NATIONAL ASSOCIATION OF REALTORS®

August 11, 2023

The Honorable Sandra Thompson
Director
Federal Housing Finance Agency
400 7th Street, SW
Washington, DC 20024

Dear Director Thompson:

On behalf of the 1.5 million members of the National Association of REALTORS® (NAR), we are writing in response to the Federal Housing Finance Agency's (FHFA) request for input on the setting of loan level pricing adjustments (LLPAs) at Fannie Mae and Freddie Mac (the Enterprises). NAR supports the FHFA's efforts to improve the fee setting processes at the Enterprises and to maintain safety and soundness. However, we strongly believe that some of the changes, driven by non-risk related additions to the Enterprise Capital Rule Framework (ECRF), are inefficient, run counter to the Enterprises' charter duties, and should be eliminated. Given the sharp increase in mortgage rates over the last year, no homebuyers should face higher fees at this time. Furthermore, the FHFA should formally adopt a return on equity (ROE) appropriate for market utilities and must establish a robust and durable process for establishing appropriate returns at the Enterprises during conservatorship and after.

NAR is America's largest trade association, including NAR's five commercial real estate institutes and its societies and councils. REALTORS® are involved in all aspects of the residential and commercial real estate industries and belong to one or more of some 1,200 local associations or boards, and 54 state and territory associations of REALTORS®. NAR represents a wide variety of housing industry professionals, including approximately 25,000 licensed and certified appraisers, committed to the development and preservation of the nation's housing stock, along with its availability to the widest range of potential homebuyers.

An Unnecessary Fee Increase

Over the last two years, the FHFA has made three revisions to the Enterprises' LLPA structure. This process is a subtle, but important part of the reform of the Enterprises. As part of this third revision, separate pricing grids were created for purchase, refinance, and cash-out refinance borrowers. REALTORS® applauded the FHFA for eliminating its second proposed change, a fee on borrowers with debt-to-income ratios (DTIs) greater than 40 percent, which was slated to be implemented August 1, 2023.

The other significant change to the LLPA structure in the third revision was a fee reduction for borrowers with credit scores below 680 as well as many borrowers with higher scores but lower down payments. Both changes were made in response to the ECRF including recognition of private mortgage insurance paid by riskier borrowers. REALTORS® appreciate the reduced fee on borrowers paying PMI given the spike in mortgage rates and strong price growth in recent years that weigh on affordability for all homebuyers. Furthermore, the LLPA reduction will help the Enterprises balance the 30-basis point reduction in the Federal Housing Administration's mortgage insurance premium implemented on March 20, 2023. This change was a responsible move to support the Enterprises' role in the entry-level portion of the market.

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The third significant change in the LLPAs was an increase on borrowers who make down payments of 5 percent to 25 percent and with credit scores greater than 680. For instance, as depicted in the table below, a borrower with a 730-credit score and 17 percent down payment will see their annual mortgage rate jump by 15 basis points or the difference between 6.0 percent and 6.15 percent. The increase resulted from a new minimum capital charge introduced in the ECRF that doesn't reflect risk from the borrower. This group is a significant segment of the Enterprises' portfolio and represents both trade-up borrowers and middle-wealth Americans. These borrowers face the same surge in financing costs as entry level homebuyers experienced over the last year.

	May 1st LLPA Changes Converted to Annual Rate Add-ons								
	< 30.00%	30.01 – 60.00%	60.01 – 70.00%	70.01 – 75.00%	75.01 – 80.00%	80.01 – 85.00%	85.01 – 90.00%	90.01 – 95.00%	95.01 – 97.00%
>760	0	-5	-5	-10	2.5	2.5	0	-10	-12.5
760-779	0	-5	-5	-5	7.5	7.5	5	-5	-10
740-759	0	-5	-2.5	-2.5	12.5	15	10	-2.5	-5
720-739	0	0	0	5	10	15	10	7.5	-5
700-719	0	0	-2.5	-2.5	2.5	10	5	2.5	-12.5
680-699	0	0	2.5	-2.5	0	7.5	5	2.5	-7.5
660-679	0	0	-5	-17.5	-17.5	-12.5	-10	-12.5	-20
640-659	0	-10	-2.5	-25	-15	-15	-15	-17.5	-25
<640	-10	-7.5	0	-17.5	-5	-7.5	-12.5	-20	
Source: NAR Calcuation based on Enterprises LLPA Grids									

Utility ROEs Best Fit the Enterprises' Market-Wide Responsibility

While the Enterprises are under conservatorship, the FHFA has a responsibility to conserve their resources, but it also must oversee the companies in compliance with their Congressionally-chartered duty to promote access to mortgage credit throughout the Nation.[1] NAR and colleagues have argued that the Enterprises should be converted to market utilities[2], while others argue that they are already effectively transformed into this structure but await further reforms.[3] As market utilities, the Enterprises should garner returns on equity of six percent to nine percent, well below the near 12 percent[4] returns factored into the pricing models. Furthermore, NAR partnered with market experts Richard Cooperstein and Susan Wachter, demonstrated that the stability of the Enterprises' returns is likely to attract investors to these returns. Attracting the correct investor base to the Enterprises, those with aligned interests in a stable of return rather than profit maximization, is a critical part of the reform process.

Some observers may argue that the credit risk business of the Enterprises does not resemble the stable services of water or electricity utilities. However, those industries face

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[1] https://www.fanniemae.com/sites/g/files/koqyhd191/files/migrated-files/resources/file/aboutus/pdf/fm-amended-charter.pdf
[2] Richard Cooperstein, Ken Fears & Susan Wachter (2019) *A Vision for Enduring Housing Finance Reform*. Working Paper. https://www.nar.realtor/sites/default/files/documents/2019-Working-Paper-A-Vision-For-Enduring-Housing-Finance-Reform.pdf
[3] See comments by former Freddie Mac CEO Don Layton https://themreport.com/news/government/10-19-2022/former-freddie-mac
[4] Richard Cooperstein, Ken Fears & Susan Wachter (2021*) Government-Sponsored Enterprises: Their Viability as Public Utilities*, Housing Policy Debate, 31:1, 33-50, DOI: 10.1080/10511482.2020.1850013 https://penniur.upenn.edu/uploads/media/2-Cooperstein-Fears-Wachter.pdf

challenges from environmental change and investors benefit from the strong, central oversight, standardization, and transparency, such as from the FHFA and Congress, over a broad national market.

REALTORS appreciate that the FHFA has taken an important step in establishing a minimum aggregate ROE since 2018. As NAR previously wrote, a minimum floor will help to prevent the GSEs from competing for market share. However, the FHFA should also impose a ceiling on returns to protect consumers and prevent the enterprises from overcharging the market and to limit their ability to shirk their charter duties.

Finally, utility ROEs should be set using market-based information. The cost of capital is derived from the costs of debt and equity the Enterprises need to fund their guarantees. Debt costs can be derived from the Enterprises' credit risk transfer and reinsurance markets. Equity costs can be estimated from a panel of financial and utility market analysts, while administrative costs are well known. By this method, the Enterprises' cost of capital can be set transparently based on market dynamics and in the process a robust oversight mechanism can be developed in the private market.

Excess Capital Convolutes ROE and Pricing Discussion

The FHFA notes in the RFI that the Enterprises are now earning implied mid-single digit ROEs. These implied ROEs are appropriate to the Enterprises but were achieved for the wrong reason; the level of capital in ECRF is excessive. In November of 2021, NAR wrote[5] the FHFA in response to your request for input on the proposed revision to the Enterprise Regulatory Capital Rule (ECRF*), that the rule retained excessive buffer capital and minimum charges that are not related to risk*. Thus, the Enterprises have excess capital and revenues built into their pricing and cost structures that they should devote to their duties as market utilities, rather than raising fees on middle-wealth borrowers. Specifically, NAR objects to the minimum risk weight of 15% and the stability capital buffer.

The stability buffer undermines the congressionally-chartered mission of the Enterprises to support liquidity in all markets including underserved communities and during periods of stress. Specifically, the stability buffer, which grows in proportion to the Enterprises' role in the market, would rise in a crisis, precisely when the Enterprises should be taking a more supportive role that implies a larger market share. NAR agrees that entities the size of the Enterprises pose a unique risk to the market, but excess capital is no substitute for effective oversight, transparency, and regulation. As evidenced by the issues with oversight and enforcement during the meltdown of Silicon Valley Bank, capital standards are no replacement for effective supervision. Furthermore, the Enterprises use their broad national market to diversify their risks and to spread their costs both horizontally and over time. Given the unique nature of the Enterprises, a more appropriate strategy is converting them to systemically important financial market utilities (SIFMU) that would have greater oversight.

Likewise, the minimum risk weight on all loans of 15% does not align with risk or the Enterprises' unique charter. The minimum risk weight creates a capital requirement for the least risky borrowers, which could result in excess pricing and a market shift. This pattern can raise the risk of the portfolio by shifting good borrowers away and eliminate an important source of financial support for the Enterprises' charter duties.

Finally, the Office of Management and Budget (OMB) has recognized that the Enterprises have a "public mission to provide stability in and increase the liquidity of the residential

[5] https://narfocus.com/billdatabase/clientfiles/172/3/4512.pdf

mortgage market and to help increase the availability of mortgage credit to low- and moderate-income families and in underserved areas."[6] REALTORS® appreciate the FHFA effort to safeguard consumers as well as safety and soundness but reiterate our concern that in specifying capital for individual borrower profiles, those individual capital profiles will in turn be used to specify guarantee pricing for individual borrowers. Without an accompanying framework to outline how the Enterprises should allocate rates of return to support the public mission, these risk-based capital standards could result in risk-based pricing that will increase the cost significantly for those borrowers that the GSEs are explicitly tasked with supporting.

REALTORS® believe that pricing should be aligned with risk. However, pricing can be set at both the individual level through pure risk-based pricing or at the aggregate level that reflects the risk of the overall program and retains appropriate capital. At the same time, REALTORS® believe that the Enterprises should seek to work with the private sector in an appropriate way. Risk-based pricing at the individual level could compromise the ability of the Enterprises to support their charter duties of maximizing market liquidity, while also putting the Enterprises in direct competition with the private sector. To this end, a pricing structure at the aggregate level can satisfy both the safety and soundness and the appropriate relationship with the private sector. Furthermore, capitalizing for the actual risk, while pricing to the market will provide the Enterprises with revenues in excess of the cost of capital and administrative costs, yielding valuable resources for the charter duties.

Furthering Housing Finance Reform

REALTORS® believe the future housing finance system must provide mortgage capital in all markets, at all times, and under all economic conditions while maintaining an explicit government guarantee in the secondary market, which includes the availability of long term, fixed-rate mortgage products (i.e. 30-year fixed-rate mortgage). To this end, there are important steps the FHFA can take to continue housing finance reform.

The sharp increase in mortgage rates over the last two years is likely to cement the role of securitization as depositories are likely to shift away from holding long-term assets. As evidenced by the troubles at the Silicon Valley Bank and others. In addition, the proposed Basel III "endgame" would dramatically increase capital charges for mortgages held in portfolio. This trend suggests the Enterprises will play an even more important role in the market and likely a larger greater share than in the low and falling rate environment of the last four decades.

Under conservatorship, the FHFA has established guarantee fees that limit the Enterprises' ability to drive out competition or to extract excess profits. The FHFA should continue its important work to develop a process that sets a band of returns for the Enterprises' cost of capital to use in establishing their g-fees and pricing **outside of conservatorship**. As mentioned above, this process should be non-political and incorporate an analysis of required returns for equity based on expertise from Wall Street analysts as well as insights from credit risk transfer (CRT) and reinsurance markets for the cost of debt. The process must be transparent, include public comment, and could explore what investments are permissible for profits above established returns (e.g. retained capital, expansion of duty to serve programs, reduced LLPAs, or larger investments in the Housing Trust Fund (HTF) and Capital Magnet Fund (CMF)). Importantly, such a process also recognizes the tenuous relationship between equity capital and charter duties by

[6] https://obamawhitehouse.archives.gov/sites/default/files/omb/budget/fy2017/assets/gov.html

demonstrating how those benefits are portioned and preserved for both investors and those benefiting from charter duties, a necessary step in developing long-term stability.

A second important step is to research the costs and benefits of various forms of a government guarantee. Such a study would analyze the extent of a guarantee (e.g. limited to the MBS and/or extended to the charter duties) and the extent of the backstop (e.g. explicit in legislation, based on a limited line of credit, or implied). The enterprise capital rule, liquidity rule, and living wills are only limited exercises without answering this important question and such a study would benefit any potential future structure for the enterprises.

Further Collaboration

Thank you again for your efforts to revise the Enterprises pricing structure and support the nation's homeowners. Now is not the time for excessive fees on homebuyers. Moreover, the Enterprises are in need of a wholistic review of how prices are set that would direct them towards a robust and durable process that will work inside of and outside of conservatorship. If you have any questions or comments, please feel free to reach out Ken Fears (KFears@Nar.Realtor), Director of Conventional Finance and Valuation Policy.

Sincerely,

Kenny Parcell
2023 President, National Association of REALTORS®