase is smaller than someone with a lower credit score or not. The point is that there are increases to housing. My question is for Mr. Parcell. In a district like mine that is over 80-percent Hispanic, how would an increase, no matter how, "small," it is, affect an Hispanic community such as mine?

Mr. PARCELL. Thank you, Congresswoman. It goes back to when I purchased my first home—\$30 to \$40 would have devastated me and kept me out of that opportunity, and that is exactly what is going to happen in your district. It is going to push people to where they just can't qualify or it is too tight as it is. It is a skinny margin with the cost of fuel, the cost of inflation, and the cost of food. Kids are more expensive. It is going to harm your people.

Ms. DE LA CRUZ. And when I think about housing, housing is so important for the community around its economy. You are not only talking about the sale of the house, but a broker who gets a fee or makes money, plus the city, plus if you go into the grocery store, things like that. So someone not purchasing a home in a community, like a rural community such as mine, actually affects the overall economy of a city. Would you say that is correct?

Mr. PARCELL. One hundred percent. They are buying local stuff at the hardware store, and they are buying stuff at the convenience store, which brings more property tax, which brings more value to your city and county.

Ms. DE LA CRUZ. So, it is important. How likely is it for someone who is actually purchasing a home in a city? Are they more likely to stay in that city and invest in that city?

Mr. PARCELL. One hundred percent. You are seeing that in test scores. You are seeing it all across-the-board, crime, everything. If you are a property owner, a homeowner, things just go a little smoother.

Ms. DE LA CRUZ. It sounds to me that if you put a barrier such as an increase of even a, "small increase," on a potential homeowner, that really this is a layered effect, not only for the homeowner, but for the economy of the city, is that correct?

Mr. PARCELL. Yes, Congresswoman, 100 percent. The best way to build wealth is through real estate, but also, the best way to build back into the community is through real estate.

Ms. DE LA CRUZ. Thank you. With that, I yield back.

Chairman DAVIDSON. The gentlelady yields back. The Chair now recognizes the ranking member of the full Financial Services Committee, the gentlewoman from California, Ms. Waters, for 5 minutes.

Ms. WATERS. Before I raise a few questions with you, this one had not been thought about a lot. We just accepted the fact that with inflation and the increased interest rates that some families are faced with, even though they tell me it is not a huge number, I am getting from individuals who had these adjustable rate mortgages that their loans have increased over \$1,000 in some cases. Can anything be done about that? Anybody? Ms. Ratcliffe, do you know?

Ms. RATCLIFFE. Congresswoman Waters, you are asking about people with adjustable rate mortgages who have seen their payments go up by \$1,000?

Ms. WATERS. Yes.

Mr. RATCLIFFE. I would guess that those are probably not GSE-insured loans, Fannie Mae and Freddie Mac loans, which shows the importance of having well-regulated loans that are structured more safely. Since the great financial crisis, new rules have been put in place to make sure that borrowers don't end up with these toxic kind of mortgages that can explode on them. So, I would be curious to know more about these lenders, who they are, and how they are operating.

Ms. WATERS. I certainly appreciate that because, of course, all of us were around for what happened in 2008, and the devastation to not only families, but whole communities, as they ended up losing their properties, et cetera, et cetera. I don't know how many fall in this category of adjustable rate mortgages now, but even if it is only a relatively small number, they are going to lose their homes. And we don't know what is happening with inflation, except that thing. I am told that it is coming down, but these housing costs are basically what is happening with inflation.

Ms. Ratcliffe, I am going to stay with you. I am so pleased that finally my colleagues on the other side of the aisle are becoming concerned about the rising costs of purchasing a home. Last Congress, Democrats sounded the alarm about rising housing costs and how these costs are a key driver of inflation. And that is why I and my colleagues, Committee Democrats, want to secure substantial new housing investments in the Build Back Better Act. You are familiar with that, right? We had \$150 billion in that Act.

Mr. RATCLIFFE. Yes, ma'am.

Ms. WATERS. And in that Act, we had money not only for Section 8 and for public housing, but for the development of affordable housing through the old Act that we put together in order to increase units that were so desperately needed, and money for homelessness, et cetera, et cetera. And I am still feeling very bad about what happened and the support that we did not get; we did not get any support from the opposite side of the aisle.

And that Build Back Better Act, which would have created 1.4 million homes and, in turn, reduced housing prices and inflation, unfortunately not a single Republican, again, voted in favor of it. But now I think, and I am hearing, and I am learning that wealthy homeowners with vacation homes, who were paying unfairly low fees under the prior FHFA fee structure, are now faced with the prospect of paying their fair share, and that maybe some of our friends on the opposite side of the aisle have seen the light because they are upset about the housing costs.

Meanwhile, the underlying lack of housing supply due to years of underinvestment or disinvestment from the Federal Government and this private sector is continuing to fuel housing price increases all across the country, hurting those with lower incomes and lower wealth, and most even when they have excellent credit. Let's not forget that our friends on the opposite side of the aisle, their concerns about housing prices come as they were pressured by the former President of the United States. President Trump threatened to tank the national economy by forcing a default on the U.S. debt.

So I am bringing in something different here, a little bit different, because we are all thinking about what is going to happen, and are we going to be able to deal with this debt crisis that we are in. Are we going to be able to raise what we need? Having said that, there is a lot to think about, and I am told that my time is up, and that is okay by me. I yield back the balance of my time.

Chairman DAVIDSON. The gentlelady's time has indeed expired. The Chair now recognizes the gentleman from Wisconsin, Mr. Fitzgerald, for 5 minutes.

Mr. FITZGERALD. Thank you, Mr. Chairman. The changes to LLPAs raise the issue of the GSE system of cross-subsidies, which are approved by the FHFA. The GSEs generate these cross-subsidies first by lowering the market rate return on their lower-income mortgage purchases, which they make up for by targeting a higher return on their other lending activities. Next, the GSEs charge higher-credit risk borrowers a lower guarantee fee than would be warranted purely on a risk-based pricing basis, while charging selected low-credit risk borrowers a higher guarantee fee than is justified by their individual risk profile and loan type or purpose.

Mr. DeMarco, do these cross-subsidies distort the market by weakening the link between loan price and credit risk, and do the changes to the LLPAs lead to further distortion?

Mr. DEMARCO. Congressman, I believe that, as I state in my written statement, mixing mission into the pricing is problematic, and it adds overall risk to the system. I think we can deliver support to families in a much more direct way than doing it through the rate. That said, I feel like I really need to clarify here how this is actually working with what FHFA has been doing. The cross-subsidy, if you will, is chiefly in what was announced last fall, where FHFA eliminated what was left in terms of LLPAs for mortgage holders who meet the affordable housing goals that are set in statute. And Congress actually tells FHFA that it can go ahead and have a lower rate of return on those loans.

The loans that are covered by the grid changes made in January are driven not by cross-subsidization, but are driven by the capital rule. And if we want more capital and are supporting this higher capital framework that was put in place by Director Calabria, and carried forward by Director Thompson, we have to come to grips with the fact that capital isn't free. There is a cost to capital, and I think what is going on in the grid change announcements that were made in January is focused not on cross-subsidization; it is focused on making sure across the grid that we are earning a rate of return sufficient for the capital that has to be raised, and that is not just for now. And conservatorship is preparing for a date in

which these companies might be private, and there is actual private capital there, because that private capital is going to want to earn an appropriate rate of return.

That is an important question, and it gets complicated because it is different parts of the books of business that we are talking about. And I hope that my answer helped to divide those up properly.

Mr. FITZGERALD. No, that is good. The cross-subsidies are based on the borrower's credit quality, right? They are affordable. The housing goals are based on the borrower's income, right?

Mr. DEMARCO. It is based on their income, not on their credit score. The housing goals are based upon the borrower income relative to the area median or, in some cases, it is based upon geography, where the borrower lives, because Congress has also identified those as target areas.

Mr. FITZGERALD. Yes, and I would further say that—and I have talked about this before—there is this whole group of adults right now in America between 25- and 35-years-old who had been frozen out of the housing market, mainly because of the increases in real estate, but quite honestly, they couldn't generate the cash, come up with the down payment if their life depended on it. So, that is really what we are fighting through here. It is not a generation obviously, but it is 10 years in which this group of adults are never going to have the opportunity to own a home and build wealth. That is our biggest issue.

Mr. DEMARCO. Yes, I think that is absolutely right. In some ways, we are now paying the cost of having suppressed mortgage rates for so long, because it did contribute directly to driving up house prices. We made the cost of mortgage credit so low, and those who were able to get in, got in, and those who are coming online now as young families, it is much harder for them, because now they have the double whammy that house prices have gone up, and mortgage rates are much higher.

Mr. FITZGERALD. In situations where low-risk borrowers face higher rates under the new fee structure, could a larger-than-expected subset of loans be originated away from the GSEs and open the door for more private market players?

Mr. DEMARCO. At the margin, that is possible, but I don't think that what was done in this last grid change is a needle-mover with regard to that particular question.

Mr. FITZGERALD. Thank you. I yield back.

Chairman DAVIDSON. The gentleman yields back. The Chair now recognizes the gentlelady from Colorado, Ms. Pettersen, for 5 minutes.

Ms. PETTERSEN. Thank you, Mr. Chairman, and thank you all for being here today and for this very important hearing. It is hopefully the beginning of many conversations. I think about this all the time, coming from Colorado. Our secret is out; it is one of the best places to live. No offense to my colleagues, but people are moving there at a significantly-high rate. Now, because it has become so unaffordable, it is starting to move in the other direction, but especially places in the southern district, in the rural communities, we saw through the pandemic people moving when they could work remotely. And we saw some of these houses increase threefold in

just a couple of years, with people being pushed out of their communities.

This is something that hits every aspect of the challenges that places across Colorado are facing when it comes to hiring workforces for small businesses, being able to keep our public servants in our community, and being able to hire firefighters or teachers. So, this is why I asked to be on the Financial Services Committee. This is something that I plan to work with all of you on and everyone here on this committee to address accessibility and affordability.

The thing that I oftentimes think about is really the housing crisis. We still haven't actually come out of that. We are still seeing some of the effects. We know that home builders were wiped out during that time. It took us back in our ability to actually increase capacity to build houses. We have a housing supply issue, and one of the number-one barriers that we are facing is, it is not just our ability to produce and build this. And I can't talk about immigration reform and our failed policies there and actually fill in the gaps, but it is also the rising costs with local permitting.

I had the opportunity to visit a business in my district called Fading West, and their goal is mass production of houses where they approach it in the way that we do with cars, have assembly lines in a warehouse, be able to turn them out and make them unique to the communities that are buying them. They said that even though they are able to reduce about 20 percent of the cost there, one of the largest costs ultimately comes down to the local permitting processes. It is what can we do to incentivize the mass production of houses, addressing the workforce shortages, and also incentivizing at the Federal level some type of local permitting process and streamlining so that we can actually address some of these significant barriers that people are facing.

I know I covered a lot there. The last thing that I will talk about is, you all mentioned mortgage insurance, and we have talked a little bit about this, and it's something that I found out about as a homeowner, because I was lucky enough to get in right before the financial collapse. That is the only reason that I had any wealth as a public servant. I was paying mortgage insurance for years that I actually didn't have to pay. It doesn't automatically come off. You have to be educated enough to know your equity in your house, and you have to advocate for yourself.

It seems like a really simple thing if we have that automatically come off to reduce costs as soon as you hit your 20-percent equity. I would like your opinion on that. And also, I would like to hear your ideas about what we do around workforce shortage, how we address our immigration reform, immigration opportunities here in this country, as well as our local permitting process.

Ms. RATCLIFFE. I did want to jump in and say that mortgage insurance should now automatically cancel at 78-percent LTV.

Ms. PETTERSEN. Great.

Mr. DEMARCO. Yes. I was going to say the same.

Ms. PETTERSEN. When did that go into effect?

Mr. DEMARCO. That has been in effect for a long time, I believe.

Ms. PETTERSEN. That is great.

Mr. DEMARCO. But, Congresswoman, I think the point there is that—

Ms. PETTERSEN. The idea is gone.

Mr. DEMARCO. Right, no. This is where homeowner knowledge can be helpful because it automatically comes up based upon the amortization of the mortgage. But if the homeowner knows that their house price has been appreciating in their community, they can get it appraised and use that evidence to have the mortgage insurance removed sooner. It is important to have educated homebuyers, and that is going to make homebuyers more sustainable and smarter about the financial decisions they make.

Ms. RATCLIFFE. And again, I just want to emphasize that because of the new pricing grid, many borrowers will actually see a decrease in their LLPAs. And a lot of that is attributable to the fact that in the previous grid, there will be overprice because they were not being given enough credit for the capital and the losses that the private mortgage insurance protects the GSEs and the taxpayers from incurring.

Ms. PETTERSEN. Great. And then, what I always talk about is our workforce shortage here in the United States, our inability to address the visas that we need for people who want to work here legally and a pathway to do so and how that affects home builders as well. Can you all talk about the significant—

Chairman DAVIDSON. The gentlelady's time has expired.

Ms. PETTERSEN. —need in that area?

Chairman DAVIDSON. I am going to ask the witnesses to respond in writing, if so inclined.

The gentleman from New York, Mr. Lawler, is now recognized for 5 minutes.

Mr. LAWLER. Thank you, Mr. Chairman. I listened with great intent to the ranking member's comments, and yes, she is correct. Democrats controlled all branches of government and passed their housing agenda, and yet here we are still talking about housing problems, so clearly, the policies have failed.

If you look at New York State, for instance, Democrats control everything in Albany. Housing policies have created 50,000 vacant units in New York City. Not looking too good. We talked about debt. The House Republican Majority is the only one that has actually raised our debt ceiling, thank you, raised our debt ceiling, and President Biden just yesterday appointed a committee of three people to finally negotiate after stalling for several months. So yes, we are going to avoid default because the President has finally come to the table to negotiate with Republicans in the House Majority.

While I am glad to see that the FHFA has canceled their impending fees based on debt-to-income ratio, I find it frankly absurd that the Administration has chosen to saddle homeowners who have good credit, with potentially thousands of dollars of additional costs on mortgage fees in order to subsidize borrowers with riskier loans. Moreover, the fact that the FHFA has further chosen to pursue unfair policies that socialize credit risk and disfavor responsible homeowners under the guise of making the housing market more equitable at a time when Americans are facing such a serious affordability crisis is especially shocking. One key and frustrating

aspect of the FHFA's botched rollout of these changes has been the complete lack of transparency in the decision-making process.

Mr. DeMarco, given your previous tenure as the Director of FHFA, can you speak about the process through which these changes were implemented? What stakeholders were interacted with, and do you believe the recently-announced RFI is an important step forward for the public and Congress to provide commentary on changes to the GSE pricing framework?

Mr. DEMARCO. Congressman, I can't speak to what process FHFA followed in making these changes. I suspect that it was based upon a lot of careful modeling, analysis of both the capital rule and historical data on defaults and losses given default. Obviously, they have quite a capable internal staff. I don't know what they did in terms of their communication with the GSEs or anyone else.

I will say FHFA had been communicating and signaling that these changes were coming, and so the fact that it happened did not come out of the blue. They have been talking about this in terms of their scorecards, and the g-fee report that they issued in November made it clear that these kinds of changes were needed because g-fees hadn't been changed yet to keep up with the changes in the capital framework.

Mr. LAWLER. All of your testimony made it clear that you applaud the FHFA's rescission of the debt-to-income up-front fee proposal. The decision came after significant stakeholder feedback and congressional oversight, and I am certainly pleased to see that this unworkable initiative was abandoned. But can you speak about the specific issues inherent with the DTI proposal for both lenders and borrowers? Do you see a scenario where an up-front fee based on DTI could be feasible for the market, and do you support congressional action to limit their ability to implement a DTI-based fee in the future?

Mr. DEMARCO. I am not sure we need congressional action here, but I do think that it is unworkable. We spent several months working with the biggest lenders in the country, and we tried to find a way to suggest, okay, if you want to do this, here is how to make it work, and we concluded it simply wasn't workable.

I credit FHFA for stepping that back, but it is important to understand why. When a family applies for a mortgage, that mortgage goes through underwriting, and underwriting is really critical. And one of the fundamental things an underwriter is doing is trying to determine what is the borrower's ability to repay. They do that by wanting to learn how much income does the borrower have, and how much other debt does the borrower have, and that is an ongoing process throughout underwriting. And what we have learned is that the answers to those questions are not easy. Someone who is not a straight-salary W-2 worker can have a very complicated income stream, and it takes a while to figure that out. Hence, it is very hard to know debt-to-income when the borrower first applies for a loan.

Mr. LAWLER. Thank you. I yield back.

Chairman DAVIDSON. Thank you. The gentleman's time has expired. The gentlewoman from Georgia, Ms. Williams, is now recognized for 5 minutes.

Ms. WILLIAMS OF GEORGIA. Thank you, Mr. Chairman. My colleagues heard me say this yesterday, and I will probably say it again and again and again until it changes. I represent the City of Atlanta, where we unfortunately have the largest racial wealth gap in the entire country. America and my constituents are sick and tired of hearing me say it and sick and tired of living it. And we all know that homeownership is the number-one way to build generational wealth, and that is why the best way that we can increase Black generational wealth is through homeownership. This means we need to be doing more to make homeownership a possibility and a reality for people who have less wealth, especially when the same people were subjected to redlining and racist housing policies not very long ago and are still feeling the effects of those discriminatory practices today.

According to the latest data from the Census Bureau, at the end of 2020, Black homeownership in Atlanta was 48.7 percent, and White homeownership in Atlanta was 75.6 percent. This isn't far off from the national rates of 44.1 percent for Black people and 74.5 percent for White people. As false information is spread by my colleagues on the other side of the aisle, I want to make one thing very clear. FHFA's recent mortgage pricing update helps borrowers with less wealth become homeowners. It might make it cost a little bit more for wealthy people to buy that second home, but I am actually okay with that given the number of my constituents who just want to own that first home.

As you know, FHFA's pricing grid was first developed in 2008 in the wake of the financial crisis. Housing advocates have long pointed out that the pricing grid, which relies on credit scores and loan-to-value ratios, both of which tend to be predicated on wealth, has locked creditworthy individuals out of homeownership for generations. As a colleague already mentioned today, credit scores are steeped in a history of discrimination. Consumers across every income bracket in the South typically have much lower credit scores than consumers living in the Northeast, Midwest, or West.

Ms. RATCLIFFE, given that FHFA's recent pricing changes help more first-time homebuyers in Southern States access homeownership, do you think it is fair to say that FHFA's action is creating equity for everyday people who live in the South, rather than lining the pockets of affluent investors?

Ms. RATCLIFFE. Thank you for your question. This is a good opportunity. What you raised is why it is so concerning that we are looking at the old grid as though it was the right grid. The thing is, the old grid overcharged borrowers with lower credit scores and less wealth to put down on buying a home. And so, when you run the numbers and you look at the actual losses by loans, the new grid actually has just a much more consistent relationship between what people are paying and what their actual losses are. So, it is really important to recognize that the old grid was overcharging those very borrowers that you are talking about, and the new grid rectifies that, given, as Mr. DeMarco has talked about, the requirements of the capital regulation that was put in place by the prior Director.

I also want to separate, which I think is useful in the case of Atlanta, that what I just discussed is not a cross-subsidy. It is just

applying an appropriate price for the risk of that group. The cross-subsidy, I would describe, is in the previous pricing changes that happened before that. Take, for example, investors—borrowers buying investment properties have to pay a higher-than-average profit margin, and that helps with the mission business. That helps lower-income borrowers. And I know Atlanta is a City where it is very hard for a low-income, first-time homebuyer to compete with the investors that are there, and so it is appropriate, I think, to think about how the additional charges and profit margin on that population can be used to give first-time homebuyers a little more level playing field.

Ms. WILLIAMS OF GEORGIA. I just saw a news alert that came across my phone yesterday, and I opened it up, and it said, “Guess which U.S. city has the most unaffordable housing costs?” And I opened it up, and it is my home City of Atlanta, out of every city in the country. So, it is my job to make sure that we look into this more so that more people can access that generational wealth that closes the racial wealth gap.

Fannie Mae and Freddie Mac’s charters state that they must promote access to mortgage credit throughout the nation by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing. Despite these obligations, huge disparities remain in terms of who gets access to a conventional mortgage. For example, in 2021, only 4.7 percent of Fannie Mae-backed and 4 percent of Freddie Mac-backed mortgages were taken out by Black homebuyers. And I am sure you already know, Ms. Ratcliffe, that research from the Urban Institute suggests that more than 1 million mortgages are missing from the U.S. financial market each year due to overly-tight credit markets, and a disproportionate percentage of those opportunities are missed by borrowers of color.

Ms. Ratcliffe, did the 2008 pricing framework serve to help or hinder credit access for homebuyers in communities of color?

Oh, is the time up? I can’t see the clock. I was going to keep going until you—

Chairman DAVIDSON. Apologies. I would just ask, Ms. Ratcliffe, if you could respond in writing.

And the gentlelady’s time has expired.

Ms. WILLIAMS OF GEORGIA. Thank you, Mr. Chairman.

Chairman DAVIDSON. You are welcome. The gentleman from Nebraska, Mr. Flood, is now recognized for 5 minutes.

Mr. FLOOD. Thank you, Mr. Chairman. I would like to begin by just expressing some of the frustration that I have heard from my constituents in Nebraska about the Federal Housing Finance Agency’s latest mortgage reassessment. One constituent in Bellevue, Nebraska, sent me an email which said, “It infuriates me that those that have been responsible with their finances are now being punished to bail out those with lower credit scores.” Nebraskans from Lincoln, Columbus, Omaha, Papillion, Seward, La Vista, and more have been writing into my office saying the same thing. They are absolutely appalled by this change. It is effectively a backdoor tax on the American people.

However, I think that, most importantly, the American people have a certain natural sense of fairness, a feeling that if you pay

your bills on time and improve your credit score, you will be rewarded when you need a loan. This fee assessment is a violation of that basic sense of fairness, and they should be upset.

I am also deeply concerned that this clearly-political decision will lead to a future pattern of using the FHFA to make future decisions based on the same principles. If we are abandoning the premise that loan-level price adjustment fees should be based upon a loan risk, what is to stop the FHFA from taking things further? Could they use Fannie and Freddie to try and push their favorite social policies or punish individuals they feel are unworthy of well-priced mortgages? Once you open this Pandora's box, I fear what will come next. The FHFA's decision can now be used as a precedent going forward for whatever ill-conceived idea a future Director of the Agency comes up with.

Dr. Rossi, do you have any concerns that this change in LLPA will set a precedent for further politically-motivated interventions for fees for mortgages?

Mr. ROSSI. I will start by saying, I completely agree with your constituent there, first of all, and it goes back to the fact that I have said before that we have to separate these missions that the GSEs have from each other. And I think we have heard Mr. DeMarco say the same thing, and several others have been saying the same thing today, which is we have to separate those from each other because it creates and it invites this kind of discussion, and I don't think it has to happen that way.

We can actually meet safety and soundness for both GSEs, while at the same time doing everything we can to be fair to our fellow citizens. And I think that comes from being able to take a closer look at how we have to, I would say, jettison the LLPAs altogether, replace it, and build it back into a risk-based pricing within the ongoing g-fee. And if you want to do something outside of that in terms of affordable housing, make it clear, make it transparent to the American public what you are doing.

Mr. FLOOD. Do you have any concern that further changes, Dr. Rossi, to weaken the integrity of the credit pricing could expose the GSEs to greater credit risk?

Mr. ROSSI. Yes. There is always that possibility, and, again, it comes back to, Mr. DeMarco talked about this in terms of the Enterprise capital framework. We are taking a much closer look at the GSEs in terms of their risk-based pricing than ever before, particularly around these stress events. So again, when I saw the grids when they came out, it first caught me off guard a little bit, because as I said earlier, I want to make sure that what we do from differentiating affordable housing policy is not muddled up with how we actually are doing credit pricing. When we do credit pricing, it is for risk. It is for the safety and soundness of those entities. That is where I am at.

Mr. FLOOD. I come back to this idea that it is just basic fairness for Americans, that if you pay your bills on time, you earn a good credit score, and there are many folks in this country who have done that, and they should be rewarded for the lower amount of risk that they pose to the financial institution. I would say this: This pricing change is a flat-out disaster. I look forward to working

with my colleagues, including Chairman Davidson, to push legislation that will rescind these changes.

The people in Nebraska, along with people across the country who believe in basic fairness, are depending on us to serve as a check on the Biden Administration on this matter specifically. I thank you all for your testimony. I yield back.

Chairman DAVIDSON. The gentleman yields back. The gentlewoman from Michigan, Ms. Tlaib, is now recognized for 5 minutes.

Ms. TLAIB. Thank you, Mr. Chairman. And thank you all so much for being here. Michigan, especially in Wayne County, really didn't recover fully from the last recession. You are all nodding your heads. You probably saw. Some of the things that we have seen include private equity firms coming and just swallowing up, not only for mortgage foreclosures, tax foreclosures. So, we got hit pretty hard and haven't truly been able to recover, and we also lost more Black homeownership than any other State in the country. One of the things I have been looking at on this committee are some structural issues.

Mr. Parcell, one of the things that I have been really trying to get the Administration to do, the previous one and the current one, is to look at small-dollar mortgages, because the majority of homes in my district are less than \$100,000, and it is not profitable for some of the institutions. And what happens is they become rental properties for those investors that come in and swallow them up. And I know there was a report recently, but there are not a lot of recommendations, just identifying the problems we already know about.

What do you think, Mr. Parcell, we could do as a Federal Government, and maybe it is a public-private partnership, I don't know, in trying to help our families, working-class families, who, if they could get access to those homes that are \$70,000, \$80,000, would probably be paying less towards housing costs than, again, continuing to rent?

Mr. PARCELL. Thank you, Congresswoman. I appreciate that. To be clear, we represent 1.5 million in every ZIP Code, and yours is one of them. We think that a reduction of all the fees would be helpful. We also think that if you can make some kind of an incentive for that investor to sell back to a homeowner, a first-time homeowner, some kind of a tax break that they may be able to have. Also, to work with some of the accessory dwelling units (ADUs), so that maybe they can rent out part of their basement to help subsidize that payment to start building wealth. It is the number-one—

Ms. TLAIB. Who is going to give them the loan?

Mr. PARCELL. They need to be able to get a loan for—

Ms. TLAIB. That is what I am saying. Who is going to give them a loan for \$70,000 or \$80,000? Ms. Ratcliffe, by the way, we are always going to have frontline workers as our neighbors. You all know that. There will always be those in hospitality, and those in agriculture, who will not be in that income class where they are going to be able to afford \$150,000 or more for a house. Ms. Ratcliffe?

Ms. RATCLIFFE. Yes. I think the fundamental challenge we have there is that the costs to make a new mortgage are the same, no

matter how big the mortgage is. So, when it comes down to limited resources and loan officers making decisions about where they are going to spend their time, it is very hard for them to, for economically working.

Ms. TLAIB. So, would it be an incentive to say, hey, if it is this amount of money, then we should be—

Ms. RATCLIFFE. FHFA recently had a request for information on low-balance mortgages, and some of the recommendations are, in fact, to subsidize that. I would also add another tool that might be useful in a case like this is better financing for purchase rehab, because a lot of the homes today are older investors having an advantage because they can come right in with deep pockets and fix them up. And the buyer can only borrow based on the as-is value and can't get credit for it. So, you know this whole story.

Ms. TLAIB. Yes. I think, Ms. Ratcliffe, you are right. I think it is really important to know that some of those homes are never move-in ready, especially at that cost. They do need rehab.

Dr. Rossi, did you have something to say?

Mr. ROSSI. No. I was nodding my head vehemently in favor of what she said about FHFA. I think that is a good response.

Ms. TLAIB. The other important thing that I have been working on is our credit scoring system. It is broken. Do you all agree that it needs some sort of overhaul? Let me tell you why. For instance, medical debt is treated the same way. I know some are not actually looking at medical debt now, I understand, but it really does hold back some of my folks because something they did at 18 is on their credit report for 7 years. I have a bill that reduced it to 4 years, which I think is a great bipartisan bill. Economists say 4 years is a better indicator anyway than 7 years. Can any of you talk about that?

Mr. DEMARCO. Medical debt is being adjusted in mortgage underwriting, but the credit score issue, Congresswoman, is a serious one. And we have been spending this whole hearing talking about FHFA, so here is another place where FHFA is playing a significant role, right? They have come out with a new framework in which we are going to update the credit score model that is used. There are going to be two different credit scoring models used. But the thing I would caution about that is it holds the potential for improved accuracy and so forth, but that is a very hard thing to implement given that credit scores appear in so many different models and uses in housing. So, having a timeline to get this done right is going to be really important to it being implemented successful.

Ms. TLAIB. I have so many other questions for you, but I ran out of time. Thank you, though, I appreciate it.

Chairman DAVIDSON. I would like to thank our witnesses and my colleagues for their testimony and questions today.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous

materials to the Chair for inclusion in the record. I ask our witnesses to please respond as promptly as you are able.

This hearing is now adjourned.

[Whereupon, at 3:40 p.m., the hearing was adjourned.]

A P P E N D I X

May 17, 2023



**Testimony of
Edward J. DeMarco
President of the Housing Policy Council**

House Committee on Financial Services
Subcommittee on Housing & Insurance

Hearing Entitled:
"The Current Mortgage Market: Undermining Housing Affordability with Politics"
Wednesday, May 17, 2023

Chairman Davidson, Ranking Member Cleaver, and Members of the Subcommittee:

Thank you for the invitation to participate in today's hearing. I am here on behalf of the Housing Policy Council, a trade association comprised of the leading national mortgage lenders and servicers, mortgage, property, and title insurers, and technology and data companies. HPC's members share a common interest in the safety and soundness of the housing finance system, the equitable and consistent regulatory treatment of all market participants, and the promotion of lending practices that create sustainable homeownership opportunities in support of vibrant communities and long-term wealth-building for families.

The topic of the hearing is the Federal Housing Finance Agency's January announcement updating the pricing of upfront fees for certain mortgages sold to the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), also known collectively as the Enterprises or the GSEs. That announcement has stirred a useful debate about the government's role in setting the price of mortgage credit. In my statement, I hope to provide insights on the issues involved and to offer HPC's perspective on the relationship between pricing, capital, risk to investors and taxpayers, safety and soundness, and expanding homeownership opportunities.

Critical Context – The GSEs Have a Single Purpose with Specified Targets

Congress created Fannie Mae and Freddie Mac and established their unique corporate charters. Those charters require the two companies to meet essentially identical purposes:

- Provide stability in the secondary mortgage market;
- Respond appropriately to the private capital market;
- 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; and
- 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.¹

Congress also created the Federal Housing Finance Agency (FHFA) in 2008 to be both the safety and soundness regulator for Fannie Mae and Freddie Mac and their mission regulator.² I served as the Acting Director of FHFA from 2009 to 2014. As a safety and soundness regulator, Congress gave FHFA an extensive set of responsibilities and authorities for setting risk-based capital requirements and supervising the prudential operations of the companies. Congress also assigned FHFA responsibility for setting affordable housing goals and duty to serve requirements for the companies.

¹ The third and fourth purposes listed are further developed in their charters in the context of meeting affordable housing goals and satisfying duty-to-serve requirements. These purposes are tied to those requirements. 12 U.S.C. §1451 Note (Freddie Mac), 12 U.S.C. §1716 (Fannie Mae).

² The Housing and Economic Recovery Act of 2008 (P.L. 110-289) amended the Federal Housing Enterprise Financial Safety and Soundness Act of 1992 (12 U.S.C. §4501 et seq.) to establish FHFA as the safety and soundness regulator and the mission regulator for the GSEs. Before 2008, the Office of Federal Housing Enterprise Oversight was the safety and soundness regulator for the GSEs, and the Department of Housing and Urban Development was the mission regulator for the GSEs.

The statutory purposes of Fannie Mae and Freddie Mac combined with FHFA's statutory responsibilities and authorities indicate that Congress expects the two companies to advance the stability and availability of mortgage credit across all markets and incomes while operating in a safe and sound manner as private financial institutions in a housing finance system supported by private capital. In other words, Fannie Mae and Freddie Mac have a mandate to facilitate and support the liquidity of the secondary mortgage market. In doing so, Congress specified that the companies operate as safe and sound private financial institutions that need to hold adequate capital and manage risk. *Accomplishing this purpose directly enhances the availability of mortgage credit throughout the country and lowers the cost of such credit to homebuyers.* Congress went a step further and instructed that Fannie Mae and Freddie Mac take specific steps and meet specific goals to expand mortgage credit availability in identified geographies and for low- and moderate-income families.

On January 19, 2023, FHFA announced a series of changes to the upfront fees applicable to certain single-family mortgages sold to Fannie Mae and Freddie Mac.³ These upfront fees are one-time payments made by lenders to the GSEs when a loan is acquired by one of the GSEs and are a critical component of maintaining a safe and sound housing finance system. They serve the purpose of compensating the GSEs for providing a credit guarantee on a mortgage security and conveying important information to consumers about the riskiness of a loan they may undertake. Underpricing mortgage credit risk was a direct and significant contributing factor to the 2008 insolvency of both companies and the broader housing crisis. Thus, these upfront fees may be credibly considered one of the post-crisis reforms put in place to help safeguard the safety and soundness of Fannie Mae and Freddie Mac and the broader economy.

For purposes of today's discussion, I will divide FHFA's most recently announced pricing changes into two buckets. First, there are the adjustments FHFA made to the pricing grids that establish the upfront fees. Second, FHFA introduced, then rescinded, a new upfront fee adjustor based on the borrower's debt-to-income (DTI) ratio.

There is nothing new or novel about the pricing grids. According to FHFA, the recently announced changes were an effort to more accurately reflect the risk of borrowers based on their credit risk profile and to align with changes made in 2020 capital rules. The result lowered the fees for some borrowers and raised them for others. Most of the changes were modest in size. One effect of these changes has been that many of the highest risk borrowers realize a reduction in such fees and certain moderate-risk borrowers realize an increase. These changes have provoked much debate in recent weeks, with reasonable people taking different positions on the appropriateness of the changes.

The new DTI-based pricing element has received less attention but was immediately a major concern for HPC members. It was an unexpected addition that created unintended problems for both lenders and borrowers.

Summary of HPC's Views

The DTI pricing element was unworkable and had negative consequences for borrowers.

The new DTI-based pricing element required higher fees for borrowers with debt-to-income ratios greater than 40 percent. DTI, however, is difficult to measure and can change throughout the

³ <https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Announces-Updates-to-Enterprises-SF-Pricing-Framework.aspx>

underwriting process. As a result, the inclusion of the DTI element in the pricing grids could cause a borrower's loan pricing to change multiple times before loan closing, resulting in multiple loan disclosures and borrower confusion.

Given the operational challenges associated with calculating DTI and the negative consequences for borrowers, HPC and others asked FHFA for an implementation delay during which lenders could review the operational challenges posed by the change. FHFA granted that extension, but after additional evaluation, HPC concluded the proposed pricing element simply was not workable. We sent a detailed letter to FHFA on April 28th outlining our reasons for this conclusion. That letter is attached to this statement.

On May 10th, FHFA announced that it was rescinding the DTI-pricing element. In its announcement, FHFA specifically cited the feedback it had received from industry and from other stakeholders. HPC is grateful for this reconsideration and for FHFA's willingness to consider relevant feedback on its actions.

The adjustments to the pricing grids appear reasonable, but pricing should be aligned with credit risk and capital requirements.

In contrast to the operational challenges posed by the DTI-based pricing element, the other adjustments to the pricing changes announced in October 2022 and January 2023 have been relatively easy to implement because the framework itself – loan level fees based on credit score and loan to value ratio – are part of each lender's loan origination process. The debate that has emerged over these adjustments relates to the appropriateness of the size and direction of the changes. In other words, the pricing adjustments raise policy questions, not operational ones.

HPC's position on these pricing adjustments is that the upfront fees and the other on-going fees charged by the GSEs (collectively "guarantee fees") should align with borrower credit risk and be consistent with how such risk is factored into risk-based capital requirements. Manipulating these fees in a way that misaligns pricing and risk or pricing and capital requirements is not a constructive way to advance safety and soundness or to promote sustainable access to mortgage credit.

Since the purpose of the upfront fees is to provide a risk-based component to guarantee fees, it makes logical sense for these fees to be based on risk. To do otherwise risks serious distortion in the cost of mortgage credit, which can result in detrimental outcomes such as inflated house prices and unstable markets. Indeed, the severe mispricing of mortgage credit risk in the runup to the Great Recession was a root cause of that disaster. Furthermore, as I explain later in my testimony, the last time Congress explicitly addressed guarantee fees, it recognized the importance of aligning pricing with risk.

As for the recent changes, they appear to be reasonably aligned with credit risk after accounting for the new capital framework, the cost of private mortgage insurance, and recognition that the riskiest cells in the grid represent very few Enterprise purchases. That said, only FHFA has the detailed data and models to explain fully how the grids align with risk and the recently finalized risk-based capital framework. This opacity has proven to be controversial and therefore, HPC and its members recommend increased transparency from FHFA regarding the pricing across the risk categories, relative to the capital standards.

While market participants often seek to moderate price adjustments as risk increases to avoid dramatic gradations in pricing, increasing the price of credit as risk increases is a sound principle. It is also a

necessary one to ensure the efficient allocation of capital and the stability and the safety and soundness of our financial system.

If market pricing produces a sub-optimal allocation of credit to certain categories of borrowers, there are better, and more effective, policy responses. In spite of the statutory allowance for affordable housing goal loans realizing lower rates of return than the rest of the business, pricing should not be deployed to promote or advance the affordable housing mission activities of the GSEs (especially when used to directly subsidize higher risk borrowers). There are more direct, and more effective, means for promoting homeownership than inducing more risk for borrowers and the secondary mortgage market.

In the balance of my statement, I provide some background on guarantee fees and their relationship to risk and on broader but related policy issues.

History, Objective and Structure of Guarantee Fee Pricing

What is a Guarantee Fee?

When Fannie Mae and Freddie Mac purchase a mortgage loan from a lender, the price they pay is a function of mortgage interest rates and the guarantee fee (g-fee). Mortgage interest rates are determined in global capital markets based on a variety of factors including the supply and demand for residential mortgage-backed securities (MBS). The g-fee charged by Fannie Mae and Freddie Mac is used to compensate those companies for:

- Expected and unexpected losses associated with the credit guarantee they provide to MBS investors, which repays the MBS investor the full principal balance should a borrower default on a mortgage loan that collateralizes the MBS;
- the company's operating costs, and
- a return on capital.

G-fees have two components: base g-fees and upfront fees. Base g-fees are expressed in basis points and embedded in the mortgage rate. The base g-fees are not aligned with borrower risk, although they may vary by product type. According to FHFA's most recent report to Congress on g-fees, the average base g-fee currently charged by the GSEs is 43 basis points.⁴

Upfront fees are assessed at the loan level based on borrower risk characteristics. They are priced in basis points and assessed against the loan balance. Determining how the upfront fee relates to the interest rate the borrower pays on a mortgage requires a calculation that reflects prepayment probabilities. As a general rule, dividing the upfront fee by four-to-six (FHFA used six in its November 2022 g-fee report)⁵ provides an estimate for how the upfront fee translates into the borrower's interest rate. The average upfront fee reported in the most recent FHFA report to Congress is 13 basis points when converted into an interest rate equivalent. This makes the total average g-fee 56 basis points or

⁴ The Director of FHFA is required to submit an annual report to Congress on g-fees, which includes a description of: (1) changes made to up-front fees and annual fees as part of the guarantee fees negotiated with lenders; (2) changes to the riskiness of the new borrowers compared to previous origination years or book years; and (3) any adjustments required to improve for future origination years or book years. (12 U.S.C. §4547(d)). The most recent annual report was released in November, 2022: "Fannie Mae and Freddie Mac Single-Family Guarantee Fees in 2021", November, 2022. <https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/GFee-Report-2021.pdf>

⁵ Ibid. Footnote 5.

just over one-half percent in mortgage rate.⁶ In other words, the average upfront fee is just 23 percent of the total g-fee.

The History of Guarantee Fees Relative to Capital Standards

Prior to 2008, the two GSEs did not engage in loan-level risk-based pricing. Both companies collected guarantee fees from sellers for the delivery of loans, but did not charge an upfront fee or vary the guarantee fee based on the risk characteristics of the loan. As already noted, guarantee fees at this time fell well short of a level commensurate with the actual credit risk assumed by the GSEs. Furthermore, FHFA's predecessor agency was constrained by statute to implement an inadequate statutory capital standard enacted in 1992. Further, prior to 2008, the g-fees charged by the GSEs were not uniform for all lenders. Favorable pricing was offered to lenders that delivered a high volume of loans, regardless of risk profile.

In March 2008, to stabilize the companies' finances, the companies introduced two upfront fees, one an adverse market fee of 25 basis points for all loans and the other an upfront fee based on two determinative risk variables, borrower credit score and loan-to-value ratios.⁷ In September 2008, the GSEs failed and were placed into conservatorships by their new regulator, FHFA.

When Congress created FHFA, it gave the agency greater authority over the capital requirements for the GSEs, including the authority to impose risk-based capital requirements. Regulatory capital requirements are a basis for assessing the amount of g-fee needed to achieve a target return on equity. The Enterprise Regulatory Capital Framework (ERCF), established in 2020, is supposed to be the basis for the capital component of that pricing determination. However, FHFA's most recent g-fee report to Congress still reflects the Conservatorship Capital Framework (CCF) established in 2017, as the GSEs move to full adoption of the ERCF in 2022.⁸ The ERCF capital standards are substantially higher than the 2017 framework and HPC supported the introduction of the ERCF standards, including the modifications subsequently made by Director Sandra Thompson to restore capital credit for credit risk transfer (CRT) transactions.

The fundamental purpose of the ERCF is to direct the GSEs to maintain a sufficient level of capital to compensate for the risks that arise in the operations and management of the companies. Capital standards are a traditional and proven safety and soundness tool for financial regulators, and the ERCF is based on a comprehensive analysis of the risk characteristics of each GSE's book of business and the appropriate levels of capital that must be available to address credit, market, and operational risk exposure, in both normal economic conditions as well as periods of market stress. In turn, GSE pricing is designed to generate sufficient revenue to cover the modeled risk of loss, ensure the companies satisfy these capital requirements, and earn a target rate of return.⁹

FHFA's annual g-fee reports to Congress present an aggregated view of how current g-fees affect GSE profitability by loan, borrower, and lender characteristics. The reports illustrate the performance of various segments of the GSEs' credit guarantee business relative to a target rate of return. As the reports illustrate, various types of loans exceed, meet, or fall short of the targeted return on regulatory

⁶ Ibid. Page 2.

⁷ Ibid. Page 12.

⁸ Ibid.

⁹ While the GSEs remain in conservatorship, they continue to rely upon taxpayer support to satisfy their capital requirements.

capital. A negative gap does not mean that the GSE sustains a loss on those loans but rather that those loans are expected to earn below the target rate of return on capital. An example of loans where the GSEs intentionally receive a lower-than-target rate of return are mortgages that satisfy the affordable housing goals. Regardless, the GSEs are expected to earn at least the target rate of return on capital for their full books of business. The g-fee reports do not indicate what segments, if any, of a GSE's book of business actually operates at a loss.

As noted above, the most recent g-fee report (November 2022) is calibrated to the old CCF, because the ERCF did not take effect until 2022. Therefore, the gaps between the revenue generated and an ERCF rate of return are not yet available. Regardless, we can surmise that the old g-fee grid was not commensurate with the new ERCF.¹⁰

Pricing to Achieve Both Target Rate of Return and Risk Management- Practices to Minimize Risk

Ultimately hitting the target rate of return requires the GSEs to price their loans at a level that will generate the revenue required to fully satisfy the ERCF. This means that pricing must adequately cover the risk of loss, expected and unexpected, with earnings sufficient to hit the target rate of return on capital. Using g-fee pricing to advance other objectives, such as subsidizing high-risk borrowers, runs counter to prudent risk management. In other words, pricing to achieve a target rate of return is essential to compensate for risk of loss that cannot be eliminated or mitigated through the GSEs' underwriting, which is intended to minimize the frequency or likelihood of borrower default, and loss mitigation programs, which moderate the severity of losses for those loans that do default.

To be more precise, absent the first loss risk absorbed by private mortgage insurers, the GSE underwriting standards serve as the primary means to control and contain the amount of risk (i.e., level of defaults) that each GSE is willing and able to bear. The risk to be contained is associated with the borrower, the property that will be the collateral for the mortgage, and the transaction terms. The credit characteristics of the borrower include: a) ability to repay the mortgage; b) past history in satisfying financial obligations; and c) cash available for a downpayment and reserves once the transaction is completed. The value of the property, which may be needed to repay the loan should a borrower default, determines the allowable size of the loan. And, finally, the terms of the loan, such as how quickly it will amortize, affect the overall risk profile of the mortgage transaction.

The GSE loss mitigation programs are designed to reduce the severity of losses to the GSEs. These programs allow a borrower in financial distress to suspend or miss payments, then recover and reperform or pay off the loan by surrendering or selling the collateral. The recovery could include resolving the arrearages through some form of immediate or deferred repayment or by restructuring the loan. Should the borrower be unable to resolve the missed payments, the property may be sold or transferred to pay off the outstanding indebtedness. Any of these measures will cost the GSEs less than

¹⁰ According to FHFA: "The transition to the ERCF will have important implications for returns and profitability gaps. Higher capital requirements and flatter risk gradients in the ERCF compared to CCF result in a lower and flatter return profile and profitability gap profile across the credit risk spectrum. Returns on loans with lower credit risk characteristics under the ERCF will be considerably lower compared to CCF and returns on loans with higher credit risk characteristics will be notably lower compared to CCF." See the November 2022 G-Fee Study, page 9.
<https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/GFee-Report-2021.pdf>

a foreclosure, thus reducing the severity of their losses (and the adverse impact on households and neighborhoods).

Risks of loss that cannot be minimized or mitigated through underwriting or loss mitigation must be covered by the loan pricing. Between the base g-fee and the loan-level pricing via upfront fees, the GSEs must generate sufficient revenue to compensate for these losses. The pricing is the lever that supports and reflects the risk management determinations and practices of the GSEs. It is not a risk management tool itself but is the mechanism that must be calibrated relative to the GSE appetite for and ability to manage risk through underwriting or loss mitigation.

Common Misconceptions Regarding Pricing for Risk and Reaching Traditionally Underserved Borrowers

Given some of the recent commentary relating g-fee pricing to support for the GSEs' housing mission, this section provides HPC's perspective that g-fee pricing should support risk management and safety and soundness and that other tools are best used to promote homeownership.

The Benefits of Risk-Based Pricing for Consumers

There are significant consumer benefits associated with risk-based pricing. Foremost, risk-based pricing provides consumers with a clear signal of the relationship between risk and what they will pay. Reliable information on the relative riskiness of a major financial transaction like a mortgage can positively influence consumer actions, providing incentive for consumers to reduce their risk to qualify for a mortgage loan at a better rate.

Second, historical analysis shows that some lower-income households are advantaged by risk-based pricing. Many lower-income households do not have low credit scores, and without risk-based pricing, these lower-income households (amongst those borrowers who actually pay fees) would subsidize higher-income homebuyers and homeowners with weak credit performance. In short, it is a mistake to simply equate credit score with income.

Third, even with risk-based pricing, GSE pricing continues to provide cross-subsidization of higher risk borrowers by lower risk borrowers, as evidenced by more than a decade's worth of FHFA g-fee reports to Congress.

Finally, in October 2022, FHFA excluded the affordable housing loans from the upfront loan-level pricing adjusters. These loans are subject only to the base g-fee. This means that if FHFA removed the upfront fees for *all* borrowers, those borrowers with affordable housing loans likely would pay more than they do under today's pricing framework. This is because the g-fees would need to be increased across-the-board to accommodate for elimination of the loan-level pricing; overall g-fees would go up, an outcome that runs counter to the arguments for removal of the loan-level pricing.

The Role of Private Mortgage Insurance

The media attention and coverage on the new pricing grids most often ignored the role of private mortgage insurance. From the consumer's perspective, the cost of credit protection on their loan is the sum of their MI premium and total g-fees. Thus, to understand the full price to a consumer, the MI price

should be added to the GSE fees. Similarly, to understand the actual risk of various lower down payment loans to the GSEs, the extent of mortgage insurance protection must be considered.

MI is one of the permitted forms of credit enhancement that is statutorily required for all mortgages with loan-to-value (LTV) ratios greater than eighty percent. In operation, the amount of MI credit protection to the GSE increases as the LTV increases and the insurance premium for that coverage also increases. That is, very low down payment mortgages usually have much deeper MI protection than mortgages with moderate down payments.

When overlaid on the GSE grids, the combined g-fee plus MI payment for a given credit score increases as LTV increases. What is most important about the MI coverage, however, is the recognition that it represents private capital standing in front of the GSEs. The mortgage insurers take the first loss risk position, accepting losses that would otherwise be borne by the GSEs. Further, the private mortgage insurers core business is pricing and managing mortgage credit risk associated with lower down payment mortgages and they provide another level of risk management. MIs put their own capital at risk and thus perform their own underwriting to verify and affirm the acceptability of the loan for delivery to the GSEs. This type of redundant risk management enhances the safety and soundness of the GSEs and the housing finance system.

Reaching the Underserved

The best way to produce sustainable homeownership for traditionally underserved borrowers is not reduced pricing or more lenient underwriting, both of which increase risk and the cost of losses. Rather than ignoring the risk or accepting the risk and compensating for it by charging all borrowers more, the government would better serve these borrowers with forms of assistance that lower their risk. This support should take the form of assistance funds or subsidies that help a borrower meet the applicable underwriting standards. For example, funds could be used to create reserve accounts or to provide equity into the transaction, both of which would improve the borrower's risk profile. Another idea would be to encourage borrowers to shorten the term of their mortgage, which would result in a faster build-up of homeowner equity. I have testified before this Committee on these ideas before and an excerpt from that testimony is attached to this statement.

Current Methods for Promoting the Housing Mission Lack Transparency and Are Poorly Targeted

HPC and its members credit FHFA for being clear in stating their intention with the various pricing changes made last year and this year. The most recent announcement was previewed in the November 2022 g-fee study and in the conservatorship scorecard. Yet despite all that, the recent debates about g-fees demonstrates that significant confusion remains among stakeholders, regarding both the magnitude of subsidies and related performance outcomes associated with the pricing framework, particularly as it is used to promote the housing mission Congress assigned the GSEs.

Of note, the annual g-fee reports fail to specify the target return on equity used to determine what portions of the book are above or below that target. At a minimum, market participants and other stakeholders would be much better informed if FHFA would disclose two key facts in its g-fee studies. First, what is the target return on equity that determines whether reported g-fee gaps are positive or negative. Second, while FHFA reports loan characteristics that produce a negative gap (that is, fails to earn the target return on equity), readers do not know whether the GSEs expect to generate a profit or

a loss on those loans. Are the expected returns positive but below the target, or are the GSEs actually losing money on particular segments of their business?

HPC and its members would also like to point out that this entire discussion of g-fees reflects how poorly targeted the pricing framework is for accomplishing the GSEs' housing mission. Congress established the GSE mission goals to advance certain affordable housing priorities. This g-fee discussion points out that the GSEs are earning above target returns on certain aspects of their business and using that revenue to subsidize the rate on other, generally riskier, portions of the business. It is unknown how much of the revenue actually benefits the targeted households rather than simply being absorbed by other parties to the transaction, creating "leakage" of the intended cross-subsidization benefit to the consumer. HPC members believe such leakage is meaningful.

There would be far greater transparency of how much financial support actually reaches low- and moderate-income families and communities if the subsidy was directly allocated to those borrowers, not embedded in the price a GSE charges the lender. For example, suppose the elimination of upfront fees on goals loans cost the GSEs \$10 million in revenue relative to what a risk-based pricing schedule would produce. That is the subsidy. Now suppose that \$10 million subsidy was transparently allocated to a pool of funds used to directly assist targeted borrowers. Perhaps the funds go to down payment assistance, or building borrower reserves, or credit repair activity. Then everyone could see how much is spent, who received the support, and how the mortgages performed over time. Surely such a system would be far more accountable than the complicated and opaque structure we have today.

An Important Price Distortion That Needs Attention

Under the statutorily-mandated affordable housing goals and the associated FHFA mandates, the GSEs are expected to purchase a specified mix of so-called housing goal loans. Several of these goals are associated with loans made to low-income and very-low-income persons. As a practical matter, however, the current target level of affordable loans materially exceeds what the market is capable of producing, given today's market conditions. That is, the number of affordable housing transactions in the market fall short of the goals.

As a result, there is a bidding war for these loans but there is no mechanism to ensure the homebuyer benefits. Moreover, competition between the two GSEs over goals loans does nothing to expand the number of borrowers reached. The GSEs are direct participants in such bidding wars in two ways. First, they use their own cash window to compete against loan aggregators, pricing loans at a level that is not commensurate with the risk. Second, they penalize loan sellers for delivering too many non-goals loans. Such penalties come in the form of pricing penalties and limits on non-goals loans the GSE will purchase. In other words, each GSE is incentivizing a given loan seller to sell its affordable loans to them and to sell their other production to the other GSE in order to make the GSE's goals numbers look better.

This is unsustainable. It distorts the market and the deadweight losses it produces do not benefit affordable housing. As one HPC member put it to me, "this unintended consequence turns the goals into merely a math exercise without a benefit to additional borrowers."

Larger Policy Questions for Congress

The recent public discussion of g-fee pricing highlights two larger public policy challenges that are fully appropriate for this committee to consider.

Congress Has Provided FHFA Limited Direction on Pricing – Fortunately, that Direction Encourages Pricing to Reflect Borrower Risk

Congress has given only limited guidance to FHFA in setting g-fees as conservator. In 2011, Congress amended the Housing and Community Development Act of 1992 by inserting a new Section 1327 that required the Director of FHFA to increase the guarantee fees charged by the Enterprises to cover projected tax revenue losses associated with a payroll tax cut.¹¹ More specifically, Congress directed FHFA to increase g-fees by an average of 10 basis points and remit those proceeds to Treasury. Congress further directed that the increase be implemented within two years and “provide for adjustments in pricing based on risk levels.” In other words, Congress has explicitly recognized the importance of aligning pricing and risk.

Absent further Congressional direction, and so long as the GSEs remain in conservatorship, FHFA should periodically review and update the g-fees. In doing so, it should be motivated to align pricing with risk.

Lessons for Housing Finance Reform

HPC believes that restoring a commercial market setting discipline, for both capital and pricing, in the secondary mortgage market requires Congressional action. The current debates over FHFA’s recent announcements highlight one of the shortcomings of utility model proposals. Namely, such models put a government entity like FHFA right back in the center of making pricing decisions over mortgage credit risk.

The mortgage market is inherently cyclical and interest rates themselves can move quickly and substantially, as we have recently witnessed. Regulated price-setting mechanisms will never keep up. If we want private capital to absorb risk, pricing and capital rules need to align with risk. If a market-based system produces a sub-optimal allocation of credit or number of homeowners from a public policy perspective, then that should be addressed directly by government programs and subsidies, not by manipulating how we price mortgages for default risk.

Concluding Remarks

In 2008, Congress created FHFA and gave it authority to appoint itself as conservator or receiver of Fannie Mae and Freddie Mac. It did not give FHFA authority to fund such actions. Instead, it gave the funding authority to Treasury. And the only authority Congress gave FHFA with regard to putting a company in receivership was to re-issue the exact same charter with the exact same corporate name, authorities, and so on. In other words, FHFA cannot combine the two companies, create more of them, or change the terms of their corporate charters, terms that ultimately contributed to their failures in 2008. Other limitations of the ongoing conservatorships are limitations on independent business decision-making across a spectrum of issues ranging from pricing to strategic plans to business development to compensation.

As conservator, the FHFA Director stands in the shoes of the boards and senior management of the conserved companies. While the conservator’s authorities are substantial, I do not believe Congress expected conservatorship to be a permanent state. Indeed, since the day the conservatorships were

¹¹ Section 401 of the Temporary Payroll Tax Cut Continuation Act of 2011, P.L. 112-78. The increase is not retained by the Enterprises but is passed through to the U.S. Department of the Treasury. This increase originally was scheduled to expire in 2021, but that year Congress extended the application of the increase until 2032.

announced, both Treasury and FHFA have sought the ultimate resolution of these failed companies to be determined by Congress. Congress wrote the charters, only Congress can change them.

As the conservatorships approach their 15th anniversary, it is asking a lot of an FHFA Director to continue to serve as both the regulator and conservator for these companies, continuing to make what would otherwise be private business decisions while regulating the companies. Setting prices for corporate credit guarantees of individual mortgages is a responsibility at the core of the secondary mortgage market activities, yet we are relying on administered rather than market-motivated processes to price this risk.

Furthermore, we need to understand that FHFA is no longer an independent agency as that term has been traditionally understood. Since the Supreme Court's Collins ruling in 2021, the Director serves at the pleasure of the President. That fact alone changes the *perception* of FHFA's actions, whether or not the Administration attempts to influence agency action on pricing, underwriting, or any other matter.

I conclude by encouraging this Committee and the Administration to focus on bringing these conservatorships to an end in a way that is both politically and economically stable and sustainable.

On behalf of HPC and its members, thank you for inviting me to participate today.

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Attachment 1:

HPC's April 27, 2023 letter to FHFA Director Thompson concerning the DTI pricing element of the January 19, 2023 FHFA announcement on g-fees.

April 27, 2023



Federal Housing Finance Agency
Office of the Director
400 7th Street, SW, 9th Floor
Washington, DC 20219

Re: Addition of DTI Element to GSE Single-Family Pricing Framework

Dear Director Thompson:

The Housing Policy Council (HPC)¹ and our member companies appreciate that the Federal Housing Finance Agency (FHFA) signaled to the industry that an update to the GSE pricing matrices was forthcoming in 2023, as highlighted in the 2022 and 2023 Enterprise Scorecards. This type of transparency benefits all market participants and stakeholders, providing advance notice that enables a level of preparation, even in the absence of details. That said, the inclusion of the new debt-to-income (DTI) adjuster as a core component of the new pricing matrices was an unexpected addition that creates risk to the borrower and negatively affects the borrower experience. The GSEs can fulfill the capital requirements established in the Enterprise Regulatory Capital Framework (ERCF) using existing mechanisms, including the base g-fees, loan-level pricing, and underwriting controls built into the Automated Underwriting Systems (AUS). In other words, the FHFA objective to align the capital standards with the pricing does not require the introduction of the DTI feature. In this letter, we present information about the significant negative impact of the DTI element and recommend that FHFA consider an alternative approach, such as an alteration to the loan-level pricing or base g-fees, both more effective and workable solutions to achieve the agency's objectives.

To be clear, HPC supports FHFA's desire to strengthen the GSEs' capital position, to support mission lending, and to promote the financial stability of the housing system. However, we are disappointed that the industry was not engaged in discussions as part of this significant operational and structural change. For example, FHFA had the opportunity to solicit feedback as part of the latest Capital Framework request for input (RFI) released in February, which covers the cross-guarantee (or "Super") fee. Among our concerns is that the new DTI pricing feature will require new processes and practices that will exacerbate the already elevated cost of mortgage origination, which will be passed on to the customer. Further, while the broader loan-level pricing changes can be operationalized within the given timeframe, the DTI-specific loan-level pricing change has multiple and lasting negative impacts for customers and the industry. Therefore, we request that FHFA further pause the August implementation for the DTI pricing adjuster until industry feedback can be fully considered. Should FHFA choose to postpone the implementation, we welcome the opportunity to partner with FHFA to examine alternative solutions.

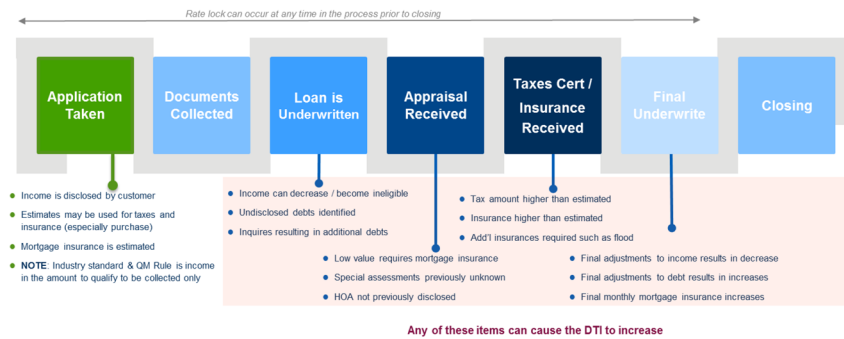
¹ The Housing Policy Council is a trade association comprised of the leading national mortgage lenders and servicers; mortgage, hazard, and title insurers; and technology and data companies. Our interest is in the safety and soundness of the housing finance system, the equitable and consistent regulatory treatment of all market participants, and the promotion of lending practices that create sustainable homeownership opportunities in support of vibrant communities and long-term wealth-building for families. For more information, visit www.housingpolicycouncil.org

Negative Impacts on Customers:

At the current level of mortgages approved by GSE automated underwriting that are not “mission rich” and have debt-to-income (DTI) ratios greater than 40 percent, a substantial percentage of customers will be negatively affected by the proposed pricing increase and by the uncertainty being introduced by the change. DTI ratios reflect a complex set of measurements and judgments. The lender assembles, verifies, and applies specialized treatment to various income types (e.g., when and how to handle commission or seasonal income) to demonstrate continuity and stability of borrower income. The underwriter must also assess the borrower’s financial obligations for accuracy, relevance, and treatment, to include in the DTI calculation. This process occurs over a period of weeks; a precise DTI is rarely, if ever, discernable at the time of loan application. This is in stark contrast to the income eligibility check that is used to meet specific affordable lending program standards. Income eligibility determinations are not always obvious either but are far more simple than the DTI calculation.

The proposed DTI element has other serious, negative consequences:

1. **Paradigm Shift Away from Ability to Repay (ATR):** Today, once ATR has been established, additional income sources are not verified. This is true for manual and digital income verification paths, creating a simpler customer experience, reducing the collection of unnecessary income documentation, and moderating the underwriting judgment required – ultimately reducing the cost to originate.
2. **Reversal of Innovation and Efficiency Gains from Underwriting Digitalization:** Multiple sources of digitally verified income are conservative by nature and have a tendency to underestimate the customer’s income. The DTI change will lead lenders to replace digitally verified sources with manual alternatives, reversing the benefits of the GSE investments in automating income verification, that provides a lower cost and more efficient customer experience.
3. **Pricing Uncertainty Poses Transaction Risks and Undermines Consumer Confidence:** DTI can change throughout the loan approval process and, as documentation is received and verified (such as income and debt outstanding), it could cause the customer’s loan pricing to change, potentially multiple times (see below graphic for points in process that DTI may change).



4. **Each time customers’ DTI changes to above or below the 40% threshold, lenders will be required to issue new disclosures, which may result in:**
 - Frustration over changing closing costs / interest rate

- Customer confusion about the multiple sets of disclosures
- Potential delay in closing timeframe
- Missed rate locks / lock uncertainty
- Contractual violations of Purchase and Sale Agreements

Re-Disclosure Requirement Overview

Changes in DTI >40% and <40%, creates a Change in Circumstance, as the change in DTI would trigger increase/reduction in pricing (potentially multiple times). Risks include:

- If a change in DTI occurs which triggers a loan-level pricing charge, lenders are required to re-baseline the Closing Disclosure (CD). As a result of the re-baseline, the consumer must then receive the closing disclosure no later than three business days before consummation, so a late change in DTI could impact the closing date for purchase customers.
- If lenders are not able to send a re-baselining Loan Estimate (LE) or Closing Disclosure timely, then they may have to “cure” the error without passing the cost on the consumer.
- If the change is on the CD and it causes the APR to change outside of tolerance, the consumer is entitled to an additional three-day waiting period.
- Penalties for violating the law are \$4,000 in an individual action and \$1M in class action, which add significant financial risk to lenders.

The pricing uncertainty introduced by DTI changes has the potential to not only undermine consumer confidence in the loan officer or lender directly, but may also lead to generalized frustration and inability to have reliable interest rate quotes upfront. This could undermine consumer confidence in the mortgage industry as a whole, and potentially generate complaints to regulators, including the CFPB.

5. *Change Results in Increased Origination Costs, Ultimately Passed on to Customers:* The proposed change will increase the overall cost to originate loans, with a disproportionate negative impact on smaller loan sizes. This is a result of the reduction in digital underwriting and need for repeated underwriting reviews, increased operational cost of managing change in circumstances requiring new system flags for income or debt changes that result in moving above or below the 40 percent DTI threshold and multiple re-disclosures, and increased repurchase risk due to the subjectivity of manual income calculations without the historically allowed 3 percent variance (see box below).

The end result is that the cost of obtaining a mortgage will increase for all customers, and those customers with DTIs greater than 40 percent will be doubly impacted - once by the proposed change and again by the resulting increase in operational costs to implement the change.

Eliminating 3 Percent Variance: FHFA Setting New Precedent for Subjective Calculation

- Calculating DTI is known to be challenging and subject to judgment, which is why the GSEs established a 3 percent variance (subject to the DTI cap) without requiring loans to be repurchased. This allowance is not permitted for other loan-level pricing factors such as FICO, Purpose, Occupancy, Property Type, number of units, etc.
- The proposed DTI pricing element would assess a loan-level pricing adjustment on a component of a loan that requires judgment and where there is acknowledgement and recognition it will not be consistent, as not everyone has the same judgment.

Unintended Impact on Equitable Housing Goals:

FHFA's recent revisions to the GSE pricing grids attempt to remove the perceived negative impact of risk-based pricing to mission lending by excluding certain lower AMI customers; however, the DTI change may actually have the unintended consequence of harming the efforts to close the homeownership equity gap for Black and Hispanic customers.

An analysis of 2022 HMDA data shows that the Racial Equity Gap persists across income bands: 72% of Black and 76% of Hispanic purchase customers are non-LMI, and 55% of Black and 61% of Hispanic purchase customers have income that exceeds 100% AMI.

HMDA Data Show that Opportunities to Reach Target Populations Increase With Income

A summary of analysis illustrates that the broader implications for minority customers may go even further and that opportunities to reach target populations increase with income:

- Income <\$50,000, for every 100 white homeowners, there are ~51 Black homeowners, ~70 Asian homeowners and ~59 Hispanic homeowners
- Income \$50,000 to \$99,999, for every 100 white homeowners, there are ~68 Black homeowners, ~76 Asian homeowners and ~70 Hispanic homeowners
- Income \$100,000 to \$149,000, for every 100 white homeowners, there are ~81 Black homeowners, ~80 Asian homeowners and ~80 Hispanic homeowners
- Income \$150,000+, for every 100 white homeowners, there are ~88 Black homeowners, ~90 Asian homeowners and ~88 Hispanic homeowners

Source and Full Analysis: [Freddie Mac, Urban Institute and Census](#)

Proposed Alternative Solution: Utilize Existing Tools to Minimize Customer Harm:

The GSEs could more effectively use their existing tools to raise additional capital, with options that include loan-level pricing, base g-fees, and AUS approvals to manage product mix, as they do today, including these options individually or in combination:

- 1) The approach that aligns most closely with current period capital needs of the GSEs would be to socialize or distribute the capital needs across the existing loan-level pricing grid (that is, earn the incremental capital by spreading the cost across all loan-level pricing cells).
- 2) Utilize a non-mission rich g-fee, which the GSEs have done previously. This increase would be the most customer-centric, as the increase would be negligible and would minimize the negative impact to customers already stretched by affordability. However, we recognize that this approach does not result in immediate capital build in the way that a loan level pricing does and it carries some modest duration risk for that model.
- 3) Adjust AUS models to further manage risk, loan mix, and non-mission lending.

In a study of agency volume for 4Q22 and 1Q23 quarters,¹ which was split into < > 40 DTI by FICO and LTV bands, an HPC member was able to size the amount of additional capital needed to meet the new DTI pricing requirement (approximately \$225 million, based on 1Q23 deliveries). To earn the same amount of capital that would be raised by the proposed change utilizing the existing loan level pricing grid, it would have resulted in an average of 16 bps if socialized across the grid.

The equivalent increase needed in g-fee² for non-mission rich customers would be 3.3 bps assuming a duration of 5 years.

Note: The study is an approximation using publicly available data, and may not include all risk multipliers and features only available to the GSEs, but is believed to be substantially accurate

Pros & Cons of Loan-Level Pricing Adjustments vs. GFee Changes to Meet Capital Requirements

Consideration	Loan-Level Pricing Approach	Guaranty Fee
Replacement of Existing DTI Loan-Level Pricing (Customer view)	Larger negative impact, as it increases cash to close or rate, affecting affordability and smaller loan amounts	Nominal rate increase ² with minimal impact as it's spread out over larger population and longer duration
Replacement of Existing DTI Loan-Level Pricing (GSE view)	More directly aligns with GSE current period capital build	Not as sufficient for replacement due to (1) time required to build capital and (2) duration risk associated with monthly fee vs. delivery fee
Ease of Implementation For GSEs and Lenders	Low - Simple loan-level pricing table update	Low - Multiple Gfee structures have existed previously
Risk Management Precision (beyond AUS)	Utilizing loan-level pricing grid allows for more precise and immediate revenue adjustments	Less precise management tool spread across non-mission loans, with longer period needed to increase capital

Footnotes

1. Study of GSE Volume for 4Q22 and 1Q23

Charts represent assumed loan-level pricing charges for each quarter if the capital charge is spread over all originations in each FICO/LTV cell, regardless of DTI.

1Q23 GSE volume - impact in bps to LLPA by cell based on 40% DTI mix

FICO	LTV							
	Sub 60	60.1-70	70.1-75	75.1-80	80.1-85	85.1-90	90.1-95	95+
780+	0	11	12	17	18	19	20	22
760-779	0	12	13	18	19	20	22	23
740-759	0	14	14	20	21	21	23	23
720-739	0	14	14	22	23	23	24	23
700-719	0	15	15	23	24	24	24	24
680-699	0	15	15	23	24	24	24	22
660-679	0	14	15	24	25	24	23	20
640-659	0	14	16	24	23	24	24	21
Sub 640	0	13	13	22	22	22	19	20

4Q22 GSE volume - impact in bps to LLPA by cell based on 40% DTI mix

FICO	LTV							
	Sub 60	60.1-70	70.1-75	75.1-80	80.1-85	85.1-90	90.1-95	95+
780+	0	11	11	16	17	18	19	20
760-779	0	12	13	18	19	19	21	22
740-759	0	13	13	19	21	20	22	22
720-739	0	14	14	21	23	22	22	22
700-719	0	14	15	22	24	23	23	21
680-699	0	14	15	22	24	22	23	20
660-679	0	14	14	22	24	23	22	18
640-659	0	13	14	22	24	22	22	18
Sub 640	0	12	13	21	19	19	19	14

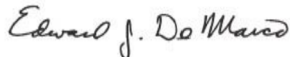
LLPA impact	201.28	\$M	23Q1
LLPA impact	236.54	\$M	22Q4

2. Potential G-Fee Increase to Cover Capital Requirements

Vol \$mm	Gfee calc	Duration options		
		5yr	7yr	10yr
122,821	23Q1	0.033%	0.023%	0.016%
153,907	22Q4	0.031%	0.022%	0.015%

We recognize that the FHFA has indicated that the delayed implementation of the DTI loan level price adjustment is intended to provide the industry with sufficient time to develop new procedures that would be needed to apply this DTI adjustor. However, we do not believe that the DTI feature is workable, even with additional runway to establish alternative practices and controls. As we have described in this letter, the unintended negative consequences conflict with the FHFA's objective and, therefore, we encourage the FHFA to reconsider this approach. As we have also stated in this letter, existing alternatives are readily available: additional refinement to the loan-level pricing grids, increasing base g-fees, or adjusting automated underwriting rules could be used to achieve the FHFA objective. Thank you for your consideration of the points made here. If you or your staff have questions or would like to discuss the concepts that we have presented here, we would be pleased to discuss them with you.

Yours Truly,



Edward DeMarco
President
Housing Policy Council

Attachment 2:

An excerpt from HPC's September 6th, 2018 [written statement](#) to the House Financial Services Committee for the hearing titled "A Failure to Act: How a Decade without GSE Reform Has Once Again Put Taxpayers at Risk." See page 15.

Preparing Borrowers to Become Sustainable Homeowners¹²

Before closing, it is important that I also address the other critical element of housing finance reform – how reform might advance the public policy interest in supporting home ownership opportunities for all Americans, especially for segments of our society that face heightened challenges in achieving home ownership. These are challenges HPC members address every day and they remain committed to seeking innovative and sustainable approaches to expanding home ownership opportunities.

A common element across many housing finance proposals is a goal to ensure homeownership is sustainable; that is, reducing the likelihood of default by borrowers, especially borrowers with less-than-perfect credit profiles. *This requires more work and thought than simply subsidizing the cost of credit to low down payment, low credit score, or lower-income borrowers. It requires greater attention to saving both for down payments and for cash reserves once in the home, greater financial literacy, homebuyer education and home ownership counseling, and more effort to repair credit histories. Many HPC members sponsor and support programs that do these things.* (emphasis added)

A challenge facing many lower income renter and owner households, indeed even moderate and some higher income households, is increased income volatility. Many people lack the resources to buffer themselves from life's disruptions, and income disruptions are more common today than in the past. Housing policy and our housing finance system need to become more attuned to this challenge so better solutions may be found.

Loan qualification standards also need to evolve and improve. Too often, Fannie Mae and Freddie Mac are looked to as the only means by which marginalized communities can be served, as the entities that bestow mortgage credit when private lenders will not. Instead, we should ask our secondary market to be open and available for securitizing eligible, privately credit enhanced mortgages while encouraging lenders in the primary market to innovate and to develop responsive and responsible products to serve the special needs of people and communities that face greater obstacles to home ownership.

¹² Testimony of Edward J. DeMarco, President, Housing Policy Council, before the House Financial Services Committee, September 6, 2018, page 15.



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Kenny Parcell
2023 President

WRITTEN TESTIMONY OF
KENNY PARCELL
2023 PRESIDENT
NATIONAL ASSOCIATION OF REALTORS®

BEFORE THE
HOUSE FINANCIAL SERVICES HOUSING AND INSURANCE SUBCOMMITTEE

HEARING TITLED
"THE CURRENT MORTGAGE MARKET: UNDERMINING HOUSING
AFFORDABILITY WITH POLITICS"

MAY 17, 2023

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Introduction

Chairman Davidson, Ranking Member Cleaver, and members of the Financial Services Subcommittee on Housing and Insurance, my name is Kenny Parcel. I am the CEO and broker of Equity Real Estate Utah, with over 25 years of experience as a REALTOR®, and the 2023 President of the National Association of REALTORS®.

Today I am testifying on behalf of the more than 1.5 million members of NAR, who thank you for the opportunity to present NAR's views on this crucial issue of housing affordability.

NAR is America's largest trade association, and our members are involved in all aspects of the residential and commercial real estate industries.

Helping the Current Market

It's no secret that today's housing market poses a number of obstacles to purchasing a home. Interest rates have risen nearly three percentage points over the last year. Inflation has cooled but remains high. And housing affordability and housing availability remain extremely restricted. Our members hear about these issues every day.

Lack of housing supply is not a new phenomenon. While it is certainly more noticeable now, even before the pandemic, NAR estimated a nearly 5 to 7 million housing unit deficit.¹

To address the ongoing issues plaguing consumers and the housing market, NAR supports proposals that will spur federal action and incentivize state and local governments, and private actors, to boost supply and affordability for all borrowers. We encourage Congress to take the necessary steps to improve the outlook for buyers, and we look forward to working together to tackle these challenges.

There is bicameral, bipartisan legislation that can be passed, and updates to existing administrative programs that can be made, to increase housing production, enhance housing assistance, and encourage rehabilitation and re-use of existing properties. NAR supports the following legislative proposals that would accomplish these goals:

The Neighborhood Homes Investment Act can make an appreciable difference in housing inventory by mobilizing private investment to build and substantially rehabilitate 500,000 affordable homes for moderate- and middle-income homeowners over the next 10 years. The GREATER Revitalization of Shopping Centers Act would provide federal grants for adapting shopping centers.

The Revitalizing Downtowns Act would expand the historic building rehabilitation tax credit to add a qualified office conversion credit to encourage the conversion of office buildings to another use, including residential. NAR proposes expanding this concept to incentivize the conversion of any kind of commercial property to residential use.

The Affordable Housing Credit Improvement Act improves the way the Low-Income Housing Tax Credit (LIHTC) works. The LIHTC is broadly regarded as the most important resource for creating affordable housing in the U.S. today.

¹ National Association of REALTORS® and Rosen Consulting Group, Housing Is Critical Infrastructure, June 2021, <https://cdn.nar.realtor/sites/default/files/documents/Housing-is-Critical-Infrastructure-Social-and-Economic-Benefits-of-Building-More-Housing-6-15-2021.pdf>

The Choice in Affordable Housing Act would expand and improve the Section 8 Housing Choice Voucher Program to incentivize landlord participation via one-time incentive payments to landlords, security deposit payments, and bonuses to public housing agencies that employ landlord liaisons.

Many tax proposals could also increase supply. For example, tax credits to alleviate labor shortages could support construction workers' training and hiring. Such credits could allow a company to hire untrained workers and pay for training or attendance at trade schools. Tax incentives for construction projects that focus on lower-cost builds, such as modular/factory-built housing, ADUs, etc., would also improve the lack of residential supply. To lower land costs, the federal government could further support the enhancement of charitable contribution deductions of land to state or local housing agencies for the creation of more affordable housing.

Additionally, Congress should explore, develop, and enhance down payment assistance programs, property tax exemptions, planning and zoning reforms, permit cost reduction and expediting, rent control laws, and expanding the homeownership voucher program at the state and local levels.

Another concern in many markets is the rising rate of housing purchases for rentals by large institutional investors, which limits inventory and particularly impacts first-time buyers and families of color.² Tax incentives to encourage large investors to sell rental homes to first-time or first-generation homebuyers would increase supply for these buyers.

Big challenges require big solutions. We look forward to working with Congress to increase housing inventory and affordability.

Background on LLPAs

These LPA adjustments were made as prices and mortgage rates have risen nationwide over recent years. But LLPAs are not new.

The Enterprises charge both a guarantee fee (g-fee) and a low loan price adjustment (LLPA). G-fees are the same for all mortgages financed by the Enterprises. They are charged on an annual basis and spread over monthly payments. These fees cover projected credit losses from borrower defaults and administrative costs and ensure a return on capital.

LLPAs, on the other hand, are tailored to the specific risks of individual loans. They are based on loan-to-value (LTV) ratios, credit scores, and other risk factors. They are quoted as a fee to be paid up front but are typically financed over time to make payments more affordable. G-fees are quoted as an annual rate, whereas LLPAs are quoted as upfront fees that are typically added on to the annual rate.

Before 2008, the Enterprises charged only the flat g-fee. With the addition of LLPAs, the Enterprises began to utilize more risk-based pricing, though the Enterprises' charters stipulate that they are allowed to charge less than market value to support their mission, including liquidity and support for underserved communities. However, economists have pointed out that the Enterprises can serve a larger market by utilizing profits in one segment to support other segments. This cross substitution is a central tool in the Enterprises' construct.

² <https://www.nar.realtor/research-and-statistics/research-reports/impact-of-institutional-buyers-on-home-sales-and-single-family-rentals>

Overview of the Changes

NAR first raised concerns regarding the FHFA's fee increases on January 19th, 2023, particularly the impact on middle-credit borrowers with strong down payments. Given the sharp rise in interest rates over the past year, we believed the change was unnecessary and would harm borrowers in an already tight housing market.

Many news reports misconstrued these changes. While it is true that buyers with lower credit scores and lower down payments received a price reduction—a reduction which NAR believes is necessary—these borrowers will continue to pay significantly more than borrowers with higher credit scores and higher down payments. This is appropriate and consistent with the principles of risk-based pricing.

We were also concerned that many reports suggested these changes would now direct the GSEs to make loans to unqualified borrowers when, in fact, the LLPAs made no changes to underwriting or borrowers' qualifications. If you did not qualify for a loan before, you do not today. All loans must still comply with the laws established in the Dodd-Frank Act, including the Ability to Repay Rule.

We have not heard from FHFA that these pricing changes are a form of cross-subsidization wherein higher-income and lower-credit risk borrowers subsidize loans for those with lower-incomes and a higher-credit risk. However, the GSEs' charters also allow them to accept lower returns to support their mission, tools which can support the broader national market.

FHFA's fee discount does not necessarily make a GSE loan more attractive or more affordable for borrowers than an FHA loan. Given the high LLPA charge the GSEs will continue to impose on these borrowers, and the additional mortgage insurance they must pay, the FHA program will prove a much more attractive option for the vast majority of borrowers with lower down payments and lower credit scores. Ultimately, only a small portion of borrowers will actually use these discounts. The media has inappropriately conflated the discounts and rate increases; the GSEs clearly would not need to raise rates on a large segment of their borrowers to support the small segment who may use these discounts. As discussed later, NAR finds the rate increases unnecessary on their own terms, given the GSEs capital position.

Lastly, we thank FHFA for rescinding its upfront fee on borrowers with debt-to-income (DTI) ratios greater than 40 percent, which was slated to take effect on August 1.³ REALTORS® applaud the FHFA in recognizing industry and consumer concerns. Additionally, FHFA's decision to release a request for information on other fee changes is a great example of good governance. NAR looks forward to working with all stakeholders on new LLPA changes, and we believe a public comment period will provide greater data and perspective for potential revisions.

REALTORS® Perspective

LLPAs are an outgrowth of the process to reform the Enterprises. While in conservatorship, the FHFA has held multiple requests for input (RFIs) on these fees. On May 11, 2023, the FHFA announced an RFI to discuss the changes to the Enterprises' pricing grid based on LTV and credit score. This process is good governance and an important hallmark of reform under conservatorship.

³ "FHFA Announces Rescission of Enterprise Upfront Fees Based on Debt-To-Income (DTI) Ratio" <https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Announces-Rescission-of-Enterprise-Upfront-Fees-Based-on-Debt-To-Income-Ratio.aspx>

Congress should work together to allow the FHFA to establish a process for setting the pricing of mortgage guarantees by the Enterprises outside of conservatorship. This process should be transparent and include public input but also give the Enterprises discretion to make important decisions to fulfill their dual obligations with important safeguards. Specifically, the FHFA should not set pricing. Rather, it should set a maximum and minimum return on equity within which the Enterprises can set pricing. This collar would prevent the Enterprises from setting pricing too high on any segment. The return should also be set high enough that they cannot undercharge in order to grab more market share and under capitalize.

Furthermore, one of the most important changes Congress could make to improve the affordability and resilience of guarantee pricing at the Enterprises would be to provide an explicit government guarantee. An important first step would be for Congress to direct the FHFA and the Government Accountability Office to study the impacts and benefits of a guarantee to consumers, market stability, private markets, competition, and government finance. These questions will need to be resolved before any serious discussion of ending the Enterprises' conservatorship.

While fee increases harm potential homebuyers, the biggest impediment to many Americans is the lack of affordable, available housing. Consumers are also facing the impacts of inflation on everyday expenses. Without tackling these issues, many Americans will remain on the sidelines. Big problems require big solutions. Potential congressional solutions include creating tax incentives to convert unused commercial spaces to residential, mobilizing private investment to revitalize affordable homes, or incentivizing more owners to sell their homes by increasing the maximum amount of capital gains a homeowner can exclude on the sale of a principal residence.

Finally, REALTORS® also believe congressional interference in the process of setting pricing could undermine market stability. While we appreciate Congress's attention to this matter, we believe pricing decisions should be made by the agency that has the best data, financial expertise, and flexibility to change pricing on a dynamic basis.

Conclusion

REALTORS® thank the Chairman and Ranking Member for holding this important hearing on mortgage pricing at the Enterprises. NAR believes a bipartisan approach to housing finance reform is necessary to ensure a safe and vibrant housing market.

NAR strongly supports a thoughtful, transparent, and disciplined process for setting guarantee pricing that recognizes their function as market utilities. REALTORS® appreciate the FHFA's efforts to this end. However, Congress should do more to canonize this process outside of conservatorship. Congress should also explore the impacts and benefits of an explicit government guarantee as it could improve support for most homebuyers served by the Enterprises.

The Enterprises are fundamental to the secondary mortgage market. It is critical for lawmakers to address issues related to mission, competition, and transparency. These are important considerations as policymakers determine how to shape the secondary mortgage market that will better serve creditworthy Americans while also protecting taxpayers.

**UNDERSTANDING THE IMPACT OF RECENT CHANGES TO THE FEDERAL HOUSING
FINANCE AGENCY'S LOAN-LEVEL PRICE ADJUSTMENT**

**Statement of
Janneke Ratcliffe
Vice President for Housing Finance Policy, Urban Institute**

**before the
Subcommittee on Housing and Insurance,
Financial Services Committee,
United States House of Representatives**

**THE CURRENT MORTGAGE MARKET:
UNDERMINING HOUSING AFFORDABILITY WITH POLITICS**

May 17, 2023

*The views expressed are my own and should not be attributed to the Urban Institute, its trustees, or its funders.

I thank Jim Parrott, Laurie Goodman, Jun Zhu whose work and helpful comments have informed this testimony. I also thank John Walsh and Katie Visalli for preparing analyses.

Chairman Davidson, Ranking Member Cleaver, and members of the subcommittee, thank you for the invitation to discuss pricing decisions with regard to loan-level price adjustments (LLPAs).

I am the vice president for housing finance policy at the Urban Institute, a leading research organization dedicated to developing evidence-based, nonpartisan insights that improve people's lives and strengthen communities. The views expressed in this testimony are my own and should not be attributed to the Urban Institute, its trustees, or its funders.

Loan-level price adjustments are a complex topic that has generated concern and confusion. I hope that analysis by my colleagues and me at the Urban Institute will help make things clearer. In this testimony I provide some background and context about LLPAs, describe their evolution, how they are set, and the impact of private mortgage insurance on losses and costs. Then, I review where we are today—what has and hasn't changed as of the May 1 adjustments, and the implications. This testimony begins with the summary presented in my oral arguments.

Summary

First, it is important to establish that the recent adjustments to the LLPAs do not compromise the safety and soundness of the GSEs. All GSE loans today are underwritten according to strict risk criteria and present low risk by historical standards. Indeed, even those falling in the lower right quadrant of the grid, with down payments less than 20 percent and credit score between 620 and 680, have low projected losses; we estimate less than 1 percent. Moreover, these loans made up less than 3 percent of Fannie Mae's 30-year fixed rate, purchase, single-family owner-occupied mortgages in 2022.

Second, rather than thinking about these adjustments as cross-subsidies, they should be viewed in light of Director Thompson's changes to better align pricing with the capital requirements established by the prior director under the Enterprise Regulatory Capital Framework.¹

The GSEs exist to support sustainable and affordable homeownership across communities and across cycles. GSE pricing is primarily structured so they can meet their capital requirements and overall target return on capital. This means the GSEs can set different profit margins for different types of loans (which is a standard business practice) to maintain safety and soundness, serve their public mission, and meet their overall return target. For example, GSEs charge the same fees for all states, even though some have much higher default rates than others and are thus less profitable. GSEs also have different margins on some products based on competitive pressures.

Within the current pricing structure, it's helpful to recognize three categories the GSEs price differentially:

1. **Mission-remote loans**, like second homes, investment properties, million-dollar loans, and cash-out refinances, which are seen as less appropriate for deep public support and less central to the basic

¹ See Jim Parrot and Janneke Ratcliffe *Fannie Mae and Freddie Mac's New Pricing Is Not Punishing Those with Better Credit: Follow the Numbers* and Jim Parrot *No, Fannie Mae and Freddie Mac aren't penalizing people with good credit to help people with good credit* (Washington DC: Urban Institute, 2020). Also see <https://home.treasury.gov/system/files/136/Executed-Letter-Agreement-for-Fannie-Mae.pdf>.

homeownership mission.² For these loans the GSEs charge as much as they can while still providing enough benefit to retain the business. These higher returns offset lower return targets on the next category, mission loans.

2. **Mission loans**, which include mortgages to people with lower incomes, in rural markets, for manufactured homes, and other categories. For this category, the aim is to price as low a margin as possible while meeting profit targets, a practice that makes these loans relatively more affordable and more sustainable.
3. **Core loans**, the bulk of the GSE's loans, are purchase and rate-term refinances for all other owner-occupied homes, which are priced to hit capital requirements and target return on equity.

The May 1, 2023, LLPA adjustments apply to the core loans and are the last in a series of steps taken over the past year, each to address different objectives. This sequencing of steps has led to some confusion because steps are being conflated, leading some to conclude that these changes are supporting mission business at the expense of the core business. But that's incorrect. The May 1 changes result in a flatter grid across the core business, give more credit for private mortgage insurance, and split up some of the prior groups into smaller groups. The May 1 additions are relatively small, adding at most \$40 a month to the median mortgage payment and apply to less than 1.5 percent of the core borrowers. All categories within the grid are still priced to cover losses and make a profit.

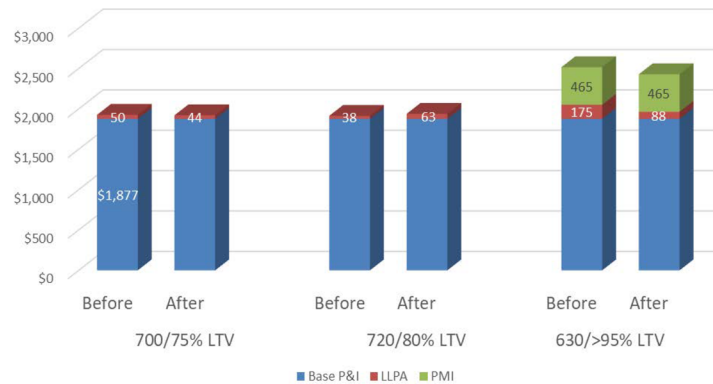
Finally, in the core business, which is the vast majority of GSE lending, borrowers who pose more risk pay more—in some cases a lot more—than borrowers who pose less risk. Borrowers with low down payments—or high LTV, which stands for loan-to-value—have to buy private mortgage insurance, or PMI. PMI reduces losses to the GSEs and raises borrowing costs for borrowers with LTV over 80 percent who were likely overcharged in the prior grids, especially those with lower credit scores. With the May 1 changes, on a \$300,000 mortgage, a borrower with a credit score of 660 and 5 percent down will still pay around \$500 more a month in LLPAs and PMI than a borrower with a credit score of 700 and 25 percent down, as shown in figure 1.

Ultimately the May 1 changes have little to nothing to do with cross-subsidy. They better align the core business LLPAs with the capital requirements, and they address previous overcharges among high-LTV borrowers by accounting for mortgage insurance.

² The percent of loans for second homes and investor properties is limited to 7% of purchases in a 52-week period; see <https://home.treasury.gov/system/files/136/Executed-Letter-Agreement-for-Fannie-Mae.pdf>.

FIGURE 1

Monthly Base Principal, Interest, LLPA, and PMI, before and after May 1



Source: Urban institute calculations based on a 30-year, \$300,000 loan at 6.4% interest, 2023 Fannie Mae Loan Level Price Adjustment Matrix for Purchase Money Loans 3.22.2023 vs 02.01.2023, annualizing LLPAs by dividing by 5 years, and adding PMI rate indications from Enact Mortgage Insurance Company: <https://content.enactmi.com/documents/rate-cards/national/Enact%20legal%20entity%2002.22/00460.NationalMonthly.FIXED.0323.pdf>.

Note: Actual mortgage insurance charged will vary depending on company used, their pricing method and other loan characteristics.

Historical Context

Before 2008, Fannie Mae and Freddie Mac had no LLPAs, and the base guarantee fee (g-fee) did not vary by borrower risk factors. As such, risks and fees were distributed across borrowers, who paid the same g-fee to access the same loan product. This flat fee structure can be described as “pooled” risk and pricing. The g-fee did vary by lender; the largest lenders extended lower g-fees. Another important difference from today is that g-fees overall were much lower before 2008, in large part because the amount of capital the GSEs were required to hold was much lower than it is today.

In 2008, the GSEs added up-front fees, known as loan-level price adjustments, based on loan-to-value and borrower credit score, as well as an “adverse market fee” charged on loans originated in certain geographic areas that posed higher risk. With the GSEs in conservatorship and under the regulation of the newly created Federal Housing Finance Agency (FHFA), a new approach to capital and pricing was ushered in. From 2008 through 2021, the base g-fee was raised and the LLPA structure was refined through a succession of steps at the direction of the FHFA. Additional changes included a 10 basis point (bp) increase (0.1%) first implemented in 2012 to cover other government spending measures, elimination of the adverse market fee in 2015, establishment of g-fee floors in July 2016, and placing a fee on refinances from

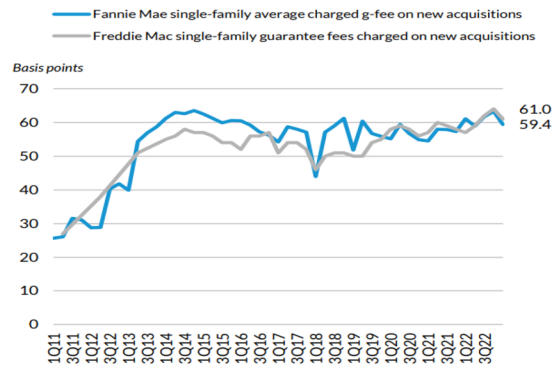
December 2020 until August 2021.³ The May 1, 2023, adjustments are the third in a series of subsequent adjustments made since 2022.

Base g-fees are an annual rate added into the interest rate, while LLPAs are one-time up-front charges. However, borrowers normally do not pay these up front; instead, LLPAs are usually converted into an annualized rate (based on the estimated life of the loan—typically around 6 years for a 30-year fixed rate mortgage) and effectively added into the interest rate along with the base g-fee.⁴

In 2007, Fannie and Freddie reported average effective guarantee-fees of 24.2 and 18 basis points, respectively.⁵ By late 2022 the average g-fee reached around 60 bp—about 40–45 bp in ongoing base g-fee and the remainder in annualized up-front LLPAs. The combined base g-fee and annualized LLPA is collectively referred to as g-fees. The average g-fee over time is shown in figure 2 below. Fluctuations in the average can also be attributed to changes in the mix of loans funded in each period.

FIGURE 2

Fannie Mae and Freddie Mac Average G-Fees, 2011–22



Source: Laurie Goodman et al., *Housing Finance at a Glance: April 2023* (Washington, DC: Urban Institute, 2023).

³ For a summary of historical changes in fees from March 2008 to November 2021, see *Fannie Mae and Freddie Mac Single-Family Guarantee Fees in 2011* (Washington, DC: Federal Housing Finance Agency, 2022), pages 12–13.

⁴ According to FHFA: “For the purposes of reporting to FHFA, the Enterprises annualize upfront fees by dividing the upfront fee for a given loan by that loan’s specific present value multiplier (PVM). For example, a loan with an upfront fee of 75.15 basis points and a PVM of 6.18 would have an annualized upfront fee of $75.15/6.18 = 12.16$ basis points. Depending on the attributes of the loan, a typical new 30-year loan may be expected to have a PVM of about 6 on average, whereas a 15-year loan may be expected to have a PVM closer to 4.” *Fannie Mae and Freddie Mac Single-Family Guarantee Fees in 2011* (Washington, DC: Federal Housing Finance Agency, 2022), page 2. In our analysis of 30 year fixed rate mortgages in this testimony we use a PVM of 5 to be conservative.

⁵ See *Fannie Mae and Freddie Mac Single-Family Guarantee Fees in 2007 and 2008* (Washington, DC: Federal Housing Finance Agency, 2009).

Risk-Based Capital and How G-Fees Are Set Today

The g-fee covers the average expected loss on a group of loans, operating expenses of the GSEs plus special fees and assessments, and the cost of (or expected return on) the capital required for that group of loans.

According to the FHFA, “An Enterprise’s cost of holding capital is its greatest cost.”⁶ The level of capital is supposed to cover the probability of unexpected losses that would be incurred in a severe stress environment. The capital levels are risk-based, meaning that the cost of capital is higher on loans with higher risk, primarily determined by LTV and credit score as well as loan type and other factors, such as whether the loan is for an investment property or a manufactured home. The capital requirements are set by the FHFA and have undergone several changes since 2008, driving much of the g-fee changes discussed above.

The GSE’s original minimum statutory capital requirement is .45 bp on mortgages it guaranteed. The FHFA’s proposed 2017 Conservatorship Capital Framework, which the GSEs followed in setting pricing until recently, was designed to better protect the taxpayers and better align capital with risk, though Urban Institute analysis suggests that the rule may have over-penalized higher-risk loans.⁷ This framework was replaced by a new 2020 Enterprise Regulatory Capital Framework.^{8, 9} The new rule further increased capital requirements on aggregate by establishing risk weight floors. According to the FHFA, “These changes reduced risk gradients in the ERCF compared to the CCF” and “increase[d] capital more significantly for loans with lower credit risk characteristics.”¹⁰ In effect, the new capital rule flattened the pricing grid.

The level of capital also affects the profits that need to be built into the g-fees. While the FHFA sets an overall target rate of return for the GSEs, they also have the flexibility to set different target rates of return for different groups of loans.

The Impact of Private Mortgage Insurance

The GSEs require credit enhancement for all mortgages over 80 LTV; it is a charter requirement. Private mortgage insurance is by far the most common form of credit enhancement. PMI reduces the actual LTV of the mortgage well below 80. For example, 30-year fixed-rate mortgages with a 95 LTV are generally required to have coverage for the first 30 percent of losses, bringing the effective LTV to the GSEs to 67 percent. A typical 97 percent LTV loan (3 percent down) requires coverage of 35 percent; a 90 percent LTV loan, 25 percent; and an 85 percent LTV loan, 12 percent. Having this insurance significantly raises the cost of the loan to the borrower and significantly lowers loss to the GSEs.

To illustrate the benefit to the GSEs, figure 3 shows that loans with PMI have lower loss severity than without, consistently across vintages.

⁶ *Fannie Mae and Freddie Mac Single-Family Guarantee Fees in 2021*, page 6.

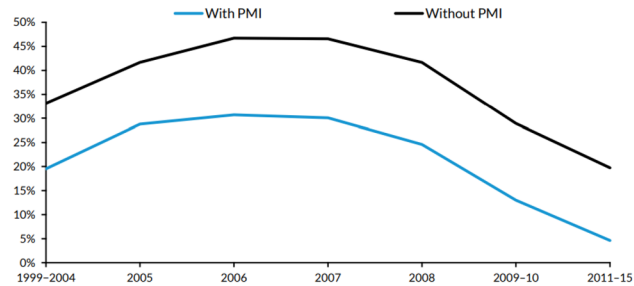
⁷ See Edward Golding, Laurie Goodman, and Jun Zhu, *Analysis of the FHFA’s Proposal on Enterprise Capital* (Washington, DC: Urban Institute, 2018).

⁸ See Jim Parrott, Bob Ryan, and Mark Zandi, *FHFA’s Capital Rule Is a Step Backward* (Washington DC: Urban Institute, 2020).

⁹ See <https://home.treasury.gov/system/files/136/Executed-Letter-Agreement-for-Fannie-Mae.pdf>

¹⁰ *Fannie Mae and Freddie Mac Single-Family Guarantee Fees in 2021*, page 8.

FIGURE 3

Loss Severity for GSE Loans with and without PMI, by Origination Year Groupings

Sources: Fannie Mae, Freddie Mac, and the Urban Institute.

Note: GSE = government-sponsored enterprise; PMI = private mortgage insurance. The GSE credit data are limited to 30-year fixed-rate, full documentation, fully amortizing mortgage loans. Adjustable-rate mortgages and Relief Refinance Mortgages are not included. Fannie Mae data include loans originated from the first quarter of 1999 (Q1 1999) to Q4 2015, with performance information on these loans through Q3 2016. Freddie Mac data include loans originated from Q1 1999 to Q3 2015, with performance information on these loans through Q1 2016.

Source: Laurie Goodman and Karan Kaul, [Sixty Years of Private Mortgage Insurance in the United States](#) (Washington, DC: Urban Institute, 2017).

After the financial crisis, the PMI industry needed to raise more capital. The PMI companies also use risk-based pricing, and, since 2014, the FHFA oversees PMI capital requirements through Fannie and Freddie-issued PMIERS (PMI Eligibility Requirements), which are also revised from time to time and are risk-based by LTV and credit score. According to Urban researchers, “The private mortgage insurers also altered their pricing in 2016 after increasing prices during the recession. The change—largely in response to higher PMIERS capital requirements—lowered prices for high-FICO-score borrowers and increased them for low-FICO-score borrowers.”¹¹ This improved the attractiveness of PMI in relation to FHA for high-FICO-score borrowers but reduced it for low-FICO score borrowers.

The May 1 Loan Level Price Adjustments: What Has Changed...

When FHFA Director Thompson was appointed, she inherited the ECRF capital rule and took several steps to adjust the pricing to reflect the capital requirements, in light of mission, risk, and return objectives. To understand the steps taken from 2022 through May 2023, it helps to understand the role of the GSEs and to segment the GSE’s loans into three buckets.

Fannie and Freddie’s guarantee (and the implicit government backing) gives investors throughout the world the confidence to provide low-cost funding for US mortgages, and it gives the majority of borrowers in today’s market access to safe, affordable fixed-rate mortgages. Fannie’s and Freddie’s primary purpose is to “provide ongoing assistance to the secondary market for residential mortgages (including activities relating to

¹¹ See Laurie Goodman and Karan Kaul, [Sixty Years of Private Mortgage Insurance in the United States](#) (Washington, DC: Urban Institute, 2017).

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)." Urban research estimates that the total economic benefit from lower mortgage rates experienced across GSE borrowers is \$6 million a year.¹² So effectively, every GSE borrower is receiving a subsidy. After all, if they could get a better rate somewhere else, they would not use the GSEs.

The mission statement says that the GSEs can earn lower return on equity levels for some categories than others, which is a standard business practice. For the GSEs, this practice is further informed by their public purpose. As previously discussed, the GSE's approach to mission, mission-remote, and core loans allows them to set different profit margins for different groups and still maintain their capital targets.

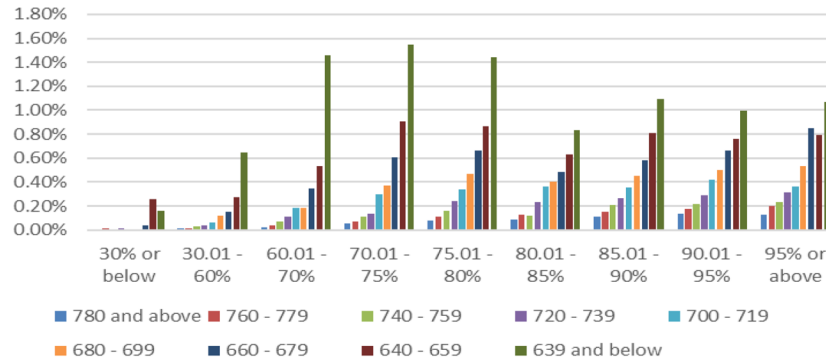
The current pricing grid reflects a balance of policy and market requirements that reflect the broader strategy that the FHFA has followed since January 2022: first, maximize returns on mission-remote loans; second, cut LLPAs on mission loans. Those steps went into effect over the past several months. The final step of this realignment is what just went into effect: adjustments within the core business to cover the remaining increase in capital and address some anomalies in the prior pricing grid.

These relatively modest adjustments added about 4 bp to total g-fees, assuming the current mix is maintained, which helped meet the higher overall capital required, as well as flattening the grid to align with the capital structure of the new rule. For each bucket with an LLPA, the total pricing covers the expected losses, as well as expenses, and still leaves a risk-free return (see figures 4,5 and 6).

We looked at losses for the 2009–15 origination (a book that experienced home price appreciation, with a 90 percent weight) and for the 2007–08 origination (a book that experienced home price depreciation, with a 10 percent weight). As shown in figure 4, losses to the GSE are **lower** on mortgages with LTVs over 80 percent because of PMI. As a result, the loss rate to the GSEs on 30-year fixed-rate mortgages originated from 2009 to 2015 with FICO of 660–79 is higher than for the 90.01–95 LTVs. While the loss frequency is higher on higher-LTV mortgages, it is more than offset by the lower loss severity.

¹² See Laurie Goodman, Jim Parrott, Bob Ryan, and Mark Zandi, [*How Fannie and Freddie Can Use Pricing to Expand Affordable Homeownership*](#) (Washington DC: Urban Institute, 2022).

FIGURE 4

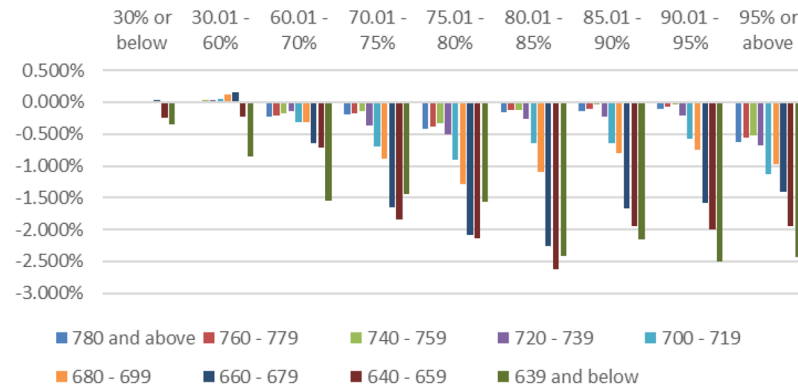
Estimated Losses by Credit Score and Loan-to-Value

Source: Fannie Mae loan-level data, purchase only, fixed-30, owner-occupied 1-unit single family mortgages.

Methodology: We calculated the loss rate for loans. We assumed 10 percent probability of distressed scenario (2007-08) and 90 percent probability of normal scenario (2009-15), then compared the weighted loss rates with the LLPA. The figure shows the difference between loss rate and LLPA.

If we compare the prior LLPAs to the estimated losses we calculated, high-LTV borrowers with credit scores from 620 to 679 were previously paying a hefty price over the risk they posed. Figure 5 shows LLPAs on the prior grid minus the estimated loss, with any negative amount showing the excess of LLPA over our estimated loss.

FIGURE 5

Difference between LLPA and Expected Loss (Pre-May 1)

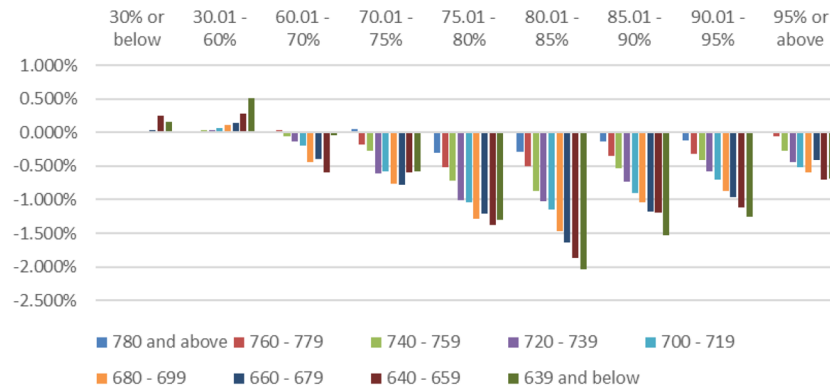
Source: Fannie Mae loan-level data, purchase only, fixed-30, owner-occupied 1-unit single family mortgages.

Methodology: We calculated the loss rate for loans. We assumed 10 percent probability of distressed scenario (2007–08) and 90 percent probability of normal scenario (2009–15), then compared the weighted loss rates with the LLPA. The figure shows the difference between loss rate and LLPA.

We then compare the new LLPAs to our estimated losses (figure 6). The higher-LTV buckets are accorded the benefit of PMI, which provides more coverage (and more private capital) as the LTV goes up. We found, for nearly every cell with a positive LLPA, the LLPAs were greater than the losses. For example, for the 640–60 FICO, 90.01–95 LTV, the weighted losses were 76 basis points; this compares with an LLPA of 1.875 percent, a difference of 1.116.

FIGURE 6

Difference between LLPA and Expected Loss (Post-May 1)



Source: Fannie Mae loan-level data, purchase only, fixed-30, owner-occupied 1-unit single family mortgages.

Methodology: We calculated the loss rate for loans. We assumed 10 percent probability of distressed scenario (2007–08) and 90 percent probability of normal scenario (2009–15), then compared the weighted loss rates with the LLPA. The figure shows the difference between loss rate and LLPA.

What explains this apparent overpayment? The GSEs are not simply factoring in losses on originations; rather, the pricing is centered on how much capital they hold and how much return they are earning on their “capital.”

Another change that affected a few high-credit score groups was that the GSEs split the low-LTV, highest score groups into multiple buckets. Most notably, the previous 740+ credit score bucket was split into three buckets (740–59, 760–79, and 780+).

As a result of all these changes, new borrowers in some buckets will face a higher LLPA than they would have before May 1; others will pay less (see table 1 below), but the number of borrowers with significant changes is small, as are the changes themselves. The largest single increase for any bucket is 75 bp (\$2,250

one time on a \$300,000 loan, which translates to less than \$40 a month and a less than 1 percent increase in debt-to-income ratio). This change affects less than 1.5 percent of the purchase money borrowers (based on 2022 distribution of Fannie Mae loans)—borrowers with credit score of 720–59 who put down more than 15 percent but less than 20 percent and who are required to have thin and relatively short-term PMI coverage (the red numbers in table 2).

Decreases are seen for GSE borrowers with credit scores between 620 (the minimum) and 679, who make up only 6 percent of the GSE's purchase loans. The highest reductions are for high-LTV borrowers, whose risk is mitigated by mortgage insurance and who were previously charged very high LLPAs. For example, borrowers with scores from 620 to 639 and above 95 percent LTV were paying 3.5 percent LLPA, translating to roughly \$150 a month on the median loan, and with mortgage insurance of 1.86 percent annually included,¹³ for total fees on top of the base rate costing over \$600 a month. It is not surprising that these loans are less than 0.1 percent of GSE purchase loans. With the post-May 1 reduction in LLPA, these borrowers will pay about \$50 less a month (around \$550 a month), but the LLPA + PMI cost will still be about 30 percent of their base total monthly payment. Even with the new grid, these borrowers are more likely to go to the FHA if that is an option, where they would pay the lower flat 1.75 percent up front and 0.55 percent annual insurance premium.

Also, because the new grid splits the previous highest credit score group into three buckets, some borrowers in those three higher score groups also see g-fees go up, and some down, depending on where they fall within those three new groups. For example, whereas before a borrower with credit score of 741 would pay the same as one with an 800 score, in the new grid, borrowers in the 740–59 bucket will now pay more than those in the 780-plus bucket.

TABLE 1

Changes to LLPAs for Purchase Money, Fixed-Rate, Owner-Occupied, One-Unit Mortgages

Credit score	Loan-to-Value Range								
	30% or below	30.01–60%	60.01–70%	70.01–75%	75.01–80%	80.01–85%	85.01–90%	90.01–95%	>95
≥780	0.000	0.000	-0.250	-0.250	-0.125	0.125	0.000	0.000	-0.625
760–779	0.000	0.000	-0.250	0.000	0.125	0.375	0.250	0.250	-0.500
740–759	0.000	0.000	-0.125	0.125	0.375	0.750	0.500	0.375	-0.250
720–739	0.000	0.000	0.000	0.250	0.500	0.750	0.500	0.375	-0.250
700–719	0.000	0.000	-0.125	-0.125	0.125	0.500	0.250	0.125	-0.625
680–699	0.000	0.000	0.125	-0.125	0.000	0.375	0.250	0.125	-0.375
660–679	0.000	0.000	-0.250	-0.875	-0.875	-0.625	-0.500	-0.625	-1.000
640–659	0.000	-0.500	-0.125	-1.250	-0.750	-0.750	-0.750	-0.875	-1.250
620–639	-0.500	-0.375	0.000	-0.875	-0.250	-0.375	-0.625	-1.000	-1.750
Below 620	-0.500	-0.375	0.000	-0.875	-0.250	-0.375	-0.625	-1.000	-2.000

¹³ Mortgage Insurance Premium indication is derived from Enact Mortgage Insurance Company monthly premium for fixed-rate primary resident purchase loans; <https://content.enactmi.com/documents/rate-cards/national/Enact%20legal%20entity%2002.22/00460.NationalMonthly.FIXED.0323.pdf>. Actual premium will vary by company, by pricing method, and other risk factors.

Source: Urban Institute analysis of Fannie Mae Loan-Level Price Adjustment Matrix-Current (v. 02.01.2023) versus May 1, 2023, effective (v.03.22.2023).

TABLE 2

Distribution of GSE Purchase Loans by Credit Score and LTV Ratio

Credit score	Loan-to-Value Range									Total
	30% or below	30.01–60%	60.01–70%	70.01–75%	75.01–80%	80.01–85%	85.01–90%	90.01–95%	>95	
≥780	0.63%	4.22%	2.42%	3.75%	8.45%	1.37%	3.27%	5.44%	1.30%	30.8%
760–779	0.19%	1.55%	1.09%	2.08%	4.66%	0.91%	2.24%	4.42%	1.30%	18.4%
740–759	0.10%	0.98%	0.78%	1.47%	3.66%	0.80%	2.01%	4.50%	1.55%	15.8%
720–739	0.07%	0.70%	0.60%	0.97%	2.66%	0.64%	1.61%	3.89%	1.47%	12.6%
700–719	0.05%	0.58%	0.50%	0.68%	1.96%	0.51%	1.21%	2.99%	1.05%	9.5%
680–699	0.04%	0.45%	0.42%	0.51%	1.39%	0.36%	0.88%	2.04%	0.66%	6.7%
660–679	0.03%	0.32%	0.29%	0.27%	0.79%	0.16%	0.41%	0.82%	0.19%	3.3%
640–659	0.02%	0.21%	0.20%	0.15%	0.50%	0.07%	0.20%	0.36%	0.07%	1.8%
≤639	0.01%	0.15%	0.13%	0.08%	0.29%	0.04%	0.08%	0.12%	0.02%	0.9%
Total	1.13%	9.16%	6.45%	9.95%	24.35%	4.86%	11.92%	24.58%	7.61%	

Source: Urban Institute calculations of eMBS data.

Notes: The table shows GSE purchase loans originated in 2022 with terms greater than 15 years. Distribution is of count of loans. This analysis includes all property types, investors, and second homes.

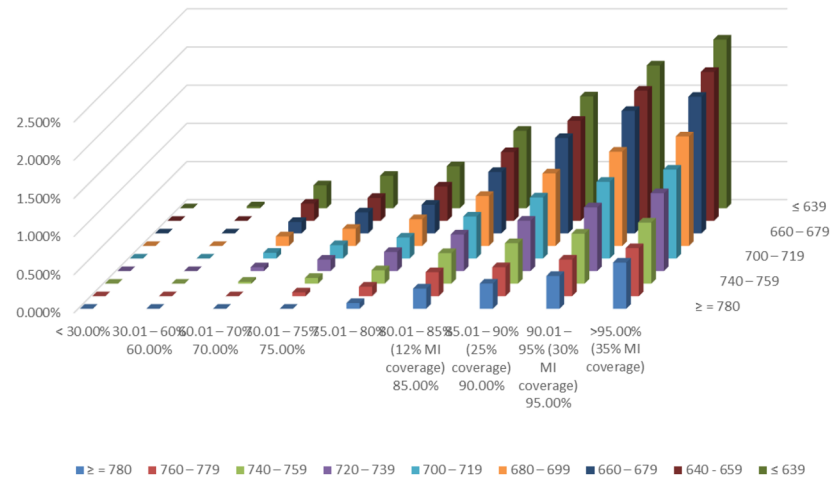
...and What Hasn't Changed

The simple comparison of the previous grid to the new grid has caused some confusion about who is paying less than whom versus who is paying less than they would have paid before. This confusion blurs the complexity of the changes actually happening. It's also important to note what isn't changing:

1. Current borrowers have already paid their LLPA (if they incurred one); this will not affect their payments.
2. A proposed LLPA based on debt-to-income was dropped, a move we highly applaud as we find that it penalizes lower-income borrowers, that debt-to-income is a poor predictor of risk, and that it would add unnecessary operational complexity, which might deter lenders from serving borrowers with higher house prices relative to their income.
3. The basic risk-based nature of the grid remains: low-risk borrowers pay less than high-risk borrowers, with LLPAs priced to cover expected losses and capital requirements, and to return a profit (figure 7).

FIGURE 7

LLPA Annualized plus PMI by LTV Bucket and Credit Score



Source: Fannie Mae Loan-Level Price Adjustment Matrix for Purchase-Money Loans. 03.22.2023. PMI rate indications from Enact Mortgage Insurance Company: <https://content.enactmi.com/documents/rate-cards/national/Enact%20legal%20entity%2002.22/00460.NationalMonthly.FIXED.0323.pdf>.

Note: Actual mortgage insurance charged will vary depending on company used, their pricing method and other loan characteristics.

Conclusion

In summary, the pricing is a natural outcome of the FHFA's pricing approach, which is a direct function of capital (return on capital target), expected risk, expenses, and special fees. We argue that the May 1 grid changes are largely motivated by implementing the ERCF and factoring in PMI coverage and capital. Following that logic, distortions, if any, in the pricing structure reflect distortions, if any, in the capital requirements.

One may take issue with the capital rule or the target return on equity. One may even take on the whole notion of whether "capital" and "return" is a meaningful a concept for these institutions in conservatorship. Or whether risk-based pricing is the best way to transmit costs to borrowers at all, especially given the complexity and lack of transparency for borrowers. Ultimately, it is important to recognize that the GSEs bring a valuable economic subsidy to all their borrowers, provide macroeconomic stability to the economy, and help foster affordable and sustainable homeownership while needing to maintain safety and soundness, all against changing market conditions. Setting pricing is a complex balance of all these considerations.

TESTIMONY of Dr. Clifford V. Rossi¹

Hearing Entitled: The Current Mortgage Market: Undermining Housing Affordability with Politics

Housing and Insurance Subcommittee of the House Financial Services Committee

May 17, 2023

Chair Davidson, Ranking Member Cleaver and Members of the Subcommittee, I am Dr. Clifford Rossi, Professor-of-the-Practice and Executive-in-Residence at the Robert H. Smith School of Business at the University of Maryland.

We are here today to discuss the updated loan-level price adjustment (LLPA) matrices (grids) implemented by Fannie Mae and Freddie Mac on May 1, 2023. I am providing testimony to present the case for why the current LLPA grids are flawed and how to improve mortgage loan pricing to achieve the FHFA's missions to ensure the safety and soundness of the Enterprises and to "foster housing finance markets that promote equitable access to affordable and sustainable housing".²

I offer a unique perspective on this issue having worked for 23 years in the financial services industry, first as a regulator during the S&L Crisis and then at both Fannie Mae and Freddie Mac—pre-conservatorship, as well as at one of the largest commercial banks, the largest savings and loan at the time and the largest nonbank mortgage company during my tenure as a C-level risk management executive, and now as a finance professor working on risk management issues affecting the financial services industry. At both Fannie Mae and Freddie Mac I helped design and work on analytical methodologies used for pricing Enterprise guarantee fees and risk-based underwriting matrices.

There remains much confusion over the process employed to price credit risk by the Enterprises and like much of the housing finance system, that credit pricing process is based on a legacy structure that in a perfect world would likely never have been designed the way it exists today. Of critical importance to this hearing is the issue of cross-subsidization among mortgage borrowers. Changes in the LLPA grids that went into effect on May 1, 2023, sparked enormous controversy over the extent to which high credit quality borrowers are subsidizing low credit quality borrowers. I too in opinion pieces

¹The views and opinions expressed in this testimony do not reflect those of the Robert H. Smith School of Business or the University of Maryland and are solely those of Dr. Rossi.

² <https://www.fhfa.gov/AboutUs>

raised concern over the appearance that fees on some high credit quality borrowers would rise while reducing fees for a number of low credit quality credit score and loan-to-value (LTV) ratio combinations in the LLPA grids. Those are immutable facts. The current and previous LLPA grids do incorporate elements of risk-based pricing though the current grids flatten the relationship between key risk attributes and credit default. Another fact is that cross-subsidization in credit pricing has been in place for decades by way of average guarantee fee pricing implemented by both Enterprises. Effectively then what we see today is a hybrid form of credit pricing that features flat or average pricing for guarantee fees (ongoing fees) and quasi-risk based pricing for upfront fees (LLPAs). The seminal question is whether such a pricing scheme is the best structure to achieve the FHFA's objectives cited earlier.

Background on Guarantee Fees and LLPAs

To understand what's wrong with the current LLPA approach we need to first review the general framework for how guarantee fees and LLPAs are developed. Both Enterprises leverage internally developed statistically-based models of mortgage default and prepayment that are simulated over hundreds of paths of interest rates and home prices. Default and prepayment models include many factors including those most commonly seen in the LLPA grids such as credit score and LTV, among others. These models are based on what we refer to as a through-the-cycle (TTC) view of mortgage performance over different economic environments, including severe stress periods such as the 2008 financial crisis. These models are used to generate estimates of expected and unexpected default cost. These estimates are then used to calculate guarantee fees which reflect expected default cost, the cost of capital required to insulate the Enterprises from severe credit shocks, and general & administrative expenses. Guarantee fees are averaged across borrowers but vary by product type (e.g., 30-year vs 15-year fixed rate mortgage). If the Enterprises followed a standard private market insurance risk-based pricing scheme, guarantee fees would be priced to be actuarially fair, i.e., cover the Enterprises' risk and costs plus provide a reasonable rate of return on a loan-by-loan basis.

In practice over the years, guarantee fees have deviated from actuarial pricing. For example, in the years leading up to the 2008 financial crisis, guarantee fees reflected market adjustments for sellers and other competitive effects leading both GSEs to compete on price in an effort to gain market share. That approach along with other issues, extremely low capital levels, greater risk-taking and poor regulatory oversight eventually drove both Enterprises into conservatorship where they remain the last vestiges of the 2008 crisis, held in a sort of perpetual regulatory captivity. Then in 2011, Congress further eroded the credit pricing process by requiring the GSEs to raise those fees by 10bps

under the Temporary Payroll Tax Cut Continuation Act of 2011 (TCCA). Clearly payroll taxes have nothing to do with mortgage credit pricing.

About the time of the financial crisis as both GSEs came under increasing stress from accelerating credit losses, they turned to a new device to raise funds to staunch those losses, LLPAs. The LLPAs are essentially an artifact of a last-ditch effort by the GSEs to save themselves rather than as a well-thought-out credit pricing structure. A key question then, is this an appropriate mechanism to achieve FHFA's touted goals?

Criteria for Mortgage Credit Pricing

In designing an optimal mortgage credit pricing structure for the Enterprises a set of key criteria are essential in guiding the process. These principles are as follows:

1. Any credit pricing structure must achieve the FHFA's goal of ensuring the safety and soundness of the Enterprises.
2. Credit pricing must be transparent and straightforward to understand
3. Credit pricing must be empirically-based, reflecting a through-the-cycle view of loan performance taking key credit risk attributes into account
4. Credit pricing should be operationally tractable and designed to minimize implementation burden for the Enterprises and mortgage originators
5. Credit pricing must seek to reduce and/or eliminate perverse incentives that may pose risk to borrowers or the Enterprises

So how do the current LLPA grids comport with these criteria? The use of the Enterprise Regulatory Capital Framework (ERCF) along with the modelling approach for generating guarantee fees aligns with the first and third criteria. However, the introduction of LLPAs violates the second, fourth and fifth criteria. While on the surface it can be argued that the LLPAs are transparent by virtue of their pricing by risk attribute, the exact mechanics are murkier, thus setting the stage for second-guessing the new LLPA grids. Much of any confusion over the changes to the LLPAs is directly attributed to the FHFA's stated objectives when these modifications to the LLPA grids were introduced:

The priorities outlined in the [2022](#) and [2023](#) Scorecards for the Enterprises include developing a pricing framework to maintain support for single-family purchase borrowers limited by wealth or income, while also ensuring a level playing field for large and small

*sellers, fostering capital accumulation, and achieving commercially viable returns on capital.*³

Note that the first objective stated by the FHFA has nothing to do with credit pricing either. Intertwining its safety and soundness and affordable housing objectives in the LLPA development process reduces pricing transparency and the relationship of credit default to key risk attributes while creating a potential unintended consequence of putting some borrowers into homes that might not be long-term sustainable for them. Let's examine each of these issues in turn.

Issues with Current LLPAs

While the FHFA argues that the process used to generate the latest LLPAs was based on sound risk-based principles leveraging the latest regulatory capital requirements and taking into account the effects of private mortgage insurance that would achieve a target rate of return for the Enterprises, their objective to also take into account issues relating to borrower wealth or income is not well explained as to how each cell in the LLPA grids was developed taking that goal into account. Without question, this objective is a critically important policy one for the country, however, there are better and more transparent ways of fulfilling that objective while also creating transparency in the LLPA process.

Continued reliance on LLPAs which were borne out of the 2008 financial crisis in conjunction with guarantee fees also reduces transparency in the credit pricing process and introduces more operational burden than needed. In effect credit pricing by the Enterprises is a hybrid of average and risk-based pricing. Ongoing fees are average priced whereas LLPAs are more risk-based though the current grids have become less so.

To gain a visual sense of how the fees have changed, consider Figures 1 and 2 that display the actual LLPAs for two critical borrower segments; 75.01-80% LTVs (no mortgage insurance required) and 80.01-85% LTVs (with mortgage insurance) by credit score. In both cases the previous and new LLPA grids show what we should expect generally if loans are risk-based priced, i.e., fees increase as credit scores decline holding LTV constant. However, notice that the new LLPA curve is significantly flatter than the previous LLPA curve for both LTV groups. A flattening of the curve suggests that there is less differentiation in fees across credit score categories, again holding LTV constant. In the extreme, without risk-based pricing, the curve would be horizontal across credit scores, i.e., no differentiation in fees. In other words, the new grids have become less risk-based,

³ FHFA Announces Updates to the Enterprises' Single-Family Pricing Framework, FHFA News Release, January 19, 2023.

and that has implications for high and low risk borrowers. By flattening the curves and pivoting around the 680-699 credit score bucket, high risk borrowers gain, and low risk borrowers lose from these changes.

Another issue with the current LLPA grids is that they are now less reflective of the relative credit risk of specific attributes. Table 1 highlights this issue. Using loan level credit performance data from Fannie Mae's Data Dynamics Tool for purchase money mortgages originated between 1999-2022, net loss rates for different FICO and LTV combinations are shown along with the ratio of net loss rates for 620-639 FICOs to 720-739 FICOs (Multiple). In addition, the actual LLPA fees for those FICO and LTV categories are shown along with their multiples. The flattening of LLPAs across FICO and LTV combinations results in pricing multiples under the new LLPA grid for purchase money loans that are substantially below those under the previous grid which was more closely aligned with historical loss experience over a long period of time.

Table 1: Comparison of Fannie Mae Net Loss Rates to LLPAs

	75-80% LTV			80.01-85% LTV			85.01-90% LTV		
	FICO Score Category			FICO Score Category			FICO Score Category		
	720-739	620-639	Multiple	720-739	620-639	Multiple	720-739	620-639	Multiple
Net Loss Rate (%)	0.2570	1.1138	4.3339	0.1312	1.0157	7.7416	0.2675	1.3660	5.1065
LLPA Fees									
Previous Grid	0.7500	3.0000	4.0000	0.5000	3.2500	6.5000	0.5000	3.2500	6.5000
New Grid	1.2500	2.7500	2.2000	1.2500	2.8750	2.3000	1.0000	2.6250	2.6250

One of the reasons for maintaining LLPA grids is that it provides the FHFA and the Enterprises with a mechanism to allow some flexibility in managing regulatory and business outcomes. Raising LLPAs on certain risky attributes such as cash-out refinances and second homes, for instance, certainly can be argued to be a sound risk-based practice that telegraphs to the market the Enterprises view on those risks. However, those factors are already embedded in the guarantee fee pricing default models used by the Enterprises. Moreover, credit policy provides the Enterprises with a powerful tool for adjusting the mix of their business and risk profiles.

A key question then is whether this hybrid pricing approach of average pricing for guarantee fees and a form of risk-based pricing for LLPAs is an appropriate approach or not to follow. Referring back to my criteria for such a credit pricing process, is there an alternative approach that increases pricing transparency, is operationally more tractable and still supports the FHFA's safety and soundness and affordable housing missions? The answer is yes and is laid out in the next section.

Figure 1: LLPA Fees for Purchase Money, 80.01-85% LTVs

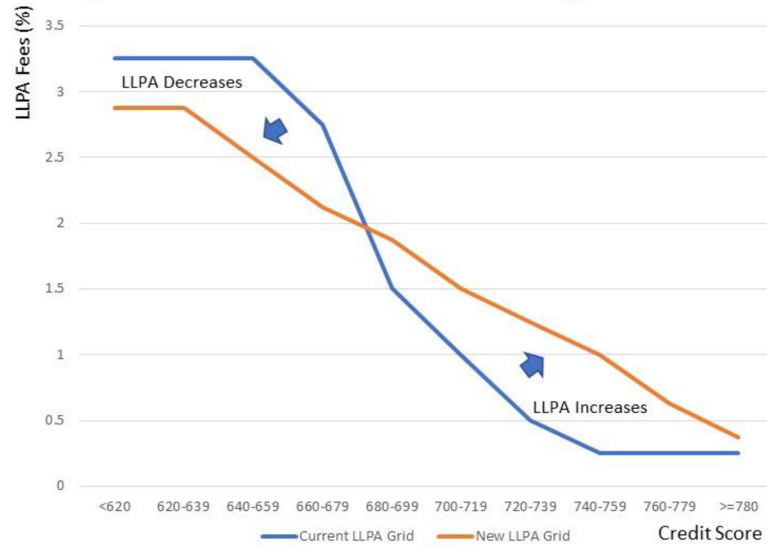
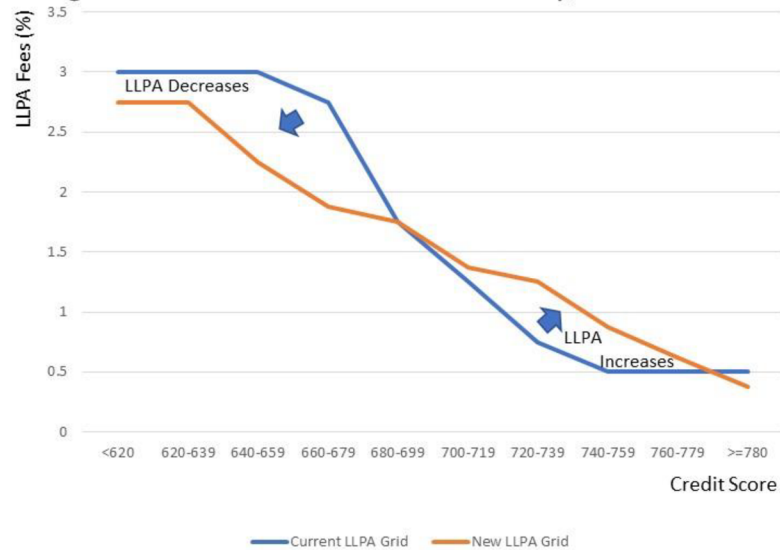


Figure 2: LLPA Fees for Purchase Money, 75.01-80% LTVs



A Proposed Enterprise Mortgage Credit Pricing Structure

Fundamentally, the combination of ongoing and upfront fees is overly cumbersome and prone to the kind of concerns we are here to discuss at this hearing. Some have argued that risk-based pricing can at times lead to adverse selection, particularly with respect to the Federal Housing Administration (FHA). That is, if the Enterprises engage in risk-based pricing while the FHA is average pricing risk, there is a tendency for the lower credit quality loans to make their way to FHA. So, while we are here to discuss Enterprise LLPAs, we should take a broader view and account for what existing policy may be doing to drive risk to other corners of the market and expose taxpayers to greater risk down the road overall.

Eliminating the current FICO and LTV LLPA grids and updating guarantee fees provides a framework that meets all the stated criteria of mortgage credit pricing laid out earlier. This proposal would require the Enterprises to update their guarantee fees consistent with achieving a target rate of return taking into account the ERCF. A precedent has already been set with the FHFA's announcement rescinding the LLPA fee for debt-to-income (DTI) ratio.

Instead of imposing LLPA fees for various risk categories, an add-on to the actuarially fair guarantee fee would be determined by the FHFA to use as a legislatively-capped rebate (the Affordable Housing Rebate, or AHR) account of sorts to borrowers that are income and/or wealth challenged. There is ample precedent for guarantee fee "on tops" for various reasons such as the FHFA's requirement over the years to add 10bps to guarantee fees to provide additional coverage for credit exposure at the Enterprises and the 10bps adjustment for TCCA. The proposed approach would eliminate existing on tops to guarantee fees. This new AHR component then would be simply an add-on not related to credit risk but in a more transparent manner provide support to borrowers most in need.

This proposal decouples the safety and soundness objective from the affordable housing mission in credit pricing, provides transparency in credit pricing, reduces operational burden, reduces risks to borrowers and the Enterprises while supporting the goal of affordable housing.

Closing Thoughts

FHFA's approach at allowing the GSEs to continue to use LLPAs and incorporating affordable housing objectives into the credit pricing process has created confusion brought on by a lack of transparency in the pricing process and results in overengineering of credit pricing. Today we have a sort of Frankenstein approach to credit pricing, cobbling together average pricing for ongoing fees with quasi-risk-based pricing for upfront fees. It is no surprise then that we have arrived at a place where so much heated debate has

occurred on these fees. Fundamentally, the FHFA should immediately eliminate the FICO and LTV LLPA grids and request the Enterprises to update their guarantee fees to reflect that change while conforming to actuarial-based pricing. This approach is essential to ensure the integrity of credit pricing and to make the process operationally tractable. Beyond that allowing for an on top affordable housing adjustment to the guarantee fee to be used as a rebate for designated borrowers provides the FHFA some discretion to modulate their affordable housing mission while disconnecting it from the credit pricing process.



1507 Longworth HOB
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<http://fitzgerald.house.gov/>

To: House Financial Services Committee
From: Congressman Scott Fitzgerald
Re: QFRs for H&I Subcommittee Hearing on FHFA LLPA Changes
Date: August 23, 2023

Hearing: “*The Current Mortgage Market: Undermining Housing Affordability with Politics*”

Date: Wednesday, May 17, 2023

1. SEC Securitization Rule: Mr. DeMarco – the Securities and Exchange Commission recently re-proposed the conflicts of interest rule, which could impair the ability of private mortgage insurers from procuring reinsurance via the capital markets. As the former FHFA director, you know firsthand that private MI companies, in addition to being subject to robust state regulation, must comply with rigorous capital requirements as part of Fannie and Freddie’s Private Mortgage Insurer Eligibility Requirements (PMIERs) and that they use reinsurance through the capital markets to manage risk and capital. Are you concerned about the unintended consequences of this rulemaking, particularly its impact on the first-time homebuyers who often rely on private mortgage insurance to become homeowners? How should the rule be clarified in order to avoid this negative outcome?

DEMARCO RESPONSE:

On March 27th, on behalf of the Housing Policy Council I submitted a comment letter to the SEC on the Conflicts of Interest rule. In the letter, we explained our concerns with the potential unintended consequences of the re-proposed rule. Specifically, we recommended that the re-proposed rule be narrowed to address only those securitization transactions structured with an intent to deceive investors. We noted that narrowing the rule in this manner would eliminate the need to exempt Fannie Mae and Freddie Mac from the definition of sponsor, as well as preserve other legitimate transactions entered in good faith in the secondary market for residential mortgages. We also requested that application of this rule and SEC’s regulatory treatment of the Enterprises be consistent with that applied to other market participants. HPC further recommended that if the Commission decides not to narrow the rule, the rule should clarify that several common practices that are routinely used in the mortgage market are not within its scope and therefore, are not subject to the rule including: interest rate risk mitigation, credit risk transfers, and mortgage insurance linked notes.

Our response letter is attached for the record.

Ralph Norman (SC-05) QFR

Subcommittee on Housing and Insurance

May 17, 2023

“The Current Mortgage Market: Undermining Affordability with Politics”

One thing Republicans did do on housing affordability was to ensure that the FHFA modernizes the credit scoring models it uses. I proudly voted for the Economic Growth, Regulatory Relief, and Consumer Protection Act in 2018. Section 310 of the bill called for the Agency to introduce competition into the credit scoring model and consider the use of new credit scoring models, should they prove to be accurate and reliable. Earlier this year, Director Thompson announced that the Agency would start accepting new credit scoring models that use rental payments, utility payments, and cell phone bill payments. If you pay your rent on time, that now benefits you when you go for a mortgage. That's the right way for us to help folks reach the American Dream of homeownership, not through subsidies and handouts.

Question for Mr. Ed DeMarco, President, Housing Policy Council (HPC)

How are new credit scoring models superior to the decades-old previous models used by the GSEs? What's the ultimate impact of this move by the Agency on home affordability and mortgage credit access?

DEMARCO RESPONSE:

New credit scoring models are better able to account for information such as recurring subscription payments and rental payments. Ideally, new information and updated methodologies for assessing how a family manages recurring financial obligations, whether those obligations are debt in the traditional sense or not, should enable lenders to better assess an applicant's ability to repay a loan. The goal of using newer models is to improve how we assess this capacity, and, in particular, enabling credit-worthy families to qualify for a mortgage that may not have qualified using older techniques.

Ralph Norman (SC-05) QFR
 Subcommittee on Housing and Insurance
 May 17, 2023

“The Current Mortgage Market: Undermining Affordability with Politics”

One thing Republicans did do on housing affordability was to ensure that the FHFA modernizes the credit scoring models it uses. I proudly voted for the Economic Growth, Regulatory Relief, and Consumer Protection Act in 2018. Section 310 of the bill called for the Agency to introduce competition into the credit scoring model and consider the use of new credit scoring models, should they prove to be accurate and reliable. Earlier this year, Director Thompson announced that the Agency would start accepting new credit scoring models that use rental payments, utility payments, and cell phone bill payments. If you pay your rent on time, that now benefits you when you go for a mortgage. That's the right way for us to help folks reach the American Dream of homeownership, not through subsidies and handouts.

Question for Ms. Janneke Ratcliffe, Vice President, Housing Finance Policy Center, Urban Institute

What are the benefits for potential homebuyers should FHFA modernize the credit scoring models used in our system of housing finance reform?

In October 2022, FHFA announced the validation and approval of two new credit score models, FICO 10T and VantageScore 4.0, for use by the GSEs. Once implemented, lenders will be required to deliver both FICO 10T and VantageScore 4.0 credit scores, when available, with each loan sold to the Fannie Mae and Freddie Mac. In general, the mortgage market and consumers [benefit from competition between credit score modeling firms](#).

The consumers who stand to benefit most from the use of new data are those who are underrepresented in traditional credit bureau files and scores. These are often millennials, first-time homebuyers and minorities, all groups that will be the main engine of [household formation and homeownership](#) in the coming decades.

The biggest benefit to these homebuyers is the addition of new payment histories like rent, utilities, and telecom payments which [may improve scores to open the door to mortgage-ready, yet currently ineligible borrowers](#). Additionally, this data and that of trended data too is likely to improve scores of borrowers who are otherwise credit invisible.



Jim Nussle
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99 M Street SE
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Washington, DC 20003-3799

May 17, 2023

The Honorable Warren Davidson
Chairman
Committee on Financial Services
Subcommittee on Housing and Insurance
United States House of Representatives
Washington, DC 20515

The Honorable Emanuel Cleaver
Ranking Member
Committee on Financial Services
Subcommittee on Housing and Insurance
United States House of Representatives
Washington, DC 20515

Dear Chairman Davidson and Ranking Member Cleaver:

On behalf of the Credit Union National Association (CUNA), I am writing regarding the hearing titled, “The Current Mortgage Market: Undermining Housing Affordability with Politics.” CUNA represents America’s credit unions and their more than 135 million members.

Credit unions are integral to achieving the Federal Housing Finance Agency (FHFA’s) mission of fostering housing finance markets that promote equitable access to affordable and sustainable housing. As member-owned, not-for-profit financial cooperatives, America’s credit unions are at the heart of the government-sponsored enterprises’ (GSEs) statutory missions. In 2022, credit unions originated \$237 billion in first-lien mortgages, selling over 16% into the secondary mortgage market.¹ Accordingly, credit unions have a substantial interest in the effective functioning of the FHFA-regulated entities, so they meet their core missions to benefit low- and moderate-income borrowers and communities.

CUNA commends the FHFA’s recent decision to rescind its proposed loan level pricing adjustment (LLPA) upfront guarantee fees based on borrowers’ higher debt-to-income (DTI) ratios for loans acquired by the GSEs. The DTI-based LLPA posed many significant operational concerns for credit unions. The significant operational concerns posed by the proposal highlights the need for more transparency and engagement with industry in connection with the FHFA’s process for pricing credit risk in a manner that promotes liquidity and stability within the secondary mortgage market.

To that end, CUNA applauds the FHFA’s recently released Request for Input regarding its Single-Family Mortgage Pricing Framework. CUNA looks forward to working with FHFA, the GSEs and other industry stakeholders to continue to provide feedback on the process for setting guarantee fees. We hope this is the beginning of a regular process of engagement by the FHFA around guarantee fee pricing, particularly when significant operational considerations are implicated by changes.

Additionally, there is more the FHFA can do to support its mission to support sustainable and affordable homeownership. CUNA has long-supported equal secondary mortgage market access to lenders of all sizes on an equitable basis as a core requirement of the housing finance system.² Smaller

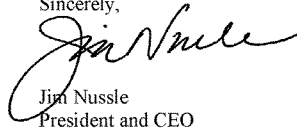
¹ National Credit Union Administration (NCUA) 2022 Credit Union Call Report Data; CUNA analysis.

² *Id.*

credit unions continue to report the existence of significant barriers in accessing the secondary market through the GSEs. These requirements apply regardless of an individual credit union's excellent record in making high quality loans and extremely limited exposure for the GSEs.

We appreciate you holding this hearing and look forward to working with you and FHFA Director Thompson on these and other critical issues. On behalf of America's credit unions and their more than 135 million members, thank you for considering our views.

Sincerely,

A handwritten signature in black ink, appearing to read "Jim Nussle", written over a horizontal line.

Jim Nussle
President and CEO

Statement for the Record
Hearing on The Current Mortgage Market
Wednesday, May 17, 2023 2:00 PM in 2220 RHOB
Housing and Insurance Subcommittee

By Edward Golding

Executive Director of the MIT Golub Center for Finance
and Policy and Senior Lecturer at the MIT Sloan School of
Management*

*Views are my own and do not represent those of my employer.

Chairman Davidson, Ranking Member Cleaver, and other members of the Subcommittee, my name is Edward Golding. I am Executive Director of the MIT Golub Center for Finance and Policy and Senior Lecturer at the MIT Sloan School of Management. The views in this statement are my own and do not represent those of my employer.

The single-family mortgage market in the United States is a \$13 trillion dollar market that, in general, works well. I have spent much of my career researching this market, having held senior positions at Freddie Mac, where I was responsible for modeling mortgages and managing capital. I also headed the Federal Housing Administration from early 2015 to January 2017. Recently, the Federal Housing Finance Agency (FHFA) made changes to the loan-level price adjustments (LLPAs) that are upfront charges imposed by Freddie Mac and Fannie Mae, the government-sponsored enterprises (GSEs) for guaranteeing the timely payment of principal and interest on their mortgage backed securities (MBS).

As I wrote in an op-ed published in the *American Banker* and appended to the end of this statement, these changes were modest and very consistent with safety and soundness and the charter purposes of Freddie Mac and Fannie Mae. I want to expand on those comments. In my professional view, the “pricing curve” is still too steep—that is, the difference between the LLPA for higher-risk borrowers and lower-risk borrowers is still too large. (I say higher- and lower-risk borrowers because it is important to remember that Freddie Mac and Fannie Mae currently take limited credit risk. See for example, Urban Institute’s Housing Credit Availability Index (HCAI) from the [April Chartbook](#), page 13, which shows risk of GSE purchases at half the level it was in 2000, prior to the housing bubble.)

In general, LLPAs have been set with an eye towards risk-based capital standards. Most of the changes recently implemented were to update the LLPAs for changes in the risk-based capital standard. However, setting LLPAs based on risk-based capital ignores four factors that would normally be incorporated into pricing by fully private, profit-maximizing firms:

1. Prepayment option
2. Leverage ratio
3. Stochastic nature of mortgage risk
4. Elasticity of demand

Each of these factors, if incorporated into pricing, would generally result in less of a differential in pricing between higher- and lower-risk mortgages. That is, if private firms were to set prices, the pricing curves would likely be flatter. Let me provide some intuition.

1. Prepayment option

As demonstrated in the paper *Mortgage Prepayment, Race, and Monetary Policy* by Kristopher Gerardi, Paul Willen, and David Hao Zhang (<https://www.bostonfed.org/publications/research-department-working-paper/2020/mortgage-prepayment-race-and-monetary-policy.aspx>),

borrowers with better credit scores and more equity, i.e., lower loan-to-value (LTV), prepay more quickly. This propensity to exercise the prepayment option on a mortgage is costly to the issuer of the MBS, Freddie Mac and Fannie Mae. It requires a fairly complicated model of interest rates and prepayments to tease out this cost, but it is significant. If factored into pricing, it would result in lower LLPAs for low-credit-score, high-LTV borrowers and in higher LLPAs for high-credit-score, low-LTV borrowers (compared to considering just credit risk).

2. Leverage ratio

Regulatory capital has several components including minimum leverage ratios. FHFA requires roughly a 3% minimum leverage ratio. There will be times when that requirement will be binding. During those times, risk-based capital is largely irrelevant and each mortgage, regardless of risk, in effect has the same requirement. This scenario happens with some probability over the life of the mortgage with the probability depending on the overall credit quality of the entire portfolio. While complicated to compute, this factor again will flatten the pricing curve.

3. Stochastic nature of mortgages

The calculation of risk-based capital at the time of mortgage origination and purchase by the GSEs is just the capital requirement at one point in time. As time goes on, mortgages that were lower-risk may become higher-risk as equity deteriorates from falling prices, or as credit scores slip due to missed payments. Similarly, mortgages that were higher-risk may become lower-risk as equity and credit scores improve. Again, while complicated to model, this process of "stochastic change" will tend to flatten the pricing curve.

4. Elasticity of demand

The first three factors all have to do with the cost side of pricing. But private firms also consider the demand side. If the demand is inelastic, firms will price up. It is unclear how this might affect a GSEs pricing decision, but it is possible that they would face more competition for the higher-risk loans from the Federal Housing Administration (FHA). Again, this could result in a flatter pricing curve.

These factors would suggest that the LLPAs that FHFA introduced are quite reasonable. Given the complication of computing LLPAs based on all factors, there is even a case to simplify pricing by eliminating LLPAs entirely. After all, they were introduced only in 2008 as a way of extracting more revenue during the collapse of the housing market and are not integral to a well-functioning secondary mortgage market.

Incorporating all cost factors (including 1 through 3 above) accurately is also necessary before one can measure what is often termed "cross-subsidies." That is, are some mortgages charged a higher multiple of their cost? I would argue that based on the above, the FHFA's new LLPAs actually reduced cross-subsidies. But again, it is not an easy measurement and very dependent on models.

To see this, just look at the relative defaults across four states: Florida, Ohio, Michigan, and California. Based on FHFA published [data](#), compared to the U.S. as a whole, Florida experienced default rates 4.63 times the average, while Ohio was 0.64, California at 0.37, and Michigan at 0.27. Based on a simple model that uses these ratios, a no-cross-subsidy guarantee fee would result in Florida paying 17 times as much as Michigan, 12 times as much as California, and 7 times as much as Ohio. Of course, a better, more complicated model would likely result in smaller multiples, but one has to ask whether a GSE chartered to create a national secondary mortgage market should be pricing based on state-level factors.

In summary, based on a lifetime of doing mortgage math, the LLPAs published by FHFA are reasonable, consistent with safety and soundness, and likely closer to mirroring all factors that would go into pricing for a private firm. Of course, one way of finding out what private firms would do would be to end conservatorship and open up the GSE charter to competition.

Edward Golding op-ed on FHFA and mortgage risk pricing

This piece was published in the *American Banker* — [click here to read on the publication website](#).

MAY 4 – 2023 “BankThink: No, FHFA is not encouraging a race to the bottom.”

By Edward L. Golding

Recently, the Federal Housing Finance Agency, acting in its capacity as conservator of Freddie Mac and Fannie Mae, [made some modest changes](#) in the pricing of mortgage risk. These modest changes in pricing [have created a firestorm of reactions](#). Even The Wall Street Journal’s editorial board [weighed in](#) decrying the cross-subsidies and income redistribution effects of these changes. Most often cited is the flattening of the credit score curve. (Low credit score borrowers now pay upfront roughly 1.25 percentage points more than high credit score borrowers compared to 2.0 percentage points before.)

Having spent a lifetime and then some analyzing and pricing mortgage risk, I was amused and chalked up the intensity of the reaction to Washington politics and vested interests protecting profits. But it is useful to peel back the rhetoric and discuss a few fundamental policy issues. When viewed through this lens, FHFA’s recently announced changes to loan-level price adjustments (LLPAs) are consistent with safety and soundness and the charter purposes of the government-sponsored enterprises.

I will focus on three key questions.

First, do the GSEs need to earn the same return on equity on each loan they purchase to remain profitable and present a low risk to the taxpayers?

Of course not. The GSEs offered one flat guarantee fee which applied to all borrowers for many years. LLPAs only began in 2008 when the GSEs wanted additional revenue to bolster earnings. The issue of profitability and risk relate to the entire company, and the questions we should be asking are what are the profits, and what is the overall leverage in the firm relative to risk? In 2008, The GSEs were charging too little (0.15 percentage points on their outstanding loan portfolios) and held only 0.45 percentage points of capital against credit risk.

In fact, risk-based pricing often encourages the loosening of credit standards and was used to justify expansion into lower credit quality loans because the GSEs thought they were earning higher risk-adjusted returns on Alt-A and subprime products. So flatter pricing accompanied by tight credit policies may be the profitable, lower-risk strategy. The FHFA’s modest change of flattening the credit curve does not create a risk to taxpayers and may very well be beneficial.

Second, should financial firms set pricing to earn the same return on regulatory capital for each asset?

Of course not. Regulatory capital is just one measure of economic risk to shield firms from unexpected losses. There are many other considerations on how firms price, including leverage ratios, demand elasticities, competition, etc. Would JPMorgan Chase use the Basel accords as the sole basis for all its pricing decisions? There is no evidence that the new FHFA pricing deviates from its recently enacted risk-based capital framework, but even if it did, that would not be a cause for concern.

Finally, what additional considerations beyond credit risk need to enter into GSE pricing decisions?

First, prepayment risk. It always baffles me that LLPAs factor in credit risk but not prepayment risk. Prepayment risk is the risk that borrowers pay off their mortgage earlier or later than expected. An early prepayment leads to an overall lower principal and interest income stream over the life of the loan, reducing that loan's overall profitability. Because lower-credit-score individuals don't prepay as quickly as higher-credit-score individuals, the net impact of lower-credit individuals on a company's returns and performance is complicated. Second, the GSE charters direct them to consider setting lower return targets for low- and moderate-income families. Third, as often has been noted, pricing affects what loans go to the Federal Housing Administration vs. the GSEs. Policymakers may want to consider this. When I headed FHA, I vehemently argued against risk-based pricing at FHA because it would unnecessarily expand FHA's footprint.

Former acting FHFA Director Ed DeMarco wanted pricing to consider state foreclosure laws and to charge more for states with longer foreclosure timelines. Others have wanted GSEs to price the earthquake risk from "the big one" that will occur one day. Now, some are looking to price in climate risk. All these have or will face political pushback as inappropriate factors for the GSEs to consider — as they were chartered by Congress to create a liquid national secondary market, not to set policy on these matters. So blind adherence to pricing purely on risk may not be a desirable policy objective or consistent with the charters of the GSEs.

It seems that FHFA pricing changes were well considered. Whether by intent or not, the flattening of the credit score curve is very consistent with incorporating prepayment risk into the pricing framework.

That said, I would encourage one change to the new pricing scheme. The additional LPA for debt-to-income ratios greater than 40% is an unwelcome complication in the pricing of mortgages. Debt-to-income ratios are difficult to measure, so the difference between a DTI of 39% and 41% is insignificant; creating a DTI cliff at 40% will cause lots of work finding more income to get below the 40% threshold. Debt-to-income also has a weak correlation with risk partly because it is not well measured. And the mismeasurement of true (permanent) income is not the same across protected classes, as was documented in Milton Friedman's 1957 paper, "The Permanent Income Hypothesis." So, I would encourage the elimination of this fee.

In conclusion, FHFA's recently announced changes to LLPAs are consistent with safety and soundness and the charter purposes of the GSEs. Eventually, explicit regulatory guidance on what factors to consider when setting prices would be useful for, if and when the GSEs emerge from conservatorship and are free to set their own prices.

Edward L. Golding is Executive Director of the MIT Golub Center for Finance and Policy. He ran the Federal Housing Administration from 2015 to 2017.



MORTGAGE BANKERS ASSOCIATION

**Statement for the Record
For the Housing and Insurance Subcommittee
House Financial Services Committee
“Current Mortgage Market: Undermining Housing Affordability with Politics”
Wednesday, May 17, 2023**

The Mortgage Bankers Association (MBA)¹ appreciates the opportunity to comment on the issues raised by the Housing and Insurance Subcommittee’s May 17, 2023, legislative hearing entitled, *“Current Mortgage Market: Undermining Housing Affordability with Politics.”*

Background

The Federal Housing Finance Agency (FHFA) has implemented a capital framework to promote safety and soundness at the housing Government Sponsored Enterprises (the GSEs), Fannie Mae and Freddie Mac, which has included ongoing efforts to ensure GSE pricing is structured to permit the agencies to increase liquidity for loans to historically underserved borrowers (as required by their charters) and foster a level playing field in the mortgage market.

MBA agrees that there is a need for recalibration of fees to improve access to credit for historically underserved borrowers. Such a recalibration is particularly warranted following recent fee increases for certain high balance loans and second home loans. Balancing these fees to better support “core mission borrowers,” as is noted in the FHFA’s Strategic Plan, can be done in several ways, including, but not limited to, targeting certain housing types such as manufactured housing or condominiums, or compressing the pricing grids across loan-to-value ratio and credit score dimensions in a targeted fashion. While conducting this pricing review, MBA has encouraged FHFA to continue to facilitate access to the secondary market on equal terms for lenders of all sizes and business models.

MBA has also proposed that the GSEs be regulated similarly to investor-owned utilities. Typically, price regulation in these markets requires nondiscriminatory pricing across the customer base, i.e., there is a level playing field. Pricing also tends to be transparent, with rates and the rate calculation posted for public input. FHFA in its role as conservator has moved regulation of pricing in this direction already, with more level and more transparent pricing than was the case pre-crisis. Pricing and underwriting across various programs and markets should be as transparent as possible to ensure that eligibility, qualification, and pricing information is

¹ The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 390,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation’s residential and commercial real estate markets, to expand homeownership, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of more than 2,200 companies includes all elements of real estate finance: independent mortgage banks, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies, credit unions, and others in the mortgage lending field. For additional information, visit MBA’s website: www.mba.org.

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clearly communicated to the market and balanced by sound risk-management practices. The impact of loan-level price adjustments and other credit enhancements must be evaluated as part of any affordable housing strategy. Lenders in the primary market are better able to serve borrowers to the full extent of the credit box when the parameters of eligibility requirements are well understood and consistent.

Through recent directives, FHFA has taken positive steps to ensure that single-family guarantee fee discounting or other favorable pricing or underwriting variances are not provided to market participants based on their volume, size, or business model.

MBA supports this comprehensive review of the existing GSE pricing framework, including FHFA's attempts to determine appropriate pricing levels that enhance support for mission-focused lending. As always, safety and soundness remain paramount, and any changes to pricing should not introduce excessive risk to the Enterprises – or unduly raise costs for borrowers in the heart of their traditional market.

Changes to the GSEs' Loan-Level Price Adjustments (LLPAs)

On Thursday, January 19, the FHFA announced changes to the GSEs' loan-level price adjustments (LLPAs) and a recalibration and reformatting of their entire pricing matrix. The industry has already adjusted to the first two iterations of changes to the pricing framework – increases to LLPAs for certain second homes and high balance loans and LLPA waivers for certain first-time homebuyers, Home Ready and Home Possible loans, HFA Advantage and HFA Preferred loans, and single-family loans supporting the Duty to Serve program. Together, those changes significantly rebalanced the LLPA framework toward mission-focused lending.

The changes announced earlier this year marked the third iteration of FHFA's ongoing pricing review since early 2022. Pricing grids are now broken out by loan purpose – purchase, rate/term refinance, and cash-out refinance – and are recalibrated to new credit score and loan-to-value ratio categories along with associated loan attributes for each. FHFA noted that these changes will be a way to lock in the previous pricing changes in a more effective framework. The changes took effect for loan deliveries on May 1, 2023, and lenders priced them into loans in the weeks beforehand.

As expressed in MBA's February 3 [letter](#) to FHFA Director Sandra Thompson, we were concerned about the unfortunate timing of the new fees at the peak of the spring homebuying season and given current affordability challenges. MBA was particularly troubled and consistently voiced our concerns to FHFA about the addition of an LLPA for loans with a debt-to-income ratio (or "DTI") greater than 40 percent. The implementation of a DTI-based LLPA would have led to several problems, including multiple changes to a borrower's pricing throughout the loan application process, operational and system issues, compliance implications related to TILA-RESPA Integrated Disclosures (TRID), compromised borrower trust, and post-closing quality control (QC) issues.

In response to our concerns and to more recent inquiries about the LLPA changes, FHFA announced last week that it is rescinding the DTI-based LLPA. We are pleased that FHFA

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engaged with industry stakeholders and the Congress, recognized the negative impacts of the fee, and rescinded its implementation.

Concurrently with the rescission of the fee, FHFA has issued a Request for Input (RFI) to provide additional transparency and receive public comment on the process for setting single-family guarantee fees. MBA will continue its engagement with lawmakers (including this Subcommittee), FHFA, and other industry stakeholders to ensure clarity and transparency regarding the GSEs' pricing framework and looks forward to responding to the RFI.

Recent Debate Regarding the LLPA Changes

Over the past few weeks, coverage of the FHFA's new LLPA grid, and in particular the extent to which the new pricing framework departs from a purely risk-based framework, has gone "viral" and resulted in significant discussion, in both the media and the Congress, igniting a spirited policy debate.

In late April, a spate of articles and TV news segments reported that riskier borrowers with weak credit and small downpayments were getting lower rates than high FICO borrowers with large downpayments. This is not true. While the changes to the base FICO/LTV grids narrowed the differences between high FICO/high downpayment borrowers and those with low FICOs/low downpayments, in no cases do higher risk borrowers pay lower fees than low risk borrowers. See the chart below from BTIG Research (which, importantly, factors in MI costs):

New GSE LLPAs Combined With Mortgage Insurance Costs



Sources: Urban Institute, BTIG Research. Notes: All mortgage insurance. The mortgage insurance data are for borrower-paid mortgage insurance on full-documentation purchase loans for primary residences with fixed or adjustable interest rates (five years or more) and amortizations of greater than 30 years. This pricing is illustrative only; an actual mortgage insurance cost may differ by geography, other risk factors, and pricing structures used. Loan-level price adjustments are annualized by dividing by five.

To be clear, there has always been cross-subsidization in federal mortgage insurance and guarantor programs. They are insurance programs at their core, and almost all insurance programs have a measure of cross subsidy. No one wants higher fees in this difficult market at this critical time. MBA and its members both understand and appreciate the concerns that the recent pricing changes represent a "turning" of the cross-subsidy dial, but this is neither new nor precedential.

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Variations in GSE Pricing for Third-Party Originated (TPO) Loans

On a separate pricing topic, MBA remains concerned about reports of variations in GSE pricing for loans with substantially similar credit characteristics but a different origination channel – specifically pricing penalties with respect to third party-originated (TPO) loans. At least one of the GSEs is providing less favorable execution and pricing on TPO loans relative to retail loans, solely due to this difference in origination channel. MBA has urged FHFA to take steps to address this issue, as we believe this inappropriate use of pricing creates an unlevel playing field among lenders and harms underserved borrowers.

In order for the GSEs to adhere to their charter requirements that they “promote access to mortgage credit throughout the nation, improve the distribution of investment capital for residential mortgage financing, and provide stability in the secondary market for residential mortgages,” they must do everything possible to ensure that lenders of varying sizes, charters, or business models – including those that specialize in different origination channels – have the ability to compete on a level playing field. FHFA appropriately has taken steps to eliminate any preferential pricing or underwriting for certain lenders – first through conservatorship directives and then through amendments to the Senior Preferred Stock Purchase Agreements (PSPAs). Such pricing and underwriting variances were a central feature of the GSEs’ flawed pre-conservatorship business models.

The disparities in pricing for TPO loans, however, are a dramatic departure from the core level “playing field” principle FHFA has established. All pricing differences should be based on loan-level factors that influence risk or the GSEs’ ability to meet their affordable housing missions. One loan is not riskier than an equivalent loan with identical characteristics simply because it was originated through a third party, nor does that loan do more or less than the equivalent loan to advance the GSEs’ missions. The inappropriate use of pricing penalties clearly violates this principle and puts correspondent and wholesale lenders at a disadvantage in the market.

These pricing variations also negatively impact borrowers, particularly those that are critical to the core missions of FHFA and the GSEs. Minority and low- to moderate-income borrowers make up a higher percentage of TPO loans than of retail loans, and the weaker pricing currently offered by at least one GSE flows through to these borrowers, resulting in higher costs for those who obtain TPO loans. FHFA consistently has reiterated its focus on efforts to address our nation’s long-standing challenges related to housing equity – particularly with respect to the racial homeownership gap. The current TPO pricing disparities run contrary to this objective and do not further efforts to increase liquidity to support historically underserved borrowers.

For the reasons outlined above, MBA continues to urge FHFA to prohibit the GSEs from varying their pricing solely based on the origination channel of a loan. While the GSEs should be permitted flexibility to adjust their pricing frameworks to meet their mission and safety-and-soundness objectives, they should not be permitted to implement pricing that violates the principle of equal access to the secondary market. Elimination of these problematic pricing variances would benefit both lenders and borrowers, as well as promote FHFA’s pursuit of a level playing field in the mortgage market.

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Congressional Action: The Need for Broad Reform

In 2008, the financial crisis threatened the viability of the housing finance system, particularly with respect to the central role that the GSEs play in the system. The crisis exposed the fundamental problems in the GSEs' business models, as well as the weaknesses in the regulatory framework that was in place at the time. The result was a breakdown of the secondary mortgage market, \$187 billion in taxpayer assistance, and continuing federal support of more than \$250 billion.

Nearly fifteen years have passed since the GSEs were placed into government conservatorship, in what was described by then-Treasury Secretary Paulson as a "time out."² Despite the intent that conservatorship would serve as a temporary bridge to stabilize the GSEs, the conservatorship persists, and their long-term status remains unresolved.

During that time, the FHFA has begun implementing some of the necessary reforms in its role as conservator of the GSEs. These reforms include secondary market pricing parity across lenders, new mechanisms for credit risk transfer (CRT) to the private sector, an improved infrastructure for the single-family secondary market, a substantial reduction in the retained mortgage portfolios, and support for continued liquidity in the multifamily market.

These reforms, while critical, are not sufficient to fully address the problems that led to conservatorship. Indeed, as the current pricing debate has indicated, broad legislative reforms are still needed — both to bring about the remaining structural changes to the GSEs and to "lock in" the reforms instituted by FHFA through its authorities as conservator.

For example, legislation is necessary to alter the existing GSE charters, clarify the nature of any federal government guarantees, and create permanence for the reforms already undertaken by FHFA. Perhaps most importantly, legislative reform is the only outcome that provides the legitimacy and public confidence necessary for long-term stability in both the primary and secondary mortgage markets.

Conservatorship of the GSEs has already persisted far longer than intended. Congress should not allow conservatorship to continue indefinitely, as market participants will suffer in several ways. Borrowers and renters will be denied the benefits of a more vibrant secondary market, lenders will face increased uncertainty about the future, and private-label security (PLS) issuers and investors will hesitate to fully engage in the market. In short, the status quo is an unacceptable long-term outcome.

Calls to recapitalize the GSEs without further structural reforms are similarly misguided. Under such plans, the post-crisis reforms already achieved could be reversed in the absence of a regulator exerting conservatorship authorities. Recapitalization without corresponding reforms would in many ways remove the existing safeguards that are preventing the GSEs from returning to their flawed pre-crisis business models. Further, an immediate recapitalization is

² "Statement by Secretary Henry M. Paulson, Jr. on Treasury and Federal Housing Finance Agency Action to Protect Financial Markets and Taxpayers," September 7, 2008. Available at: <https://www.treasury.gov/press-center/press-releases/Pages/hp1129.aspx>.

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unnecessary from a safety and soundness perspective, as the ongoing capital support from the U.S. Treasury eliminates any practical near-term threat to the GSEs' solvency.³ Should either GSE need to draw on this capital support, there would be no change in its existing book of business, day-to-day operations, or prospective ability to provide liquidity to mortgage markets.

Our nation simply should not have a housing finance system that produces suboptimal results due to the limits imposed by conservatorship, nor can we go back to a system that provides private gains when markets are strong yet relies on support from taxpayers when losses occur. Only by enacting comprehensive legislative reform can borrowers, renters, lenders, investors, and taxpayers realize the full benefits of a diverse, competitive primary market and a vibrant, liquid secondary market.

MBA Principles for a Sustainable, More Vibrant Secondary Market

To address the need for reforms, MBA convened its Task Force for a Future Secondary Mortgage Market (Task Force). The "blue ribbon" Task Force, composed of members covering a broad cross-section of the real estate finance industry, developed a comprehensive set of recommendations for an improved secondary market.

The [MBA proposal](#) recognizes the need for any comprehensive reform plan to balance three major priorities: 1) taxpayer protection; 2) investor returns; and 3) consumer cost and access to credit. Pushing too far in any one direction may lead to a mortgage market that does not adequately meet the needs of all participants. To achieve the appropriate equilibrium among these priorities, the Task Force developed the following core principles to guide its work. It is against these core principles that MBA evaluates any potential reforms to the housing finance system.

Core Principles:

- Preserve the 30-year, fixed-rate, prepayable single-family mortgage, as well as long-term financing for multifamily mortgages;
- Maintain a deep, liquid to-be-announced (TBA) market for securities backed by conventional single-family loans;
- Attract global capital and preserve liquidity during times of economic stress through an explicit government guarantee for eligible mortgage-backed securities (MBS) collateralized by single-family and multifamily mortgages;
- Limit the explicit government guarantee to the eligible MBS, while prohibiting the extension of the guarantee to institutional debt;
- Require an effective national affordable-housing strategy that helps meet the needs of low-income and underserved households and communities;

³ In the 2018 Dodd-Frank Act Stress Test Results, FHFA estimates that, under a severely adverse scenario, the Enterprises would require a combined draw from the U.S. Treasury ranging from \$42.1 billion to \$77.6 billion. These figures fall far short of the combined \$254.1 billion in existing funding commitment from the U.S. Treasury. For more information, see: https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/2018_DFAST_Severely-Adverse-Scenario.pdf.

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- Support a competitive and diverse primary market for lenders of all sizes and business models;
- Enable a robust, innovative, and purely private mortgage market to coexist alongside the government-backed market;
- Preserve existing multifamily financing executions and permit new options;
- Establish a strong, transparent regulatory framework that promotes liquidity while protecting the taxpayers;
- Ensure that private capital assumes significant amounts of the credit risk;
- Ensure liquidity in the event of a full-blown systemic crisis; and
- Minimize risks to the liquidity and stability of the mortgage markets during the transition to the end state.

As the GSEs continue through their second decade of government conservatorship, it is critical that policymakers tackle the remaining work of housing finance reform. Access to affordable, sustainable housing is a necessity for all Americans, and as such, it requires a system of financing that is robust in all parts of the country, through all parts of the credit cycle. Legislative reforms of the GSEs, no matter how thorny the journey, offer the best path to reach this desired end state.

Conclusion

MBA continues to urge FHFA to engage with the mortgage industry to improve clarity and transparency regarding the GSEs' pricing framework. We will continue our work with lawmakers, FHFA, the GSEs, and the Biden administration on policies and actions that lower costs and advance sustainable access to homeownership while protecting taxpayers.

More broadly, the housing finance system requires structural reforms that will better ensure a stable, liquid secondary market. Comprehensive legislation remains the best vehicle for such reforms.

Thank you in advance for your consideration of the views expressed within this statement for the record. As always, MBA stands ready to work with members of this Subcommittee (and the full Committee) to ensure a robust housing market that is accessible, affordable, and sustainable – and works to benefit all borrowers, renters, and other critical stakeholders.

Questions for the Record from Ranking Member Maxine Waters
Subcommittee Hearing, entitled “ The Current Mortgage Market: Undermining Housing
Affordability with Politics”
Wednesday, May 17, 2023, 2:00 p.m.

Ms. Janneke Ratcliffe

1. Which of the following options best describes your self-identified race? (you may choose more than one)
 - a) White or Caucasian
 - b) Black or African American
 - c) Hispanic/Latinx
 - d) Asian
 - e) Middle Eastern/North African
 - f) Choose not to answer
 - g) Prefer to self-describe (please specify)

2. Which of the following options best describes your gender identity?
 - a) Woman
 - b) Man
 - c) Non-binary
 - d) Transgender man
 - e) Transgender Woman
 - f) Choose not to answer
 - g) Prefer to self-describe (please specify)

