

July 21, 2010

**RE: Public Input on Reform of the Housing Finance System  
Docket No. TREAS-DO-2010-0001; HUD-2010-0029  
Answers to Questions 1-6**

To Whom It May Concern:

The National Fair Housing Alliance is pleased to submit the following comments in response to the above captioned opportunity for public input on reform of the housing finance system. In the following pages, we address questions one through six. In doing so, we offer a fair housing perspective on the roles that the housing finance system must fulfill in order to ensure that housing opportunity, and the path to building wealth that it offers, are available throughout the country in an equitable manner. The secondary market must balance the dual needs of directing affordable and sustainable credit for both rental housing and owner-occupied housing into underserved communities – those with high levels of poverty and racial segregation, and also promotes expanded housing opportunities for lower-income people in middle- and upper-income neighborhoods and for people of color in communities that are not segregated. Only by explicitly addressing both of these goals can the secondary market play its part in fulfilling the nation’s stated housing policy of ending housing discrimination and eliminating segregation.. The nation needs a well-regulated and unified secondary market to provide necessary liquidity and access to affordable and fair credit. Within the secondary market, there is a clear and obvious need for government-backed institutions tasked with a public mission of financing affordable housing in the sales and rental markets in a non-discriminatory and pro-integrative fashion.

**1. How should federal housing finance objectives be prioritized in the context of the broader objectives of housing policy?**

This question underscores the important fact that housing finance policy does not exist in a vacuum, but is part of a larger set of national housing policies with which it interacts. Only by considering all of these policies in a unified manner can we be sure that all of our national housing goals will be met. In particular, we believe it is important to note the intersection of housing finance policy with policies designed to promote equal access to housing for all, and to promote healthy and sustainable communities. These latter goals are embodied in the Fair Housing Act, which explicitly applies to all aspects of housing finance, at both the primary and secondary market levels.

To achieve the vision of one America, free from housing discrimination, the authors of the Fair Housing Act (42 USC § 3601, et seq.) built into the law a provision that calls for the federal government, through all of the relevant programs of all of its agencies, to use its resources to take positive steps to break down the barriers of residential segregation and promote opportunity for all. The term used by the law is “affirmatively furthering fair housing,” and is defined in 42 USC § 3601(d) as follows:

All executive departments and agencies shall administer their programs and activities relating to housing and urban development (including any Federal agency having regulatory or supervisory authority over financial institutions) in a manner affirmatively to further the purpose of this subchapter...

In plain language, this means that federal housing and community development programs must not only comply by the anti-discrimination provisions of the Fair Housing Act which makes it illegal to make housing unavailable to a person because of their membership in a class protected by the Act, but must also proactively promote healthy neighborhoods and geographic opportunity for all people.

In evaluating federal housing finance objectives, it is imperative that the federal government consider how the functioning of the secondary market impacts fair housing and fair lending laws. The responsibility to affirmatively further fair housing must be a litmus test against which the housing finance market is judged: every policy, goal, or objective must be judged based on whether or not it will affirmatively further fair housing or fail to affirmatively further fair housing.

This lens is particularly important, as the federal government's role in creating a sustainable and liquid national housing market has often created residential opportunities and wealth-building opportunities in ways that have privileged white families and disadvantaged African American and Latino families. American communities today remain segregated by race and class. Discriminatory housing policies and practices have restricted opportunities for people of color, who are much more likely than white families to live in impoverished and resource-poor neighborhoods.<sup>1</sup> Areas of opportunity – those places with the best schools, the best transportation, the best health care, and the best municipal services – tend to suffer from a lack of affirmatively-marketed affordable housing, while underserved areas tend to have an abundance of poorly maintained affordable housing.

Opportunities for homeownership also vary dramatically based on both race and place. People living in areas of opportunity tend to have access to inexpensive and safe credit while people living in underserved areas have tended to only have access to the fringe market – expensive, subprime, and unsafe credit – while communities of opportunity have an abundance

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<sup>1</sup> Three times as many poor African Americans and over twice as many poor Latinos live in resource-poor neighborhoods as poor whites and African Americans, regardless of income are likely to live in a poor neighborhood over the course of a decade while only ten percent of whites are expected to do the same. See *Segregation: The Rising Costs for America*, edited by James Carr and Nandinee Kutty. New York: Routledge, 2008, 14.

of mainstream bank branches representing prime lenders. This has obviously had a profound affect on communities affected by the foreclosure crisis. A recent study from the Center for Responsible Lending shows that African American and Latino borrowers are far more likely to be at imminent risk of foreclosure than non-Hispanic white borrowers.<sup>2</sup> Unfortunately, Latinos and African Americans already had far lower rates of homeownership than whites, which resulted in substantially lower family net worth,<sup>3</sup> especially considering that African Americans in particular rely upon homeownership twice as much as whites when building wealth.<sup>4</sup>

The housing finance market is in a unique role to correct these inequities within the housing market by creating sustainable homeownership opportunities and rental housing in high opportunity areas. Federal housing finance objectives must take into account the history of discrimination in our nation's housing market and be geared towards reducing the great disparities that have traditionally plagued the United States' housing and credit markets. It must also place a special emphasis on eliminating barriers and disparities that the federal government itself has helped to create and perpetuate.

The secondary market must be prepared to meet a range of housing needs meant to build wealth and opportunity in balanced ways. Rather than walking away from the goal of increasing homeownership, federal housing finance policy must be focused on providing sustainable

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<sup>2</sup> Gruenstein, Debbie, Wei Li, and Keith Ernst. "Foreclosures by Race and Ethnicity: The Demographics of a Crisis." Center for Responsible Lending. (June 18, 2010). Available at <http://www.responsiblelending.org/mortgage-lending/research-analysis/foreclosures-by-race-and-ethnicity.pdf>.

<sup>3</sup> *Id.*

<sup>4</sup> Hamilton, Darrick and William Darity, Jr. "Race, Wealth, and Intergenerational Poverty: There will never be a post-racial America if the wealth gap persists." *The American Prospect*. (September 16, 2009). Available at [http://www.prospect.org/cs/articles?article=race\\_wealth\\_and\\_intergenerational\\_poverty](http://www.prospect.org/cs/articles?article=race_wealth_and_intergenerational_poverty).

homeownership opportunities. Meanwhile, federal housing finance policy must also focus on providing a range of affordable rental housing opportunities throughout the country with a focus on financing affordable multi-family housing located in opportunity rich areas. Recently GSEs have developed a significant and important market presence in multi-family projects with more than 50 units – and that should continue—but their share of small multifamily loans remained flat.<sup>5</sup>

In approaching housing finance, it is important to remember that homeownership was not the villain of the housing crisis. Rather, the widespread marketing, origination, and securitization of loan products with predatory and equity-stripping terms and conditions drove the finance and foreclosure crises. This experience should not push us away from a policy of encouraging homeownership, rather it should push us towards a policy of encouraging sustainable homeownership. After all, a majority of subprime loans were refinance loans rather than purchase loan, and a majority of people that received subprime loans qualified for prime loans.<sup>6</sup>

Furthermore, it is important to continue to remember the deep interconnectedness of the primary market and the secondary market, and realize that perverse short-term profit opportunities available in the secondary market encouraged abusive and predatory behavior in the primary market. A strong secondary market that provides stability, liquidity, affordability, and access in a way that promotes sustainability will help discipline the primary market, but does not replace the very necessary enforcement of anti-discrimination laws across both the primary and secondary markets.

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<sup>5</sup> *State of the Nation's Housing 2010*, Joint Center for Housing Studies, Harvard University, p. 24

<sup>6</sup> Rick Brooks and Ruth Simon, "Subprime Debacle Traps Even Very Credit-Worthy." *The Wall Street Journal online* December 3, 2007.

**2. What role should the federal government play in supporting a stable, well-functioning housing finance system and what risks, if any, should the federal government bear in meeting its housing finance objectives?**

Based on past experience, we do not have confidence that the primary market, left to its own devices, will do an adequate job of meeting the housing credit needs of underserved communities and borrowers, and we also do not have confidence that it will adequately police itself. A strong secondary market, including participation by the federal government, must be in place to provide necessary liquidity and access to standardized fixed-rate, long-term mortgages. Federally-backed housing finance entities must be primarily focused on their duty to serve underserved communities and people with low and moderate incomes, and must also have an explicit responsibility to affirmatively further fair housing written into their charters. Furthermore, the federal government must play an active role in regulating the remainder of the secondary market that is not government backed.

For the federal government to meet its first goal, it should play an active role in the secondary market by both securitizing loans and maintaining a portfolio that may include loans for affordable rental properties and also certain types of owner-occupied properties and/or hybrid ownership models, such as land trusts and shared equity properties . The federal government should explicitly guarantee mortgage backed securities offered by issuers that are tasked with the explicit mission of serving the public with fair and affordable homeownership and rental opportunities. These issuers must have a duty to serve underserved communities with sustainable homeownership opportunities and must also have the duty to meet affordable housing rental goals that have the function of increasing integration in communities.

In order to meet the goal of providing both sustainable homeownership opportunities and affordable rental opportunities that affirmatively further fair housing, these institutions must value sustainability of its products over profitability. As recent history has shown, products that are unsustainable, while profitable in the short-run, are ultimately doomed to fail.

In order to meet their anti-discrimination and affirmative obligations established by the Fair Housing Act, a fair housing mandate must be incorporated into the institutions' charters, and the institutions' structures must include a senior level officer responsible solely for ensuring compliance with our nation's housing and lending anti-discrimination laws. This officer should report directly to the president and CEO of the agency and provide regular reports to the agency's governing or oversight body on how well the agency is complying with its fair lending responsibilities and its obligation to affirmatively further fair housing. Moreover, any oversight and/or governing body for the agency(ies) must include members with civil rights and fair lending expertise.

For the federal government to meet its second goal of promoting a strong, unified secondary market, it must regulate the private secondary market, which resembled the Wild West during the heyday of subprime lending. This means it must set minimum standards for mortgages that issuers of private mortgage-backed securities can securitize, and employ policies and systems that ensure appropriate risk alignment. Risk should be aligned among all of the parties to the transaction. In particular, we must be sure to prevent the conflict between the interests of the borrower and the interests of other parties (such as originators, securitizers and investors) that gave rise to the current crisis. Although the Dodd-Frank Wall Street Reform and Consumer Protection Act establishes loan origination guidelines designed to curtail predatory lending, this scrutiny should not be reserved for the primary market. Additional regulation of the private

secondary market should also focus on ensuring that the private secondary market serves traditionally underserved communities in a safe and sustainable way.

As the crisis showed, the private secondary market fueled predatory lending in communities of color and other underserved communities, flooding them with bad credit that was quickly bundled into securities. A better regulated private secondary market should be assessed not only by the “safety” of the credit that it is securitizing, but it should also be evaluated by the geographic distribution of its mortgages. Regulation of the private secondary market means ensuring that safe credit is offered fairly, and that the secondary market complies with the fair lending and fair housing responsibilities established by the Fair Housing Act and Equal Credit Opportunity Act. Private secondary market players must not be complicit in securitizing loans made by originators that offer discriminatory credit terms to their customers.

The federal government should also promote a stable, equitable and well-functioning finance system by promoting policies and systems that effectively monitor and manage risk. A key component of this is promoting the use of accurate and appropriate data. We now know that models used to make projections about the housing and finance markets were deeply flawed. Models did not adequately identify or apportion risk. Moreover, risk assessment models were based on unreliable or inaccurate data and assumptions. This led to breakdowns in the financial system.

For example, the primary and secondary markets placed undue emphasis on FICO and/or credit scores undervaluing the importance of other critical elements like underwriting considerations, product features and product sustainability. Once the market imploded, analysts discovered that elements such as prepayment penalty, fraudulent appraisal practices, yield spread

premiums and type of mortgage were actually better predictors of loan performance and risk than credit scores. The federal government must place a greater emphasis on utilizing and analyzing sound, empirical data to develop its policies and to support the financial marketplace. Moreover, the government must never again be overly reliant on data provided by the private financial industry. Rather the government must also seriously consider data and analysis conducted by civil rights and consumer advocacy groups as well as its own careful analysis of the markets to develop policies and objectives that will further the stability, integrity and effectiveness of the marketplace. The government must take this responsibility seriously because when risk is inappropriately assessed it can, as it did, lead to a collapse of the system.

### **3. Should the government approach differ across different segments of the market, and if so, how?**

It is critically important that GSEs do not reinforce existing patterns of segregation that currently exist throughout our country. It is also critically important that GSEs provide financing for sustainable housing opportunities in communities that have been severely impacted by predatory lending and the foreclosure crisis. As such, the government must approach the market in a place-based way that balances and addresses the needs and vulnerabilities of metropolitan areas. A GSE system judged on its duty to serve both affordable housing and fair housing goals must have a nuanced way of meeting its obligations in order to ensure that it is not further concentrating poverty through its production of rental housing.

Additionally, GSEs must support local initiatives to increase available affordable housing. This means offering financing for smaller rental housing development, providing financing to preserve existing affordable housing, especially pro-integrative affordable housing, and through engagement with community land trusts, communities with inclusionary zoning programs, and active CDFIs.

As the Consumer Federation of America has suggested in its white paper on GSE reform, the federal government's role in the secondary market should be narrower than the role that Freddie Mac and Fannie Mae have recently served.<sup>7</sup> It should focus on securitizing home loans with smaller limits so that low and moderate income homeowners have access to safe and sustainable credit.

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<sup>7</sup> Zigas, Barry. "Re-engineering the Mortgage Finance System: Charting a Future Course for the Secondary Market." Consumer Federation of America (Dec. 2, 2009)

Furthermore, the federal government should have the responsibility of supporting innovative products for first-time homebuyers and underserved buyers and also supporting rental housing and subsidized housing. This can be done through the careful use of a real estate portfolio. The Mortgage Working Group convened by the Center for American Progress has suggested that GSEs offer mortgage backed securities with the backing of the federal government and also maintain portfolios with multi-family rental housing that do not enjoy the government guarantee.<sup>8</sup> The Consumer Federation of America has suggested that the government license or charter all issuers of mortgage backed securities, but create at least one specialized and sponsored entity tasked with providing credit liquidity to rental and ownership opportunities. Transactional fees would provide necessary insurance in the event of mortgage defaults and also feed an affordable rental housing trust fund.<sup>9</sup>

Whatever the structure or manner through which federally-sponsored secondary market players manage their rental housing portfolios, it is necessary that they serve a public mission in doing so. This should include providing fair and accessible underwriting for subsidized rental opportunities such as Section 8 housing and other public housing, and rehabilitation opportunities for smaller rental properties (particularly rental properties in opportunity neighborhoods).

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<sup>8</sup> Mortgage Finance Working Group. "A Responsible Market for Housing Finance: Draft White Paper on the Future of the U.S. Secondary market for Residential Mortgages." Center for American Progress. December 2009. Available at [http://www.americanprogress.org/issues/2009/12/pdf/housing\\_finance.pdf](http://www.americanprogress.org/issues/2009/12/pdf/housing_finance.pdf).

<sup>9</sup> Zigas, p. 46-48

#### **4. How should the current organization of the housing finance system be improved?**

Any reform of the housing finance system that does not eliminate the dual secondary market will not solve the principle problem that gave rise to the crisis. The housing finance system cannot be defined by one unregulated side and one side held to regulatory standards and a duty to serve. As stated above, this means the private secondary market must be prudentially regulated and must also meet certain obligations of serving underserved communities. We are supportive of a secondary market organization that creates a unitary market governed by clear, bright lines, and we are also supportive of a secondary market organization that includes institutions with the specific responsibility of serving underserved communities and people in affirmative ways.

In reorganizing the housing finance system, the federal government must be attuned to fair housing as it creates nuanced duties for the secondary market to serve, and it must also be aware of ways in which the many pieces of government housing and capital markets policy are interacting. GSEs, federal bank regulators, the Consumer Financial Protection Bureau, the Securities and Exchange Commission, HUD, and Treasury employees overseeing the Low Income Housing Tax Credit program must openly cooperate to ensure that their programs are increasing opportunities to access prime, safe credit for underserved communities and people of color in a way that maximizes each of their programs' effectiveness.

Fair housing and fair lending must be integrated into every program and function of GSEs, including product development, risk assessment, underwriting, loan origination, distribution, servicing, and secondary market functions, and prudential regulators of other secondary market players must take fair housing and fair lending concerns into consideration when examining them.

## **5. How should the housing finance system support sound market practices?**

The housing finance system can support sound market practices by creating market discipline through underwriting standards. Following the foreclosure crisis, it is especially important that the secondary market – led by government guaranteed entities – exercise this unique ability. The GSEs demonstrated their ability to do this clearly when they stopped purchasing and securitizing mortgages that included predatory single premium credit insurance. With this decision, Freddie and Fannie essentially banished this predatory product from the marketplace.

Following the foreclosure crisis, one of the most critical roles the secondary market can play is to use its power to reframe how lenders in the primary market think of and define credit worthy borrowers. A study by the University of North Carolina and the Center for Responsible Lending showed that loan terms and features, such as prepayment penalties, yield spread premiums and rapidly adjusting interest rates, are better predictors of foreclosure than borrower characteristics.<sup>10</sup> This remains particularly pertinent today, as foreclosures have badly damaged consumers' credit scores. More than three million households have gone through foreclosure over the last three years, and many millions more may face foreclosure before this crisis ends. 25.5% of consumers – 43.4 million people - now have FICO scores of 599 or lower, placing them in the highest risk category for credit.<sup>11</sup> The implications of these numbers are profound. These people will have limited access to many forms of credit for a long time to come. They

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<sup>10</sup> Lei Ding, Roberto G. Quercia, and Janneke Ratcliffe (Center for Community Capital at The University of North Carolina) with Wei Li (Center for Responsible Lending.) “Risky Borrowers or Risky Mortgages? Disaggregating Effects Using Propensity Score Models” Working Paper October 2008. Accessed at [http://www.cc.unc.edu/documents/RiskyBorrowers\\_RiskyMortgages\\_1008.pdf](http://www.cc.unc.edu/documents/RiskyBorrowers_RiskyMortgages_1008.pdf)

<sup>11</sup> Connelly, Eileen Aj, “More Americans’ Credit Scores Sink to New Lows,” Associated Press, July 12, 2010, available at <http://finance.yahoo.com/news/More-Americans-credit-scores-apf-490198280.html?x=0&sec=topStories&pos=5&asset=&ccode=>.

may not be able to get mortgages, insurance, credit cards, cars or cell phones. If they can obtain credit, they will be forced to pay more for it. They may be denied access to a place to live or even a job because of their credit scores. If we want families to get back on their feet, communities to regain stability, the housing market to level out and the economy to grow, we must make sure that credit flows again, and that it does so on fair and equitable terms. Given its ability to set the terms upon which loans are underwritten and the criteria upon which borrower creditworthiness is assessed, the secondary market can help achieve this goal.

Another way that the secondary market can support sound practices in the primary market is to use its ability to set the parameters for loans it will purchase to prevent loan products from being offered inappropriately. Option ARMs, a product whose failure has played a key role in the foreclosure crisis, were originally designed for a very limited set of borrowers. Had they been sold only to the borrowers for whom they were intended, the housing market and the economy might look very different today. But like exotic invasive plants, Option ARMs escaped their intended market niche and crowded out responsible, sustainable credit. If the secondary market had provided a check on the use these loans, we could have avoided many of our current problems. In these and other ways, the secondary market can promote sound practices in the primary market.

**6. What is the best way for the housing finance system to help ensure consumers are protected from unfair, abusive or deceptive practices?**

The first thing we must do to ensure that consumers are protected from unfair, abusive or deceptive practices is to eliminate the current dual housing finance system. The current dual scheme in which under-served groups are primarily served by an unregulated, high-cost, equity-stripping and abusive system must be totally abolished. The federal government must promote and support a housing finance system in which both the primary market and the secondary market are open and operate free of illegal discrimination. Our housing finance system cannot perpetuate unfairness and inequity and must be a system where everyone has equal access to affordable, quality, sustainable credit that helps build and establish wealth for consumers. Our system must not operate in a manner that debilitates family wealth.

Moreover, everyone in the finance system must play by the same rules. We cannot have a bifurcated structure in which some entities are answerable to effective regulation and others are left to their own governance and policing. History has borne out that in such a scheme, under-served groups will be ill-served by the more highly functioning and lower costs market leaving them prey and susceptible to those operating in the fringe market.

Just as banks are regulated for fair lending compliance, the secondary market should be as well. Private secondary market players that are not held to the heightened duty to serve that any government backed entity may be must be regularly examined to ensure that the securities they are selling do not contain discriminatory loans and to make sure that their securities include sustainable loans coming from a broad area of the marketplace. Government-backed entities

must cooperate with the CFPB and with agencies responsible for overseeing financial institutions' compliance with the Fair Housing Act and Community Reinvestment Act in order to harmonize the community development and fair lending goals of both the primary and the secondary market.

In the past, GSEs purchased subprime mortgages in order to fulfill their affordable housing goals and also purchased mortgage backed securities that contained provisions that violated their own anti-predatory lending policy restrictions for mortgages. In the future, this cannot continue.

The secondary market can further ensure that consumers are protected from unfair, abusive, or deceptive practices by securitizing loans that meet higher standards than the minimum mortgage standards established in the Dodd-Frank Wall Street Reform and Consumer Protection Bill. Although the mortgage reform provisions in the bill establish maximum points and fees caps and also ban certain predatory loan terms that decimated both the primary and secondary market, it still leaves room for abuse in the primary market.

Finally, the secondary market has traditionally provided a room for incubation of innovative loans intended for underserved borrowers who do not meet traditional credit standards. These include lower down-payment loans with higher loan-to-value ratios than conventional 30 year fixed rate loans, but loans that do not have the predatory terms and conditions that brought down the subprime market. The secondary market must continue to serve as this incubator by purchasing innovative loans for its portfolio. This will ensure that underserved borrowers have access to safe and sustainable credit so they do not have to turn to more dangerous alternatives.

The secondary market must also be transparent to the public. First, its underwriting policies and practices must be accessible to the public and presented in a way that is easy for the public to understand. Criteria that government-sponsored entities will use to evaluate credit and

other underwriting considerations should be available for public scrutiny. The data generated by government-sponsored entities for public release, such as market penetration information, should be available in an easy to use format that can be accessed by non-profit agencies. It is critical for the public to be able to determine where government supported dollars are being invested and who is benefitting from government sponsored activities. It is also critical for the public to be able to determine the benefit and impact of government sponsored investments.