Consumer Federation of America

TESTIMONY OF

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BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
OF THE
UNITED STATES HOUSE OF REPRESENTATIVES

REGARDING

LEGISLATIVE PROPOSALS ON GSE REFORM

MARCH 15, 2007

Thank you Chairman Frank and Ranking Member Bachus for inviting me to testify before you today on "Legislative Proposals on GSE Reform." My name is Allen J. Fishbein and I am the Director of Housing and Credit Policy for the Consumer Federation of America. We commend you for your leadership and dedication in working to improve regulatory oversight of the Government Sponsored Housing Enterprises – Fannie Mae, Freddie Mac, and the Federal Home Loan Banks (GSEs). [1]

CFA is a non-profit association of some 300 pro-consumer organizations, founded in 1968, to advance the consumer interest through education, research and advocacy.[2] My background in the area of GSE regulation includes tenure at the U.S. Department of Housing and Urban Development (HUD), where I served as the Senior Advisor for GSE Oversight. In this capacity I assisted with supervision of the department's public mission regulation of Fannie Mae and Freddie Mac and with coordination of rulemaking to establish affordable housing goals for the two Enterprises.

Consumers have a huge stake in the outcome of GSE legislation. The GSEs are extremely valuable to the nation's housing finance system, making important contributions to expanding the mortgage market and increasing homeownership levels. Their business model requires that all three operate as for-profit entities. However, it is their public mission and affordable housing mandates as prescribed by Congress that make the GSEs unique and that ultimately justify their government charters and benefits afforded them through this status.

Strengthening financial oversight to ensure the GSEs' ongoing safety and soundness is a worthwhile public policy objective. We believe that such legislation can and should be achieved in a manner consistent with these entities congressionally chartered status, their housing mission, and affordable housing activities, and urge that the Committee follow this course. Accordingly, we support revising the present regulatory structure and the creation of a new independent regulator with jurisdiction over all three housing GSEs. We also believe that both financial and mission oversight should be performed by this same regulator. It is also critical that the new financial oversight powers provided are commensurate and appropriate to the task at hand, while not unnecessarily diminishing the ability of the GSEs to continue to perform their vital housing mission activities.

Reaffirming and strengthening the GSEs' mission and related affordable housing activities also should be a central part of any new regulatory regime. Pending consideration of GSE legislation provides an important opportunity to accomplish this objective for all three GSEs. Mr. Chairman, we especially thank you for working to ensure mission considerations and important new affordable housing mandates are a vital part of GSE legislation.

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[1] For today's testimony I use the term "GSEs" when referring to all three entities and the term "Enterprises" when only referring to Fannie Mae and Freddie Mac.

[2] www.consumerfed.org

With a few notable exceptions, the bill introduced last week, H.R.1427, largely tracks the provisions that were part of the legislation passed by this Committee and the House of Representatives in the last Congress (H.R. 1461). I offer specific comments on the bill's affordable housing provisions later in my testimony.

The GSEs' Public Mission Matters to Consumers

Fannie Mae, Freddie Mac and the Federal Home Loan Banks (FHLBs) were established at different times by Congress to ensure the smooth flow of mortgage credit throughout the nation. Each engages in activities that are valuable to promoting a sound housing market and targeting resources for affordable housing activities to benefit less affluent families. Fannie Mae and Freddie Mac accomplish this through their secondary market activities, while the twelve FHLBs are cooperative entities that function somewhat independently of each other and serve as a "wholesale lender" to their financial institution members. Collectively, these entities hold 46 percent of the total mortgage debt outstanding in the United States.[3] Although the Enterprises market share has declined in recent years, through their underwriting and the other standards they employ they continue have sway over who gets credit and on what terms.

The GSEs are owned by private shareholders and operated for-profit or, in the case of the FHLBs, for the mutual benefit of their owner-members. Yet they differ from fully private companies in that they are intended to serve as an instrument of national housing policy and therefore are required to perform a broad public mission and also fulfill certain public policy objectives that are set by Congress. For this reason, the GSEs are granted certain legal privileges and exemptions not generally available to others. They are also limited to a narrow range of business activities deemed important to public policy. Because of the importance of their mission as reflected by their charters and the collection of privileges conferred to achieve that mission, the capital markets continue to infer an implicit government guarantees behind the GSEs. Consequently, the GSEs' are able to fund their operations at lower cost than other firms with similar financial characteristics.

Fannie Mae and Freddie Mac (and in different ways the FHLBs) make important contributions to bringing capital to the mortgage market, which in turn, has helped improve credit access for many consumers. Fannie Mae and Freddie Mac purchase residential mortgages from originating lenders that they use these proceeds to make additional mortgages. Although they hold some whole mortgages in their portfolios, most mortgages are placed in mortgage pools to support Mortgage Backed Securities (MBS) that are issued and then either sold to investors or held in their retained portfolios. They also guarantee timely payment of interest and principal on MBS that they issue. Through these functions Fannie Mae and Freddie Mac have been highly successful at bringing capital into the housing loan market from domestic and international sources which, in turn, works to make mortgage credit available more broadly to U.S. consumers.

[3] Lockhart, James, Director of the Office of Fair Housing Oversight, Remarks before America's Community Bankers Association, Wash, DC, March 5, 2007.

The FHLB system is comprised of twelve publicly chartered and privately owned regional banks which collectively have over 8,000 member financial institutions. Originally members were exclusively savings and loan associations, but today most of these are commercial banks, thrifts and credit unions. Traditionally the primary function of the regional banks was to make loans, known as credit advances, to their members. More recently, the FHLBs have experimented with programs to purchase mortgages directly from their members and hold them in their retained portfolios. This process is similar to Fannie Mae's and Freddie Mac's traditional business activities, although it is not clear that the FHLBs' currently have authority to securitize mortgages.

Congressional Mandates Help Bolster the GSEs' Affordable Housing Activities

In addition to serving the broad mission to promote homeownership, Congress decided more than a decade and one-half ago to require the GSEs to devote more of their investment capital to serving special demands for low- and moderate-income housing finance.

Fannie Mae and Freddie Mac by statute presently are required to meet three broad annual percentage-of- business goals – a low and moderate income goal (up to area median income), an underserved geographic areas goal and a special affordable housing goal directed at very low income and low income households. Established in 1992, the annual housing goal levels are currently set by HUD, the Enterprises mission regulator. These goal levels have risen steadily since 1996.

In November 2004 HUD issued a final rule that established new housing goal levels for calendar years 2005 through 2008. Under this rule the goals increase gradually over this period. For 2007 the overall low and moderate income goal is 55 percent, meaning that at least 55 percent of the dwelling units in properties whose mortgages are purchased by each of the Enterprises' must be occupied by eligible low and moderate income households.

Both GSEs have regularly met the annual housing goals set for them. There is also some research evidence indicating that the affordable housing goals have played a role in helping to boost low-income and minority homeownership rates.[4]

The HUD analysis for the most recent rulemaking to set goal levels indicated that the GSEs' on average tended to be less successful in purchasing qualifying mortgages than their share of the overall market. Important market segments where the department's analysis indicated that the GSEs could step up their performance include first-time homebuyers, especially minority first-time home buyers, credit impaired borrowers, the single and multifamily rental housing market, including loan purchases for rehabilitation of these properties. At the same time, the most recent HUD data (through 2003) shows that Fannie Mae in particular matched or led the market in many low and

[4] Ambrose, Thibodeau, Temkin, An Analysis of the Effects of the GSE Affordable Housing Goal on Low- and Moderate-Income Families, prepared for HUD by The Urban Institute, 2002.

moderate income loan categories. Freddie Mac also has shown improvements in many of the same market segments.[5]

Congress also expanded the role of the FHLBs in providing capital for affordable housing as part of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) of 1989. This act, among other things, mandated the establishment of an Affordable Housing Program (AHP) that requires each FHLB to devote at least 10 percent of net earnings to the program. These funds are used to provide grants and write-downs of loans to support the financing of lower income homeownership and rental housing. FIRREA also required the establishment of a targeted cash advance program for eligible affordable housing and community development activities. Such advances are provided to member institutions at the FHLBs' cost of funds.

H. R. 1427 Would Strengthen Affordable Housing Mandates for Fannie Mae and Freddie Mac

The statutory affordable housing responsibilities for the GSEs have remained mostly unchanged since their inception in the early 1990s and late 1980s. H.R. 1427 seeks to update and expand upon existing requirements. This includes extensive revisions to the affordable housing goals structure, the creation of an Affordable Housing Fund, and other steps to improve mission oversight:

- *Establishment of Assessment Authority for Mission Oversight (Sec 106)*

  Although often overlooked, the lack of mission oversight assessment authority has hampered efforts by HUD, the present mission regulator, to provide needed oversight in some areas. Unlike most bank regulators, HUD continues to be dependent upon the congressional appropriations process to fund its activities in this area. When I was at the department direct appropriations for this work was not provided and consequently, this important work tended to be under-funded. The new authority the bill provides should enable the mission oversight function to be sufficiently funded in the future.

- *Revisions to the Affordable Housing Goals (Sec. 125)*

  HR 1427 (as did the former House passed bill) revises the goals structure. In particular, it replaces the three present goals with more targeted purchase money goals. It also provides tighter income targets that bring these standards into alignment with Community Reinvestment Act (CRA) income requirements for banks and thrifts. The hope is that through tighter income targeting Fannie Mae and Freddie Mac would be directed to increase the focus of their mortgage purchase activities low income households and communities.

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[5] Final Rule, HUD's Housing Goals for Fannie Mae and Freddie Mac for the years 2005-2008, 69 Federal Register 63580, November 2, 2004.

We are particularly pleased that this year's legislation would require a separate home refinance subgoal for low income families. The inclusion of a home refinance component has been part of the housing goals structure from the beginning. Establishing annual home refinance subgoals will encourage the Enterprises to be active in this market. Their increased involvement provides alternatives for low income homeowners who otherwise may be forced to refinance their homes with predatory lenders that continue to plague this market.

We also favor establishment of a new Multifamily Special Affordable Housing Goal. HUD currently applies an annual volume figure that operates more like a floor than a goal. A new needs based goal would provide an incentive for the Enterprises to become more active in financing multifamily rental housing, including smaller multifamily rental housing, serving low income households.

Creation of a new Enterprise "duty to serve" for certain designated underserved markets should also help. Market segments specifically included are manufactured housing, affordable housing preservation and rural housing. The Enterprises would be evaluated on the activities they undertake to serve important housing needs that may not represent the volume look to for their normal book of business. We suggest that this provision enable the regulator from time to time to add to this list.

Recommendations for additional refinements to these provisions:

First, based on my reading, the bill excludes single family rental housing from future goals' calculations. Since single family rental housing represents a rich source of housing for lower income families we suggest it remain as part of the single family housing goals.

Second, the method for calculating annual housing targets may work to understate market size in rural areas. Home Mortgage Disclosure Act data would be used to make the initial determination on market size based on a three year rolling average. However, while HMDA represents a reasonably accurate measure for sizing metropolitan area markets, it tends to be less useful for rural areas. Permitting the use supplemental data for determining rural housing market size would help to correct for this problem.

Third, we have concerns about the deletion of "ability to lead the market" as a factor for determining annual goal levels. This factor recognizes that Fannie Mae and Freddie Mac through their activities are have great capacity to expand market size not just seek to match it. In fact, has proven quite useful to establish stretch goals that seek to increase mortgage activity for underserved markets.

Finally, much has changed in mortgage lending since the affordable housing goals were first mandated. Today's problems often have more to do with the quality of mortgage credit provided to consumers rather than credit access problems that once were all too prevalent. HUD regulations at present permit the department to make a determination through rulemaking to disallow goals credit for the purchases of mortgage loans with features deemed to be "contrary to good lending practices." A number of practices already identified are based on corporate policies adopted by Fannie Mae and Freddie Mac. Indeed, both Enterprises have gone further than these rules with their own corporate practices. Several years ago they decided to discontinue the purchase of mortgages with mandatory arbitration clauses and to also limit prepayment penalties. These steps have helped reduce the use of these often predatory practices by lenders.

Freddie Mac's recent announcement that it would stop buying or otherwise invest in certain subprime hybrid adjustable rate mortgages is yet another example. Presently, HUD can take similar steps to prevent these mortgages from being counted for goals qualifying purposes.[6] Accordingly, we think it useful for the new regulator to be specifically directed through the legislation to continue to use this authority.[7]

- *Establishment of an Affordable Housing Fund (Sec. 128)*

We strongly support the establishment of an Affordable Housing Fund as part of any GSE legislation. Such a fund would provide an estimated $500 million a year to support a host of very need activities, many of which are not supporting through the mortgage purchase activities of the Enterprises. The bill would require that funds from the two Enterprises be earmarked through contributions and would be tightly targeted to serve the needs of very low income and extremely low income households primarily through bricks and mortar rental housing production and rehabilitation.

- *Annual Housing Report Regarding Regulated Entities (Sec. 124)*

Detailed annual reporting by the regulators on affordable housing activity would help to address the long-standing "information vacuum" that seems to surround GSE affordable housing activities. Thus we favor this requirement, but suggest an addition: that subsection (7) also require annual reporting on any activities undertaken by the regulator with regard to ensuring that the Enterprises underwriting and appraisal guidelines are consistent with the Fair Housing Act (see Sec. 1325 (6)).

Greater transparency also would help to improve the utility for users of the Public Use Data Base. The PUDB is intended to provide the public with information on the annual mortgage purchase activities of Fannie Mae and Freddie Mac. At a minimum, this data base should parallel the data elements reported by mortgage lenders under the Home Mortgage Disclosure Act. This is not now the case.

[6] "*Freddie Mac announces tougher subprime lending standards to help reduce the risk of future borrower default*," February 27, 2007.
[7] Mortgage Contrary to Good Lending Practices, 24 CFA Sec. 81.16.

- *Federal Home Loan Banks (Title II)*

We continue to believe that GSE legislation provides an opportunity to strengthen the affordable housing and community economic development financing requirements for the FHLBs. To the In particular, we favor the establishment of public use data base that discloses loan level data for each FHLBs' core business activities, affordable housing and community investment activities comparable to the data base that exists for the mortgage purchase activities for Fannie Mae and Freddie Mac.

We also favor the inclusion of a provision that would direct the new regulator to establish appropriate public purpose performance goals for the FHLBs' core advance and mortgage purchase activities. The current requirement that at least 40 percent of the board of directors' seats for each FHLB be comprised of Public Interest Director, including at least two specifically for Community Interest Directors should be retained.

Thank you again, Mr. Chairman for the opportunity to offer our views on this important subject. We look forward to working with you and other committee members as the bill progresses.