UNDERSTANDING THE IMPACT OF RECENT CHANGES TO THE FEDERAL HOUSING FINANCE AGENCY'S LOAN-LEVEL PRICE ADJUSTMENT

Statement of

Janneke Ratcliffe

Vice President for Housing Finance Policy, Urban Institute

before the

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Financial Services Committee,

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THE CURRENT MORTGAGE MARKET: UNDERMINING HOUSING AFFORDABILITY WITH POLITICS

May 17, 2023

*The views expressed are my own and should not be attributed to the Urban Institute, its trustees, or its funders.

I thank Jim Parrott, Laurie Goodman, Jun Zhu whose work and helpful comments have informed this testimony. I also thank John Walsh and Katie Visalli for preparing analyses.

Chairman Davidson, Ranking Member Cleaver, and members of the subcommittee, thank you for the invitation to discuss pricing decisions with regard to loan-level price adjustments (LLPAs).

I am the vice president for housing finance policy at the Urban Institute, a leading research organization dedicated to developing evidence-based, nonpartisan insights that improve people's lives and strengthen communities. The views expressed in this testimony are my own and should not be attributed to the Urban Institute, its trustees, or its funders.

Loan-level price adjustments are a complex topic that has generated concern and confusion. I hope that analysis by my colleagues and me at the Urban Institute will help make things clearer. In this testimony I provide some background and context about LLPAs, describe their evolution, how they are set, and the impact of private mortgage insurance on losses and costs. Then, I review where we are today—what has and hasn't changed as of the May 1 adjustments, and the implications. This testimony begins with the summary presented in my oral arguments.

Summary

First, it is important to establish that the recent adjustments to the LLPAs do not compromise the safety and soundness of the GSEs. All GSE loans today are underwritten according to strict risk criteria and present low risk by historical standards. Indeed, even those falling in the lower right quadrant of the grid, with down payments less than 20 percent and credit score between 620 and 680, have low projected losses; we estimate less than 1 percent. Moreover, these loans made up less than 3 percent of Fannie Mae's 30-year fixed rate, purchase, single-family owner-occupied mortgages in 2022.

Second, rather than thinking about these adjustments as cross-subsidies, they should be viewed in light of Director Thompson's changes to better align pricing with the capital requirements established by the prior director under the Enterprise Regulatory Capital Framework.[1]

The GSEs exist to support sustainable and affordable homeownership across communities and across cycles. GSE pricing is primarily structured so they can meet their capital requirements and overall target return on capital. This means the GSEs can set different profit margins for different types of loans (which is a standard business practice) to maintain safety and soundness, serve their public mission, and meet their overall return target. For example, GSEs charge the same fees for all states, even though some have much higher default rates than others and are thus less profitable. GSEs also have different margins on some products based on competitive pressures.

Within the current pricing structure, it's helpful to recognize three categories the GSEs price differentially:

1. **Mission-remote loans,** like second homes, investment properties, million-dollar loans, and cash-out refinances, which are seen as less appropriate for deep public support and less central to the basic

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[1] See Jim Parrot and Janneke Ratcliffe *Fannie Mae and Freddie Mac's New Pricing Is Not Punishing Those with Better Credit: Follow the Numbers* and Jim Parrot *No, Fannie Mae and Freddie Mac aren't penalizing people with good credit to help people with good credit* (Washington DC: Urban Institute, 2020). Also see https://home.treasury.gov/system/files/136/Executed-Letter-Agreement-for-Fannie-Mae.pdf.

homeownership mission.[2] For these loans the GSEs charge as much as they can while still providing enough benefit to retain the business. These higher returns offset lower return targets on the next category, mission loans.

2. **Mission loans,** which include mortgages to people with lower incomes, in rural markets, for manufactured homes, and other categories. For this category, the aim is to price as low a margin as possible while meeting profit targets, a practice that makes these loans relatively more affordable and more sustainable.
3. **Core loans,** the bulk of the GSE's loans, are purchase and rate-term refinances for all other owner-occupied homes, which are priced to hit capital requirements and target return on equity.

The May 1, 2023, LLPA adjustments apply to the core loans and are the last in a series of steps taken over the past year, each to address different objectives. This sequencing of steps has led to some confusion because steps are being conflated, leading some to conclude that these changes are supporting mission business at the expense of the core business. But that's incorrect. The May 1 changes result in a flatter grid across the core business, give more credit for private mortgage insurance, and split up some of the prior groups into smaller groups. The May 1 additions are relatively small, adding at most $40 a month to the median mortgage payment and apply to less than 1.5 percent of the core borrowers. All categories within the grid are still priced to cover losses and make a profit.

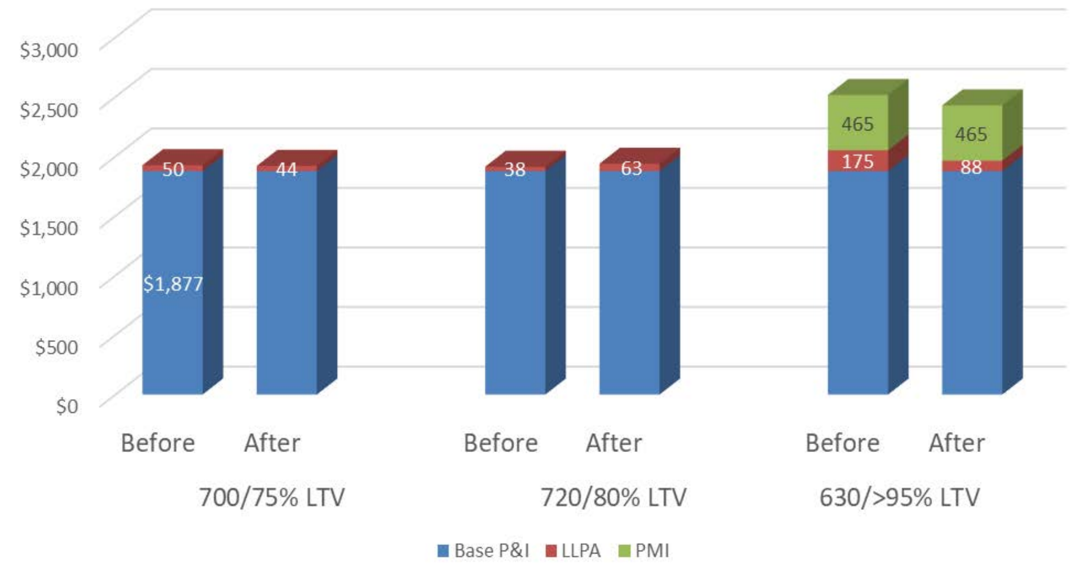
Finally, in the core business, which is the vast majority of GSE lending, borrowers who pose more risk pay more—in some cases a lot more—than borrowers who pose less risk. Borrowers with low down payments—or high LTV, which stands for loan-to-value—have to buy private mortgage insurance, or PMI. PMI reduces losses to the GSEs and raises borrowing costs for borrowers with LTV over 80 percent who were likely overcharged in the prior grids, especially those with lower credit scores. With the May 1 changes, on a $300,000 mortgage, a borrower with a credit score of 660 and 5 percent down will still pay around $500 more a month in LLPAs and PMI than a borrower with a credit score of 700 and 25 percent down, as shown in figure 1.

Ultimately the May 1 changes have little to nothing to do with cross-subsidy. They better align the core business LLPAs with the capital requirements, and they address previous overcharges among high-LTV borrowers by accounting for mortgage insurance.

[2] The percent of loans for second homes and investor properties is limited to 7% of purchases in a 52-week period; see https://home.treasury.gov/system/files/136/Executed-Letter-Agreement-for-Fannie-Mae.pdf.

FIGURE 1

Monthly Base Principal, Interest, LLPA, and PMI, before and after May 1



Source: Urban institute calculations based on a 30-year, $300,000 loan at 6.4% interest, 2023 Fannie Mae Loan Level Price Adjustment Matrix for Purchase Money Loans 3.22.2023 vs 02.01.2023, annualizing LLPAs by dividing by 5 years, and adding PMI rate indications from Enact Mortgage Insurance Company: https://content.enactmi.com/documents/rate-cards/national/Enact%20legal%20entity%2002.22/00460.NationalMonthly.FIXED.0323.pdf.

Note: Actual mortgage insurance charged will vary depending on company used, their pricing method and other loan characteristics.

Historical Context

Before 2008, Fannie Mae and Freddie Mac had no LLPAs, and the base guarantee fee (g-fee) did not vary by borrower risk factors. As such, risks and fees were distributed across borrowers, who paid the same g-fee to access the same loan product. This flat fee structure can be described as "pooled" risk and pricing. The g-fee did vary by lender; the largest lenders extended lower g-fees. Another important difference from today is that g-fees overall were much lower before 2008, in large part because the amount of capital the GSEs were required to hold was much lower than it is today.

In 2008, the GSEs added up-front fees, known as loan-level price adjustments, based on loan-to-value and borrower credit score, as well as an "adverse market fee" charged on loans originated in certain geographic areas that posed higher risk. With the GSEs in conservatorship and under the regulation of the newly created Federal Housing Finance Agency (FHFA), a new approach to capital and pricing was ushered in. From 2008 through 2021, the base g-fee was raised and the LLPA structure was refined through a succession of steps at the direction of the FHFA. Additional changes included a 10 basis point (bp) increase (0.1%) first implemented in 2012 to cover other government spending measures, elimination of the adverse market fee in 2015, establishment of g-fee floors in July 2016, and placing a fee on refinances from

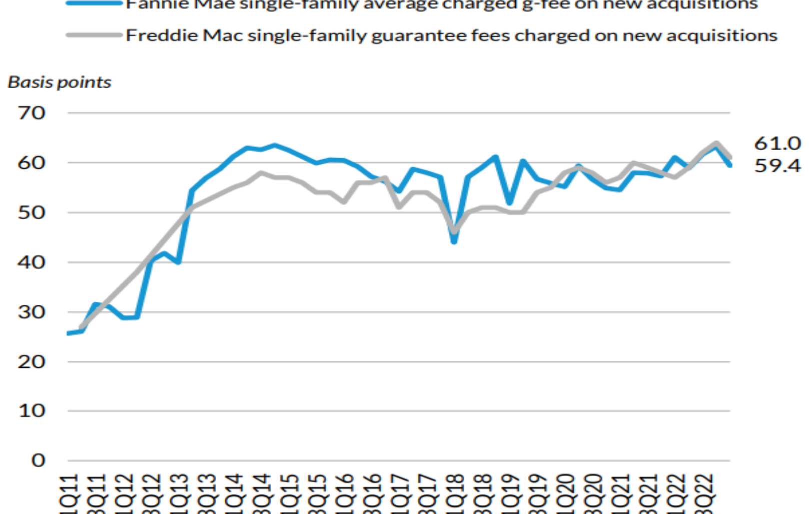
December 2020 until August 2021.[3] The May 1, 2023, adjustments are the third in a series of subsequent adjustments made since 2022.

Base g-fees are an annual rate added into the interest rate, while LLPAs are one-time up-front charges. However, borrowers normally do not pay these up front; instead, LLPAs are usually converted into an annualized rate (based on the estimated life of the loan—typically around 6 years for a 30-year fixed rate mortgage) and effectively added into the interest rate along with the base g-fee.[4]

In 2007, Fannie and Freddie reported average effective guarantee-fees of 24.2 and 18 basis points, respectively.[5] By late 2022 the average g-fee reached around 60 bp—about 40–45 bp in ongoing base g-fee and the remainder in annualized up-front LLPAs. The combined base g-fee and annualized LLPA is collectively referred to as g-fees. The average g-fee over time is shown in figure 2 below. Fluctuations in the average can also be attributed to changes in the mix of loans funded in each period.

FIGURE 2

Fannie Mae and Freddie Mac Average G-Fees, 2011–22



Source: Laurie Goodman et al., *Housing Finance at a Glance: April 2023* (Washington, DC: Urban Institute, 2023).

[3] For a summary of historical changes in fees from March 2008 to November 2021, see *Fannie Mae and Freddie Mac Single-Family Guarantee Fees in 2011* (Washington, DC: Federal Housing Finance Agency, 2022), pages 12–13.

[4] According to FHFA: "For the purposes of reporting to FHFA, the Enterprises annualize upfront fees by dividing the upfront fee for a given loan by that loan's specific present value multiplier (PVM). For example, a loan with an upfront fee of 75.15 basis points and a PVM of 6.18 would have an annualized upfront fee of 75.15/6.18 = 12.16 basis points. Depending on the attributes of the loan, a typical new 30-year loan may be expected to have a PVM of about 6 on average, whereas a 15-year loan may be expected to have a PVM closer to 4." *Fannie Mae and Freddie Mac Single-Family Guarantee Fees in 2011* (Washington, DC: Federal Housing Finance Agency, 2022), page 2. In our analysis of 30 year fixed rate mortgages in this testimony we use a PVM of 5 to be conservative.

[5] See *Fannie Mae and Freddie Mac Single-Family Guarantee Fees in 2007 and 2008* (Washington, DC: Federal Housing Finance Agency, 2009).

Risk-Based Capital and How G-Fees Are Set Today

The g-fee covers the average expected loss on a group of loans, operating expenses of the GSEs plus special fees and assessments, and the cost of (or expected return on) the capital required for that group of loans.

According to the FHFA, "An Enterprise's cost of holding capital is its greatest cost."[6] The level of capital is supposed to cover the probability of unexpected losses that would be incurred in a severe stress environment. The capital levels are risk-based, meaning that the cost of capital is higher on loans with higher risk, primarily determined by LTV and credit score as well as loan type and other factors, such as whether the loan is for an investment property or a manufactured home. The capital requirements are set by the FHFA and have undergone several changes since 2008, driving much of the g-fee changes discussed above.

The GSE's original minimum statutory capital requirement is .45 bp on mortgages it guaranteed. The FHFA's proposed 2017 Conservatorship Capital Framework, which the GSEs followed in setting pricing until recently, was designed to better protect the taxpayers and better align capital with risk, though Urban Institute analysis suggests that the rule may have over-penalized higher-risk loans.[7] This framework was replaced by a new 2020 Enterprise Regulatory Capital Framework.[8],[9] The new rule further increased capital requirements on aggregate by establishing risk weight floors. According to the FHFA, "These changes reduced risk gradients in the ERCF compared to the CCF" and "increase[d] capital more significantly for loans with lower credit risk characteristics."[10] In effect, the new capital rule flattened the pricing grid.

The level of capital also affects the profits that need to be built into the g-fees. While the FHFA sets an overall target rate of return for the GSEs, they also have the flexibility to set different target rates of return for different groups of loans.

The Impact of Private Mortgage Insurance

The GSEs require credit enhancement for all mortgages over 80 LTV; it is a charter requirement. Private mortgage insurance is by far the most common form of credit enhancement. PMI reduces the actual LTV of the mortgage well below 80. For example, 30-year fixed-rate mortgages with a 95 LTV are generally required to have coverage for the first 30 percent of losses, bringing the effective LTV to the GSEs to 67 percent. A typical 97 percent LTV loan (3 percent down) requires coverage of 35 percent; a 90 percent LTV loan, 25 percent; and an 85 percent LTV loan, 12 percent. Having this insurance significantly raises the cost of the loan to the borrower and significantly lowers loss to the GSEs.

To illustrate the benefit to the GSEs, figure 3 shows that loans with PMI have lower loss severity than without, consistently across vintages.

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[6] *Fannie Mae and Freddie Mac Single-Family Guarantee Fees in 2021*, page 6.

[7] See Edward Golding, Laurie Goodman, and Jun Zhu, *Analysis of the FHFA's Proposal on Enterprise Capital* (Washington, DC: Urban Institute, 2018).

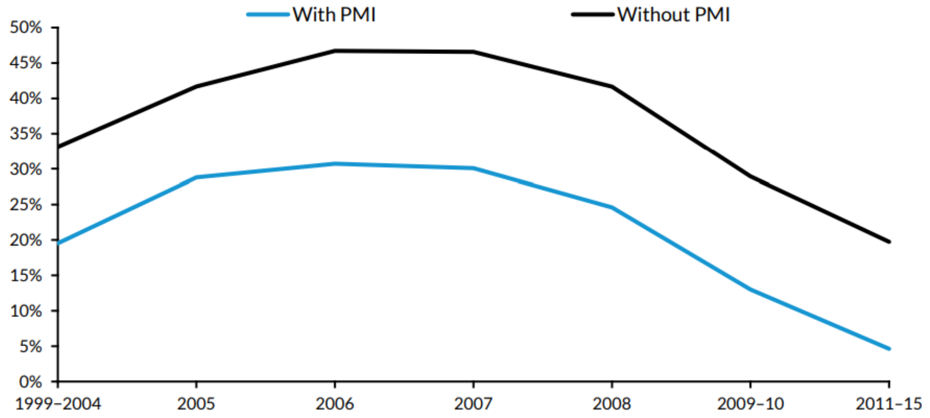
[8] See Jim Parrott, Bob Ryan, and Mark Zandi, *FHFA's Capital Rule Is a Step Backward* (Washington DC: Urban Institute, 2020).

[9] See https://home.treasury.gov/system/files/136/Executed-Letter-Agreement-for-Fannie-Mae.pdf

[10] *Fannie Mae and Freddie Mac Single-Family Guarantee Fees in 2021*, page 8.

FIGURE 3

Loss Severity for GSE Loans with and without PMI, by Origination Year Groupings



Sources: Fannie Mae, Freddie Mac, and the Urban Institute.
Note: GSE = government-sponsored enterprise; PMI = private mortgage insurance. The GSE credit data are limited to 30-year fixed-rate, full documentation, fully amortizing mortgage loans. Adjustable-rate mortgages and Relief Refinance Mortgages are not included. Fannie Mae data include loans originated from the first quarter of 1999 (Q1 1999) to Q4 2015, with performance information on these loans through Q3 2016. Freddie Mac data include loans originated from Q1 1999 to Q3 2015, with performance information on these loans through Q1 2016.

Source: Laurie Goodman and Karan Kaul, *Sixty Years of Private Mortgage Insurance in the United States* (Washington, DC: Urban Institute, 2017).

After the financial crisis, the PMI industry needed to raise more capital. The PMI companies also use risk-based pricing, and, since 2014, the FHFA oversees PMI capital requirements through Fannie and Freddie-issued PMIERs (PMI Eligibility Requirements), which are also revised from time to time and are risk-based by LTV and credit score. According to Urban researchers, "The private mortgage insurers also altered their pricing in 2016 after increasing prices during the recession. The change—largely in response to higher PMIER capital requirements—lowered prices for high-FICO-score borrowers and increased them for low-FICO-score borrowers."[11] This improved the attractiveness of PMI in relation to FHA for high-FICO-score borrowers but reduced it for low-FICO score borrowers.

The May 1 Loan Level Price Adjustments: What Has Changed…

When FHFA Director Thompson was appointed, she inherited the ECRF capital rule and took several steps to adjust the pricing to reflect the capital requirements, in light of mission, risk, and return objectives. To understand the steps taken from 2022 through May 2023, it helps to understand the role of the GSEs and to segment the GSE's loans into three buckets.

Fannie and Freddie's guarantee (and the implicit government backing) gives investors throughout the world the confidence to provide low-cost funding for US mortgages, and it gives the majority of borrowers in today's market access to safe, affordable fixed-rate mortgages. Fannie's and Freddie's primary purpose is to "*provide ongoing assistance to the secondary market for residential mortgages (including activities relating to*

[11] See Laurie Goodman and Karan Kaul, *Sixty Years of Private Mortgage Insurance in the United States* (Washington, DC: Urban Institute, 2017).

mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities)." Urban research estimates that the total economic benefit from lower mortgage rates experienced across GSE borrowers is $6 billion a year.[12] So effectively, every GSE borrower is receiving a subsidy. After all, if they could get a better rate somewhere else, they would not use the GSEs.

The mission statement says that the GSEs can earn lower return on equity levels for some categories than others, which is a standard business practice. For the GSEs, this practice is further informed by their public purpose. As previously discussed, the GSE's approach to mission, mission-remote, and core loans allows them to set different profit margins for different groups and still maintain their capital targets.

The current pricing grid reflects a balance of policy and market requirements that reflect the broader strategy that the FHFA has followed since January 2022: first, maximize returns on mission-remote loans; second, cut LLPAs on mission loans. Those steps went into effect over the past several months. The final step of this realignment is what just went into effect: adjustments within the core business to cover the remaining increase in capital and address some anomalies in the prior pricing grid.

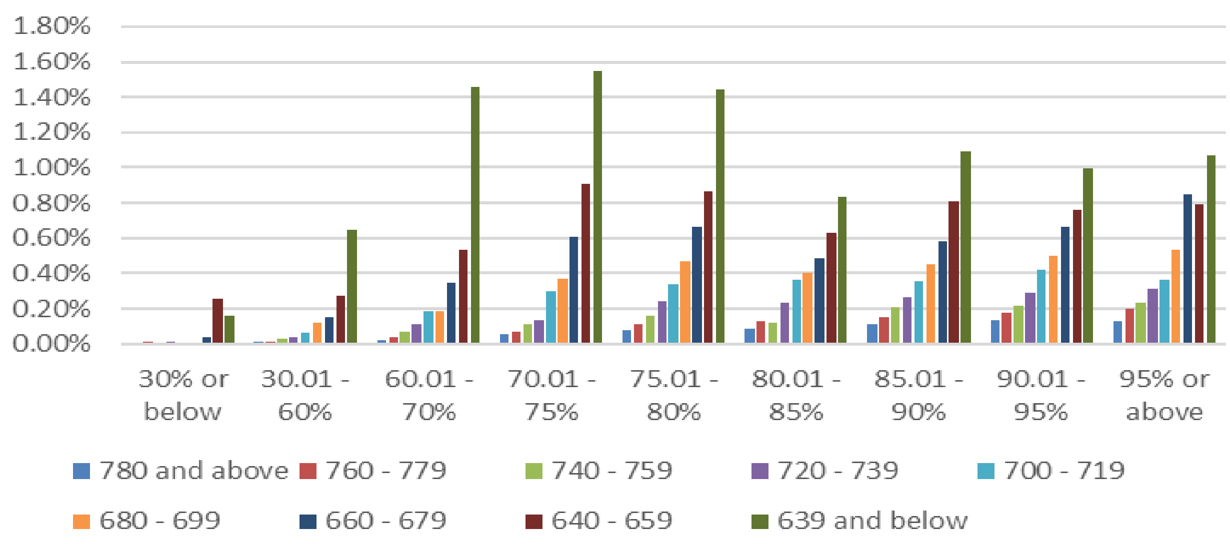
These relatively modest adjustments added about 4 bp to total g-fees, assuming the current mix is maintained, which helped meet the higher overall capital required, as well as flattening the grid to align with the capital structure of the new rule. For each bucket with an LLPA, the total pricing covers the expected losses, as well as expenses, and still leaves a risk-free return (see figures 4,5 and 6).

We looked at losses for the 2009–15 origination (a book that experienced home price appreciation, with a 90 percent weight) and for the 2007–08 origination (a book that experienced home price depreciation, with a 10 percent weight). As shown in figure 4, losses to the GSE are **lower** on mortgages with LTVs over 80 percent because of PMI. As a result, the loss rate to the GSEs on 30-year fixed-rate mortgages originated from 2009 to 2015 with FICOs of 660–79 and LTV of 80% is higher than for the 90.01–95 LTVs. While the loss frequency is higher on higher-LTV mortgages, it is more than offset by the lower loss severity.

[12] See Laurie Goodman, Jim Parrott, Bob Ryan, and Mark Zandi, *How Fannie and Freddie Can Use Pricing to Expand Affordable Homeownership* (Washington DC: Urban Institute, 2022).

FIGURE 4

Estimated Losses by Credit Score and Loan-to-Value

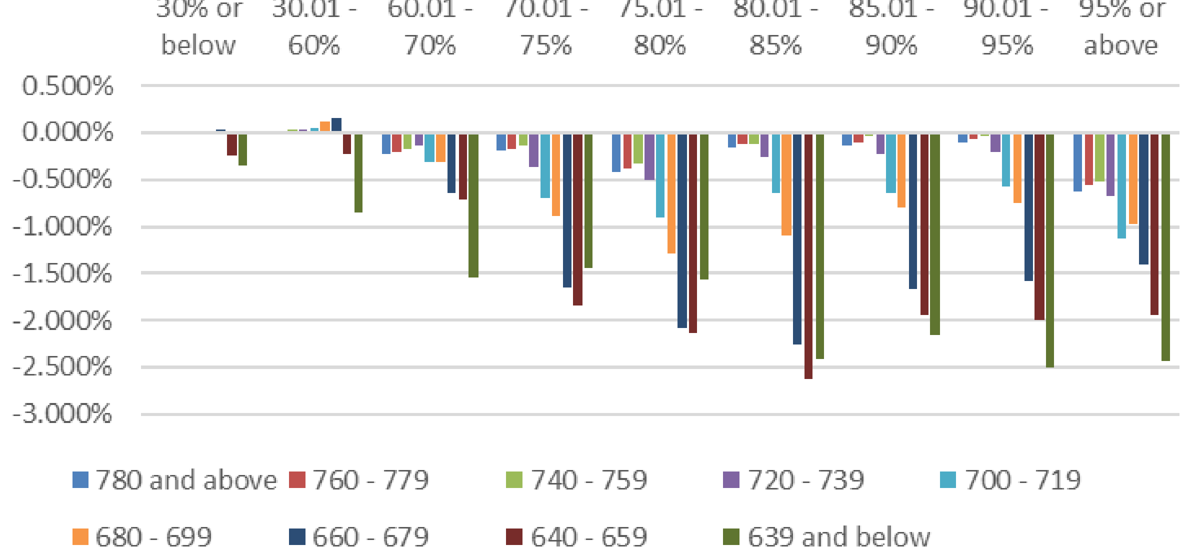


Source: Fannie Mae loan-level data, purchase only, fixed-30, owner-occupied 1-unit single family mortgages.
Methodology: We calculated the loss rate for loans. We assumed 10 percent probability of distressed scenario (2007–08) and 90 percent probability of normal scenario (2009–15), then compared the weighted loss rates with the LLPA. The figure shows the difference between loss rate and LLPA.

If we compare the prior LLPAs to the estimated losses we calculated, high-LTV borrowers with credit scores from 620 to 679 were previously paying a hefty price over the risk they posed. Figure 5 shows LLPAs on the prior grid minus the estimated loss, with any negative amount showing the excess of LLPA over our estimated loss.

FIGURE 5

Difference between LLPA and Expected Loss (Pre-May 1)

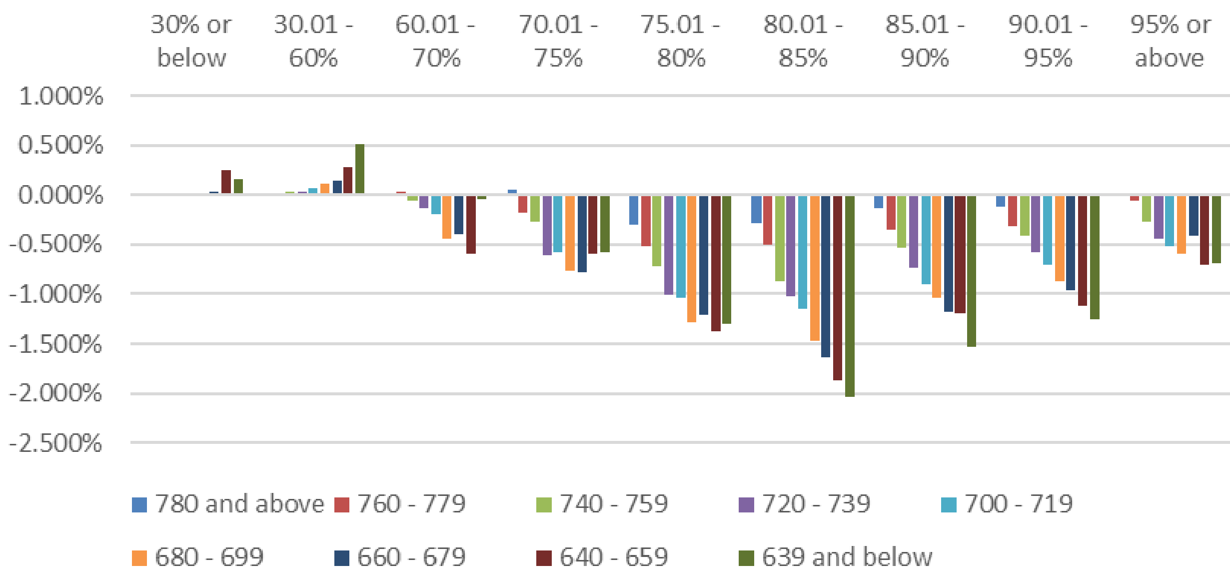


Source: Fannie Mae loan-level data, purchase only, fixed-30, owner-occupied 1-unit single family mortgages.
Methodology: We calculated the loss rate for loans. We assumed 10 percent probability of distressed scenario (2007–08) and 90 percent probability of normal scenario (2009–15), then compared the weighted loss rates with the LLPA. The figure shows the difference between loss rate and LLPA.

We then compare the new LLPAs to our estimated losses (figure 6). The higher-LTV buckets are accorded the benefit of PMI, which provides more coverage (and more private capital) as the LTV goes up. We found, for nearly every cell with a positive LLPA, the LLPAs were greater than the losses. For example, for the 640–60 FICO, 90.01–95 LTV, the weighted losses were 76 basis points; this compares with an LLPA of 1.875 percent, a difference of 1.116.

FIGURE 6

Difference between LLPA and Expected Loss (Post-May 1)



Source: Fannie Mae loan-level data, purchase only, fixed-30, owner-occupied 1-unit single family mortgages.
Methodology: We calculated the loss rate for loans. We assumed 10 percent probability of distressed scenario (2007–08) and 90 percent probability of normal scenario (2009–15), then compared the weighted loss rates with the LLPA. The figure shows the difference between loss rate and LLPA.

What explains this apparent overpayment? The GSEs are not simply factoring in losses on originations; rather, the pricing is centered on how much capital they hold and how much return they are earning on their "capital."

Another change that affected a few high–credit score groups was that the GSEs split the low-LTV, highest score groups into multiple buckets. Most notably, the previous 740+ credit score bucket was split into three buckets (740–59, 760–79, and 780+).

As a result of all these changes, new borrowers in some buckets will face a higher LLPA than they would have before May 1; others will pay less (see table 1 below), but the number of borrowers with significant changes is small, as are the changes themselves. The largest single increase for any bucket is 75 bp ($2,250

one time on a $300,000 loan, which translates to less than $40 a month and a less than 1 percent increase in debt-to-income ratio). This change affects less than 1.5 percent of the purchase money borrowers (based on 2022 distribution of Fannie Mae loans)—borrowers with credit score of 720–59 who put down more than 15 percent but less than 20 percent and who are required to have thin and relatively short-term PMI coverage (the red numbers in table 2).

Decreases are seen for GSE borrowers with credit scores between 620 (the minimum) and 679, who make up only 6 percent of the GSE's purchase loans. The highest reductions are for high-LTV borrowers, whose risk is mitigated by mortgage insurance and who were previously charged very high LLPAs. For example, borrowers with scores from 620 to 639 and above 95 percent LTV were paying 3.5 percent LLPA, translating to roughly $150 a month on the median loan, and with mortgage insurance of 1.86 percent annually included,[13] for total fees on top of the base rate costing over $600 a month. It is not surprising that these loans are less than 0.1 percent of GSE purchase loans. With the post–May 1 reduction in LLPA, these borrowers will pay about $50 less a month (around $550 a month), but the LLPA + PMI cost will still be about 30 percent of their base total monthly payment. Even with the new grid, these borrowers are more likely to go to the FHA if that is an option, where they would pay the lower flat 1.75 percent up front and 0.55 percent annual insurance premium.

Also, because the new grid splits the previous highest credit score group into three buckets, some borrowers in those three higher score groups also see g-fees go up, and some down, depending on where they fall within those three new groups. For example, whereas before a borrower with credit score of 741 would pay the same as one with an 800 score, in the new grid, borrowers in the 740–59 bucket will now pay more than those in the 780-plus bucket.

TABLE 1

Changes to LLPAs for Purchase Money, Fixed-Rate, Owner-Occupied, One-Unit Mortgages

decrease
increase

	Loan-to-Value Range								
Credit score	30% or below	30.01–60%	60.01–70%	70.01–75%	75.01–80%	80.01–85%	85.01–90%	90.01–95%	>95
≥780	0.000	0.000	-0.250	-0.250	-0.125	0.125	0.000	0.000	-0.625
760–779	0.000	0.000	-0.250	0.000	0.125	0.375	0.250	0.250	-0.500
740–759	0.000	0.000	-0.125	0.125	0.375	0.750	0.500	0.375	-0.250
720–739	0.000	0.000	0.000	0.250	0.500	0.750	0.500	0.375	-0.250
700–719	0.000	0.000	-0.125	-0.125	0.125	0.500	0.250	0.125	-0.625
680–699	0.000	0.000	0.125	-0.125	0.000	0.375	0.250	0.125	-0.375
660–679	0.000	0.000	-0.250	-0.875	-0.875	-0.625	-0.500	-0.625	-1.000
640–659	0.000	-0.500	-0.125	-1.250	-0.750	-0.750	-0.750	-0.875	-1.250
620–639	-0.500	-0.375	0.000	-0.875	-0.250	-0.375	-0.625	-1.000	-1.750
Below 620	-0.500	-0.375	0.000	-0.875	-0.250	-0.375	-0.625	-1.000	-2.000

[13] Mortgage Insurance Premium indication is derived from Enact Mortgage Insurance Company monthly premium for fixed-rate primary resident purchase loans; https://content.enactmi.com/documents/rate-cards/national/Enact%20legal%20entity%2002.22/00460.NationalMonthly.FIXED.0323.pdf. Actual premium will vary by company, by pricing method, and other risk factors.

Source: Urban Institute analysis of Fannie Mae Loan-Level Price Adjustment Matrix–Current (v. 02.01.2023) versus May 1, 2023, effective (v.03.22.2023).

TABLE 2

Distribution of GSE Purchase Loans by Credit Score and LTV Ratio

	Loan-to-Value Range									
Credit score	30% or below	30.01–60%	60.01–70%	70.01–75%	75.01–80%	80.01–85%	85.01–90%	90.01–95%	>95	Total
≥780	0.63%	4.22%	2.42%	3.75%	8.45%	1.37%	3.27%	5.44%	1.30%	**30.8%**
760–779	0.19%	1.55%	1.09%	2.08%	4.66%	0.91%	2.24%	4.42%	1.30%	**18.4%**
740–759	0.10%	0.98%	0.78%	1.47%	3.66%	0.80%	2.01%	4.50%	1.55%	**15.8%**
720–739	0.07%	0.70%	0.60%	0.97%	2.66%	0.64%	1.61%	3.89%	1.47%	**12.6%**
700–719	0.05%	0.58%	0.50%	0.68%	1.96%	0.51%	1.21%	2.99%	1.05%	**9.5%**
680–699	0.04%	0.45%	0.42%	0.51%	1.39%	0.36%	0.88%	2.04%	0.66%	**6.7%**
660–679	0.03%	0.32%	0.29%	0.27%	0.79%	0.16%	0.41%	0.82%	0.19%	**3.3%**
640–659	0.02%	0.21%	0.20%	0.15%	0.50%	0.07%	0.20%	0.36%	0.07%	**1.8%**
≤639	0.01%	0.15%	0.13%	0.08%	0.29%	0.04%	0.08%	0.12%	0.02%	**0.9%**
Total	**1.13%**	**9.16%**	**6.45%**	**9.95%**	**24.35%**	**4.86%**	**11.92%**	**24.58%**	**7.61%**	

Source: Urban Institute calculations of eMBS data.
Notes: The table shows GSE purchase loans originated in 2022 with terms greater than 15 years. Distribution is of count of loans. This analysis includes all property types, investors, and second homes.

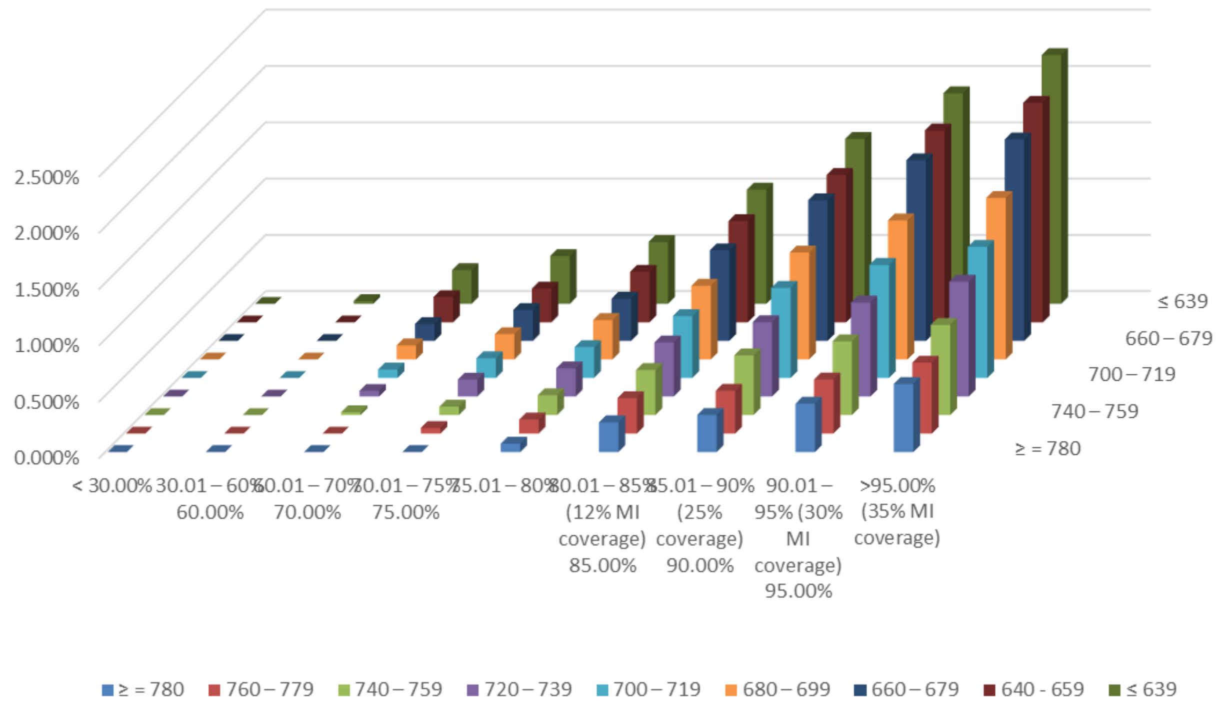
…and What Hasn't Changed

The simple comparison of the previous grid to the new grid has caused some confusion about who is paying less than whom versus who is paying less than they would have paid before. This confusion blurs the complexity of the changes actually happening. It's also important to note what isn't changing:

1. Current borrowers have already paid their LLPA (if they incurred one); this will not affect their payments.
2. A proposed LLPA based on debt-to-income was dropped, a move we highly applaud as we find that it penalizes lower-income borrowers, that debt-to-income is a poor predictor of risk, and that it would add unnecessary operational complexity, which might deter lenders from serving borrowers with higher house prices relative to their income.
3. The basic risk-based nature of the grid remains: low-risk borrowers pay less than high-risk borrowers, with LLPAs priced to cover expected losses and capital requirements, and to return a profit (figure 7).

FIGURE 7

LLPA Annualized plus PMI by LTV Bucket and Credit Score



Source: Fannie Mae Loan-Level Price Adjustment Matrix for Purchase-Money Loans. 03.22.2023. PMI rate indications from Enact Mortgage Insurance Company: https://content.enactmi.com/documents/rate-cards/national/Enact%20legal%20entity%2002.22/00460.NationalMonthly.FIXED.0323.pdf.
Note: Actual mortgage insurance charged will vary depending on company used, their pricing method and other loan characteristics.

Conclusion

In summary, the pricing is a natural outcome of the FHFA's pricing approach, which is a direct function of capital (return on capital target), expected risk, expenses, and special fees. We argue that the May 1 grid changes are largely motivated by implementing the ERCF and factoring in PMI coverage and capital. Following that logic, distortions, if any, in the pricing structure reflect distortions, if any, in the capital requirements.

One may take issue with the capital rule or the target return on equity. One may even take on the whole notion of whether "capital" and "return" is a meaningful a concept for these institutions in conservatorship. Or whether risk-based pricing is the best way to transmit costs to borrowers at all, especially given the complexity and lack of transparency for borrowers. Ultimately, it is important to recognize that the GSEs bring a valuable economic subsidy to all their borrowers, provide macroeconomic stability to the economy, and help foster affordable and sustainable homeownership while needing to maintain safety and soundness, all against changing market conditions. Setting pricing is a complex balance of all these considerations.