M E M O R A N D U M

To: Members of the Committee on Financial Services

From: Committee Staff

Date: May 12, 2023

Subject: May 17, 2023, Subcommittee on Housing and Insurance Hearing Entitled "The Current Mortgage Market: Undermining Housing Affordability with Politics"

On Wednesday, May 17, 2023, at 2 p.m. in Room 2220 of the Rayburn House Office Building, the Subcommittee on Housing and Insurance will hold a hearing entitled "The Current Mortgage Market: Undermining Housing Affordability with Politics." This hearing will examine recent new pricing changes implemented by the Federal Housing and Finance Agency and the impact they have had on the mortgage market. This includes its January 2023 changes to the loan level price adjustment fee structure used by Fannie Mae and Freddie Mac. The following witnesses will testify:

- **Mr. Edward J. DeMarco**, President, Housing Policy Council (HPC)
- **Mr. Kenny Parcell**, President, National Association of REALTORS®
- **Dr. Clifford Rossi**, Professor-of-the-Practice and Executive-in-Residence at the Robert H. Smith School of Business, University of Maryland
- **Ms. Janneke Ratcliffe**, Vice President, Housing Finance Policy Center, Urban Institute

General FHFA/GSE Background

The Federal Housing Finance Agency (FHFA) is an independent regulatory agency responsible for overseeing the housing government-sponsored enterprises (GSEs) – Fannie Mae and Freddie Mac. FHFA, which was created by the Housing and Economic Recovery Act of 2008 (P.L. #110–289), is headed by a single Director appointed by the President and confirmed by the Senate to a five-year term. The current Director, Sandra Thompson, was sworn in following her confirmation in June of 2022. She previously served as FHFA's Acting Director.

FHFA's primary statutory mission is to regulate the GSEs. Its Director is charged with ensuring that "each regulated entity operates in a safe and sound manner."[1] The GSEs are private corporations chartered by the federal government with special benefits. They were established to make homeownership more available and affordable for lower- and middle-income Americans.

[1] 12 U.S.C. 4513(a)(1)(B)(i).

Congress established Fannie Mae during the New Deal. It later created Freddie Mac in 1970 as its competitor. The GSEs were chartered to provide liquidity in the mortgage market and promote homeownership for underserved groups and locations. The GSEs are not mortgage lenders. They do not lend directly to individual borrowers. Instead, they purchase mortgages from lenders, guarantee them, and package them in mortgage-backed securities, which they either keep as investments or sell to institutional investors.

In addition to being their regulator, FHFA serves as conservator of the GSEs. Since their financial collapse in September 2008, both Fannie Mae and Freddie Mac have been under separate government conservatorships. This means they are financially backed by taxpayers and remain significantly undercapitalized for their prominence and size. In fact, at the end of 2021, the GSEs combined owned or guaranteed approximately $7.3 trillion in single-family and multifamily mortgages. This represents more than half of all the $12.8 trillion in mortgage debt outstanding in the United States.

Background on Loan Level Price Adjustments (LLPAs) and Guarantee Fees

When purchasing loans, the GSEs charge lenders guarantee fees (G-fees) to help offset their risk. According to FHFA, the statutory charter for each GSE "authorizes it to impose fees and, based on that authority, each [GSE] has historically set fees for the guarantees provided for timely payment of principal and interest on securities issued."[2] The two G-fees currently assessed include an ongoing fee collected over the life of the loan and a one-time upfront fee when the loan is purchased, frequently called a loan level price adjustment (LLPA).

LLPAs were first implemented in March 2008 as a response to the financial crisis. As financial conditions worsened in the mortgage market, the GSEs recognized their ongoing G-fees would be insufficient to cover their risks. They needed a mechanism to increase their capital and better mitigate risk as they acquired new loans. LLPAs were introduced to provide more flexibility in pricing to ensure that fees for government-backed loans matched the risk-profile of the borrower. LLPAs only apply to loans purchased by Fannie Mae and Freddie Mac, and exclude mortgages backed by other government programs.

Importantly, unlike ongoing G-fees, LLPAs are risk-based fees, meaning they vary by the individual attributes of the loan. This risk-based pricing is essential to LLPAs. It allows the GSEs to protect their balance sheets against unforeseen risks as well as taxpayers against the ultimate costs of borrowers defaulting on their loans. LLPAs are assessed based on various factors,

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[2] FHFA press release, "FHFA Seeks Input on Fannie Mae and Freddie Mac Guarantee Fees," June 5, 2014, available at: https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Seeks-Input-on-Fannie-Mae-and-Freddie-Mac-Guarantee-Fees.aspx.

including credit score, loan-to-value (down payment size), loan purpose, occupancy, number of units, and mortgage type.

Risk-based pricing allows creditworthy borrowers to benefit because, in general, the higher the risk associated with a borrower's mortgage loan, the higher the LLPAs will be. This encourages responsible borrowing and lending. Although these upfront fees are charged to lenders, they are typically passed onto borrowers in the form of increased mortgage rates. LLPAs can have a significant impact on a borrower's mortgage rate, raising it by as much as 100 basis points (1 percent) or more in some cases.

FHFA's Recent Changes to LLPAs

In 2021, under Director Thompson, FHFA launched a comprehensive review of the GSEs' pricing rules. As a result, FHFA announced various changes to the pricing framework, most notably was a new initiative to "recalibrate" the current LLPA pricing structure that affects the majority of GSE loans.[3] These changes were announced in January and took effect on May 1, 2023. The changes apply to the GSEs' single-family pricing framework for purchase, rate-term refinance, and cash-out refinance loans, with a few limited exceptions. In general, the changes increased LLPAs for many homebuyers with better credit or who make larger down payments. They also reduced fees for many low credit score borrowers and those with lower down payments. As calculated by the National Association of Realtors, the new fees – expressed below as changes to mortgage rates actually paid by borrowers – tend to result in increased rates for those with higher credit scores and down payments (the boxes shaded in red) and decreased rates for borrowers with lower credit scores or the lowest down payments (the boxes shaded in blue).

	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									

[3] FHFA press release, "FHFA Announces Updates to the Enterprises' Single-Family Pricing Framework," dated January 19, 2023, available at: https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Announces-Updates-to-Enterprises-SF-Pricing-Framework.aspx.

Due to the January 2023 changes, the LLPA pricing structure is now significantly less risk-based than its predecessor. According to calculations by the market analysis firm Evercore ISI, buyers with strong credit scores between 720 and 739 who make down payments between 15-20 percent will see their rates increase by 0.75 percent. Meanwhile, borrowers who put down 20-25 will see rates increase by 0.5 percent.[4] These changes significantly impact the spread on LLPAs between low and high credit score borrowers. According to Zillow economist Orphe Divounguy:

> A homebuyer with a credit score between 640 to 659 — considered "fair" — and who has a down payment of 5% will incur an LLPA of 1.5%. Prior to the change, the fee for this group of buyers was 2.75%. That means someone purchasing a $200,000 home would pay an LLPA fee of $3,000 under the new structure, down from $5,000 previously.
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> Many purchasers are impacted negatively by this new fee change. For instance, homebuyers with credit scores of 740 to 759 — considered "very good" — and putting 20% down will face a new LLPA of 1%, compared with 0.5% previously. For the purchase of a $200,000 home, that means the fee will double to $2,000.[5]

In defense of the changes, Director Thompson recently issued a statement suggesting a "fundamental misunderstanding about the fees charged by the [GSEs], and why they were updated." She went on to say that FHFA's "objectives were to maintain support for purchase borrowers limited by income or wealth, ensure a level playing field for large and small lenders, foster capital accumulation at the [GSEs], and achieve commercially viable returns on capital over time." She further added "the [GSEs] engage in risk-based pricing to, among other things, better ensure their safety and soundness, protect taxpayers, and serve their mission," noting:

> Some updated fees are higher and some are lower, in differing amounts. They do not represent pure decreases for high-risk borrowers or pure increases for low-risk borrowers. Many borrowers with high credit scores or large down payments will see their fees decrease or remain flat.[6]

Others supporters of the changes have also opined. They have suggested that when the presence of private mortgage insurance is factored in on loans with LTVs below 80 percent, the cost of the new fees added "to the total cost a borrower pays for their mortgage, the apparent disconnection

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[4] Wall Street Journal, "Spinning Federal Mortgage Fees," April 2023, available at: https://www.wsj.com/articles/federal-housing-finance-agency-sandra-thompson-mortgages-credit-e66fd493.

[5] CBS News, "Mortgage fee structure for some homebuyers is changing this month. Here's how," May 2023, available at: https://www.cbsnews.com/news/mortgage-fee-structure-2023-llpa-credit-score-buying-a-home/.

[6] FHFA statement, "Setting the Record Straight on Mortgage Pricing: A Statement from FHFA Director Sandra L. Thompson," dated April 25, 2023, available at: https://www.fhfa.gov/Media/PublicAffairs/Pages/Statement-from-FHFA-Director-Sandra-Thompson-on-Mortgage-Pricing.aspx.

between risk and price in the table above disappears, with borrowers' payments rising or falling according to the risk they pose."[7]

On April 25, 2023, Financial Services Committee Chairman Patrick McHenry and Subcommittee on Housing and Insurance Chairman Warren Davidson sent a letter to Director Thompson expressing strong opposition to these changes. They expressed concern that changes will weaken the GSEs' risk-based pricing tools that encourage responsible lending and protect taxpayers from undue risk. They cautioned that the new pricing structure "will result in higher mortgage rates and reduced access to credit" and urged that the Director act to "take the necessary steps to reverse these unwise changes and eliminate this tax on creditworthy borrowers."[8]

Legislative Proposals

- **H.R. ___, the Middle Class Borrower Protection Act of 2023.**

This discussion draft would repeal the new LLPA fee structure and reinstate the fee structure in effect prior to May 1, 2023. It would also institute a temporary LLPA fee change freeze pending a GAO review of the process and considerations FHFA uses to set LLPA fees, make future LLPA fee changes subject to a standard notice and comment procedure, require all future FHFA-required LLPA fee changes to be risk-based when FHFA is acting as the GSEs' conservator, and prohibit FHFA or the GSEs from imposing any new LLPA fee changes based on the debt-to-income (DTI) ratio of borrowers.

- **H.J. Res. ___, providing for congressional disapproval under chapter 8 of title 5, United States Code, of the rule submitted by the Federal Housing Finance Agency relating to "Updates to the Enterprises' Single-Family Pricing Framework" (Rep. Davidson)**

This joint resolution discussion draft would nullify FHFA's May 1, 2023, LLPA fee structure change through the expedited disapproval process under the Congressional Review Act.

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[7] Jim Parrott and Janneke Ratcliffe, "Fannie Mae and Freddie Mac's New Pricing Is Not Punishing Those with Better Credit: Follow the Numbers," Urban Institute, April 27, 2023, available at: https://www.urban.org/urban-wire/fannie-mae-and-freddie-macs-new-pricing-not-punishing-those-better-credit-follow-numbers.

[8] House Committee on Financial Services, "McHenry, Davidson Demand FHFA Reverse Changes to the Loan Level Pricing Adjustment Structure," dated April 25, 2023, available at: https://financialservices.house.gov/uploadedfiles/2023-04-25_mchenry_davidson_letter_to_fhfa_llpas_final.pdf.