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September 8, 2014

The Honorable Melvin L. Watt
Director
Federal Housing Finance Agency
400 7th Street SW
Washington, DC 20024

Dear Director Watt:

I write on behalf of the over one million members of the National Association of REALTORS® (NAR) to respond to the Request for Input on the guarantee fees (g-fees) that Fannie Mae and Freddie Mac (the government-sponsored enterprises or Enterprises) charge lenders; and to raise concerns about implementation of proposed increases to both the g-fee and upfront fees charged to borrowers (loan level pricing adjustments or LLPAs).

NAR is America's largest trade association, including our eight affiliated Institutes, 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 1,400 local associations or boards, and 54 state and territory associations of REALTORS®.

Background

Fannie Mae and Freddie Mac buy single-family mortgages from mortgage companies, commercial banks, credit unions, and other financial institutions. A key revenue component for the Enterprises is a guarantee fee received for guaranteeing the payment of principal and interest on their mortgage backed securities (MBS). The g-fee is a significant factor in determining profits earned from this credit guarantee. The g-fee covers projected credit losses from borrower defaults over the life of the loans, administrative costs, and a return on capital. FHFA's announcement on December 9, 2013, will result in g-fees that are more than double the level of fees in 2007.

In March 2008, the Enterprises implemented two new fees. The first was an upfront adverse market fee of 25 basis points that was intended to protect against the heightened credit risk posed by deteriorating housing market conditions. At the time, the adverse market fee was equivalent to an ongoing guarantee fee of approximately five basis points. The second new fee was loan level pricing adjustments (LLPAs), which are additional fees based on loan-to-value (LTV) ratios, credit scores, and other risk factors. Both of these charges, like the g-fee, are passed onto borrowers, typically in the form of higher mortgage rates, since borrowers often use available cash to contribute toward down payment, rather than additional fees. In addition to the LLPAs, ongoing g-fees are included in the interest rate charged to the borrower, while borrowers with LTVs higher than 80 percent will often contribute hundreds of

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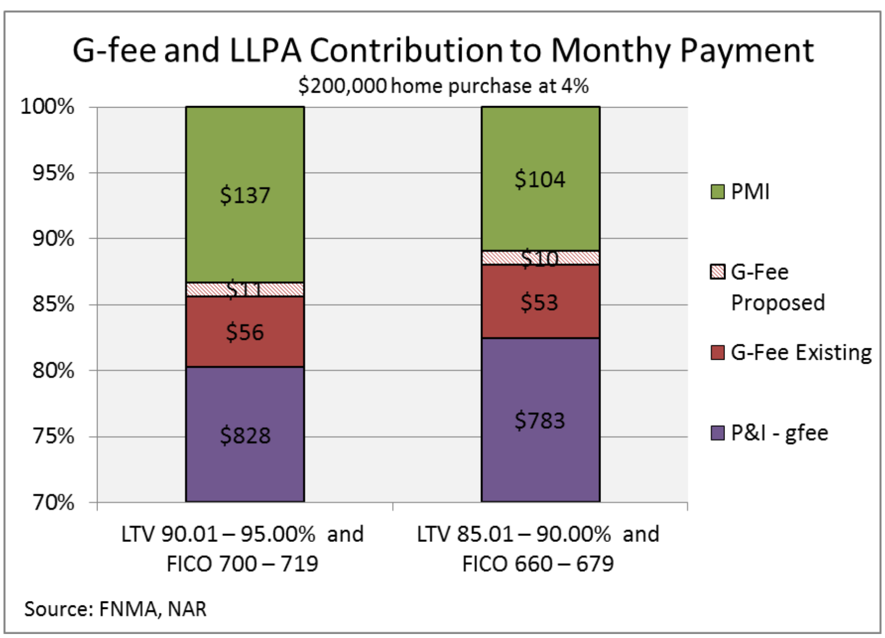
dollars a month toward mortgage insurance premiums that protect the Enterprises for losses well beyond that. As an example, Exhibit 1 shows the additional fees borrowers at different down payment levels are required to pay to the Enterprises.

Exhibit 1

LLPAs and AMDC Paid Upfront on $200,000 Home								
	< 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%
> 740	$0	$325	$363	$775	$825	$875	$925	$960
720 – 739	$0	$325	$725	$1,163	$1,238	$1,313	$1,388	$1,440
700 – 719	$0	$975	$1,450	$1,938	$2,063	$2,188	$2,313	$2,400
680 – 699	$300	$975	$2,175	$3,100	$2,888	$2,625	$2,775	$2,400
660 – 679	$300	$1,625	$3,263	$4,263	$4,950	$4,375	$4,625	$3,840
640 – 659	$900	$1,950	$3,988	$5,038	$5,775	$5,250	$5,550	$4,800
620 – 639	$900	$2,275	$4,713	$5,038	$5,775	$6,125	$6,475	$6,240
< 620 (1)	$900	$2,275	$4,713	$5,038	$5,775	$6,125	$6,475	$6,720
Source: FNMA, NAR								

Accordingly, a borrower with a down payment slightly under 10 percent will pay for credit protection to the Enterprises in the form of $2,313 in upfront fees (if they are able to) and ongoing monthly guarantee and credit insurance costs that represent 18.9 percent of their monthly mortgage payment as shown in Exhibit 2. To provide context, the borrower in this example is paying for mortgage insurance coverage up to 30 percent in losses, which exceeds the charter requirement for 20 percent protection, based on the purchase price or the appraised value of the house[1].

Exhibit 2



NAR's foremost concern is that a continued increase in these already elevated fees directly impacts the cost and, ultimately, access to conventional mortgages for an ever increasing number of borrowers. While these changes have a strong likelihood of impacting many borrowers, NAR is especially concerned with the disparate impact the changes will have on first time homebuyers and other traditionally underserved borrowers. These families are more

[1] 12 U.S.C. 1454(a); 12 U.S.C. 1717(b).

likely to bear the brunt of these fees typically due to credit histories that do not reflect payments toward housing expenses and smaller down payments than made by other borrowers. Though REALTORS® agree that it is prudent to protect taxpayers against further Enterprise losses, FHFA policies must avoid the unintended consequence of raising fees so high that they choke off the housing recovery by making many potential homebuyers ineligible for loans at precisely the time when property investors, who have recently buoyed the market, are beginning to exit.

Below are NAR's general concerns about FHFA's proposed increases to g-fees and LLPAs announced on December 9, 2013; also included are detailed responses to FHFA's Request for Input on questions related to g-fee policy and implementation in the accompanying appendix.

Guarantee Fees Should Protect Taxpayers From Losses, Not Increase Profit

Continued increases in g-fees and upfront borrower costs will extend a trend of reduced access to mortgage credit, which is counter to a principal duty of the FHFA Director under the Housing and Economic Recovery Act of 2008 (HERA).[2] Continuing to increase the fee will mean that larger numbers of consumers, many of them first time homebuyers, will be forced to pay substantially higher mortgage rates, or be left with limited housing finance options. NAR believes borrowers who are either purchasing a home or refinancing their existing mortgage using conventional financing are being charged excessive fees due to policy goals that go beyond protecting taxpayers from Enterprise losses.

On December 13, 2013, as part of a yearly analysis of g-fees, FHFA indicated that, at its direction, Freddie Mac and Fannie Mae implemented new costing models in 2012 that resulted in sizeable increases in the Enterprises' estimates of the cost of guaranteeing single-family mortgages.[3] Though these changes don't reflect the reduced credit losses the Enterprises experienced throughout 2013, FHFA indicated that it believed that the estimates more fully reflected the credit risk posed by the loans, thus substantiating continued increases to g-fees. It should be noted, that the same report indicated that the Enterprises were guaranteeing a substantially lower amount of "high-risk" loans and that over 87 percent of loans originated were from borrowers with credit scores greater than or equal to 720, contradicting the idea that the estimated increase in costs were based on risk, rather than prescriptive policy measures to try to make high private market rates appear competitive.

Another flaw with the Enterprises' models is that they do not take into account the new regulatory framework under the Consumer Financial Protection Bureau's Ability-to-Repay rule that prevents the highest risk loans from being originated.[4] In addition, the cost models also don't factor improvements in mortgage servicing which will reduce losses should borrowers fall behind on payments. Instead, both of the Enterprises are attempting to achieve a significant target rate of return to guarantee mortgages – well over and above projected losses. NAR's interpretation of this decision is that these fees are excessive and forcing taxpayers to pay substantially higher rates for their mortgages than the actual risk that they pose. As FHFA notes in its Request for Input, the Enterprises' return on capital is positive in *all* borrower loan-to-value and credit score risk buckets, and the "cost" expressed is not actually a cost, it merely reflects a profit that is less than the targeted rate.

As previously stated, our concern is that consumers, taxpayers, and congress will conclude that the excessive returns and enormous profits generated by Fannie Mae and Freddie Mac, at the direction of FHFA, was based on cost models based on charging borrowers substantially higher fees than the actual risk those borrowers present. This policy has seemingly overcharged every taxpayer who has purchased or refinanced their home using conventional financing since 2008, approximately 14.6 million transactions.

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2 12 U.S.C. § 4513(a)(1)(B).
3 Federal Housing Finance Agency, Fannie Mae and Freddie Mac Single-Family Guarantee Fees in 2012. (Link)
4 Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z), 78 FR 6407

It is important that FHFA not encourage policies that target substantial private sector returns for companies serving a public mission while in conservatorship, while generating billions of dollars of profits for the Enterprises.

Private Market Remains Broken, Reducing Access To Financing Won't Fix It

REALTORS® believe that the Enterprises must continue to play a vital role in the success of our nation's housing market by serving as a reliable source of liquidity for housing finance. NAR believes home buying taxpayers are being charged excessive fees due to agency policy goals that cannot be met through pricing. By reducing access to conventional mortgages through g-fee increases, FHFA risks denying homeownership to many creditworthy consumers who are not in a position to meet the extremely risk adverse standards of the private market, best exemplified by the current jumbo lending market.

More private sector participation is essential to a stronger and more balanced housing finance market. Homebuyers who are good credit risks should have access to other financing options. The question is whether higher costs for loans purchased or guaranteed by the Enterprises will have the desired effect of returning private sector capital to the mortgage market. FHFA's continued fee increases to entice a return of private capital does not appear to account for the aversion to, and lack of trust in, issuers of private mortgage backed securities that many investors still harbor since suffering tremendous losses during the recent housing crisis. This lack of trust remains and is hard to quantify. Future data will show that the effect of raising fees will simply be increased costs to home buying taxpayers who can afford to become homeowners, and that the true effect has be redirection of more mortgage loans to FHA without a robust private sector return.

Conclusion

REALTORS® agree that it is prudent to protect taxpayers against further losses and bailouts of the Enterprises. However, it its capacity of conservator, FHFA should not encourage policies or economic models that significantly overcharge consumers in an attempt to achieve exceedingly high Wall Street-like returns that will result in billions of dollars of profits for the Enterprises, while having a negative impact on consumer lending. To do so is counter to one of the Director's principal duties under HERA, and runs the risk of reversing progress being made in our nation's economic recovery.

Policy objectives that would have the Enterprises increase fees with the goal of enticing the private sector back into the mortgage market should not only have performance measures, but the Agency should also examine other factors that are holding back the private market in conjunction with the Treasury Department. An analysis of what it would take to achieve this goal is crucial, especially if the policies do not achieve the intended goal of increasing private sector lending in the mortgage market in the current environment.

Though many have commented that prior to the 2008 financial crisis the Enterprises underestimated projected losses, FHFA's announcement of December 9, 2013 will have result in more than doubling the guarantee fee since 2007. This is a result of credit risk models that don't factor regulatory changes made after the financial crisis such as the Ability-to-Repay rule and improvements in mortgage servicing standards. These rules restrict many of the loans and practices that were responsible for the substantial losses the Enterprises experienced.

The excessiveness of these continued fee increase will harm the nation's housing recovery. First time homebuyers and other traditionally underserved borrowers are more likely to make smaller down payments have been disproportionately affected by the upfront LLPA fees. Given the need to encourage borrowers to return to the housing market, unnecessarily increasing borrowing costs for this class of homebuyers is irresponsible housing policy and impacts borrowers who are essential to our housing recovery.

If you have any questions or would like to meet to discuss these concerns, please feel free to contact Charlie Dawson, NAR's Senior Policy Representative for Financial Services, at 202.383.7522 or cdawson@realtors.org.

Sincerely,

Steve Brown
2014 President, National Association of REALTORS®

APPENDIX

1. **Are there factors other than those described in section III – expected losses, unexpected losses, and general and administrative expenses that FHFA and the Enterprises should consider in setting g-fees? What goals should FHFA further in setting g-fees?**

Guarantee fees should protect taxpayers from losses, not increase profit. The guarantee fee (g-fee) is set to cover projected credit losses from borrower defaults over the life of the loan, administrative costs, and also provides a return on capital with a substantial profit margin. While in conservatorship, both of the Enterprises, along with the acquiescence of the FHFA, are attempting to achieve a significant target rate of return to guarantee mortgages – well over and above projected losses. Many have commented that prior to the 2008 financial crisis that the Enterprises underestimated projected losses, thereby underpricing this fee. FHFA's announcement on December 9, 2013, will result in g-fees that are more than double the level of fees in 2007, while market reforms will further pare-back potential losses.

NAR also suggests that FHFA fully consider the reduction of credit risk on loans with private mortgage insurance coverage (PMI) for which borrowers pay. On loans originated with down payments less than 20 percent, the Enterprises require borrowers to maintain standard PMI coverage at levels exceeding the charter requirement for 20 percent protection.

Lastly, in addition to protecting taxpayers from losses, NAR believes FHFA must consider a principal duty of the Director, which is ensuring the Enterprises serve as a reliable source of liquidity and funding for housing finance and community investment. This includes financing for low- and moderate-income families with a reasonable economic return that may be less that the return earned on other activities.[5] As noted, one of the key assumptions of each Enterprise's costing model is its uniform target rate of return on required capital, which then misrepresents the estimated 'cost' of providing financing for these families. As FHFA notes in the request, the Enterprises are profitable on *every* risk bucket across the credit score and LTV spectrum.

3. **Currently, target return on capital and the amount of capital largely determine required g-fees. What factors should FHFA and the Enterprises consider in setting target return on capital and amount of capital required? How should the Enterprises allocate capital across risk buckets?**

Freddie Mac and Fannie Mae implemented new costing models in January and November 2012, respectively. The increases in guarantee fees, produced by the new costing models at FHFA's direction, were unsurprisingly consistent with FHFA's higher estimates of the costs of bearing the credit risk of single-family mortgages.[6] Each Enterprise's new model resulted in sizeable increases in the Enterprise's estimates of the costs of guaranteeing single-family mortgages. A more prudent approach would be to base assumptions of the costing models on the economics of markets operating under the current regulatory environment that will limit the extent of housing bubbles based on unsustainable lending.

4. **At what g-fee level would private-label securities (PLS) investors find it profitable to enter the market or would depository institutions be willing to use their own balance sheets to hold loans? Are these levels the same? Is it desirable to set g-fees at PLS or depository price levels to shrink the Enterprises' footprints, even if this causes g-fees to be set higher than required to compensate taxpayers for bearing mortgage credit risk and results in higher costs to borrowers?**

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[5] 12 U.S.C. § 4513(a)(1)(B).

[6] Federal Housing Finance Agency, Fannie Mae and Freddie Mac Single-Family Guarantee Fees in 2012. (Link)

FHFA had previously made increasing guarantee fees charged by the Enterprises "closer to the level that other market participants would charge to assume the credit risk" part of its Strategic Plan.[7] This assumed that if the Enterprises continued to increase the fee they charge for the guarantee of the prompt payment of principal and interest on their mortgage backed securities, the high rates that borrowers would pay would be attractive enough to draw private enterprises back into the mortgage market.

As NAR has previously written, there may be many other factors keeping purely private sector lending at low levels. On September 17th, 2013, NAR President Gary Thomas wrote a letter to the FHFA agreeing that more private sector participation would provide for a more balanced housing finance market. However, FHFA's continued fee increases to entice a return of private capital does not appear to account for the aversion to, and lack of trust in, issuers of private mortgage backed securities that many investors still harbor since suffering tremendous losses during the recent housing crisis. In light of these losses suffered by investors in private label mortgage backed securities (PLS), it may be many years before investors will be willing to invest in the PLS mortgage market, no matter how high FHFA raises the guarantee fees charged by the Enterprises.

Furthermore, while elevated pricing can make bank balance sheet lending more attractive in the short term, this avenue is only available for borrowers with the best credit, substantial cash reserves, and significant down payments. Additionally, as these consumers migrate to bank portfolios, the solid profits and reduced risk that these borrowers represent may diminish the Enterprises ability to serve the underserved. In the current environment, high fees cannot stimulate the private securitization market, but will hurt the consumer. Another consideration for FHFA to mull along with other regulators is how an expansion of bank portfolio lending in an environment of rising mortgage rates could be unsound for the long-term health of the housing recovery and mortgage market.

6. Is it desirable for the Enterprises to charge higher g-fees on low credit score/high LTV loans if it causes these loans to be insured/securitized through FHA/Ginnie Mae rather than through the Enterprises?

Charging higher fees cannot cause, with certainty, borrowers to be insured by the FHA and securitized by Ginnie Mae. For borrowers on the margins of qualification guidelines, the rate increase required for pricing parity with the FHA may price the borrower out of the market completely.[8] Further, this increase in rate may push the borrower closer to the rebuttable presumption definition in the "ability-to-repay" Qualified Mortgage (QM) rule and underwriting standard established by the Consumer Financial Protection Bureau (CFPB).[9] Thus far, investors have shown reluctance to participate in this portion of the market.

7. Is it desirable for the Enterprises to (a) charge higher g-fees on high credit score/low LTV loans if it causes these loans to be insured/securitized through PLS or (b) held on depository balance sheets, rather than guaranteed by the Enterprises?

Many borrowers in areas across the country would not qualify under the tight credit standards currently required by the private market. While there has been some return of private lending without the benefit of a federal guarantee, it remains limited and available only to the most highly qualified borrowers with minimum down payments of over 20 percent. These qualifications leave the American dream of homeownership out of reach for many families.

Though some banks have taken small steps to serve affluent borrowers by holding loans on their balance sheet, an analysis of borrowers who may still have access to financing should fees continue to increase must also account for the type of mortgage products that would be available. Currently, institutions typically only offer adjustable rate mortgage products to borrowers whose loans would remain with the bank rather than be securitized. The reduction

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[7] Federal Housing Finance Agency, Strategic Plan Fiscal Years 2013-2017 (Link)
[8] http://economistsoutlook.blogs.realtor.org/2014/07/25/lenders-note-impact-of-higher-fha-fees/
[9] Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z), 78 FR 6407

in the availability of the 30-year fixed rate mortgage leaves the burden and instability of rising interest rates on a large majority of borrowers. This leaves many middle class and older Americans on fixed incomes without the option to responsibly plan for their financial futures.

11. **Taking into consideration that FHFA has previously received input on state-level pricing adjustments, do the g-fee changes proposed in December 2013 have any additional implications that should be considered in deciding whether to price for the length of state foreclosure timelines, unable to market periods or eviction timelines? Are there interactions with other pricing components under consideration that FHFA should consider in making decisions on the state-level adjustments?**

REALTORS® believe that the proposed state-level fee increases are in fact an excessive response to the overwhelming number of cases of foreclosure brought on by the recent housing crisis and delays caused by deficient mortgage servicing practices of the GSEs' own mortgage servicers and service providers. Instead of charging differing fees, FHFA, along with other federal agencies, should take a more integrated and coordinated approach to housing policy.

NAR is concerned that the approach described may overestimate the timelines and costs in these particular states due to the large volume of foreclosure brought on by the recent housing crisis, and delays caused by deficient mortgage servicing practices of the GSE's own mortgage servicers and service providers. The exponential increase in foreclosure starts has overwhelmed many state judicial systems, as well as the largest institutions responsible for servicing loans on behalf of the GSEs. The data used by the GSEs to estimate the timelines is based on recent experience and estimation, at a time when mortgage foreclosure filings and seriously delinquent mortgages continue at historically elevated levels. Recent standardization and improvements in mortgage servicing will also assist in reducing delinquencies, defaults, and subsequent loss severities.

NAR believes FHFA's approach to increase g-fees in states with foreclosure prevention measures is also inconsistent with other federal foreclosure prevention efforts specifically at a time when mortgage servicers are improving performance. NAR also recommends that FHFA conduct further study on the effect the large number of mortgage defaults and servicing deficiencies have had on foreclosure timelines and how the increased credit quality of the Enterprises' current books of business and the regulatory reforms that they reflect will reduce the volume and therefore costs of processing foreclosures in the impacted states.

12. **Are there interactions with the Consumer Financial Protection Bureau's Qualified Mortgage definition that FHFA should consider in determining g-fee changes?**

REALTORS® believe stability in the mortgage market is a key component in expanding private capital participation in the secondary mortgage market. It is difficult to encourage greater participation without the participants having a clear understanding of the rules. In addition to the QM requirements that went into effect in January 2014, the Qualified Residential Mortgage (QRM) in the Credit Risk Retention rule will also hopefully be finalized in the later this year.[10] We generally support CFPB's QM rule and believe this standard should be used to define a QRM. Providing the certainty of a regulatory framework for safely underwriting loans and securitizing mortgages will go much further in encouraging the return of private capitol than arbitrarily increasing costs to borrowers.

FHFA must also consider how the significant upfront fees charged by Enterprises now require borrowers to pay higher interest rates since a borrower will be unable to pay these fees and stay under the 3% cap on points and fees required to qualify under the QM rule. As shown in exhibit 1, even borrowers with a significant down payment on a $200,000 home would breach the 3% cap before any other typical closing fees are paid. In order to stay under this cap, lenders will increase the interest rate on the entire loan amount meaning that borrowers will be paying a

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[10] 78 Fed. Reg. 57928 (September 20, 2013).

substantial portion of their total monthly mortgage payment toward Enterprise credit protection in the form of elevated g-fees and LLPAs all to ensure substantial returns to the Enterprises.

Exhibit 1

Total upfront Fees: $200,000 Home and Typical Fees*
(red indicates breach of 3% cap under QM)

	< 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%
> 740	1.8%	2.0%	1.9%	2.1%	2.1%	2.1%	2.0%	2.0%
720 – 739	1.8%	2.0%	2.2%	2.4%	2.3%	2.3%	2.3%	2.3%
700 – 719	1.8%	2.5%	2.7%	2.9%	2.8%	2.8%	2.8%	2.8%
680 – 699	2.1%	2.5%	3.2%	3.6%	3.3%	3.1%	3.0%	2.8%
660 – 679	2.1%	3.0%	3.9%	4.4%	4.6%	4.1%	4.0%	3.5%
640 – 659	2.6%	3.3%	4.4%	4.9%	5.1%	4.6%	4.5%	4.0%
620 – 639	2.6%	3.5%	4.9%	4.9%	5.1%	5.1%	5.0%	4.8%
< 620 (1)	2.6%	3.5%	4.9%	4.9%	5.1%	5.1%	5.0%	5.0%

*Note: fees include estimates of origination, processing, application, tax service, wire transfer, and flood search
Source: NAR

Finally, financial models built to ascertain credit risk should reflect historical patterns; however, these models should also reflect the protections that have been implemented under the Dodd-Frank Act along with additional reforms.. The new reforms ensure that the high risk mortgage products that had been sold to the Enterprises, and largely contributed to the losses experienced, will no longer available. Analytics that not only incorporate the performance, but also the indirect impact the availability of these mortgages had on housing prices, would more accurately reflect expected loss severity scenarios than those that don't factor this impact.