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Mr. Alfred M. Pollard, General Counsel
Attention: Comments/RIN 2590-AA49
Federal Housing Finance Agency
Eighth Floor, 400 Seventh Street SW
Washington, DC 20024

RE: The Federal Housing Finance Agency's proposed housing goals for Fannie Mae and Freddie Mac for 2012-2014

Dear Mr. Pollard:

Thank you for the opportunity to comment on the critical issue of the Enterprises' single-family housing goals, established by the Safety and Soundness Act (1992) and amended by HERA (2008); and as implemented by 12 CFR §1282.12.

The Center for Community Capital at the University of North Carolina at Chapel Hill conducts research to help policymakers, advocates, and the private sector find sustainable ways to broaden economic opportunity. In a recent book, *Regaining the Dream*, UNC Center for Community Capital researchers examine how to ensure broad access to mortgage credit while minimizing risk. *Regaining the Dream* aggregates over a decade of Center for Community Capital research, providing ample evidence that serving the market broadly, including households with lower incomes, can be done profitably and in accordance with safety and soundness.

One of the stated objectives of the conservatorship is to "ensure profitability in the new book of business without deterring market participation or hindering market recovery." We underscore the importance to the health of the overall market of maintaining a steady supply of responsible credit to qualified lower income households –those who arguably benefit most from it.

We applaud that the housing goals have been observed and the measures improved during conservatorship. While previous housing goals were not responsible for the mortgage crisis, it is clear that the metrics needed improvement. Done right, the goals can be a tangible indicator of the effectiveness of the Enterprises. Even as FHFA seeks to gradually shrink the market's reliance on the Enterprises, the Enterprises should remain focused on this vital role.

Our concern is that the new proposed benchmarks go in the opposite direction, down from more than a quarter of the relevant market (all eligible conventional conforming loans) to 20% for purchase loans to low-income borrowers (those earning no more than 80% of area median income), and are also reduced for the very-low income borrowers and the low-income areas home purchase goal. We question the rationale for reducing the benchmarks given that the Enterprises have consistently outperformed the proposed targets and that FHA share, while still high, is declining. If anything, the performance should be improving. We note that underwriting and pricing actions taken by the Enterprises themselves can play an important role in determining the share of lower income borrowers they serve.

Below, we address these points in more detail:

Serving the market broadly, including households with lower incomes, can be fully consistent with safety and soundness. There is ample evidence that lending to lower-income households and communities can be consistent with safety and soundness. Moreover, multiple studies using robust regression-discontinuity research designs have rebutted the notion that the Enterprises' affordable housing goals contributed to the increase in credit risk that occurred during the housing bubble (e.g., Bhutta 2008; Avery and Brevoort 2011; Hernandez-Murillo et al. 2012; and Bolotnyy 2012). For example, Hernandez-Murillo et al. (2012) find no evidence that the housing goals affected the volume, pricing, or performance of subprime mortgages originated in California and Florida between 2004 and 2006.

Further, the Financial Crisis Inquiry Commission (FCIC) determined that the housing goals were not the reason behind the Enterprises' purchases of riskier loans and mortgage-backed securities (MBS). Separate analyses on behalf of both Enterprises calculated that the cost of the housing goals between 2000 and 2003 was effectively zero, as the goals were reached through normal business. Afterwards, only 4% of loans purchased by Freddie Mac were bought specifically because they contributed to the housing goals. These loans were expected to account for 19% of total projected credit losses—and Freddie had adjusted their guarantee fees accordingly— but they had actually accounted for just 8% by late 2008 according to the materials obtained by the FCIC.

Instead, a disproportionate share of the Enterprises' credit losses came from Alt-A mortgages, which did not contribute to meeting the goals.[1] Large Enterprise losses also came from purchases of MBS. The Financial Crisis Inquiry Commission determined that, while whole loan purchases were adequate to meet the Enterprises' housing goals, non-agency MBS were sometimes structured to improve performance on certain subgoals. Enterprise purchases of private-label MBS is an inversion of their traditional role and bypasses their underwriting standards, which serve as a standard for the industry as a whole. Fortunately, 12 CFR §1282.16(b)(13) specifically excludes the purchase of private label securities from either the numerator or denominator in calculating housing goal performance as of 2010, a major improvement over the prior metric.

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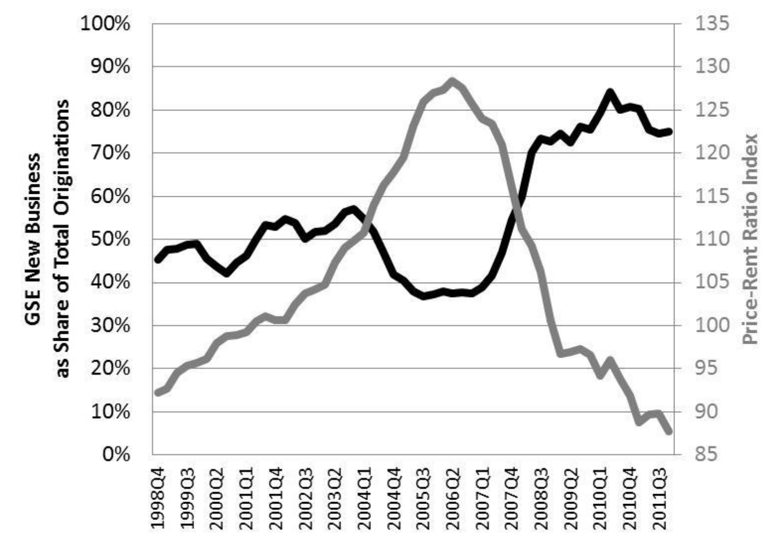
[1] For illustration, Fannie Mae's Credit Supplements shows that Alt-A loans accounted for less than 12% of the Enterprise's single-family conventional book of business in 2007, but these mortgages accounted for nearly 46% of its credit losses in 2008 – the year it went into conservatorship. For more, see Park (2010).

We commend improvements to the housing goals made under conservatorship. The first, already mentioned, is the exclusion of securities and loan types which do not further access and affordability, some of which may even be detrimental to borrowers. The use of "dual" measures, both prospective benchmarks and retrospective actual market performance, allows for a flexible approach that is more responsive to market conditions. Likewise, distinguishing between purchase loans and refinances makes for more reliable benchmarks and improves the ability to gage how different benefits of the system are delivered. Finally, the benchmarks are now better aligned with the Community Reinvestment Act objectives operating in much of the primary market.

The health of the overall market depends on the Enterprises maintaining a flow of credit. The Enterprises have provided stabilizing, countercyclical liquidity to the housing market. From 2004 to 2006, the Enterprises saw their share of the market diminish, only to dramatically increase as the bubble burst. Since 2007, the Enterprises have accounted for 70-80% of the mortgage market (see Figure 1).

Figure 1 – GSE's Countercyclical Market Share

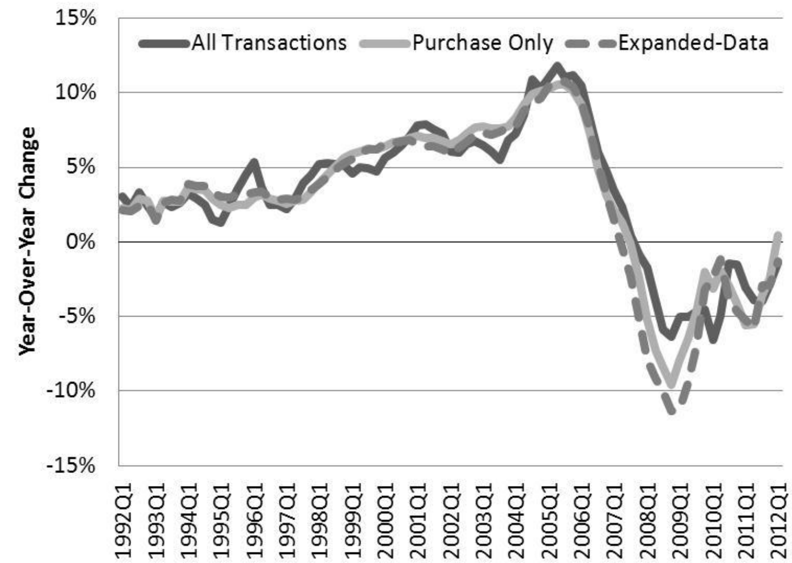


Note: Price-Rent Ratio is home price scaled by owners' equivalent rent of residences and indexed to average since 1991.

Source: *Mortgage Market Statistical Annual*, Inside Mortgage Finance; Federal Housing Finance Agency Expanded-Data Home Price Index; Bureau of Labor Statistics

Despite the high level of Enterprise support, the housing market has yet to show sustained recovery. Of the quarterly home price indices developed by the Federal Housing Finance Agency, only the index using only home purchase mortgages has ever shown a year-over-year increase since 2007—a 0.4% increase between 2011Q1 and 2012Q1 (see Figure 2). Of course, these markets cannot be expected to recover as long as the general economy remains depressed, but housing remains a key deterrent to recovery.

Figure 2 – Year-Over-Year Change in House Prices



Source: Federal Housing Finance Agency

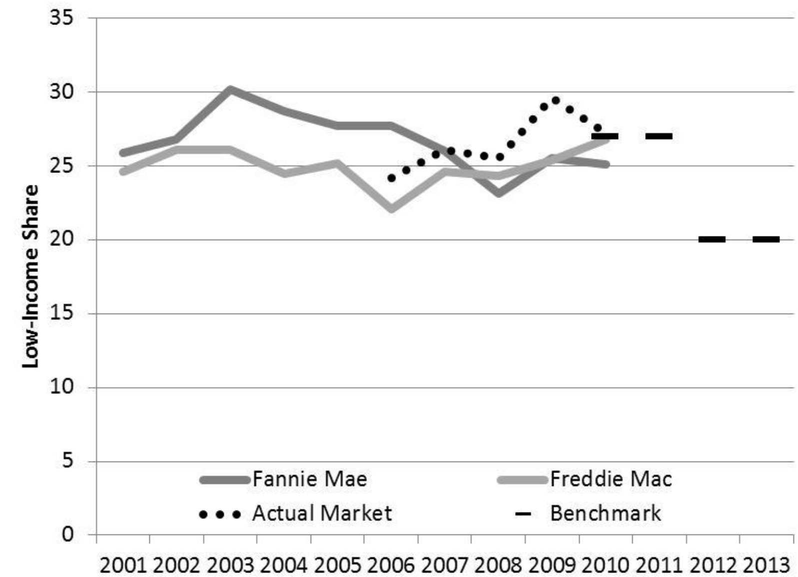
Nevertheless, the FHFA has announced steps to reduce the role of the Enterprises in the market. We caution against premature withdrawal of Enterprise support, particularly without a replacement plan. In particular, the uncertainty regarding the implementation of Dodd-Frank and other financial reforms requires a known entity continue to lead the recovery. Lower-income families and communities are likely to be especially affected by regulatory reforms and institutional changes to the mortgage market.

Any withdrawal must preserve access for all qualified households, including lower- income families. Reducing the role of the Enterprises in the mortgage market should be done while preserving the value of the government guarantee – rather than pulling back – from those borrowers who benefit from and rely on it most. Higher targets would encourage the Enterprises to reduce their relative lending in the portion of the market that is most affluent.

We are concerned that instead, FHFA has proposed lowering the housing goals, particularly the Low-Income Home Purchase Goal for families with incomes no greater than 80% of area median income. The new goal of 20% is less than the previous benchmark of 27%. In fact, the rationale for dropping the benchmark is not at all clear, for several reasons.

First, as shown in Figure 3, the Enterprises have been performing above the new proposed benchmark historically, even after adjusting for changes in how the qualifying market is calculated. Why should the new benchmarks be set below the historical record of either the Enterprises' performance or the actual market?

Figure 3 – Historical Low-Income Goal Performance



Source: Federal Housing Finance Agency

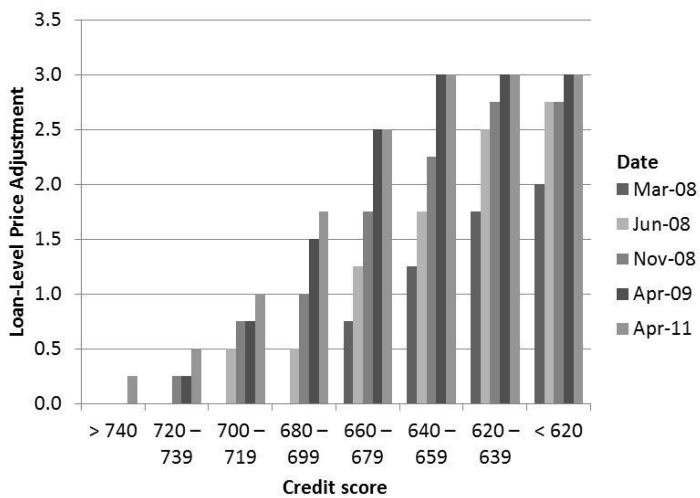
Second, performance should ultimately be measured by actual market share. The dual measurement approach described in the Federal Register states, "An Enterprise has failed to meet a goal if its annual performance falls below *both* the benchmark level *and* the actual share of the market that meets the criteria for a particular goal for that year" (emphasis added). Setting prospective benchmarks substantially below the actual market share, as the proposed benchmarks appear to do, would enable the Enterprises to meet the letter of goals without satisfying the spirit in which they were created. Moreover, the benchmark could become a self-fulfilling prophecy given the dominant current position of the Enterprises in the conventional market. That is, a reduction in Enterprise funding to lower income families will in turn reduce this segment's representation in the reference market, seemingly justifying the low benchmark.

The role of FHA is not a justification for lowering benchmarks. While FHA endorsements are still at historically high levels, the volume of endorsements has actually been falling in the recent years. According to Inside Mortgage Finance's *Mortgage Market Statistical Annual*, FHA insured $205.54 billion in new mortgages in 2011, down 45% from the $375.79 billion in 2009. FHA's market share of total originations similarly fell from almost 21 to 15%. Consequently, if both Fannie Mae and Freddie Mac have been able to devote around a quarter of their conventional purchases to low-income families, even in 2009, they should be expected to commit at least as much in the future.

The Enterprises' own actions play an important role in housing goal performance*.* As the FHFA notes, "Underwriting standards in the mortgage market generally, and at Fannie Mae and Freddie Mac in particular, have tightened considerably since 2008…" While tightening is warranted in the face of market risks, overly restrictive guidelines disproportionately affect lower-income and minority households and communities (Quercia, Ding and Reid, 2012).

The Enterprises' use of Loan-Level Price Adjustments also plays a role. By increasing the cost of mortgages to certain segments (see example in Figure 4), these price adjustments may run counter to duty to serve and result in disparate impacts by borrower race and income (Rust 2011). Higher mortgage costs may prevent applicants from becoming homeowners. Alternatively, higher conventional pricing may deflect some borrowers to FHA instead.

Figure 4 – Loan-Level Price Adjustments



Note: LLPAs are for mortgages with loan-to-value ratios between 75.01% and 80.00%.

Source: Fannie Mae announcements

Conclusion

Ensuring that qualified lower-income households can access the benefits afforded other borrowers in the conforming conventional market is an integral function of the Enterprises and an important contributor to housing market health. By contrast, the financial crisis was precipitated by unregulated mortgage lending that fell largely outside the purview of the Enterprises, and much of which exploited underserved market segments. However, when creditworthy borrowers are provided access to traditional, sustainable loan products, lending to lower -income households and communities has proven to be safe and sound. We commend improvements made to the goals during conservatorship, and strongly encourage the FHFA to maintain the existing prospective benchmarks for Enterprise purchase market housing goals. Thank you for your consideration.

Sincerely yours,

Janneke Ratcliffe
Kevin Park

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