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Committee on Financial Services'

Subcommittee on Housing and Insurance

Sustainable Housing Finance: Private Sector Perspectives on Housing Finance Reform

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I. Introduction

Good morning Chairman Duffy, Ranking Member Cleaver, and Members of the House Committee on Financial Services' Subcommittee on Housing and Insurance. Thank you for the opportunity to testify regarding our nation's housing finance system, an issue that profoundly affects American families and is also critical to the overall housing industry, which is nearly 20 percent of the United States economy. I am Executive Vice President of the Center for Responsible Lending (CRL), a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, a community development lender headquartered in Durham, NC. Since 1980, Self-Help has provided over \$7 billion in financing to 131,000 families, individuals and businesses under-served by traditional financial institutions. It helps drive economic development and strengthen communities by financing hundreds of homebuyers each year, as well as nonprofits, child care centers, community health facilities, public charter schools and residential and commercial real estate projects. Through its credit union network, Self-Help's two credit unions serve over 130,000 people in North Carolina, California, Chicago, Florida and Wisconsin and offers a full range of financial products and services. Learn more at www.self-help.org and www.self-helpfcu.org.

This important hearing provides an opportunity to offer ways that we can build on existing reforms to the nation's secondary market, and repair the parts that are broken without major disruption to the system. We should move forward in a responsible way to incorporate more equitably important market segments – people of color, low-to-moderate income families, and rural residents – that a well-functioning future system depends on. Changes to the system must build upon the significant reforms offered by the Housing and Economic Recovery Act of 2008 (HERA), and the new protections created by the Dodd-Frank Act and the Consumer Financial Protection Bureau. It is imperative that the system serves the full universe of credit worthy borrowers, and provides equal treatment for small lenders, including community banks and credit unions, which often are the only sources of mortgage credit in underserved communities across the nation. Congress must also be careful not to provoke unanticipated harms, which could result in elevated systemic risk. Such risk would result in increases to the cost of mortgage loans and a stifling of the housing market, which has demonstrated modest growth since 2014. Our testimony today draws heavily from our June 29, 2017 remarks delivered before the United States Senate Committee on Banking, Housing, and Urban Affairs.

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

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

You do not wipe away the scars of centuries by saying: Now you are free to go where you want, and do as you desire, and choose the leaders as you please.

You do not take a person who, for years, has been hobbled by chains and liberate him, bring him up to the starting line of a race and then say, "you are free to compete with others," and still justly believe that you have been completely fair.

Thus is it not enough just to open the gates of opportunity. All our citizens must have the ability to walk through those gates.¹

Regrettably, President Johnson's recommendation did not occur within the nation's housing finance system. Federal housing policies initiated in the twentieth century drafted as seemingly race-neutral solutions to the

¹ Lyndon B. Johnson: Commencement Address at Howard University: 'To Fulfill These Rights.' Accessed October 23, 2017, *available at* <http://www.presidency.ucsb.edu/ws/?pid=27021>.

Great Depression provided direct affirmative action to white families who descended from European ethnic groups--Germans, Scottish, Irish, Polish, French, Italians, etc. In fact, for decades, federal policies granted white families a monopoly on the ability to build wealth through homeownership, offering whites an unfair economic advantage that has been passed on to future generations through intergenerational wealth transfers. These same federal housing policies overtly excluded families of color, denying them a chance to secure an equal footing in homeownership with whites and the resulting ability to build home equity over time. According to a report by Demos, if homeownership rates were the same for whites and people of color we would see a decrease in the racial wealth gap by 31 percent for African-Americans and 28 percent for Latinos.² The current mortgage market was built on discriminatory federal housing policies and has yet to offer an equitable solution forward.

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

Homeownership is the foundation of the American Dream, and is still the primary way that most middle-class families build wealth and achieve economic stability. Wide access to credit is critical for building family wealth, closing the racial wealth gap, and for sustaining the housing market overall—which in turn, contributes significantly to our overall economy. Today, the opportunity to purchase, maintain, and refinance a home has not reached significant portions of low-wealth families and people of color. As a result, these communities lag far behind wealthier and white communities that had a head start due to historic lending inequity supported by our federal government’s mortgage policies. These well-documented policies began in 1933 with the underwriting guidelines of the Home Owners Loan Corporation (HOLC) and allowed redlining of African-American and other communities of color, denying them access to mainstream banking services.³ Examples of the impact of this inequity include the reality that only 2% of Federal Housing Administration (FHA) insured mortgage loans went to homebuyers of color during the first 35 years of the program due to redlining.⁴ Further, the administration of the GI Bill loan programs enacted by Congress in 1944 continued this discrimination.⁵ In the state of Mississippi alone, just 2 out of 3,229 VA insured mortgages went to African-Americans servicemembers seeking to finance a home or business in the first three years of the program.⁶

Likewise, the lasting impacts of the Great Recession have eroded the modest increase in homeownership rates that African-American and Latino families enjoyed since the passage of the Fair Housing Act in 1968. Evidence from data provided by the Home Mortgage Disclosure Act suggest that communities of color

² Tanvi Misra, Why America’s Racial Wealth Gap is Really a Homeownership Gap, Demos, March 12, 2015, *available at* <http://www.demos.org/news/why-americas-racial-wealth-gap-really-homeownership-gap>.

³ For a more robust discussion of how federal housing policies benefitted whites while disadvantaging African-Americans and other people of color, see Ta-Nehisi Coates, The Case for Reparations, *The Atlantic*, *available at* <http://www.theatlantic.com/features/archive/2014/05/the-case-for-reparations/361631/> (2014); Bob Herbert, Against All Odds: The Fight for the Black Middle Class, Bob Herbert and Public Square Media, Inc (2016), *available at* <http://www.pbs.org/wnet/chasing-the-dream/films/against-all-odds/>; James Carr and Nandinee Kutty, Segregation: The Rise Costs for America, Routledge (2008); Ira Katznelson, When Affirmative Action Was White: An Untold History of Racial Inequality in Twentieth-Century America, W. W. Norton & Company (2005); Thomas M. Shapiro, The Hidden Cost of Being African American: How Wealth Perpetuates Inequality, Oxford University Press (2004); Melvin L. Oliver and Thomas M. Shapiro, Black Wealth/White Wealth: A New Perspective on Racial Inequality, Routledge (1997).

⁴ DEDRICK ASANTE-MUHAMMAD, ET AL., THE ROAD TO ZERO WEALTH: HOW THE RACIAL WEALTH DIVIDE IS HALLOWING OUT AMERICA'S MIDDLE CLASS 15 (2017), *AVAILABLE AT* https://prosperitynow.org/files/PDFs/road_to_zero_wealth.pdf.

⁵*Id.* at 16.

⁶ *Id.*

continue to be underserved by the conventional mortgage market and are more likely than white borrowers to receive FHA loans.⁷ At the same time, while FHA remains an important part of the mortgage market, lending backed by Fannie Mae and Freddie Mac is also a critical part of the housing finance system in low-wealth communities, rural communities and communities of color.

The Great Recession exacerbated inequality in wealth distributions. According to the Pew Research Center, in 2012 whites had 13 times the wealth of African-Americans and 10 times the wealth of non-white Hispanics.⁸ Specifically, whites had a median wealth of \$141,900 compared to \$13,700 and \$11,000 for non-Hispanic whites and African-Americans respectively.⁹ Also, the St. Louis Federal Reserve reports that one in nine whites have less than \$1,000 in wealth compared to one in four for Latinos and one in three for African-Americans.¹⁰ Home equity plays a great role in determining a families' wealth and is the furthestmost contributor to the racial wealth gap between whites and people of color.¹¹

Unfortunately, the decline in homeownership that followed the Great Recession wiped out thirty years of homeownership gains among African-Americans and substantially reduced the homeownership rate among Hispanics (Figure 1). Between 1970 and 2000, African-American homeownership rate increased 5.5% and the Hispanic homeownership rate increased 2.9%. Since 2000, the homeownership rate decreased 6.1% among African-Americans and 1.8% among Hispanics.¹²

⁷ Center for Responsible Lending, *New HMDA Data Show Despite Growing Market, African-Americans and Latinos Remain Underserved* (2017) *available at* <http://www.responsiblelending.org/research-publication/new-hmda-data-show-despite-growing-market-african-americans-and-latinos-remain>.

⁸ Rakesh Kochhar and Richard Fry, *Wealth inequality has widened along racial, ethnic lines since end of Great Recession*, Pew Research Center (2014), *available at* <http://www.pewresearch.org/fact-tank/2014/12/12/racial-wealth-gaps-great-recession/>.

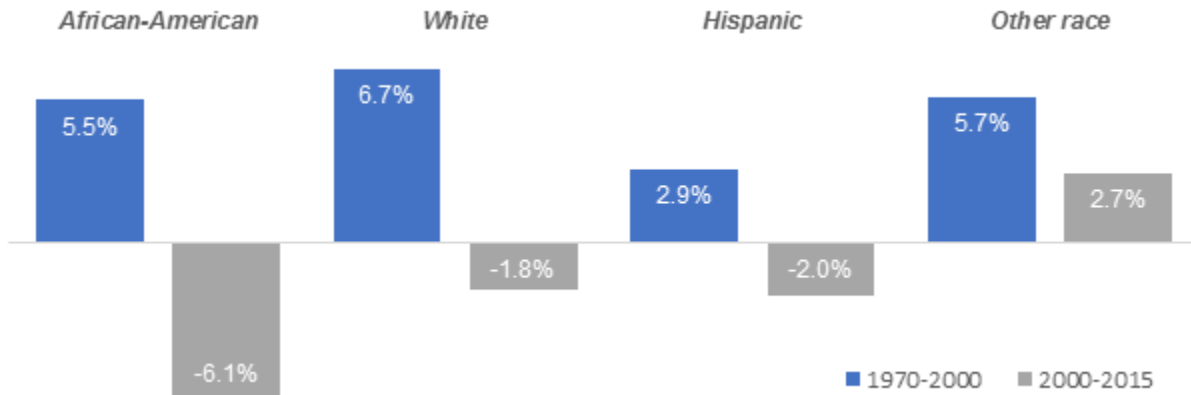
⁹ *Id.*

¹⁰ Ray Boshara and William Emmons, *Stark Disparities in Wealth Are Key in Discussions on Race in the United States*, Washington Post (2014), *available at* https://www.washingtonpost.com/opinions/policies-that-can-bootstrap-the-poor-out-of-the-wealth-gap/2014/12/30/3bf972a6-8f87-11e4-a412-4b735edc7175_story.html?utm_term=.bfc010a14313.

¹¹ SEE SHAPIRO ET AL., *THE ROOTS OF THE WIDENING RACIAL WEALTH GAP: EXPLAINING THE BLACK-WHITE ECONOMIC DIVIDE*, INSTITUTE ON ASSETS AND SOCIAL POLICY, (2013).

¹² LAURIE GOODMAN ET AL., *ARE GAINS IN BLACK HOMEOWNERSHIP HISTORY?* URBAN INSTITUTE (2017), *AVAILABLE AT* <https://www.urban.org/urban-wire/are-gains-black-homeownership-history>.

Figure 1. All gains in African-American homeownership since the Fair Housing Act have been erased since 2000



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

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

The 2016 mortgage data submitted by lenders under the Home Mortgage Disclosure Act (HMDA) shows the mortgage market overall has rebounded slightly from the depths of the Great Recession, but not for all American homebuyers. People of color and low- to moderate-income families continue to face challenges in accessing credit, particularly for loans not provided through government-backed programs.¹³ Discrepancies for African-Americans and Latinos persist even as the mortgage market overall has nearly returned to pre-crisis lending volumes. These data reflect how secondary market actors and private lenders are failing to serve the full universe of credit worthy borrowers and the next generation of potential homebuyers (Figures 2 and 3).

¹³ Despite Growing Market, African-Americans and Latinos Remain Underserved, Durham, NC, September 2017. See <http://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-2016hmda-policy-brief-sep2017.pdf>.

Figure 2. Mortgage originations and demographic details for purchase mortgages¹³

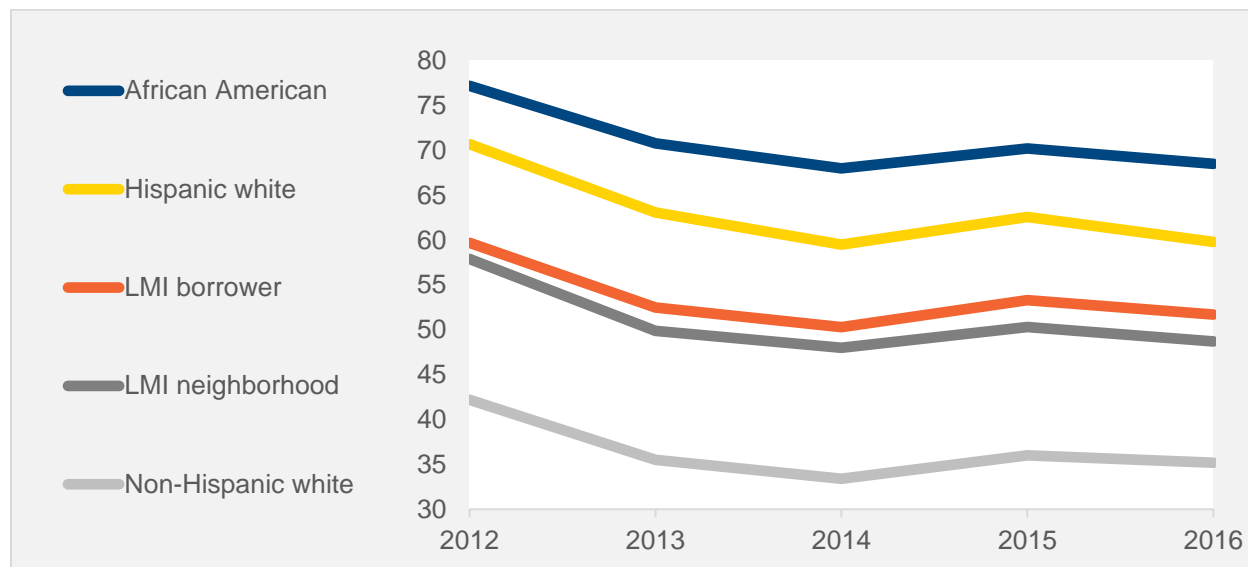
	2016		2015	
	#	%	#	%
Total originations	6,916,000		6,041,000	
Purchase mortgages	3,545,000	51.3%	3,200,000	53.0%
to African-Americans	207,780	6.0%	171,820	5.5%
to Hispanic-whites	304,744	8.8%	259,292	8.3%
to Non-Hispanic whites	2,299,432	66.4%	2,127,444	68.1%
Low- and moderate-income	907,306	26.2%	874,720	28.0%
Refinance mortgages	3,371,000	48.7%	2,841,000	47.0%
to African-Americans	166,850	5.0%	140,500	5.0%
to Hispanic-whites	206,894	6.2%	177,030	6.3%
to Non-Hispanic whites	2,175,724	65.2%	1,888,320	67.2%
Low- and moderate-income	563,953	16.9%	533,900	19.0%

Figure 3. Conventional and Non-conventional purchase mortgage originations, demographic details¹⁴

	2016		2015	
	#	%	#	%
Conventional (site built)	2,123,000		1,894,000	
to African-Americans	65,451	3.1%	51,202	2.7%
to Hispanic-whites	122,507	5.8%	96,975	5.1%
to Non-Hispanic whites	1,490,032	70.2%	1,361,564	71.9%
Low- and moderate-income	438,229	20.6%	408,494	21.6%
Non-conventional (site built)	1,340,000		1,230,000	
FHA	866,000	64.6%	794,580	64.6%
to African-Americans	142,329	10.6%	120,618	9.8%
to Hispanic whites	182,237	13.6%	162,317	13.2%
to Non-Hispanic whites	809,400	60.4%	765,880	62.3%
Low- and moderate-income	469,077	35.0%	466,226	37.9%

Government-backed mortgages have been a particularly important source of mortgage credit since the start of the Great Recession. This has particularly been true for borrowers of color. As shown in Figure 4, the proportion of these loans for all borrowers has gradually diminished since 2012.

Figure 4. Non-conventional percent of purchase loans for selected borrower groups



Source: Center for Responsible Lending analysis of the 2016 Home Mortgage Disclosure Act Data originally provided by the Federal Reserve Board, available at: https://www.federalreserve.gov/publications/files/2016_HMDA.pdf.

While the overall market share for these programs continues to decline as the market improves, the rate at which people of color rely on these programs has not diminished. Government-insured loans, such as those insured by FHA, have clearly been an important source of credit post-crisis. FHA mortgages are the primary source of credit for African-Americans and Latino home purchasers. However, compared to conventional loans these loans can be costlier over the life of the loan. Further, increasingly, lenders have also been less willing to make these loans. In 2015, large lenders, including Wells Fargo and JP Morgan Chase¹⁴ took steps to pull back from FHA lending and the 2016 data show that more and more FHA loans are being made by non-bank lenders.

These programs are critical and deserve ongoing federal support. The FHA program must be adequately funded and modernized to ensure its viability. However, these data also underscore the urgent need for federal regulators to better enforce fair lending requirements to ensure a more robust conventional mortgage market that serves borrowers of color.

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

In 2016 the average credit score for all new loan originations fell from its high of 750 in 2013 to stand at 732 in December of 2016. However, the average score remained about 33 pts above the average score a

¹⁴ Kate Berry, JPMorgan Leads Big Banks Out the Door of FHA, National Mortgage News (2015), available at <http://www.nationalmortgagenews.com/news/compliance-regulation/jpmorgan-leads-big-banks-out-the-door-of-fha-1062309-1.html>.

decade before.¹⁵ At the same time, market-level credit availability indices continue to show that lenders have a very low tolerance for taking reasonable risk for new loans.¹⁶ Recent vintages of new mortgages (loans originated from 2011-2015) have had near zero rates of default.¹⁷

These tight credit standards are preventing homeownership opportunity for credit worthy borrowers of color and low- to moderate-income borrowers. Recent data released by Fannie Mae show that loans to low-income borrowers originated from 2010-2015 had a default rate of just 0.3 percent, approximately equal to that of loans to high-income borrowers originated from 2002-2004.¹⁸ There is ample opportunity in the mortgage market to expand lending to borrowers while still offering responsible loans that borrowers can successfully repay.

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

Both the GSEs and Ginnie Mae continue to provide critical mortgage capital to underserved communities. The GSEs purchased over 2 million home purchase and refinance mortgage loans in 2015, including nearly a half a million loans to low- and moderate-income borrowers, nearly 400,000 loans to borrowers of color and over 300,000 loans to borrowers living in rural areas. At the same time, smaller financial institutions (those with assets less than \$2 billion) relied on loans sold to the GSEs to meet the credit needs of nearly 200,000 borrowers seeking mortgage credit in rural communities. Loans backed by Ginnie Mae also continue to play a significant role in serving borrowers whose credit may warrant additional enhancement or who have limited resources for a down payment. Government-backed lending cannot and should not be sole source of mortgage lending in these communities.

To better understand the GSE market share among low- and moderate-income borrowers, borrowers of color, rural borrowers and among community banks and credit unions, CRL analyzed over six million home purchase and refinance mortgages for first-lien, owner-occupied, 1-4 family homes (including manufactured homes) reported under the Home Mortgage Disclosure Act in 2015 (referred to as purchase lending and refinance lending going forward). Of these loans, 34.2 percent were sold to Fannie Mae, Freddie Mac or Farmer Mac (collectively, the GSEs) and 16.2 percent were loans guaranteed through Ginnie Mae (see Figure 5).

¹⁵ LAURIE GOODMAN ET AL., HOUSING FINANCE AT A GLANCE: A MONTHLY CHARTBOOK (2017), AVAILABLE AT https://www.urban.org/research/publication/housing-finance-glance-monthly-chartbook-march-2017/view/full_report.

¹⁶ *Id.*; Mortgage Bankers Association, Mortgage Credit Availability Index (2017), available at <https://www.mba.org/newsresearch-and-resources/research-and-economics/single-family-research/mortgage-credit-availability-index>.

¹⁷ Laurie Goodman, Squeaky Clean Loans Lead to Near-Zero Borrower Defaults – And That is Not a Good Thing, Urban Institute (2016), available at <http://www.urban.org/urban-wire/squeaky-clean-loans-lead-near-zero-borrower-defaults-and-not-good-thing>.

¹⁸ Fannie Mae 2016 Annual Housing Activities Report and Annual Mortgage Report, chart at page 19, available at https://www.fhfa.gov/PolicyProgramsResearch/Programs/AffordableHousing/Documents/Fan_M_Goals/2017/Fannie-Mae-2016-AHAR-AMR-FINAL.pdf.

Figure 5. 2015 purchase and refinance loans by purchaser

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

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

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

In 2015, GSEs purchased 457,450 purchase and refinance loans made to low- and moderate-income borrowers making up 31.3 percent of purchase and refinance mortgage lending to LMI borrowers, or borrowers with incomes less than 80 percent of the area median income. Likewise, Ginnie Mae guaranteed 235,514 purchase and refinance loans to LMI borrowers making up 16.1 percent of all purchase and refinance lending to low- and moderate-income borrowers (Figure 5).

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

ii. *GSE Market Share Exceeds Ginnie Mae Market Share in Rural Communities*

The GSEs also provide an important source of mortgage capital in rural communities, where they purchased nearly one out of every three new mortgages in 2015. In 2015, lenders made over one million purchase and refinance loans in rural areas.¹⁹ The GSEs also purchased 76,661 purchase and refinance loans to LMI borrowers in rural areas and 20,504 loans to rural borrowers of color, a 26.2 percent and 21.9 percent market share, respectively (Figure 6).

In comparison, Ginnie Mae guaranteed 196,963 FHA loans in rural areas, including 52,876 loans (18.1 percent) to LMI borrowers and 24,234 loans (25.9 percent) to rural borrowers of color.

¹⁹ Census tracts, which were classified as either urban or rural areas based on the 2017 definition of rural area at 12 CFR 1282.1, and available at <https://www.fhfa.gov/DataTools/Downloads/Pages/Duty-to-Serve-Data.aspx>.

Figure 6. 2015 purchase and refinance loans by purchaser in rural areas

	All rural loans		Loans to rural LMI borrowers		Loans to rural borrowers of color	
	#	%	#	%	#	%
GSEs	320,525	30.0%	76,661	26.2%	20,504	21.9%
Ginnie Mae	196,963	18.4%	52,876	18.1%	24,234	25.9%
Not sold in 2015	271,145	25.3%	77,405	26.4%	22,872	24.4%
Other	281,233	26.3%	85,999	29.4%	25,982	27.8%
Total	1,069,866		292,941		93,592	

Source: CRL analysis of 2015 Home Mortgage Disclosure Act data

The GSEs also provide a critical source of mortgage capital for smaller lenders, those with assets of less than \$2 billion in 2015. The GSEs purchased 177,028 purchase and refinance loans from smaller lenders lending in rural areas, or 25.1 percent of the market. Ginnie Mae guaranteed 139,792 purchase and refinance loans made by small lenders in rural areas that same year—a 19.8 percent market share (Figure 7).

Figure 7. 2015 purchase and refinance loans originated by small lenders by purchaser in rural areas

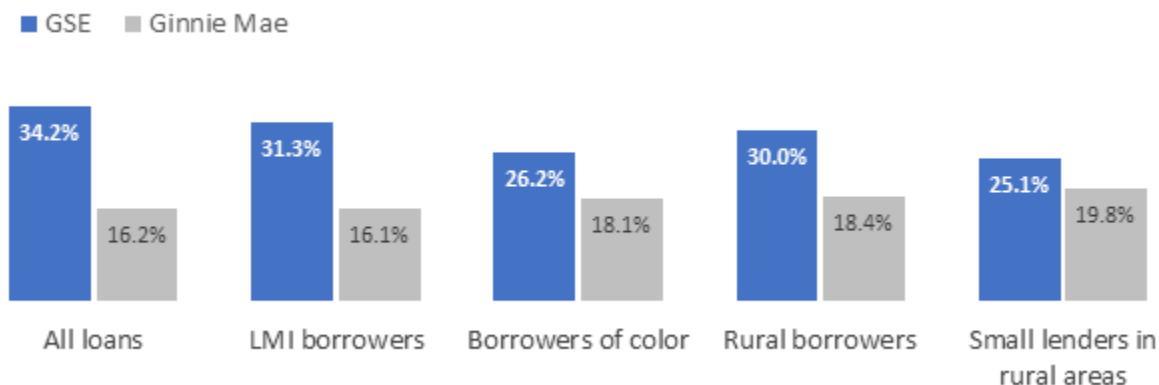
	Purchase loans		Refinance loans		Total	
	#	%	#	%	#	%
GSEs	73,564	18.5%	103,464	33.4%	177,028	25.1%
Ginnie Mae	70,417	17.8%	69,375	22.4%	139,792	19.8%
Not sold in 2015	86,709	21.9%	71,089	22.9%	157,798	22.3%
Other	165,920	41.8%	66,122	21.3%	232,042	32.8%
Total	396,610		310,050		706,660	

Source: CRL analysis of 2015 Home Mortgage Disclosure Act data

In all, the GSE market share exceeds the market share of Ginnie Mae among low- and moderate-income borrowers, borrowers of color and rural borrowers. The GSEs also purchase one out of every four loans issued by smaller lenders in rural areas, exceeding the market share of loans guaranteed by Ginnie Mae and even exceeding the market share of loans that are originated but not sold to other institutions or the secondary market (Figure 8).²⁰

²⁰ FHA operations have been hampered in recent years due to a variety of challenges including excessive uncertainty regarding lending liability, structural defects in its servicing process and outdated and under resourced technology and operations infrastructure. See, The Federal Housing Administration Can Do More With More, April 2017, available at <https://www.brookings.edu/research/the-federal-housing-administration-can-do-more-with-more/>.

Figure 8. Market share of GSEs and Ginnie Mae



Source: CRL analysis of 2015 Home Mortgage Disclosure Act data

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

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

Existing homeowners, especially older Americans, will need buyers when they want to sell, and new families need access to affordable mortgage credit to buy their homes. In the future, homebuyers will be more racially and ethnically diverse than they have been in the past. Harvard's Joint Center for Housing Studies found that non-whites accounted for 60 percent of household growth from 1995-2015 and predicted that half of millennial households by 2035 will be non-white.²¹ The mortgage market will need to find ways to serve borrowers of color and lower-wealth borrowers to sustain a robust market in the coming years.

Responsible and affordable refinance loans are also crucial to allowing borrowers to preserve homeownership. Recent history shows this to be the case, as toxic refinance loans helped spur the housing crisis. In fact, 90 percent of borrowers who took out subprime loans from 1998 to 2006 were already homeowners.²² Yet, discrepancies persist in access to refinance mortgages as well as purchase mortgages. In fact, while very modest gains were made in 2016 in the access of borrowers of color to purchase mortgages, these gains did not carry over for African-American and Hispanic white borrowers, relative to the growing refinance market. In addition to making loans broadly available for home purchase, responsible and affordable refinance mortgages need to be broadly available to support sustained homeownership.

²¹ Joint Center for Housing Studies of Harvard University, *State of the Nation's Housing 2017*, (2017), available at http://www.jchs.harvard.edu/research/state_nations_housing.

²² Maura Reynolds, *Refinancing spurred subprime crisis*, Los-Angeles Times (2008), available at <http://articles.latimes.com/2008/jul/05/business/fi-refi5>; Amir Khandani, Andrew Lo, and Robert Merton, *Systemic Risk and the Refinancing Ratchet Effect*, National Bureau of Economic Research Working Paper No. 15362 (2009), available at <http://www.nber.org/papers/w15362>.

III. Congress Has Already Substantially Reformed the Housing Finance System with HERA and New Mortgage Protections

In response to the financial crash, Congress took action to strengthen and improve the regulatory structure of the housing market. The Housing and Economic Recovery Act of 2008 (HERA), The Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), and Consumer Financial Protection Bureau (CFPB) regulations have reformed the housing market and made it safer for all market participants. As we pursue further reform, we should build upon the current market and regulatory structure.

HERA substantially changed the regulatory landscape of the housing finance system.²³ In fact, after the passage of HERA, substantial GSE reform has already been implemented, and these reforms should be continued, expanded, and made permanent.

A. HERA’s Reforms Should Be Maintained

Congress’ creation of the Federal Housing Finance Agency (FHFA) was a central reform of the housing finance system. HERA abolished the Office of Federal Housing Enterprise Oversight (OFHEO) and the Federal Housing Finance Board, and established FHFA – a strong independent regulator with the legal authority and tools required to supervise the full activities of the GSEs. Prior to HERA, oversight of the GSEs was split between OFHEO and the Secretary of HUD. The absence of a primary and comprehensive regulator resulted in the lack of robust and efficient enforcement. OFHEO, an independent agency within HUD, was the safety and soundness regulator, and the Secretary of HUD was the mission regulator. The affordable housing goals were under the Secretary of HUD’s purview. This regime was problematic for many reasons, but the most significant issue was that OFHEO did not possess the legal authority necessary to adequately supervise the GSEs or enforce the law. As FHFA’s General Counsel stated in congressional testimony in 2013, “At OFHEO much had to be done with implied authorities; HERA corrected that, providing explicit authorities and language regarding ‘incidental authority.’”²⁴

OFHEO’s authority over the GSEs was weak and not comparable to other financial regulators. The agency did not have sufficient authority to establish prudential standards, including internal controls, audits, risk management, and management of the portfolio. In contrast, HERA empowered FHFA with the legal authority to comprehensively and robustly regulate the GSEs. FHFA has the tools to ensure adequate capital,²⁵ establish prudential standards,²⁶ review and approve new product offerings,²⁷ place a regulated entity into receivership,²⁸ and closely supervise the full activities of the GSEs.

Furthermore, OFHEO did not hold adequate enforcement authority. OFHEO had to rely on the Attorney General to sue on the agency’s behalf. HERA provided FHFA with a broad range of administrative enforcement tools, including cease and desist orders, civil money penalties, debarment of officials, and the ability to act against entity-affiliated parties.²⁹ FHFA may also access the courts through its independent

²³ 12 U.S.C. § 4501 et. seq.

²⁴ Housing Finance Reform: Powers and Structure of a Strong Regulator, Statement of Alfred M. Pollard before the U.S. Senate Committee on Banking, Housing, and Urban Affairs (2013), *available at* <https://www.fhfa.gov/mobile/Pages/public-affairs-detail.aspx?PageName=Housing-Finance-Reform-Powers-andStructure-of-a-Strong-Regulator.aspx>.

²⁵ 12 U.S.C. §§ 4611-4613.

²⁶ 12 U.S.C. § 4513b.

²⁷ 12 U.S.C. § 4541.

²⁸ 12 U.S.C. § 4617

²⁹ 12 U.S.C. §§ 4581, 4631.

litigation authority.³⁰ Additionally, while OFHEO funded operations through assessments on the GSEs, it could only collect the assessments when approved through appropriations. Consequently, OFHEO was perpetually underfunded. HERA corrected this so FHFA would not be subject to the appropriations process and the politics accompanying it.³¹

In addition, HERA corrected the bifurcated authority issue that OFHEO experienced. On the mission side, HERA provided FHFA with authority over the affordable housing goals and established a duty to serve underserved markets requirement. The duty to serve rule's purpose is to increase the liquidity of mortgage investments and improve the distribution of investment capital available for mortgage financing for very low-, low-, and moderate-income families in manufactured housing, affordable housing preservation, and rural markets.³² FHFA's authority to administer the duty to serve requirement and the affordable housing goals should be applied robustly to expand affordable homeownership opportunity.

Congress should continue to build upon HERA's important reforms to the housing finance system. For instance, FHFA has required reinsuring of credit risk and it has greatly shrunk portfolios to reduce taxpayer exposure. The ban on lobbying and campaign activity should be made permanent, portfolios should be further reduced and limited to necessary business purposes (such as modifying loans), and capital standards should be set and achieved. Utility regulation and rules regarding returns for the GSEs would further prevent excessive risk taking. Much authority already exists to continue advancing this reform while Congress considers GSE legislation.

Furthermore, the GSEs' affordable housing goals – particularly the purchase of single-family loans from low and very low-income borrowers – are essential to encourage affordable homeownership opportunities. Contrary to the unfortunate myth, the affordable housing goals and the Community Reinvestment Act (CRA) did not cause the mortgage meltdown.³³ According to the Financial Crisis Inquiry Commission (FCIC), the housing goals only contributed marginally to Fannie Mae and Freddie Mac's participation in risky mortgages.³⁴ The GSEs could have met their housing goals without any purchases of Alt-A or subprime securities. Furthermore, lenders made few subprime loans to meet their CRA requirements. A Federal Reserve study found that banks and thrifts only made 6 percent of higher-cost loans to low- or moderate-income borrowers or in low- or moderate-income neighborhoods that were covered by the CRA.³⁵ The remaining 94 percent of high-cost loans were made by CRA-covered institutions that did not receive CRA credit for the loans, or were made by lenders not covered by the CRA.³⁶ Other research corroborated these conclusions.³⁷

In fact, evidence shows that borrowers perform well when they receive safe and responsible loans. For example, a report on Self-Help Credit Union's Community Advantage Program from the University of North Carolina's Center for Community Capital, showed that borrowers amassed a net worth of \$38,000,

³⁰ 12 U.S.C. § 4635.

³¹ 12 U.S.C. § 4516.

³² 12 U.S.C. § 4565; 12 C.F.R. 1282, Subpart C.

³³ The Financial Crisis Inquiry Report, Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States (2011), at xxvii, *available at* <https://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf>.

³⁴ *Id.*

³⁵ *Id.* at 220.

³⁶ *Id.*

³⁷ *Id.*

compared with renters' \$266, even as housing values plunged during the crisis.³⁸ The Community Advantage Program securitized mortgages for more than 50,000 families in 48 states.

B. Dodd-Frank Act Mortgage Protections Made the Market Safer

Additionally, the Dodd-Frank mortgage protections and CFPB regulations – such as the Ability-to-Repay (ATR) and Qualified Mortgage (QM) rules – are needed to protect consumers, small businesses, taxpayers, and the nation's economy. These protections have not negatively impacted lending, but have made the market safer.

QM and ATR define bright line standards to move the market away from high-risk, unsustainable loans and ensure borrowers have an ability to repay the loans they receive. QM and Ability-to-Repay promote product features that are reorienting the housing market back toward safe, sustainable lending for all borrowers. All financial institutions benefit from the underlying purposes of financial regulation: protecting consumers, ensuring the safety and soundness of institutions, protecting community financial institutions from unfair competition, and defending the nation's financial market from systemic risk.

Contrary to theories that the Dodd-Frank Act has stifled growth, the financial sector has had record profits. In 2016 U.S. financial institutions had total annual profits of \$171.3 billion, the highest level since 2013.³⁹ While this profit level is slightly lower than the profit level in the peak of the false housing boom in the years immediately prior to the financial crisis (2004-2006), it remains higher than inflation-adjusted financial sector profits for any other time period since World War II.

Community bank profitability has also rebounded strongly and meets pre-recession levels. In 2010, less than 78 percent of community banks were profitable. By the end of 2015, over 95 percent of community banks were profitable.⁴⁰ The most recent FDIC report from the 2016 third quarter notes that the percentage of unprofitable community banks sunk to 4.6 percent, which is the “lowest percentage since the third quarter of 1997.”⁴¹ Full year earnings were up 9.7 percent in 2015, which is a higher figure than the overall increase of 7.5 percent for all banks.⁴²

Moreover, according to CRL's 2016 HMDA analysis, for the third straight year, mortgage lending volume overall has not been affected by ATR and QM. Instead, lending trends show incremental increases signaling modest growth in 2014, 2015, and again in 2016. In 2016, 2,123,000 conventional loans were approved. An additional 866,000 non-conventional loans were also made last year.⁴³

Furthermore, although access to credit persists as problem in today's market, it is lender overcorrections in the post- crises market, not Ability-to-Repay/QM that explain constrained lending patterns. This

³⁸ Allison Freeman, UNC Center for Community Capital, *The Continuing Importance of Homeownership: Evidence from the Community Advantage Program* (2014), at 9, *available at* http://www.frbsf.org/community-development/files/ci_vol26no2-Continuing-Importance-of-Homeownership.pdf.

³⁹ Wall Street Journal, *U.S. Banking Industry Annual Profit Hit Record in 2016* (2017), *available at* <https://www.wsj.com/articles/u-s-banking-industry-annual-profit-hit-record-in-2016-1488295836>.

⁴⁰ Federal Deposit Insurance Corporation, *Core Profitability of Community Banks 1985-2015 1* (2016), *available at* https://www.fdic.gov/bank/analytical/quarterly/2016_vol10_4/article1.pdf.

⁴¹ Federal Deposit Insurance Corporation, *Quarterly Banking Profile: Third Quarter 2016 I*, *available at* https://www.fdic.gov/bank/analytical/quarterly/2016_vol10_4/fdic_v10n4_3q16_quarterly.pdf.

⁴² *Id.*

⁴³ Center for Responsible Lending, *New HMDA Data Show Despite Growing Market, African-Americans and Latinos Remain Underserved* (2017), *available at* <http://www.responsiblelending.org/research-publication/new-hmda-data-show-despite-growing-market-african-americans-and-latinos-remain>.

environment is most harmful to lower-wealth households with lower FICO scores, and fewer resources for a down payment.⁴⁴ Evidence of tight credit standards includes:

- The median credit score on new origination currently stands at 729, up 25 points from 2001. The lower bound, 10th percentile, rose from the low 600s to 645 over this same time period.⁴⁵
- The Urban Institute's Credit Availability Index remains low, standing at 5.2 for the fourth quarter of 2016 (the most up to date value). It was near 10 in 1998, rose to over 16 in 2006 and 2007 and fell precipitously in 2008.⁴⁶
- The MBA's Mortgage Credit Availability Index, most recently valued at 183 in April 2017, is half the value in June 2004.⁴⁷
- Mortgage default rates on recently originated loans are near zero. The default rate for loans originated from 2011 to 1Q2016 was 0.2% for Fannie Mae loans and 0.1% for Freddie Mac loans through 4Q2016.⁴⁸

Ultimately, millions of loans that could be responsibly made have not been due to these unnecessary credit constraints. Lack of access to credit in today's mortgage market is particularly problematic because QM rules ensure that the loans available today are safe. The Ability-to-Repay standard provides borrowers and lenders much more certainty that the loan is affordable. The elimination of products like option adjustable rate mortgages (ARMs) and teaser rate loans means borrowers receive clear information about what they will owe monthly. Additionally, overall interest rates remain low and house prices are still rebounding, resulting in affordable homebuying opportunities in many markets. The Urban Institute's maximum affordable home price (\$311,453) remains well above the median sales price (\$278,745).⁴⁹ Lack of access to responsible loans in this market can and should be addressed.

Today's housing market is safer due to legislative reform, like HERA and Dodd-Frank, as well as through CFPB regulations. These reforms have substantially changed the regulatory landscape of the housing finance system. As we pursue further reform we should build upon the current market and regulatory structure and be particularly mindful of how policies affect access to responsible mortgage credit.

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

⁴⁴ Jim Parrot and Mark Zandi, *Opening up the Credit Box* (2013), *available at* <http://www.urban.org/UploadedPDF/412910-Openingthe-Credit-Box.pdf>, see also LAURIE GOODMAN ET AL., TIGHT CREDIT STANDARDS PREVENTED 5.2 MILLION MORTGAGES BETWEEN 2009 AND 2014 (2016), *AVAILABLE AT* <http://www.urban.org/urban-wire/tight-credit-standards-prevented-52-million-mortgages-between-2009-and-2014>.

⁴⁵ LAURIE GOODMAN ET AL., HOUSING FINANCE AT A GLANCE: A MONTHLY CHARTBOOK (2017) 14, *AVAILABLE AT* http://www.urban.org/research/publication/housing-finance-glance-monthly-chartbook-june-2017/view/full_report.

⁴⁶ *Id.* at 13.

⁴⁷ Mortgage Bankers Association, *Mortgage Credit Availability Index* (2017), *available at* <https://www.mba.org/newsresearch-and-resources/research-and-economics/single-family-research/mortgage-credit-availability-index>.

⁴⁸ LAURIE GOODMAN ET AL., *supra* note 45.

⁴⁹ *Id.* at 16.

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

The GSEs and FHA ensured that stable and affordable mortgage credit was available across the country and throughout the economic downturn. Currently, they hold mortgages worth \$6.17 trillion with Fannie Mae at 44.2 percent, Freddie Mac at 27.5 percent, and Ginnie Mae at 28.3 percent.⁵⁰ The GSEs were created by Congress in the 1930s to provide stability to the capital markets and to increase the availability of mortgage credit throughout the United States following periods of significant economic instability. The GSEs have a mandate to serve all credit markets at all times, which guarantees broad credit availability in all regions of the nation. The charters of the GSEs state that they must “promote access to mortgage credit throughout the nation (including central cities, rural areas, and underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing.”⁵¹ By pooling and securitizing mortgages, backed by an implied federal government guarantee, the GSEs have ensured the flow of credit to all parts of the nation. We now have a national mortgage market, investor confidence, increased loan volume, and widespread use of the 30-year fixed rate mortgage.

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

Private capital withdrew from the market during the housing crash. The countercyclical nature of the GSEs and FHA insured mortgage credit sustained the market. Private label lending peaked in 2006 with approximately 40 percent of all mortgage originations.⁵² It began to decline in 2007 and virtually stopped by 2008.⁵³ With record levels of defaults and foreclosures occurring alongside sharp declining prices nationwide, overall mortgage lending quickly dried up.

Credit would not have been available for most mortgagees if not for government support during the financial crisis. Backed by government guarantees, the GSEs under Federal Housing Finance Administration conservatorship beginning in September 2008 and FHA continued to ensure the availability of credit. GSE lending jumped to over 65 percent of all mortgage originations in 2008.⁵⁴ FHA lending also played a key role as its involvement increasing rapidly.⁵⁵ Since then, FHA purchase loans have dropped steadily and returned closer to the normal levels of the early 2000s (Figure 9).⁵⁶ Moody’s estimated that FHA’s contribution prevented a second collapse in the housing market, which could have sent the U.S. economy

⁵⁰ LAURIE GOODMAN ET AL., HOUSING FINANCE AT A GLANCE: A MONTHLY CHARTBOOK 6-7 (2017), AVAILABLE AT http://edit.urban.org/sites/default/files/publication/90451/may_chartbook.pdf.

⁵¹ Fannie Mae’s charter is in Title III of the National Housing Act, 12 U.S. Code § 1716 et. seq. Freddie Mac’s charter is in 12 U.S.C. §1451 et. seq.

⁵² LAURIE GOODMAN ET AL., *supra* note 50.

⁵³ *Id.*

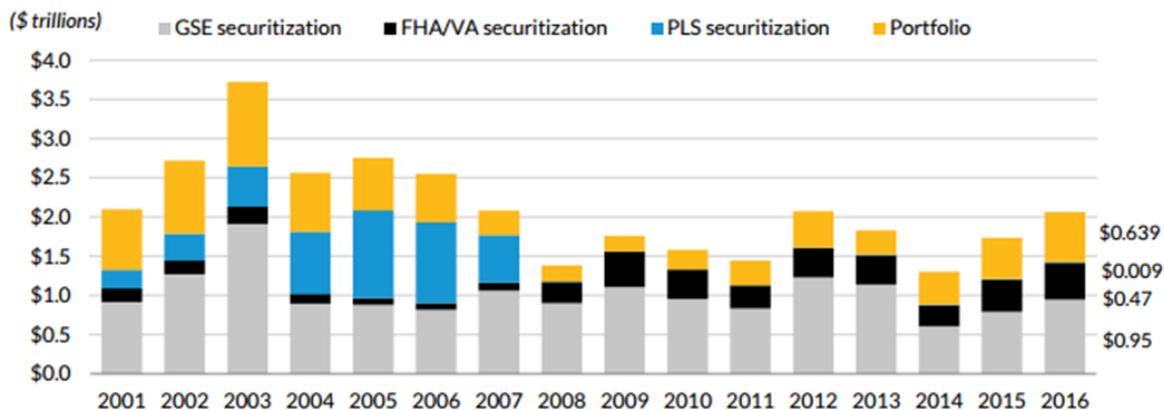
⁵⁴ *Id.*

⁵⁵ John Griffith, “The Federal Housing Administration Saved the Housing Market” (Washington: Center for American Progress, 2012), available at <https://www.americanprogress.org/issues/housing/report/2012/10/11/40824/the-federalhousing-administration-saved-the-housing-market/>. This report cites data estimates from Moody’s Analytics in October 2010.

⁵⁶ US Department of Housing and Urban Development, Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund Fiscal Year 2010, at 2 (2010), available at https://portal.hud.gov/hudportal/documents/huddoc?id=report_to_congress.pdf; See also US Department of Housing and Urban Development, Federal Housing Administration Annual Report to Congress, The Financial Status Of the FHA Mutual Mortgage Insurance Fund Fiscal Year 2016, at 8 (2016), available at <https://portal.hud.gov/hudportal/documents/huddoc?id=2016fhaannualreport1.pdf>.

into a double-dip recession and caused the economy to shed another 3 million jobs and the unemployment rate to rise an additional 1.6 percent.⁵⁷

Figure 9. First lien origination volume



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

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

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

i. The False Claims Act

Lender liability under the False Claims Act has been the subject of a variety of proposed reforms. There is a recognized need to clarify what types of errors can trigger liability under the Act. The statute imposes treble damages against anyone who submits a false claim to the government, including FHA insurance payments. Because these treble penalties can cost a far greater amount than the loan itself, this has the potential to decrease the appetite for making FHA insured loans that have only a modest risk of defaulting.⁵⁸ This has potential negative effects on access to mortgage credit, especially for those borrowers that rely on FHA to secure mortgage loans. The False Claims Act can be a strong tool to curb fraud in the mortgage lending space, and should be reformed to clarify the liability provisions so it can bolster access to credit.

ii. Program Funding

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

⁵⁷ John Griffith, *supra* note 55. This report cites data estimates from Moody’s Analytics in October 2010.

⁵⁸ See, Michael D. Calhoun, *The Federal Housing Administration Can Do More With More*, Brookings (2017), available at <https://www.brookings.edu/research/the-federal-housing-administration-can-do-more-with-more/>.

counterintuitively negatively impacted FHA's operations.⁵⁹ Under statute the entirety of FHA's revenue is sent to the Mutual Mortgage Insurance Fund (MMIF) and cannot be used for FHA's operations, regardless if that funding could significantly improve operational or program efficiency. For example, FHA attempted to address the false claims act ambiguity by establishing which errors would and would not trigger liability, but this effort was abandoned due to lack of funding.⁶⁰ Additionally, FHA loan servicing for modifications for troubled loans is expensive and risky, so servicers will be constrained in their ability to provide payment relief for borrowers without programmatic changes.

FHA has made attempts to secure additional funding to address these (and more) complications, but has been met with resistance. One of these proposals was legislation authorizing a 4 basis point ongoing fee on FHA loans. Additionally, HERA authorized \$25 million a year for 5 years out of a "negative credit subsidy", proceeds from the MMIF, to target system upgrades and quality control.⁶¹ These upgrades would substantially advance FHA's role in the housing market, protecting taxpayers, and support the overall economy.

V. Access and Affordability are Central Tenants to the Future of the Housing Finance System

Despite historical inequities in access to mortgage credit, the future of the market depends on often-excluded borrowers including people of color and LMI families. As stated above, these borrowers have less wealth, which has translated into lower credit profiles and an inability to make large down payments on mortgage loans.⁶² Therefore, a future well-functioning system must serve all credit worthy borrowers.

A. Serve all credit worthy borrowers

Rural borrowers, new emerging households, LMI borrowers and borrowers of color all face obstacles to receiving competitive and affordable mortgage loans. Current statutory provisions governing the GSEs include important measures to further service of these markets: the mandate to serve the broad market, even at a lower rate of return; affordable housing goals; the duty to serve under-reached markets; and the affordable housing funds. These were all included in or reaffirmed by HERA, which passed with strong bipartisan support. These bipartisan compromises, worked out over nearly a decade, must be preserved and expanded in order to meet the current and future mortgage market, which will include large proportions of these borrowers. Equally important, credit risk transfers must continue to be done by the issuer-guarantors through mechanisms that do not price these borrowers or small lenders out of the market. This means credit

⁵⁹ Id.

⁶⁰ Id.

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

⁶² See *The State of the Nation's Housing*, Joint Center for Housing Studies, at 3 (2013) (stating that "[m]inorities—and particularly younger adults—will also contribute significantly to household growth in 2013–23, accounting for seven out of ten net new households. An important implication of this trend is that minorities will make up an ever-larger share of potential first-time homebuyers. But these households have relatively few resources to draw on to make down payments. For example, among renters aged 25–34 in 2010, the median net wealth was only \$1,400 for blacks and \$4,400 for Hispanics, compared with \$6,500 for whites. Even higher-income minority renters have relatively little net wealth, with both blacks and Hispanics in the top income quartile having less than half the average net wealth of whites. Proposed limits on low-down payment mortgages would thus pose a substantial obstacle for many of tomorrow's potential homebuyers.")

risk transfers must be executed through reinsurance structures that permit pooling of loans and risk, and not through deeper upfront risk transfers.

B. Pricing Practices Should Expand Mortgage Access

The GSEs and FHA today have an affirmative duty to serve all markets which incentivizes them to set prices in a way that balances risk and access.⁶³ These participants in today's housing finance system are incentivized to pool risk and price credit risk on a pooled basis. Unfortunately, recent proposals for legislative housing finance reform share a common feature that undermines this pricing approach. Deep upfront credit risk transferred to private capital would incentivize actors to segment, rather than pool, credit risk and prices. Segmented pricing puts mortgage credit out of reach for too many credit worthy borrowers.

The total amount borrowers pay to cover credit risk is a function of modeled losses, capital standards and the required rate of return on capital.⁶⁴ Modeled losses are largely independent of system structures.⁶⁵ Capital requirements and required rates of return on capital are dependent on the structure of a future system, and function to increase or decrease the overall total amount to be held to guard against losses.

It is the policies of participants in the housing finance system that translate predicted credit losses into borrower prices and distribute prices for borrowers with different characteristics. Importantly, the degree to which costs are pooled or distributed is determined by the structure of the housing finance system. For example, FHA charges the same insurance premium to borrowers regardless of credit score,⁶⁶ whereas private mortgage insurers charge widely different fees to borrowers with different credit scores and/or levels of down payment (Figure 10).

⁶³ CRL continues to work with FHFA to encourage changes which could further open access to credit. For example, eliminating the loan level price adjustments (LLPAs) that were put in place after the crisis.

⁶⁴ For a more detailed discussion of the levers that affect pricing and the distribution of pricing for credit risk see Calhoun, M. and Wolff, S. *Who Will Receive Home Loans, and How Much Will They Pay?* (2016), *available at* <http://www.urban.org/policy-centers/housing-finance-policy-center/projects/housing-finance-reform-incubator/mike-calhoun-and-sarah-wolff-who-will-receive-home-loans-and-how-much-will-they-pay>.

⁶⁵ System structure could introduce new risks. For example, if a future system made it very difficult or costly for first-time homebuyers to purchase a home, then existing homeowners would have a difficult time selling their homes. This could depress housing prices or limit liquidity in the housing system overall, which could result in a downturn and create losses in the system above what would be predicted by current models.

⁶⁶ FHA premium rates *available at* <https://portal.hud.gov/hudportal/documents/huddoc?id=17-07ml.pdf>.

Figure 10. Private mortgage insurance pricing, 2017

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

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

Underwriting structures determine if borrowers are credit worthy, but pricing structures determine if a credit worthy borrower can afford a mortgage. Differential pricing creates an additional barrier to mortgage credit by increasing the price, sometimes significantly, for some borrowers relative to others. There is evidence of price acting as a barrier even in today’s mortgage market. For example, although Fannie Mae’s guidelines allow the GSE to purchase loans with credit scores down to 620 and loan-to-value (LTV) ratios of up to 97 percent, very few loans purchased by the GSE have these characteristics.⁶⁷ One reason is that risk-based pricing by both the GSEs and private mortgage insurers add significantly to the cost of loans for borrowers with lower scores and less wealth for a down payment. For example, the combination of loan-level price adjustments (LLPAs) and mortgage insurance (MI) premiums adds over 300 basis points to the cost of a mortgage for a borrower with a credit score of 620 and an LTV of 97 percent.⁶⁸

The GSEs, though, currently set prices based on a more consolidated set of borrower characteristics than private actors like private mortgage insurers. They lay off credit risk largely through back-end credit risk transfer mechanisms which allows for pooling of loans and risk. Ultimately, these policies limit the degree to which loan pricing is highly segmented.⁶⁹

Comparing the GSE guarantee fee structure to the MI pricing structure reveals the private market’s tendency to create finely defined bands. GSE guarantee fee pricing⁷⁰ breaks up credit scores into three bands: >=740, 700-739, and 620-699. From December 2013 to April 2016, MI companies broke up this same range into four bands: >=760, 720-759, 680-719, and 620-679. The most recent set of MI pricing, released in April 2016,⁷¹ breaks this same range of credit scores into eight different bands: >=760, 740-759, 720-739, 700-719, 680-699, 660-679, 640-659, and 620-639.

⁶⁷ See p. 6 of *2017 First Quarter Credit Supplement*, Fannie Mae, May 5, 201, available at http://www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2017/q12017_credit_summary.pdf.

⁶⁸ $350/4+225=312.5$ basis points. Fannie’s Mae’s LLPA for this combination of credit score and LTV is a one-time fee of 350 basis points (see page 2: <https://www.fanniemae.com/content/pricing/llpa-matrix.pdf>), we assumed a LLPA multiple of 4 to convert this upfront fee to an ongoing cost comparable to the MI premium. Borrower paid MI from Genworth for this combination of credit score and LTV is a continuing fee of 225 basis points (see: https://mortgageinsurance.genworth.com/pdfs/Rates/11370775.Monthly_Natl.FIXED.0616.pdf).

⁶⁹ Through the LLPAs the GSEs also have differential pricing, which limits their reach to underserved borrowers.

⁷⁰ As described in Fannie Mae and Freddie Mac Guarantee Fees: Request for Input, FHFA (2015), available at <https://www.fhfa.gov/policyprogramsresearch/policy/documents/gferfi060514f.pdf>.

⁷¹ Shown in Figure 11.

Finely defined pricing frameworks produce more extreme pricing. Figure 7 below shows the change in basis points borrowers with a given credit score experienced when PMI pricing changes were implemented in April 2016. Some borrowers, those with credit scores above 740, enjoyed a reduction in fees whereas others, almost all borrowers with scores below 680, experienced increases. The cells highlighted in dark green saw a decrease of more than 30 basis points. The cells highlighted in dark orange saw an increase of more than 30 basis points (Figure 11).

Figure 11. Change in MI pricing by credit score and LTV December 2013 to April 2016

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

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

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

C. Community Banks and Other Small Lenders Must Be Supported in Housing Finance Reform

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

Community banks, credit unions, and other small financial institutions deliver mortgages to their customers, along with other essential financial services, in the communities where they are located. As has been noted by many, these institutions have a different business model than larger institutions, often serving local markets and having close relationships with their customers. In rural areas, these institutions play a particularly important role. In many rural communities, community banks and credit unions are the only financial institutions providing retail branches and services in the community. These institutions also focus on traditional banking services and do not engage in many of the complex lines of business that larger

institutions do, such as securities issuance, credit default swaps, or proprietary trading.⁷² Disruptions to the traditional banking services, such as mortgages, cannot be offset with other products and lines of service. As a result, stress on community banks and their mortgage lending would be felt elsewhere. For example, community banks provide almost half of small business lending, and that is dependent on the overall sustainability of the institutions.

The GSEs provide a number of features that are essential for community banks. First is the GSEs' cash window, which provides lenders the option of selling individual loans. This means that smaller institutions do not have to trade their loans for securities or sell their loans to other large banks. Although many larger lenders trade their loans for GSE securities, this is difficult for small lenders. The securities carry the interest rate risk of the underlying loans and, as a result, can change substantially in value if market interest rates change. An increase in market interest rates would significantly reduce the value of the securities and create a loss for the bank holding the security. Larger institutions can purchase interest rate swaps to hedge this risk, but this is much harder for small lenders to do.

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

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

Given the importance of these provisions in the current housing finance system, they should be continued and expanded. However, some of the proposals for housing reform have provisions that would tilt the government supported mortgage market heavily against community banks. While most options preserve some form of a cash window, they do not have the supporting protections that make it workable. Most important is pricing parity with the securities option. If securities trade at a better price, it greatly diminishes the value of the cash window. This is true even if there is a provision that prohibits volume pricing or discounts. If all cash transactions are disfavored to securities, the lack of discounts in either market are of little consolation to community banks who are disproportionately dependent on the cash window transactions. To provide this pricing parity, the guarantor/issuer must have the ability to pool costs across the market. This makes it essential that guarantor/issuers serve a national market and have a duty to equitably serve all lenders. Otherwise, if some guarantors/issuers can choose to cream the market, serving only the large lenders and the most lucrative markets, the remaining guarantors will not have sufficient

⁷² These distinctions have been recognized by the CFPB, which created a number of special provisions for these lenders in the mortgage regulations, exempting smaller lenders from many requirements and providing additional flexibility for underwriting and servicing of loans.

loans from the full market to be able to provide pricing parity to small lenders and still compete in the overall market. In order to provide this parity, the guarantor/issuers also must be able to pool the credit risk that they hold and reinsure. If all but the catastrophic credit risk is transferred before the loans are purchased by the guarantor/issuers, there is insufficient revenue remaining for the guarantors/issuers to pool the costs and provide viable pricing to small lenders. If substantially all of the credit risk is sold and priced before the loans are acquired by the guarantor/issuer, then these other parties control the access and pricing and they will favor the larger lender transactions, which will be more profitable.

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

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

D. Preserve Duty to Serve and the Affordable Housing Goals for All Market Participants

The duty-to-serve requirements ensure broad availability of mortgage credit throughout the business cycle, which ensures that no region of the nation is left out of the housing finance system. Congress created the obligation within the actual charters of the GSEs, and they state that the GSEs must “promote access to mortgage credit throughout the nation (including central cities, rural areas, and underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing.”⁷³ These obligations continue through the Fair Housing Act of 1968, which Congress passed immediately following the death of Dr. Martin Luther King, Jr. who spent a crucial portion of his life working to address housing discrimination.⁷⁴ They are carried forward in the Equal Credit Opportunity Act of 1974 (ECOA), and are implemented through the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (FHEFSSA) and Housing and Economic Recovery Act in 2008 (HERA).⁷⁵ They represent Congress’ long-term view that all secondary mortgage market participants have an affirmative duty to further fair lending.

Congress also created the Affordable Housing Goals in 1992 with FHEFSSA, and carried them forward in 2008 with HERA to help expand credit access for underserved groups, ensure liquidity in the financial markets, and further fair lending goals.⁷⁶ Originally, the goals advanced lending opportunities to low-income families in underserved areas, which resulted in mortgage originators making more affordable loans. The affordable housing goals made a tremendous impact on helping credit worthy borrowers purchase homes. From 2003 through 2012, the National Community Reinvestment Coalition reported that more than 25 million hard-working families nationwide were able to become homeowners due to the

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

⁷⁴ 42 U.S.C. § 3601 et seq.

⁷⁵ 15 U.S.C. § 1691 et seq; 12 U.S.C. 4501 et seq; Pub. L. 110-289 (July 30, 2008).

⁷⁶ 12 U.S.C. § 4562 (single-family housing goals).

goals.⁷⁷ Now, they are a metric for accountability by the GSEs' conservator, the FHFA, to address underservice to important, and often excluded, market segments such as low-and moderate-income families, rural communities, and people of color.

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

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

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

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

Following the mortgage crisis of 2008, which was found to be caused by Wall Street's appetite for excessive profits, market overcorrections emerged that led to excessive pricing of risk in the system. FHFA instituted loan level price adjustments (LLPAs) to offset risk from borrowers with lower credit profiles and smaller down payments, despite compelling evidence that when provided with safe and affordable mortgage loans, these borrowers perform well. Further, these increased fees disproportionately impact potential homebuyers of color and low-to-moderate income families whose ability to save for down payments and credit profiles have been negatively impacted by discrimination and lack of opportunity in the mortgage market that has been previously been discussed.⁷⁸

Moreover, families of color and low-and moderate-income communities have been deeply harmed by irresponsible lending in the last decade. Predatory mortgage lending dominated formerly redlined communities and, the brunt of the impact was experienced in communities of color across the nation. The Center for Responsible Lending's research on the effects of subprime lending found that a disproportionate number of foreclosures occurred in communities of color — even when these borrowers qualified for less expensive and sustainable mortgage loans.⁷⁹ Core Logic reports that 7.8 million foreclosures have been completed.⁸⁰ The post foreclosure spillover costs within communities of color totaled \$1 trillion dollars.⁸¹

⁷⁷ National Community Reinvestment Coalition, *Nationwide Benefits from the Affordable Housing Goals*, available at <http://www.ncrc.org/images/PDFs/ahg/nationwide%20ahg.pdf>.

⁷⁸For a more detailed discussion of how discrimination contributes to lower credit scores for borrowers of color see, Racial Justice Project of the National Consumer Law Center, *Past Imperfect: How Credit Scores and Other Analytics “Bake In” and Perpetuate Past Discrimination* (2016), available at https://www.nclc.org/images/pdf/credit_discrimination/Past_Imperfect050616.pdf.

⁷⁹ DEBBIE GRUENSTEIN BOCIAN ET AL., *FORECLOSURES BY RACE AND ETHNICITY: THE DEMOGRAPHICS OF A CRISIS* (2010), AVAILABLE AT <http://www.responsiblelending.org/mortgage-lending/research-analysis/foreclosures-by-race-and-ethnicity.pdf>

⁸⁰ CoreLogic *Issues US Residential Foreclosure Crisis Decade in Review*, available at <http://www.corelogic.com/about-us/news/corelogic-issues-us-residential-foreclosure-crisis-decade-in-review.aspx>.

⁸¹DEBBIE GRUENSTEIN BOCIAN, ET AL., *COLLATERAL DAMAGE: THE SPILLOVER COSTS OF FORECLOSURES* (2012), AVAILABLE AT <http://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/collateral-damage.pdf>.

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

Today, rather than remediate the damage done by abusive subprime lending and its disproportionate impact on communities of color, lenders and FHFA responded by closing off lending options for these communities. The Urban Institute reports that from 2009-2014 there were 5.2 million mortgage loans missing from the secondary market system due to unnecessarily overly tight credit restrictions put in place by the GSEs.⁸²

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

Removing regulator flexibility in establishing down payments in housing finance reform and mandating down payments would unnecessarily restrict access to credit for lower-wealth families. As an initial matter, these mandates overlook the fact that borrowers must also save for closing costs – roughly 3 percent of the loan amount – on top of any down payment required. And, the mandates would increase the number of years that borrowers would need to save for a down payment. An analysis by the Center for Responsible Lending demonstrates that it would take the typical family 17 years to save for a 10 percent down payment and 11 years to save for a 5 percent down payment.⁸³ This time frame is greatly expanded for African-American and Latino borrowers. Considering that many of these households have limited wealth, down payment mandates could significantly reduce the number of future first-time homebuyers.⁸⁴ This reduced pool of buyers could lead to lower home prices, more difficulty selling an existing home, and even some existing borrowers defaulting on their mortgage.

Not only is there a huge cost to legislatively mandating down payments, but there is also a limited benefit in terms of reducing default rates. When looking at loans that already meet the product requirements for a Qualified Mortgage, a UNC Center for Community Capital and CRL study shows that these requirements

⁸² LAURIE GOODMAN ET AL., TIGHT CREDIT STANDARDS PREVENTED 5.2 MILLION MORTGAGES BETWEEN 2009 AND 2014 (2016), AVAILABLE AT <http://www.urban.org/urban-wire/tight-credit-standards-prevented-52-million-mortgages-between-2009-and-2014>.

⁸³ CRL years-to-save calculations are based on purchase of a 2011 median priced house (\$173,600) by borrower with median income in 2011 (\$50,502). Assumes an annual savings rate dedicated for down payment of 2.6%. Median income for 2011 is from American Community Survey. Savings rate assumption is derived from the Bureau of Economic Analysis's (the 1-year average of the BEA's personal savings rate from July 2012-July 2013 is 4.9 percent; the 20-year average was 5.0 percent). However, the BEA's rate is based on take home, not gross, income, and therefore, a 5.0 personal savings rate translates to a 3.6 percent rate for gross income, assuming a combined federal, state and local tax rate of 28 percent (see effective tax burden for the middle 80s.html?pagewanted=all&_r=2&). Assumes that, of this 3.6 percent, 1 percentage point must be used by families for retirement, college, and emergencies, leaving 2.6% available for homeownership savings.

⁸⁴ See The State of the Nation's Housing, Joint Center for Housing Studies, at 3 (2013) (stating that "[m]inorities—and particularly younger adults—will also contribute significantly to household growth in 2013–23, accounting for seven out of ten net new households. An important implication of this trend is that minorities will make up an ever-larger share of potential first-time homebuyers. But these households have relatively few resources to draw on to make downpayments. For example, among renters aged 25–34 in 2010, the median net wealth was only \$1,400 for blacks and \$4,400 for Hispanics, compared with \$6,500 for whites. Even higher-income minority renters have relatively little net wealth, with both blacks and Hispanics in the top income quartile having less than half the average net wealth of whites. Proposed limits on low-downpayment mortgages would thus pose a substantial obstacle for many of tomorrow's potential homebuyers.").

cut the overall default rate by almost half compared with loans that did not.⁸⁵ Layering on a down payment requirement on top of these protections produces a marginal benefit.⁸⁶ This makes sense, because risky product features and poor lending practices caused the crisis by pushing borrowers into default, and the Dodd-Frank Act reforms address these abuses. The Qualified Mortgage and Ability-to-Repay reforms restrict risky features such as high fees, interest-only payments, prepayment penalties, yield-spread premiums paid to mortgage brokers, lack of escrows for taxes and insurance for higher priced mortgage loans, teaser rates that spiked to unaffordable levels even with constant interest rates, and outlawing no-doc loans. These reforms address the unaffordable and abusive loan products that caused the crisis.⁸⁷

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

Throughout these remarks, the federal government’s role in furthering housing discrimination within the mortgage market has been described. Now, is the appropriate time to fully investigate the impact of those discriminatory practices on the ability of families of color to build wealth through homeownership in an equitable manner with whites. According to recent research by Prosperity Now, it will take 228 years for the average African-American family to reach the level of wealth white families own today.⁸⁸ For the average Latino family, matching the wealth of white families will take 84 years.⁸⁹ The U.S. Commission on Civil Rights should convene hearings to probe and complete an official record of this discrimination similar to work done by the Financial Crisis Inquiry Commission following the Housing Crash of 2008. Once an official record is completed, Congress should request that the Congressional Budget Office issue a report on the economic impact of the discrimination and offer legislative action that directly addresses this discrimination.

VI. Conclusion

In 2018, America will commemorate 50 years of the passage of the Fair Housing Act of 1968. Many of the promises of that important legislation have yet to be realized, especially within the nation’s housing finance system. Congress has a unique opportunity to reform the secondary mortgage market in a more equitable manner. Such action will allow far more American citizens the opportunity to thrive and keep smaller lenders on equal footing with large national banks. Congress must also act with extreme care and build upon existing reforms that have stabilized the marketplace and made it safe for consumers and lenders alike.

⁸⁵ ROBERTO G. QUERCIA, ET AL., BALANCING RISK AND ACCESS: UNDERWRITING STANDARDS FOR QUALIFIED RESIDENTIAL MORTGAGES, CENTER FOR RESPONSIBLE LENDING AND UNC CENTER FOR COMMUNITY CAPITAL (Revised 2012), stating that “[l]oans consistent with the QM product features—which include both prime and subprime loans—have fared extremely well, with just 5.8 percent of loans either 90+ days delinquent, in the foreclosure process, or foreclosed upon as of February 2011. In comparison, the default rate for prime conventional loans in our sample was 7.7 percent, nearly two percentage points higher...[T]he rates for the subprime and Alt-A market segments [were] 32.3 and 22.3 percent, respectively.” AVAILABLE AT <http://www.responsiblelending.org/mortgage-lending/researchanalysis/Underwriting-Standards-for-Qualified-Residential-Mortgages.pdf>.

⁸⁶ *Id.* at 18.

⁸⁷ SEE DEBBIE GRUENSTEIN BOCIAN, ET AL., LOST GROUND, 2011: DISPARITIES IN MORTGAGE LENDING AND FORECLOSURES, CENTER FOR RESPONSIBLE LENDING AND UNC CENTER FOR COMMUNITY CAPITAL (2011), AVAILABLE AT <http://www.responsiblelending.org/mortgagelending/research-analysis/Lost-Ground-2011.pdf>.

⁸⁸ DEDRICK ASANTE-MUHAMMAD, ET AL., THE ROAD TO ZERO WEALTH: HOW THE RACIAL WEALTH DIVIDE IS HOLLOWING OUT AMERICA’S MIDDLE CLASS, PROSPERITY NOW, 5 (2017), AVAILABLE AT https://prosperitynow.org/files/PDFs/road_to_zero_wealth.pdf.

⁸⁹ *Id.*