SUSTAINABLE HOUSING FINANCE: AN UPDATE FROM THE DIRECTOR OF THE FEDERAL HOUSING FINANCE AGENCY

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTEENTH CONGRESS

FIRST SESSION

JANUARY 27, 2015

Printed for the use of the Committee on Financial Services

Serial No. 114–1

U.S. GOVERNMENT PUBLISHING OFFICE

95–045 PDF WASHINGTON : 2015

For sale by the Superintendent of Documents, U.S. Government Publishing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

HOUSE COMMITTEE ON FINANCIAL SERVICES

JEB HENSARLING, Texas, *Chairman*

PATRICK T. MCHENRY, North Carolina, *Vice Chairman*
PETER T. KING, New York
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
SCOTT GARRETT, New Jersey
RANDY NEUGEBAUER, Texas
STEVAN PEARCE, New Mexico
BILL POSEY, Florida
MICHAEL G. FITZPATRICK, Pennsylvania
LYNN A. WESTMORELAND, Georgia
BLAINE LUETKEMEYER, Missouri
BILL HUIZENGA, Michigan
SEAN P. DUFFY, Wisconsin
ROBERT HURT, Virginia
STEVE STIVERS, Ohio
STEPHEN LEE FINCHER, Tennessee
MARLIN A. STUTZMAN, Indiana
MICK MULVANEY, South Carolina
RANDY HULTGREN, Illinois
DENNIS A. ROSS, Florida
ROBERT PITTENGER, North Carolina
ANN WAGNER, Missouri
ANDY BARR, Kentucky
KEITH J. ROTHFUS, Pennsylvania
LUKE MESSER, Indiana
DAVID SCHWEIKERT, Arizona
ROBERT DOLD, Illinois
FRANK GUINTA, New Hampshire
SCOTT TIPTON, Colorado
ROGER WILLIAMS, Texas
BRUCE POLIQUIN, Maine
MIA LOVE, Utah
FRENCH HILL, Arkansas

MAXINE WATERS, California, *Ranking Member*
CAROLYN B. MALONEY, New York
NYDIA M. VELÁZQUEZ, New York
BRAD SHERMAN, California
GREGORY W. MEEKS, New York
MICHAEL E. CAPUANO, Massachusetts
RUBÉN HINOJOSA, Texas
WM. LACY CLAY, Missouri
STEPHEN F. LYNCH, Massachusetts
DAVID SCOTT, Georgia
AL GREEN, Texas
EMANUEL CLEAVER, Missouri
GWEN MOORE, Wisconsin
KEITH ELLISON, Minnesota
ED PERLMUTTER, Colorado
JAMES A. HIMES, Connecticut
JOHN C. CARNEY, JR., Delaware
TERRI A. SEWELL, Alabama
BILL FOSTER, Illinois
DANIEL T. KILDEE, Michigan
PATRICK MURPHY, Florida
JOHN K. DELANEY, Maryland
KYRSTEN SINEMA, Arizona
JOYCE BEATTY, Ohio
DENNY HECK, Washington
JUAN VARGAS, California

SHANNON MCGAHN, *Staff Director*
JAMES H. CLINGER, *Chief Counsel*

CONTENTS

SUSTAINABLE HOUSING FINANCE: AN UPDATE FROM THE DIRECTOR OF THE FEDERAL HOUSING FINANCE AGENCY

Tuesday, January 27, 2015

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:07 a.m., in room 2175, Rayburn House Office Building, Hon. Jeb Hensarling [chairman of the committee] presiding.

Members present: Representatives Hensarling, King, Royce, Lucas, Garrett, Neugebauer, McHenry, Pearce, Posey, Fitzpatrick, Luetkemeyer, Huizenga, Duffy, Stivers, Fincher, Mulvaney, Hultgren, Ross, Pittenger, Wagner, Barr, Rothfus, Messer, Schweikert, Dold, Guinta, Tipton, Williams, Poliquin, Love, Hill; Waters, Maloney, Velazquez, Sherman, Hinojosa, Clay, Lynch, Scott, Green, Cleaver, Moore, Ellison, Himes, Carney, Sewell, Foster, Kildee, Murphy, Delaney, Sinema, Beatty, Heck, and Vargas.

Chairman HENSARLING. The Financial Services Committee will come to order. Without objection, the Chair is authorized to declare a recess of the committee at any time.

Today, we meet to hear from the Director of the Federal Housing Finance Agency (FHFA). No stranger to this committee, he is our former colleague and truly our friend, Mel Watt, whom the Senate confirmed to his current position in December of 2013. A special welcome to the Director. Most of us know him well. He was the Representative of North Carolina's 12th District for 21 years. And I can say from both sides of the aisle, he is one who served on this committee with both honor and distinction.

It was a pleasure to serve with Mel. And I always listened very carefully when he spoke. I rarely agreed with anything that he said, but he always commanded my respect. And I listened carefully because, again, he was a thoughtful member of this committee. I certainly admire the fact that the Director has chosen to continue his career in public service.

I might remind my friend and colleague that when he was on this side of the witness table, he always demanded of the witnesses short, concise, and substantive answers. So I have no doubt that now that he is on the other side of the witness table, he will continue to demand the exact same from that side of the witness table.

And once this hearing is over, I can't wait to ask my last question, which is: Mr. Director, which did you enjoy being more, the inquisitor or the inquisitee? Although I suspect I already know the answer to that question.

Now, before we get started with opening statements, I wish to yield a brief moment to the ranking member for a special welcome, as well.

Ms. WATERS. Thank you very much, Mr. Chairman. I, too, would like to welcome Director Mel Watt to this hearing today. I must admit, I was somewhat torn when Mr. Watt received this appointment. While I know and always knew that he would do a great job at FHFA, I knew I was going to miss him on this committee, and not only because he was such a thoughtful, well-prepared member of the committee.

I could count on him as the one person who had read every line of a bill. Mel Watt not only had read every line of a bill, he was the one who could come up with the question that no one else could come up with, because he had spent so much time reading the bill.

I also appreciate the fact that he served an important role, even when Barney Frank was the Chair of this committee. When there was a need for tough negotiations, Barney Frank turned to Mel Watt and would ask him to work with the opposite side of the aisle to work out the differences. And he did that on any number of occasions. Barney Frank could never trust me with that. And I understand why and everybody else understands why. But Mel Watt certainly did serve in that role for all of us.

So we are so pleased, again, that you are over at FHFA. And despite the fact that I mourn your not being here with us on this committee, we know that you are the right person for that position.

And we are very pleased that you were able to hit the ground running because you knew and you know the issues so well. So welcome, Mel Watt. We look forward to hearing from you today. And don't worry. If anybody on the opposite side of the aisle tries anything with you, I will take them on. Okay?

Thank you.

Chairman HENSARLING. The purpose, again, of today's hearing is to take testimony from the Director of the FHFA to learn about the conservatorship of the GSEs. I now recognize myself for 3 minutes for an opening statement.

As Yogi Bera once famously said, it is deja vu all over again. Memories are clearly short among Washington's ruling class, because they are repeating the same mistakes that caused the 2008 financial crisis in the first place. Contrary to the fable told by the left, the root cause of the financial crisis was not deregulation, but dumb regulation: regulations and statutes that either incented or mandated financial institutions to loan money to people to buy homes they ultimately could not afford to keep.

Exhibit one, Fannie Mae and Freddie Mac's Affordable Housing Goals. Seventy percent of all troubled mortgages were backstopped by Fannie, Freddie, and other Federal agencies. Contrary to the fable of the left, it ultimately wasn't Wall Street greed that brought down the system.

Of course there is greed on Wall Street. When hasn't there been? But there is also something known as Washington greed: greed for power to command and control huge swaths of our economy; greed to have Washington allocate credit within our society, as opposed to We, the People, in a free and competitive, transparent, and innovative market.

The mentality of this Washington greed is best summed up by Obama architect, Jonathan Gruber, who famously stated, "The American people are too stupid to know the difference." I doubt the American people collectively would have been foolish enough to roll the dice on taxpayer-backed subprime lending. Clearly, Washington was. The dice were rolled, millions lost their homes, the economy was brought to its knees, and hardworking taxpayers had to pay for the mother of all bailouts.

Regrettably, Washington appears to be rolling the dice yet again. Within the last 12 months, FHFA has announced three different policies that are harmful to transitioning us to a sustainable housing finance system that protects both homeowners and taxpayers. First, by suspending a previously scheduled increase to fees Fannie and Freddie charge for their loan guarantees, FHFA is leveraging the taxpayer balance sheet—one that is clearly awash in red ink—to lock in a near government monopoly.

Next, in a race to the bottom with FHA to become the Nation's largest subprime lender, FHFA has announced that it will begin to allow the GSEs to buy mortgages with as little as 3 percent down. As history repeats itself, historically-prudent underwriting standards are yet again being thrown out the window. The data is overwhelming that there is a direct correlation between delinquencies and foreclosures on the one hand and low downpayments on the other.

Finally, and most recently, FHFA has announced it will begin siphoning off taxpayer funds from Fannie and Freddie in order to begin filling government housing slush funds. All the while, Fannie and Freddie remain ridiculously leveraged and continue to threaten hardworking American taxpayers.

The best affordable housing program is a healthy economy, not a doubling down on failed Obama economics and certainly not more risky housing schemes from Washington. It is time to grow our economy from Main Street up, not from Washington down. It is time to get off the boom-bust-bailout cycle. It is time hardworking middle-income families have greater economic opportunity to achieve financial independence and the opportunity to buy a home they can actually afford to keep.

I now recognize the ranking member for 3 minutes.

Ms. WATERS. Thank you, Mr. Chairman.

Again, let me welcome my friend and our former colleague, Mel Watt, back. Director Watt, in the years since you became head of the Federal Housing Finance Agency, you have taken important steps to ensure that our housing market remains affordable and works for everyone. With Fannie Mae and Freddie Mac now having paid the government $225 billion—which is $38 billion more than the Treasury invested during the crisis—I think it is fair to say that our actions to prevent a total collapse of our housing market have been a resounding success.

If we close the GSEs without putting in place a viable alternative, as my Republican colleagues would do, we would likely reenter a recession. In fact, I think it is in our economy's best interest that the PATH Act lost what little momentum it may have ever had. And, Director Watt, your actions demonstrate that you are fulfilling your statutory mandate to preserve a liquid, competitive, and national housing market.

Similarly, the FHFA has finally abided by another statutory mandate to fund the Affordable Housing Trust Fund. This one action will help improve, especially in districts like mine, the availability and affordability of rental housing. There are 7.1 million American households for whom safe and decent housing is neither affordable nor available, a situation made worse due to Republican attacks on public housing and voucher programs.

But by complying with your statutory obligation to allocate a tiny percentage of Fannie Mae and Freddie Mac's profits to these funds, we have the chance to improve the lives of millions of American children, families, people with disabilities, and the elderly.

I also applaud your efforts to expand the availability of homeownership for all Americans, including Americans who are qualified borrowers but are not fortunate enough to come from wealthy families. When FHFA lowered the downpayment requirements, it appropriately balanced safeguards to protect the taxpayer with expanded credits for eligible borrowers.

Moving forward, I encourage FHFA to think outside the box when it comes to credit scores to ensure that all creditworthy borrowers have a chance at the American dream.

So I thank you, Director Watt. And again, we welcome your testimony today. I yield back the balance of my time.

Chairman HENSARLING. The Chair now recognizes the gentleman from New Jersey, the chairman of our Capital Markets and Government Sponsored Enterprises (GSEs) Subcommittee, Mr. Garrett, for 2 minutes.

Mr. GARRETT. Thank you, Mr. Chairman, for convening this very important hearing today. And thank you, Director Watt, also, for being here and for your testimony, as well.

I would like to begin today's hearing by commending Chairman Hensarling for your work and your steadfast commitment to reforming our Nation's broken housing finance system. Our housing finance system and, more specifically the GSEs, were at the heart and center of the recent financial crisis. I realize the odds are long and the political issues to overcome are immense. I do believe that reforming this broken marketplace must remain a priority of this committee in the 114th Congress.

So I am heartened at the level of substantive engagement by Members on both sides of the aisle with a number of specific legislative proposals introduced by the chairman, the ranking member, and Mr. Delaney, as well. These proposals and the bipartisan bills provide a foundation for which to continue negotiations with Congress and hopefully reach bipartisan consensus on a reform package.

Now, Director Watt, you have been quoted as saying that you believe that GSE reform should be left up to Congress, and the FHFA should not interfere. While I appreciate the appropriate deference you pay to the body where you once served, it is important to understand that no matter your intent, any decisions that you make as Director will impact upon reform efforts, either positively or negatively. There is no way for you to avoid them.

So given that, I would hope that your decisions, then, would err on the side of helping to facilitate reform, and not acting as an impediment to it. So lowering downpayments, preventing risk-based guaranteed pricing, and the funding of the Housing Trust Fund, those things will make it harder to reform these entities and quite possibly lead us down the path of another multibillion dollar taxpayer bailout.

These decisions bring to mind the old saying, “Those who don’t learn from history are doomed to repeat it.” So subpar underwriting standards, taxpayer-subsidized pricing, encouraging people to buy homes that they simply can’t afford, well, they were the main causes of the last crisis.

So I would ask the Director, please, don’t let these decisions lead to the next one.

With that, I yield back.

Chairman HENSARLING. The Chair now recognizes the gentlelady from New York, the ranking member of our Capital Markets and GSEs Subcommittee, Mrs. Maloney, for 2 minutes.

Mrs. MALONEY. I thank the chairman and ranking member for calling this important hearing. And it is a pleasure to welcome our former colleague and good friend, Mel Watt. You are missed on this committee.

Director Watt has been on the job for 386 days. And he has proven to be a thoughtful, deliberative, and conscientious leader of this tremendously important agency. He has focused on maintaining the liquidity of the mortgage markets and on increasing access to credit for creditworthy borrowers. For example, his first act as Director of FHFA was to delay a planned increase in Fannie and Freddie’s guarantee fees, which would have raised g-fees even more in States with stronger consumer protections, such as the one I represent.

There was never a sound basis for penalizing States that have strong consumer protections in foreclosure. And I applaud Director Watt for this decision. States that have strong consumer protections should be rewarded, not penalized. In addition, he halted the arbitrary 10 percent cuts to Fannie and Freddie’s multifamily businesses, and created an exception for small and affordable multifamily housing. This is hugely important for my district, where multifamily housing is our single family business.

He has also allowed Fannie and Freddie to buy certain mortgages with a 3 percent downpayment, which will allow borrowers with strong credit histories but not stockpiles of extra cash to get a mortgage. I think that decision is tremendously important. And he was guided by the data, which clearly demonstrates that the size of the downpayment is not the most important factor in predicting default rates.

Finally, he recently made the decision to start funding the National Housing Trust Fund and the Capital Magnet Fund, which will provide hundreds of millions of dollars for affordable housing programs. This was a critically important decision, because this was one of the only dedicated sources of funding for affordable housing that we have.

Thank you very much. We are delighted to have you back here before the committee.

Chairman HENSARLING. The gentlelady yields back. Director Watt, welcome once again to that side of the witness table. And you are now recognized for your opening statement.

STATEMENT OF THE HONORABLE MELVIN L. WATT, DIRECTOR, FEDERAL HOUSING FINANCE AGENCY (FHFA)

Mr. WATT. Chairman Hensarling, Ranking Member Waters, and members of the committee, thank you for inviting me to discuss the work we are doing at the Federal Housing Finance Agency, and for providing my first opportunity to return to this committee since I left Congress. This actually might be the first time since I left that I have the sense that I might be better off on that side of the table.

FHFA is mandated by statute to ensure the safety and soundness of the Federal Home Loan Banks, Fannie Mae, Freddie Mac, and to ensure that they provide liquidity in the national housing finance market. FHFA works to balance these obligations across all of our activities.

Because Fannie Mae and Freddie Mac are also in conservatorship, we are also mandated by statute to preserve and conserve their assets. Earlier this month, FHFA issued a new scorecard that outlines our conservatorship expectations for the enterprises in 2015. FHFA's conservatorship strategic plan that we issued in 2014 and the scorecards we issued in 2014 and 2015 are centered around three strategic goals that are fully aligned with FHFA's statutory mandates.

The first goal is to maintain the credit availability and foreclosure prevention activities supported by the enterprises, and to do so in a safe and sound way. During 2014, in support of this goal, FHFA made considerable progress with the enterprises to clarify their representation and warranty framework, to encourage responsible lending to creditworthy borrowers, and to enhance the enterprises' outreach and provision of services to small and rural lenders.

In 2015, the enterprises will continue their work on these and other priorities, such as analyzing the potential benefits and feasibility of using updated or alternative credit score models.

The second goal is to reduce taxpayer risk. The primary way we do this is by increasing the role of private capital in the mortgage market. In 2014, FHFA tripled the enterprises' credit risk transfer requirement and the enterprises' executed transfers on single family mortgages with a combined unpaid principal balance of over $300 billion last year.

In 2015, the enterprises will continue to use the models that have already proven successful to transfer credit risk, and they will explore other ways of transferring and reducing risk to taxpayers.

Our third goal is to build a new securitization infrastructure for use by the enterprises and adaptable for use in the future mortgage market, whatever that might be. Last year, we defined the governance structure of the common securitization platform, and the enterprises announced a CEO for this joint venture. We also made significant progress toward our multiyear goal of developing common securitization platform technology and a single security. Our strategic plan and the 2015 scorecard also have affordable rental housing priorities for the enterprises.

The focus here is not to compete where there is adequate private sector coverage of the multifamily market, but to ensure that affordable housing is available and that the housing needs of people in rural and other underserved areas are met, including areas that rely heavily on manufactured housing.

FHFA is also focused on regulating the Federal Home Loan Banks. As part of our responsibility to ensure that the Banks fulfill their statutory mission and support housing finance in a safe and sound manner, we proposed a rule last year concerning the Banks' membership requirements. Our comment period ended earlier in January, and we received approximately 1,300 comments.

I want to emphasize that getting and evaluating input from stakeholders is a crucial part of our policymaking process. We will carefully consider comments made by members of this committee and the public in determining our final rule on the bank membership standards. We are also actively considering input we have received on guarantee fees, single security, and the enterprise housing goals.

I have covered a lot more areas and provided a lot more details in my written statement. And I look forward to responding to your questions. Again, thank you for the opportunity to testify. I am happy to be back, especially since I know that I am free to leave after the hearing is over.

[The prepared statement of Director Watt can be found on page 66 of the appendix.]

Chairman HENSARLING. The Chair now yields himself 5 minutes for questions. Again, thank you, Director Watt.

I wish to echo the comments of the Chair of our Capital Markets and GSEs Subcommittee. I fear, Director Watt, that you have reversed the policies of your predecessor, which will make it more difficult to have a sustainable housing finance system.

I want to first focus on what you have done in authorizing the GSEs to backstop 3-percent-down loans. You have previously testified before the Senate that, "We know that the size of a downpayment by itself is not the most reliable indicator of whether a borrower will repay a loan." All things being equal—because I have looked, and I can't find your thoughts on this subject—is a 3-percent-down loan riskier to the taxpayer than a 10-percent-down loan?

Mr. WATT. I would say, Mr. Chairman, that is generally true. But when you pair the downpayment with other compensating factors—which is part of the sentence that apparently people missed when I announced this—you can make a 3-percent downpayment loan as—

Chairman HENSARLING. —I understand there are other factors—okay. I understand there are other factors, Mr. Director. But also, ability to repay certainly is an indication of whether or not a homebuyer can save. If they can only afford 3 percent down, do you believe that 3 percent down is riskier to the home purchaser than 10 percent down?

Mr. WATT. Again, the same considerations would apply to the borrower as would apply to the lender. If you carefully look at other considerations and take them into account in deciding whether to extend that credit—or in Fannie and Freddie's case, whether to back that credit—then you can ensure that a 3 percent loan is just as safe as a 10 percent downpayment loan.

Chairman HENSARLING. Let's explore some information that has come out of your agency previously. Can I have the chart from the Federal Register, please?

Your agency, frankly, along with Treasury, the Fed, the FDIC, the SEC, and HUD—I know, like most charts, it is somewhat difficult to read. But on the horizontal axis, this is loan-to-value ratio. On the vertical axis is default rate. And to the far right-hand corner, you see a precipitous rise in default rates when you go from 90 percent loan-to-value. And particularly, an incredible slope from 95 percent as we reach no downpayment whatsoever.

Again, this is information that is coming from your agency, along with just about every other prudential banking and housing regulator. So doesn't that seem to indicate that, again, a 3 percent downpayment, not only is it not too good for the taxpayer—you are once again putting people in homes that they can't afford to keep. And you had previously testified when you were on this side of the table during the Dodd-Frank Act proceedings, "I have always believed that you cannot make a loan to somebody who cannot afford to repay it. That is unstainable." This is data from your agency and others. So why is it sustainable?

Mr. WATT. Mr. Chairman, I haven't changed my position on that. And I want to assure this committee that I have not changed my position. You should never make a loan to somebody that you cannot anticipate would pay it. But if you couple—

Chairman HENSARLING. Again, this is data. This is data from your agency—

Mr. WATT. —other factors and make a loan as safe, which is exactly what we have done with this 97 percent product; compensating factors including housing counseling, including—

Chairman HENSARLING. Okay. Well, Director Watt, let's not just look—

Mr. WATT. —private mortage insurance—

Chairman HENSARLING. —let's not just look—

Mr. WATT. —all of those things—

Chairman HENSARLING. —you do recall I get to control—

Mr. WATT. —taken into account in determining—

Chairman HENSARLING. Let me quote from the same document, "Default rates increase noticeably among loans used to purchase homes at LTV ratios above 80 percent. There is substantial data indicating that loans with LTV ratios of 80 percent or less perform noticeably better than those with LTV ratios above 80 percent."

So notwithstanding, Mr. Director, with all due respect, I understand what you are saying. But I fear what you are doing is again repeating the exact same mistakes that brought us here in the first place. And now, you are in a contest with FHA to see who can be the Nation's largest subprime lender. I fear we are going in the complete wrong direction with your policy.

I now recognize the ranking member for 5 minutes.

Ms. WATERS. Thank you very much. Mel Watt, I really wanted to spend my time on the Affordable Housing Trust Fund. But I must step in here to basically ask, when we take a look at those that we would lend to with the 3 percent down, are we not talking about people who have shown that they pay their bills every month, they have basically good credit, they have not defaulted, they don't have any bankruptcies? They just are not able to save up a 10 to 20 percent, as some more wealthier people are able to do.

But these are good, hardworking taxpayers. Are these the kind of people you are talking about?

Mr. WATT. That is exactly the kind of people that we would be looking for. And we would pair that with strong credit scores, lower debt-to-income ratios, housing counseling, and private mortgage insurance. All of which put together, compensate for the fact that you are making a loan to somebody with a lower downpayment.

We have no interest in going back to irresponsible lending. And it is part of our statutory mandate to make sure that doesn't happen.

Ms. WATERS. Thank you. I think that even though I don't have the data or the information, that a large part of our society fits into that category. And they deserve to be homeowners if, in fact, they are hardworking citizens who pay their bills, who have not had any problems. A 3 percent downpayment should not cause us any problems at all.

Let me get to the Affordable Housing Trust Fund. I would like to commend you on your recent decision to follow the requirements set forth in the Housing and Economic Recovery Act of 2008 and lift the suspension on Fannie Mae and Freddie Mac's obligation to fund the National Housing Trust Fund and the Capital Magnet Fund.

As you are well-aware, we are in the worst rental housing crisis this Nation has ever seen. In the richest country in the world, it is unconscionable that there are 7.1 million American households for whom safe and decent housing is neither affordable nor available. In my own district alone, there is a shortage of nearly 43,000 affordable and available rental units for extremely and very-low-income households.

These critical new funds will not only add to the supply of affordable rental housing, but will also help to address homelessness and poverty across the country. Please talk to us about what factors you considered in coming to your decision to end the suspension of contributions to the funds.

Mr. WATT. Ranking Member Waters, I simply followed the statute. The statute tells us the exact circumstances for the criteria to be applied on the suspension of the contributions to the Housing Trust Fund. And it tells us the criteria to be applied under normal circumstances for funding. And that is whether the contributions to these funds would contribute or are contributing to the financial instability of the enterprises, whether they are causing or would cause the enterprises to be classified as undercapitalized, or whether they are preventing or would prevent the enterprises from successfully completing a capital restoration plan. Those are the statutory provisions.

They are the same provisions that Mr. DeMarco applied appropriately, in my opinion, at the time that they were applied to suspend contributions to the trust fund. They are the same criteria that I applied, appropriately in my opinion, to reinstate them. Because circumstances have changed in that interim. So I simply followed the statute. That is all I did.

Ms. WATERS. Thank you very much. That is very important to know, because there are those—and some are my friends on the opposite side of the aisle—who would have us believe that you have done something outside of the statutory requirements or mandates. And so I am very pleased that you were able to clarify that. And I think it is going to be—if we can get this implemented, it is going to be very good for this country.

I yield back the balance of my time.

Chairman HENSARLING. The gentlelady yields back. The Chair now recognizes the gentleman from New Jersey, Mr. Garrett, chairman of our Capital Markets and GSEs Subcommittee. He is recognized for 5 minutes.

Mr. GARRETT. Thanks, Mr. Chairman. I will follow up, Mr. Chairman, on your questions with regard to the downpayment.

So obviously, we are seeing a return to loose underwriting standards at the agencies. I am sure, Director, you have read that one of the largest banks in the country has publically stated that 3 percent downpayment loans are simply too risky for them to originate. And yet here, on the other hand, you are having the agencies—you are instructing them to basically take on more risk than the largest too-big-to-fail banks.

Now, every day we read in the paper how Wall Street banks are greedy and risk-taking. But it would appear that in this situation, you are doing just the exact opposite of what they are doing; they are being more prudential in this matter, and you are saying, as someone else once said, let's roll the dice. But the difference here is we are rolling the dice once again with taxpayer money, as opposed to private investors. Is that wise to do, to be riskier than—

Mr. WATT. —let me clarify that I haven't instructed any bank to make any loans that they think—

Mr. GARRETT. Well, not the banks. You are instructing your agencies.

Mr. WATT. I have instructed that Fannie and Freddie can guarantee loans that are made responsibly that fit our criteria. The bank you are talking about, I think, is the same one that made the decision to acquire Countrywide. In following their experience, I can understand why they might be a little bit reticent to go back into that business, but that shouldn't control the entire mortgage market—

Mr. GARRETT. I am reclaiming my time.

They are doing that on behalf of their investors. And I guess I am speaking on behalf of the American taxpayer, that we are concerned that where the taxpayer dollars could potentially be as we return to these very loose underwriting standards.

Another point that we read in the paper is how after the last crisis, a lot of people felt they did everything right and still they got burned at the end of the day from this crisis. And it seems to me that with the handling you are doing with the g-fees, that is exactly the same thing you are doing now.

With regard to loan-level price adjustments there is, as you know, a fair amount of cross-subsidization that occurs on the pricing here. What does that mean? That means that you have good borrowers with high downpayments and better credit scores, they are being told that they have to pay the exact same fees as borrowers who have lower downpayments and have worse credit scores.

Would you explain to me why you consider it is fair to tell people who have done everything right, saved their money, acted in a prudential way, that they have to pay the exact same fees and have the cross-subsidization there to those people who have done everything wrong, haven't saved, have bad credit, worse credit scores, and what have you? Why is that fair?

Mr. WATT. I think your question illustrates the complexity of this issue, Representative Garrett. And all I did was suspend it, suspend the increase in guarantee fees, until we had a chance to evaluate all of the implications of it. And when we announce the guarantee fees—which we will do hopefully by the end of this quarter—we might take into account some of the things that you are talking about.

But doing that without a thorough evaluation and consideration of all of the aspects of it—as you suggest we should do—I think would have been irresponsible.

Mr. GARRETT. But it is pretty—and you only suspended the decreases, I understand. And it seems to be pretty plain on its face that those that did good are being penalized for those that did poorly. And yet, here we are three hundred—a year later, and we are still in the situation of rewarding bad behavior and unfairly treating those who showed good behavior.

Moving over to some other items. We don't have a clock on here. The securitization platform—I mentioned earlier that there is bipartisan support as far as moving forward. One of those areas is the securitization platform. All parties, I think, seem to agree that we should be having this.

And yet, we see that the industry seems to be cut out of some of the development of the securitization platform. They are not really allowed in at the ground floor, the creation of it and the governance of this. Why are we, when we have a bipartisan initiative here, when we have both sides of the aisle and both chambers looking at it in the same manner, why are you cutting out industry? Is this another attempt by the GSEs to try to continue what they did before, to control the marketplace, to manipulate the going reforms, as opposed to allowing those players in the future to be able to have a say in it?

Mr. WATT. My response would be twofold. Number one, we are not cutting out private industry in our consultations. We are in regular consultation with private idustry on the common securitization platform. But—

Mr. GARRETT. Do they have a role in the governance? Do they have a role in the governance of—

Mr. WATT. —the Chair when I discussed it with him, what I did was exactly what I thought Republicans really support, is de-risk this whole process by not trying to form a common securitization platform for a future that you all had not yet defined.

Chairman HENSARLING. The time of the gentleman has expired. Members probably don't need to be reminded that we are not in our usual hearing room. Obviously, we are lacking the individual clocks. So to gauge your time, you need to look at the little color wheel, if you will, at the witness table. And I think you otherwise know the drill.

The Chair now recognizes the gentlelady from New York, Mrs. Maloney, ranking member of our Capital Markets and GSEs Subcommittee.

Mrs. MALONEY. Thank you.

Director Watt, I was pleased last year when you delayed your predecessor's decision to raise g-fees. As you know, your predecessor wanted to raise g-fees even more in four States, one of which was New York. And New York and the other four have particularly strong consumer protections for foreclosures. This would have needlessly harmed New York's economy and would have discouraged States from enacting stronger consumer protections. I think this was an important decision. We should be rewarding States that put strong consumer protections in, not penalizing them.

Now, of course, what I am hearing the markets are telling me—or some of them—that they anticipate a possible decrease in the g-fees, rather than an increase. So can you just give an update on your review of the g-fees in general? And do you anticipate that they will be going down and not going up? That is what I was told, so—

Mr. WATT. I don't know where that information would come from. We are still in the process of evaluating the input that we have gotten in response to a request for input from the public on this issue. And we anticipate making a decision hopefully by the end of this quarter. It may slip into next quarter. But we are going to make a decision, and then we will talk; we will justify and outline the reasons for that decision.

I don't think I have any information about whether they are going down or going up. Risk-based might have some adverse impact on some of the States that you were talking about. But at this point, I think it would be premature to talk about what that result will be. Because I don't even know what it will be. We are in the process of evaluating it.

Mrs. MALONEY. In your deliberations, I hope that strong consumer protections for foreclosures are considered a plus, something for which States should be rewarded.

I have another question. Director Watt, we have heard a lot about the Housing Trust Fund and the Capital Magnet Fund, some of which has been critical. But, of course, we know the facts are that the Capital Magnet Fund has already had one successful round of funding in 2010, and it was a huge success through a public-private partnership model: $80 million in funding from the Capital Magnet Fund was turned into $1 billion for affordable housing. And I congratulate this effort.

Now, with your decision to start funding for both the Housing Trust Fund and the Capital Magnet Fund, there will be hundreds of millions of dollars for affordable housing every year. Can you talk a little bit about the impact that you expect this funding to have on the affordable housing crisis that our country is facing? And can you talk a little bit about the public-private partnership that emerged to help magnify the money? And are you looking at more public-private partnerships? Just in general, where this program is going for affordable housing.

Mr. WATT. Representative Maloney, to be quite honest, I didn't take any of that into account. Those are policy decisions that I think are legislative decisions, congressional decisions. And we don't have any control over at FHFA over the use of these funds. Those decisions are actually made at Treasury and HUD. Our decision related only to whether or not to fund it, and applying the statutory criteria to determine whether it should be funded or should not be funded.

And so, we didn't look at the use of these funds. We didn't look at the history of—I didn't—I am not even sure I knew that there had been projects—

Mrs. MALONEY. Thank you for clarifying.

I would like to ask you about the risk retention rule. As you know, the final rule inadvertently failed to exempt Freddie Mac's multifamily securities, even though it did exempt Fannie's multifamily securities. And I understand that the FHFA is working on a possible solution for this already. Can you give us an update on these efforts?

Mr. WATT. The risk retention rule was not done by FHFA. That was a combined—that was a joint rulemaking process. So I am not sure that we are looking at anything that is—

Mrs. MALONEY. But the fact that it inadvertently failed to exempt Freddie Mac's multifamily securities, even though it did exempt Fannie's multifamily securities—they should be treated the same. That is a—

Mr. WATT. I would hope that whatever rule comes out would treat both Fannie's and Freddie's securities the same. That is what we are trying to work our way towards—

Mrs. MALONEY. Okay.

Mr. WATT. —in the single security. So—

Mrs. MALONEY. Thank you.

Mr. WATT. —certainly—

Mrs. MALONEY. My time has expired. Thank you.

Chairman HENSARLING. The time of the gentlelady has expired. The Chair now recognizes the gentleman from North Carolina, Mr. McHenry, vice chairman of the committee.

Mr. MCHENRY. Director Watt, thank you. It is good to see you again. And it is always good to see you on the plane coming back and forth from your former district in Charlotte.

Mr. WATT. Congratulations on that beautiful baby.

Mr. MCHENRY. Thank you. Thank you, Mel. I appreciate it. And I appreciate your kindness and friendship over the years. We have been able to have conversations even when we disagree about issues. And so, I just wanted to ask you a few questions. But you know me fairly well, so I figured at some point, you will cut me off here.

So it seems that we have some conflicting actions that you have taken. One is you suspend the g-fees, right, and you move away from risk-based pricing. At the same time, you start holding up reserves to the Housing Trust Fund and allocating capital to the Housing Trust Fund. In one respect, you are conserving capital for an assessment. In the other, you are actually moving capital away from the enterprise. How do you reconcile that?

Mr. WATT. Representative McHenry, all I am doing is following the statutes that were written by Congress and passed by Congress. And we are trying to do it as judiciously and prudently as we can. I am not even trying to connect those two things. The Housing Trust Fund funding was an independent decision that was based on the statute. The g-fee decision was a prudence decision just to give us an opportunity to study the issue thoroughly. And we are doing that. And we don't know where we are going to get to on that. So I think judging where that might go at this point would be premature.

Mr. MCHENRY. So under the statute, you have no choice? You have to allocate capital for the Housing Trust Fund?

Mr. WATT. If the statutory standards are met, the contributions to the trust fund can be suspended. They were suspended in 2008 by the acting Director at that time. And we applied the same principles under changed circumstances to reinstate them. That is all we did.

But the Housing Trust Fund was not created by FHFA. The Housing Trust Fund was created by Congress. And the decision to fund it or not fund it is based on statutory criteria.

Mr. MCHENRY. Yes. But most of us look at Freddie being leveraged at 156 to 1, and Fannie being leveraged at 134 to 1, and think that the conditions are not right. Because the requirement to suspend the allocation of capital to the Housing Trust Fund shouldn't be justified under these circumstances with this type of leverage rate of these institutions.

Mr. WATT. That is not what is one of the statutory criteria that Congress set for evaluating whether to fund the Housing Trust Fund or not fund the Housing Trust Fund.

Mr. MCHENRY. So is this an odd circumstance? Because you were outspoken about the subprime lending in the private sector leading up to the crisis. I heard you in debates here, I heard you on TV at home; you said that these really high-LTV loans were problematic, that this was deeply concerning, especially for those who didn't have savings, that a small fluctuation in the marketplace could cause problems.

Do you have that similar concern? Because in many respects, you are making substantial decisions—no, no—you are making huge decisions. And the consequences of these actions are real. I know you know that. But is there that conflict looking back at what you said about the private sector versus the actions you are taking right now?

Mr. WATT. I don't think there is any conflict between what I said then and what I am doing now. You need to make responsible loans. And this decision was surrounded by a bunch of compensating factors for every borrower who would make their loan as reliable a loan as a 10 percent downpayment loan, a 20 percent downpayment loan. And that is our responsibility.

And I would hope that you all would rely on the same things that I said in advocating for reform in this area, to know that we are going to apply those principles and not sanction loans backed by Fannie and Freddie and the taxpayers that are not reliably expected to be paid.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentlelady from New York, Ms. Velazquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman. And welcome, esteemed colleague Director Watt.

I just would like to revisit again the question that was asked by Congresswoman Carolyn Maloney regarding the National Housing Trust Fund. I heard you when you said that it will be hard on Treasury, the one making the decision as to which projects to fund. My question to you is, when will that money make it out there? Have you had any discussion with those two agencies?

Mr. WATT. I have not had any discussions with them about the application of the funding. That is their decision to make. Treasury makes the decisions about the Capital fund, and HUD makes the decisions about Housing Trust Fund side of it. So those are their decisions to make.

Ms. VELAZQUEZ. But do you have any idea as to when this money will start?

Mr. WATT. Yes. I can tell you that because the process that we followed directs Fannie and Freddie to start setting aside the funds in January of 2015; and at the end of 2015, if circumstances don't reverse, then the moneys would actually be allocated into the Trust Fund and the Capital Magnet Fund and could be used. So there won't be any use of those funds during 2015. It would be 2016 at the earliest before the funds would be available.

Ms. VELAZQUEZ. Thank you. Director Watt, as part of the public mission, Fannie Mae and Freddie Mac maintain a duty to serve the entire housing market and support affordable housing preservation. In 2008, Congress asked FHFA to issue a rule to implement this duty-to-serve requirement. But while a proposed rule was issued in 2010, a final rule has not been promulgated to date. When do you plan to issue a final rule?

Mr. WATT. We are in the process of looking at that. And you are right, a proposed rule was issued in 2008 or 2009. It never was finalized because of whatever reasons. I don't know. We haven't tried to evaluate that. But we are going to have a duty-to-serve rule finalized hopefully in the year 2015.

Ms. VELAZQUEZ. Thank you. In August, FHFA proposed a new housing rule category for small multifamily properties that have units affordable to low-income families. This effort, of course, is very important for places like New York City, where these properties are an important part of the housing stock.

While your agency has set initial benchmarks in an effort to take a gradual approach, please explain how this goal will be evaluated so that more ambitious targets can be set in the future.

Mr. WATT. We will evaluate it on the same terms that we evaluate everything. First of all, make sure that the loans are safe and sound. And second of all, that they achieve the purpose of serving a group or a category of people who have been underserved. Which is why we encouraged—directed Fannie and Freddie to look at how to incentivize small developments. Because generally, smaller developments have more orientation toward middle- and lower-income people.

So that is included in the 2015 scorecard for Fannie and Freddie to continue to work to encourage those kinds of loans. And we will have in place an evaluation mechanism that makes sure that is effective. Or we will revise the expectations in the future based on experience, which is something that we do quite regularly.

Ms. VELAZQUEZ. Thank you. Thank you, Mr. Chairman.

Chairman HENSARLING. The Chair now recognizes the gentleman from Oklahoma, Mr. Lucas.

Mr. LUCAS. Thank you, Mr. Chairman, and my old colleague, Director Watt.

I would like to address the Federal Home Loan Housing Finances proposed rulemaking regarding membership requirements for Federal Home Loan Banks. And I am concerned that the proposed rule would unnecessarily harm a significant number of community financial institutions in Oklahoma and across the country by limiting membership in the Federal Home Loan Bank System.

In recent years, it is been increasingly difficult for these institutions to provide mortgage financing needed in their communities. And the Federal Home Loan Banks have served a very critical role as a source of liquidity during these challenges times.

I guess my question, Mel, is why propose such a regulation at a time when community banks and credit unions are in need of every credit resource available to them to serve their communities? Or as Congressman Watt would have said, what is the problem you are trying to fix with this rule?

Mr. WATT. There are some potential problems that we are trying to fix to make sure that the Federal Home Loan Banks meet the statutory purposes that have been set.

First of all, you don't want anybody to be a member of the Federal Home Loan Bank System and get the benefits of it unless they meet the criteria that Congress has set. And we were concerned that some of the members of Federal Home Loan Banks were not meeting these criteria.

I can go into more detail. I can give you a complete outline of the rationale. But we are trying also to do this in a way that does not have the adverse impact that you are talking about.

Mr. LUCAS. But as I understand it, Director, under the present system, once an institution meets the requirement to participate, they still have all the obligations and all the standards that have to be met by any Home Loan Bank board institution.

There is just some concern out there in the countryside, and perhaps in the hallways of Congress, that there is more to this than just an ongoing set of standards, that perhaps since the Administration has not really been able to legislate much in the last 4-plus years, that this is another effort to change how the system works by rule and not by law, since I don't think this institution would pass a bill to do this.

So I guess my question is, is this an effort by the Administration to be able to channel and steer how these institutions use this resource?

Mr. WATT. First of all, let me be clear with you, as I have been with the Administration. I am not part of the Administration. The

Federal Housing Finance Agency is an independent regulatory agency. We don't play out the Administration's policy. We follow the statute. And that is what we are doing in this case.

Mr. LUCAS. But once again, to paraphrase Congressman Watt: The folks what brung ya are the folks what keep you there; i.e., the question still goes back to, is this an effort to try through the rule process to determine how these resources are used and, in effect, to put the institutions that are a part of the Home Loan Bank board system on a rather short leash?

Mr. WATT. We have no agenda, other than making sure that they—that members of Federal Home Loan Banks meet the criteria that Congress has established for membership.

The one that—and I know this is a controversial issue because we put out the rule, we got 1,300 comments. That is almost unprecedented. We are going to go through every one of those comments and evaluate every single one of them. And most of them, to be quite—I would say probably 90 percent of them appear to be against the proposed rule. So obviously, we have touched a nerve.

Mr. LUCAS. It is good—

Mr. WATT. But we are going to apply the statute and try not to have the adverse impact that people are contemplating might be a result of this rule.

Mr. LUCAS. You have always been a man of your word. I take you as a man of your word. But we are in an environment where a lot of things are going on in very interesting ways. And I would just note that I would hope the committee would be very sensitive about doing anything to a model that has worked really well and is working well in a particularly tough set of times for those institutions.

Mr. WATT. I agree with you.

Mr. LUCAS. I appreciate our friendship. And many of the underclassmen weren't here when you and I worked to help whomever the ranking member and chairman were at any given time, over 2 decades almost. So as we helped leadership, I am going to try and help you, sir.

Mr. WATT. Thank you so much. It is great to see you again.

Mr. LUCAS. I yield back, Mr. Chairman

Chairman HENSARLING. The gentleman yields back. The Chair now recognizes the gentleman from Massachusetts, Mr. Lynch, for 5 minutes

Mr. LYNCH. Thank you, Mr. Chairman. And I want to welcome back Director Watt. It is good to see you again. And as you can see, some things have not changed here in terms of how we might view affordable housing and the way FHFA works

There was a great article yesterday in the New York Times by Searcey and Bob Gebeloff. It talked about how the middle class is continuing to shrink. And this phenomenon is resulting in more people being squeezed into the very bottom of income earners. That is obviously putting a lot of pressure on affordable housing, which is where you come in.

According to the National Low Income Housing Coalition, we need about 7 million more homes nationwide that are affordable and available to extremely-low-income households and those with incomes at 30 percent or less of the area median income. And I know that in my home State of Massachusetts, there is a shortfall of about 175,000 affordable units, and in my district it is about—let's see—16,000 units.

There are a couple of tools that you have. And I am happy to see that they are beginning to be used. The Housing Trust Fund and the Capital Magnet Fund, I think can be part of the solution. And now, I know that you are following statutory directives in terms of the Magnet Fund. But can you talk a little bit more broadly about how your affordable housing goals are consistent with the reality that we are seeing out there?

I know that the situation seems to be getting worse for that tier of people who would benefit from access to affordable rental housing, never mind the 3 percent downpayment on purchasing housing. But there are folks who are, I think, have resigned themselves that they are not home purchasers, that they are renters now. How does your affordable housing goal help those people?

Mr. WATT. First of all, we haven't finalized the affordable housing goals yet. The rule is in process. And we are evaluating comments, so—

Mr. LYNCH. How do you anticipate your goals once you figure them out?

Mr. WATT. Here is the way we think of this. First of all, we want to, on the ownership side for people who can afford to pay a mortgage, make it available to them. On the rental side, we want to make sure that affordable housing is available in the marketplace. There is, actually, a very robust multifamily market on the high end, but not so much on the affordable end. Which is why when we wrote the scorecard criteria, we exempted from the $30 billion—or whatever the figure was; I can't even remember what it was—cap, affordable housing developments to try to encourage Fannie and Freddie to be more involved and active in getting into that space, which is underserved by the private sector.

So, that is what we have done. And the rule itself, we will try to build on that and incentivize that. You are right; there are a lot more people renting now than had been historically renting. The rental market is robust and there are not enough units to serve that market.

Mr. LYNCH. Okay. I see my time is just about expired. I yield back. And I thank you.

Chairman HENSARLING. The gentleman yields back. The Chair now recognizes the gentleman from Texas, Mr. Neugebauer, chairman of our Financial Institutions Subcommittee.

Mr. NEUGEBAUER. Director Watt, it is good to see you again. You mentioned a couple of times—I want to talk about g-fees first. That goal—or you are currently studying the g-fee issue and will make a determination? It is my understanding that a study was done prior to the previous Director issuing a directive to increase the g-fee to 10 percent.

So I guess my first question is, if we have already studied it, why are we studying it again?

Mr. WATT. I don't think we should ever stop evaluating issues. I was not a party to the study that was done before. We obviously are taking that study and any conclusions that it reached into account in reaching our conclusion. But we have been very transparent in seeking input about how these g-fees should be set, what criteria should be applied in setting the g-fees, should it be just about protecting against the risk that Fannie and Freddie are assuming? Should it be about capital formation? Should it be about attracting private capital into the—the process has been very transparent. And—

Mr. NEUGEBAUER. So you decided to study it again, is what—

Mr. WATT. Yes.

Mr. NEUGEBAUER. Okay. So the cross-subsidization issue that the gentleman from New Jersey brought up I think is an issue that I am interested in, as well. And, in fact, I had conversations with your predecessor in that there are some States that have very, very stringent foreclosure procedures that in many cases keep the people who loan the money in good faith, not months from getting their property back if the person's not paying, but in some cases years.

And so I think that in those cases, I support those—that is a higher risk to those entities and those—where those foreclosure rules are very consumer-oriented. And so I am not opposed to those States deciding that. I think that is their right. But I think what they have to also understand is when you make it so consumer-oriented, you penalize the people who are loaning the money and causing losses—and what we have seen in many of those States where they had—where it is very difficult to get your property back, that those properties were stripped of windows and sinks.

And so, I just want to say to you that I think pricing your g-fees on risk is important.

Now, one of the things that you alluded to you in your report—I mean in your written testimony, and you brought it up as well, is you have been doing some risk transferring. And I guess the question is, if you are not taking a risk, you don't have to transfer it. But I wondered if you could give the committee some idea how many basis points it is costing to transfer that risk. What is the pricing on those transactions that you are doing that would—to give us some idea of what it is costing to reinsure those risks?

Mr. WATT. I can't tell you in basis points. But I can tell you that one of the criteria that is always applied is that a risk transfer must be done in a commercially reasonable manner, and it can't be just giving away assets. Because that would be inconsistent with our conserve and preserve mandate under the conservatorship statute, so—

Mr. NEUGEBAUER. I think what I am trying to get to, though, is in the current situation, where Freddie and Fannie really don't—they need to make a profit but there are really no market forces in place there to determine whether—what is the value of these entities.

And so the question is, is if you are transferring that risk, it would be helpful for us to know that. Because that may—should also influence what your g-fee pricing is going to be. In other words—

Mr. WATT. We have that information. I don't mean to suggest that we don't have that information. We have the information on every risk transfer transaction that has been undertaken: the cost; what the models say the value was; what Fannie and Freddie made on the transactions. We have that information. But you asked me what are the number of basis points. That is information I wouldn't have off the top of my head. But we can provide more information to you, if that is what you need.

Mr. NEUGEBAUER. I would like that. And the final point I would make is that, on the downpayment, I think it is erroneous—kind of ironic—maybe erroneous, too. But it is ironic that we made FHA increase their downpayment to 3.5 percent. And it looks like the two of you have a race here of seeing who can get the most market share here. And so you have kind of one-upped FHA by going to a 3 percent downpayment when they have a 3.5 percent downpayment.

Mr. WATT. First of all, you should be clear that we are not in competition with FHA.

Mr. NEUGEBAUER. Sure you are.

Mr. WATT. We are not. The market might—the market is going to go to whomever gives them the best deal. We know that. But we are not competing with FHA. We are trying to provide liquidity in the market, which is what our mandates says we are supposed to do.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Georgia, Mr. Scott.

Mr. SCOTT. Thank you, Mr. Chairman. And welcome, Director. I feel good and I feel proud to see you sitting where you are sitting and doing what you are doing for the people of this Nation. Congratulations. I think you are doing a great job.

I would like for us to revisit for a moment the Housing Trust Fund. And I would like to clear up some things so that folks will understand. First of all, both you and I were here sitting on this committee when none other than President George W. Bush authorized this Housing Trust Fund. And if you recall, when he authorized it he said that this is perhaps the best tool that we could use to help get housing for our most vulnerable population.

So I want to set the record straight that this is both a Democratic and a Republican initiative. And secondly, you have moved to reinstate the payments largely following the orders of us in Congress. Because during the economic recovery, we put three criterion in for suspending it. Those criterion now no longer exist for the GSEs.

And so you are operating on this trust fund within the authority, first of all, that President George Bush gave you. And secondly, what the Congress of the United States reinforced. I just want to make sure that is clear.

Now I want to talk about one other thing, because I think it is very important, and that is principal reduction. That is really at the core of helping people. And all the evidence is that that is the case.

Recently, you went to—and that is another thing I want to commend you for. Because you go out where the problems are. You have been out in the Nation. You have been to Atlanta, and we certainly appreciated you there with the HARP program. But you went to Detroit where this problem is very pronounced. And I think you articulated there your concern about being able to use the necessary tools for principal reduction.

I think that this is the core of it. Would you mind addressing that within the light of what you said and how important principal reduction is?

Mr. WATT. It allows me to go back to a point that I made with Representative Neugebauer. This is one of those issues that I have received a lot of second-guessing about. Because there was a study done about principal reduction before I got there at FHFA also. And I haven't done principal reduction either. We are still studying that issue, just like we are still studying the g-fee issue.

And what we are trying to do on principal reduction is find a place where it is beneficial to borrowers and not negative net present value to Fannie and Freddie. Right?

And there are some instances in which that is the case; it is beneficial to borrowers and not negative to Fannie and Freddie. And when we find that niche, that is when we are going to make a decision about this.

Now, in Detroit, we are, under the Neighborhood Stabilization Initiative, testing some things there to see where that sweet spot is. Because if you have a whole neighborhood that is sitting there with vacant properties, half of the properties—

Mr. SCOTT. Right.

Mr. WATT. —vacant, it pulls down the value of the other properties in that neighborhood. So we are trying to craft something that will work for the enterprises and for the borrowers.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Missouri, Mr. Luetkemeyer, chairman of our Housing and Insurance Subcommittee.

Mr. LUETKEMEYER. Thank you, Mr. Chairman. And congratulations to you, Mr. Watt, on your appointment. I don't know whether to congratulate you or empathize or sympathize with you. But we are glad you are here today.

So, to follow up on a couple of comments that were made earlier with regards to the capital that you have in the GSEs and the ability to provide stability, one of the things that I am looking at here as I look through this is, your past dues on Fannie Mae and Freddie Mac right now are just a little less than 2 percent, both of them. So that is good. Is my microphone not on?

Mr. WATT. I can hear you, but I am having a little trouble picking up all of your sentences. I'm sorry.

Mr. LUETKEMEYER. Okay. Then I will hold the microphone a little closer. I apologize. Your past dues for Fannie and Freddie both are a little under 2 percent right now, which is very good. But your capital is at .4 percent. We are supposed to be at 2. And so I guess my question is how—and in your testimony, you say enterprises do not have the ability to build capital internally while they remain in conservatorship. How do we solve the problem of additional bad debts popping up?

And I guess another subsequent question to go with that is, do you have any lawsuits pending that can bring in cash to add to your capital count? Or whenever a lawsuit is filed and you win it, does that money go to the treasurer or does it go into—how do you solve the problem of having enough capital to absorb the losses, is my question.

Mr. WATT. We can't build up capital because we are operating under a preferred stock purchase agreement with Treasury in conservatorship that sweeps all of the profits that Fannie and Freddie make to the taxpayers.

Mr. LUETKEMEYER. Right.

Mr. WATT. That was the quid pro quo for—

Mr. LUETKEMEYER. If that is the case though—

Mr. WATT. —keeping them from going—Fannie and Freddie from going into—

Mr. LUETKEMEYER. If that is the case, though, how do you—whenever further bad debts losses occur, where do you take those losses? Eventually just go to the treasurer and ask them to write a check to build more accounts?

Mr. WATT. That is what would happen under the preferred stock purchase agreements. Basically, the taxpayers are backing Fannie and Freddie. And they will be until GSE reform is done. And we don't—we can't do that. We don't do GSE reform. That is why it is so important for Congress to act on GSEs.

Mr. LUETKEMEYER. So I saw that you had some nice income figures. And I assume part of that is also the settlement of lawsuits with different entities. Are there any—

Mr. WATT. It has been substantial.

Mr. LUETKEMEYER. —lawsuits pending now?

Mr. WATT. There are three more lawsuits—two more lawsuits pending.

Mr. LUETKEMEYER. Okay. When you win those lawsuits, do those dollars go to your capital account, or do they go to the Treasury?

Mr. WATT. They will go into Freddie and Fannie's account. And if at the end of the year they are—

Mr. LUETKEMEYER. That gets swept—

Mr. WATT. —they are profits, they will be swept—

Mr. LUETKEMEYER. All right.

Mr. WATT. —to Treasury. Yes.

Mr. LUETKEMEYER. Very good.

One of the concerns that I have—excuse me—also is with regards to the way that you are pricing things and the way that you are changing some of your rules and regulations. Having been in the money loaning business for 35 years, I can tell you that there are certain tenets of lending you can't get away from, no matter how much you want to do it. Certain things have to happen. If they don't, you lose. It is just that simple.

Mr. WATT. It is a risk. You are right.

Mr. LUETKEMEYER. Just that simple. Everybody wants to say well, I can slice the bread thinner. I am a little smarter than the next guy. All I have to do is just tweak here, tweak there. I'm sorry. It doesn't work. After 35 years, I have stubbed my toes against certain things stumbling over this. There are certain tenets that have to be there, that is it.

And so my concern is that when we change these things and we loosen rules up—as you have seen over the last 6 years, Fannie and Freddie have had a resurgence. They actually now are profitable; they are turning a profit. So why in the world do you go back now and want to change those sound tenets of lending to loosen it up and head down the same path that caused the problem before?

Mr. WATT. First of all, you are absolutely right; we are in the risk business. And there is no way to get away from risk. You can make—any loan at some point can become risky. So what we do is on every loan that we back, we try to assess what are the risks associated with this loan. And we try to minimize those risks. Now, you can't eliminate risk—

Mr. LUETKEMEYER. With respect, I have one more question, and I see my time is about up here.

Mr. WATT. Okay.

Mr. LUETKEMEYER. With regards to—in your testimony, you also want to try to move a lot of stuff to the private sector. And I think that is laudable. That is a thing that we need to be doing.

My concern is, though, that if you continue to compete with the private sector by lowering guarantee fees, by loosening lending standards, it makes it more difficult for the private sector to step in and do that. Would you agree with that statement?

Mr. WATT. Yes. I agree with it generally. But at the same time, our responsibility is to assure a liquid housing finance market in the interim until you all do GSE reform. So we are balancing risk and availability of housing finance, which is what I said in my opening statement—

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Texas, Mr. Green, ranking member of our Oversight and Investigations Subcommittee.

Mr. GREEN. Thank you, Mr. Chairman. I thank the ranking member, as well. And Director Watt, it was a preeminent privilege to serve with you for nearly a decade in Congress. You were always a voice of reason. And I see that you continue to be that voice of reason.

I would like to talk to you about the FICO score that the GSEs are required to adhere to. Under this current FICO standard, we have a circumstance that allows bad credit for utilities and rental payments to be utilized when ascertaining a score, but the good credit that one has for these very same utilities and rental payments is not utilized.

And I am mentioning this to you because I think we need a more inclusive model. I am not talking about doing anything that would in any way impair or prevent a good FICO score from being developed. I just think that it is fair—we have used this term "fairness" this morning, "fair play." It seems fair to me that if you are going to use the adverse information, that we should use that information in a positive way when it is available for Fair Isaac to score.

These FICO scores, as you know, are exceedingly important. In fact, they are everything when it comes to getting a loan.

So can you please give me just a bit of intelligence on this in terms of how we might work with your office to try to expand and have a more inclusive credit scoring model?

Mr. WATT. First of all, you are right—credit scoring is one of those areas where there have been—

Chairman HENSARLING. Director Watt, is your microphone on?

Mr. WATT. Did it go off? I'm sorry.

Chairman HENSARLING. If you could pull it a little closer to you, please.

Mr. GREEN. Would you add these 30 seconds to my time, please?

Chairman HENSARLING. I will consider it.

Mr. GREEN. Thank you, Mr. Chairman.

Mr. WATT. Some things don't change in this committee.

So there are alternative credit scoring models that are beginning to be out there now. FICO is updating its credit scoring model. Vantage has a credit scoring model. There are several. And what we have done in this year's 2015 scorecard is we have instructed Fannie and Freddie to evaluate these credit score—these alternative credit scoring models to see if we can get to a better place in this area. Not a race to the bottom. We don't want credit scores—

Mr. GREEN. Exactly.

Mr. WATT. —that get more people the ability to get loans and are not reliable. So we asked them to evaluate the reliability of it. We asked them to evaluate the operational challenges that would go with implementing alternative credit scoring models.

So this is an area that we are working aggressively on this year. We started it last year in response—well, not in response, but a number of people on this committee have written to me about the alternative credit scoring models, both on the Republican side and the Democratic side. It is not a partisan issue. So we are trying to figure out how we can do this, but do it in a reliable way and in a way that operationally doesn't create angst in the entire market. Because what we do in this space could have some significant implications.

Mr. GREEN. Thank you for exploring the possibilities. Because I concur with you, there are alternative models that seem to indicate that we have some opportunities.

Let me move quickly to the Housing Trust Fund, because I think it is important for us to explain that when we—and you were here—developed the formula, if you will, we put a trigger in. And that trigger was placed there to prevent a person who might be in your position, who might have opinions that would vary from what we thought the law should require. So the trigger required that we not fund because of circumstances, and then it requires that we do fund because of circumstances. It allows circumstances to dictate the actions of the Director, as opposed to the will of the Director.

I think it was a pretty good idea then. It seems like it is a pretty good idea now to take the Director to the extent that you can out of play. And this is no disrespect to you. It is just like we were trying to protect the process that could help the people that I was sent here to represent, a good many of whom don't have as much in assets liquidity as others.

Chairman HENSARLING. Very brief answer, please.

Mr. WATT. I am happy to follow the statute that was written. And that is exactly what we have done. And I stand by that decision—

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from California, Mr. Royce, Chair of the House Foreign Affairs Committee.

Mr. ROYCE. Director, congratulations. It is good to see you again.

Mr. WATT. Thank you. It is good to see you again.

Mr. ROYCE. Thank you. As you know, my concerns have always gone to these issues of moral hazard and over-leverage, whether it was a Republican Administration or a Democratic Administration. But I think until 2007, we probably could have considered some of my concerns hypothetical or philosophical. But after 2007, I think that over-leverage issue sort of proved a point.

And looking at the headlines—the headlines read, "Government keeps pushing mortgage guarantees as risk index rises." Here is another headline, "FHFA orders GSEs to start supporting affordable housing trust funds." Now, surprisingly, the year here is not 2005, it is 2015.

And so we find the FHA today engaged in this race with Fannie and Freddie to see who can more swiftly crowd out the private sector, who can assume more risk on behalf of the American taxpayer. And I would just point out that this is kind of a frightening race here. Because, in my view, we have seen it before. The FHFA has joined sort of a moral hazard problem here.

In December, you announced that the GSEs should begin to put more money into the coffers of housing advocacy groups through the Housing Trust Fund, established under the Housing and Economic Recovery Act. And you made this move, despite the fact that Fannie and Freddie have yet to repay a lot of the money due to the American people. We can argue about whether it is $200 billion or—but there was a lot of money lost at the end of the day because of over-leverage.

So it is difficult to see how you can argue that as it is required by law, the GSEs are financially stable enough to begin the transfer of money to housing groups. Let me show you the ratios here. And I think this was pointed out earlier. Fannie Mae leveraged at 341 to 1. Now, that is a capital ratio of .29 percent. Freddie Mac, 153 to 1, and an equally concerning leverage ratio of .65 percent. You remember a decade ago, I was arguing against 100 to 1 leverage ratios. These ratios are excessive of that.

And you said earlier in this hearing that the leverage ratio is not something the statute requires you to look at when resuming allocations. I have a different reading of that statute that I will share with you. What the statute requires is that you "shall" suspend allocations, not "may." The statute reads, "shall suspend allocations if they would contribute to the financial instability of the enterprise or would cause the enterprise to be classified as undercapitalized. So in reality, the statistics cited earlier do come into play. So, Director, how can the enterprises be in this state with these leverage ratios—in one case 341 to 1—and not be deemed both financially instable and undercapitalized? That is my question.

Mr. WATT. First of all, we put in place prudential stops if circumstances go back in the other direction. If we ever have a draw on the Treasury, that would automatically stop the funding of the Housing Trust Fund.

Mr. ROYCE. But it is already undercapitalized, is the point I am making.

Mr. WATT. We don't have—when Fannie and Freddie were put into conservatorship and the preferred stock purchase agreements were entered into with Treasury, that suspended the capital of Fannie and Freddie. Now, if we were building up capital, I understand exactly what you are saying. But those two criteria don't apply anymore, because they are in conservatorship. Every dime is going to the taxpayers if there is a profit.

Mr. ROYCE. There is statutory language here that requires an end to the allocation. I think it is very straightforward. But I will close with this.

Today I, along with many of my Republican colleagues, will re-introduce the Pay Back the Taxpayers Act. And this bill will ensure that money coming in from the GSEs will go to the taxpayers, in other words, will go to address this issue, instead of being diverted to the Housing Trust Fund. But thank you, Director. It is good to see you again.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Missouri, Mr. Cleaver, ranking member of our Housing and Insurance Subcommittee.

Mr. CLEAVER. Thank you, Mr. Chairman, and Ranking Member Waters. And thank you for being here, Mr. Watt.

There has been a lot of discussion about the 3 percent down. And I am not sure if the suggestion is that a 3 percent down is reckless. I was looking at a study, V.A. has a 0 percent down and a lower foreclosure rate than the prime lenders.

So is there any evidence that 3 percent is going to cause more foreclosures if 0 percent is not causing foreclosures? And what is it about 0 to 3 that creates this problem?

Mr. WATT. I think, Representative Cleaver, the challenge is to look at lenders and make a determination; when the downpayment is lower, there is the potential that it could be a riskier loan. But when you pair that with other compensating factors—which this product does—you offset that additional risk.

And that is exactly what we have done. Lending is about assessing the ability of people to pay. And what most people don't realize is that probably 90 percent of the people who are underwater, who have no equity in their mortgages at this point, are continuing to pay their mortgages.

Right? So that is not a criteria whether somebody is going to pay, whether you have 3 percent, 10 percent. It is about whether you want to have a home that you own, right? And so you assess those criteria. And there are substantial studies that suggest that—confirm that housing counseling, homeownership counseling, makes people better borrowers, more reliable borrowers. This program is—that is one of the compensating factors. And if all else fails, you have to have private mortgage insurance to back the loan.

So it is not as if we have created a risky situation. These are not the loans that had no documentation, no resets after 90 days or 3 years. These are not risky loans. And we have made that assessment based on research, not based on politics. Based on research, we have made that assessment. And I stand behind this decision. That is why I was happy to come here and have the opportunity to talk about the prudential compensating factors that we have put around this thing to make sure that you all understand that my philosophy has not changed; if somebody cannot pay a loan, they shouldn't be given the loan.

If you look down there and say this person can't pay this loan, it would be irresponsible for us to say that we should be making loans to those people, or that Fannie and Freddie should be backing those loans—

Mr. CLEAVER. Yes. I think I heard you clearly.

Mr. WATT. —to understand.

Mr. CLEAVER. Maybe I have time for a quick question. Let's remove the sociological issues, if people want to connect that to the loans. The economy is not healing for some people. We still have stagnant wages. And, in fact, hourly wages are actually ticking down in terms of keeping up with inflation. So if we are having stagnant wages and we are trying to heal the economy and housing is a significant part of healing the economy, having a housing market that is healthy, does it make sense then for us to put interest rates and downpayments high when we are trying to get the housing industry healed?

Can we heal the housing industry without getting more people to buy houses, people who qualify, creditworthy people? Is there any other way to do it, to get people to buy more houses without making it affordable?

Mr. WATT. Congress has given us this mandate: Do lending, back loans that are safe and sound, and provide liquidity in the market. We are constantly balancing those two objectives. That is what we are in business to do, and that is what we are planning to continue to do.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Michigan, Mr. Huizenga, chairman of our Monetary Policy and Trade Subcommittee.

Mr. HUIZENGA. Thank you, Mr. Chairman. And welcome back to—well, I guess this isn't quite home turf, since we are visiting somebody else's committee hearing room while ours is under some much-needed repair. But almost 2 years ago, I had a chance to ask your predecessor, Mr. DeMarco, about FHFA's intentions as it related to new regulations in the lender-placed insurance market, the LPI market. And I urged Director DeMarco to make sure that any such regulations met a test of producing a fair and open marketplace for providers of LPI and for, more importantly, even the consumers, which in turn would produce potentially lower prices for these consumers.

Can you please provide the committee with any kind of update in this particular area that has gone on? I know at that time he was looking at some rules, so—

Mr. WATT. First of all, Acting Director DeMarco is to be commended and FHFA is to be commended for getting into this space. Because there was a lot of abuse going on. There were virtually no controls. And FHFA addressed some of those inappropriate practices by directing the enterprises to prohibit servicers or servicer affiliates from receiving compensation in the form of commissions for placing insurance, because there was a perverse financial incentive for placing insurance in these circumstances with affiliates or people who were paying commissions.

We have formed a working group, because this is an issue that is not only an FHFA issue, it impacts everybody who has a mortgage in this country. And we have set up a regulatory working group consisting of 14 State insurance regulators, the National Association of Insurance Commissioners, and 8 Federal regulatory agency representatives to try to figure out how best to attack this problem.

Mr. HUIZENGA. And when was that formed?

Mr. WATT. Beg your pardon?

Mr. HUIZENGA. When was that formed?

Mr. WATT. That was formed in 2013.

Mr. HUIZENGA. Okay. And is there a status update?

Mr. WATT. They have had seven meetings up to this point. And in the meantime, things have improved because of these interim requirements we imposed on Fannie and Freddie. But we are continuing to work on a set of guidelines that would apply across the whole housing industry.

Mr. HUIZENGA. Do you have a timeframe/timeline of when that will be completed? I think anything that is in limbo like that is, probably needs to get wrapped up.

Mr. WATT. It is hard to set a timeframe on a lot of these things, as you have noted. But we are going to do it as soon as soon as they come out with a set of recommendations. We are evaluating those. And we are—

Mr. HUIZENGA. So they have not come up with those recommendations as of yet?

Mr. WATT. They have not come up with those recommendations as of yet.

Mr. HUIZENGA. Okay.

Mr. WATT. And so we expect that to happen sometime during this year.

Mr. HUIZENGA. Okay. All right. We will follow up on that.

Now I am going to ask you a question as I was going back over some of the testimony from back then. I am going to ask you a question that I asked Mr. DeMarco, as well.

Is the 30-year mortgage necessary, and why?

Mr. WATT. Now you have gotten me into congressional territory. I think that is a decision that really is more appropriately made— I can tell you that demographics are changing. People are a lot more mobile than they used to be. And a 30-year mortgage was bottomed on people staying in the same place for 30 years, or that assumption. And on the fact that it would get you a lower payment if it—so there—there are a lot of factors that go into that. But that isn't a—

Mr. HUIZENGA. But isn't that really—

Mr. WATT. —decision that FHFA is going to make. That is a decision that I think is more appropriately made in the legislative context.

Mr. HUIZENGA. Personally, I think it might be the private market space that is probably where most of that is—

Mr. WATT. That is true also.

Mr. HUIZENGA. I don't know if you are aware of this. And I am going to quote this: "The Methuselah of mortgages has arrived; the 50-year home loan." That gets me very, very nervous when we are having these types of timeframes out there. But I appreciate it. Thank you, Mr. Chairman.

Mr. WATT. Mr. Chairman, just for his information, we don't allow Fannie and Freddie to back 50-year mortgages. Thirty years is our limit. So, be clear on that.

Chairman HENSARLING. In listening to your comments, it was one of the few times I agreed with you. I was about to yield you more time. But instead, we will turn to the gentleman from Texas. Mr. Hinojosa is recognized for 5 minutes.

Mr. HINOJOSA. Thank you, Mr. Chairman. I apologize for not being here earlier, but I was at another committee where we were reorganizing. I want to say good morning and thank you to my former colleague, Director Watt, for being here today to give the Financial Services Committee an update on the changes to the housing finance system and FHFA's role going forward.

I believe that Fannie Mae and Freddie Mac share very important goals such as ensuring liquidity in the mortgage market and promoting homeownership. However, due to their financial trouble in recent years, we have seen attempts to not just reform them, but wind them down completely, and I don't agree with that.

I would like to go right into the questions. Director Watt, last year President Obama said that he would like to see Fannie Mae and Freddie Mac wound down and replaced by a government-backed mortgage bond insurer. Can you tell us where you stand on that proposal? And do you think this could negatively or positively affect the homebuying market?

Mr. WATT. Representative Hinojosa, that is a subject that I am not going to express an opinion about. That is a legislative congressional decision. And just to kind of put it in perspective, when I got to FHFA, there were multiple visions or views about GSE reform. And I kind of took FHFA out of that discussion, because we were sending mixed messages. It wasn't part of the statutory mission that FHFA has, which is to, in the present, guarantee liquidity and safety and soundness in the market. That is a congressional decision, not an FHFA one.

Mr. HINOJOSA. I respect your answer. But I want to commend you, because since FHFA's conservatorship of Fannie Mae and Freddie Mac, we have seen a stark change in the finances of GSEs for the better. And we thank you for your leadership and your being able to make those improvements. I especially like the $38 billion in extra funds that you gave our Nation's Treasury.

I have another question. Late last year, Fannie Mae and Freddie Mac announced new lending guidelines designed to help more low-income and first-time buyers afford homes, including a reduction of the minimum downpayment for a home from 5 percent to 3 percent. What are other proposals is FHFA looking at to encourage first-time homebuyers? And how is the agency making people aware of these initiatives that I have mentioned?

Mr. WATT. We have a number of things already on the books. I don't know that we are looking at any new proposals that I would indicate to you. But we have homeowner modification programs. We have the HARP program, which is a refinance program for people who are underwater but have been regularly paying their mortgage. And the 97 percent loan product.

I think what we have tasked Fannie and Freddie to do is to in this space evaluate how we can make credit available to creditworthy people. And that is part of the 2015 scorecard. It was part of the 2014 scorecard. They operate in this area regularly. We evaluate what they propose. It is all research-based. And we try to make good, prudent decisions in the interest of safety and soundness and the interest of liquidity in the market.

Mr. HINOJOSA. I want to ask my last question. What steps, if any, is FHFA taking to ensure that private capital is reentering the market? Because I can see some months where it—the numbers being—that people are buying new homes or used homes has been going up, and then suddenly they went down. So this is important to be on the private capital reentering the market.

Mr. WATT. The major way is that we are doing aggressive risk transferring to the private sector. We are not holding onto these loans. We are transferring that risk back into the private sector. And we have tripled—quadrupled, really, the risk transfers since I have been there.

Mr. HINOJOSA. Thank you, Mr. Chairman.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Wisconsin, Mr. Duffy, chairman of our Oversight and Investigations Subcommittee.

Mr. DUFFY. Thank you, Mr. Chairman. And welcome again, Mr. Watt. Over the course of your testimony, you have indicated that you are following the law and following the statute, which we appreciate, because we don't always think that laws and statutes are followed.

I want to follow up on Mr. Royce's line of questioning in regard to the funding of the Housing Trust Fund. Now, you are obviously aware of Section 1337. And basically, we have a discussion about whether the GSEs are well-capitalized. And if they are undercapitalized, you really can't fund the Housing Trust Fund. Would you agree with that?

Mr. WATT. Yes. Well, no.

Mr. DUFFY. Kind of?

Mr. WATT. Not undercapitalized. But if they are not making a profit, I absolutely agree with you.

Mr. DUFFY. They have to be well-capitalized.

Mr. WATT. Capital is a whole different issue that basically when Fannie and Freddie were put into conservatorship, the capital considerations went away. Because basically, we don't have any capital at this point.

Mr. DUFFY. One of the drawbacks of statutes is you don't get to split hairs. The language is usually pretty clear. And you would agree that the language in the statute requires that the GSEs are well-capitalized, not undercapitalized; correct?

Mr. WATT. They—

Mr. DUFFY. Before you can fund the Housing Trust Fund, you have to find that the GSEs are not undercapitalized; correct?

Mr. WATT. No, I don't think that is the case.

Mr. DUFFY. You think the GSEs—

Mr. WATT. It says I can't make a decision that causes or would cause the enterprises to be classified as undercapitalized. But the decision about capital was not on my plate. That was in the letter that I wrote that reinstated the contributions. I specifically said that neither that provision nor the third provision was applicable anymore, because they were in conservatorship. It was the only the first provision that was applicable to my decision.

Mr. DUFFY. Can you direct me to the section of the statute that says unless the GSEs are in conservatorship?

Mr. WATT. There is nothing in there that says unless they are in conservatorship. But we—

Mr. DUFFY. Where did you come up with that?

Mr. WATT. Beg your—

Mr. DUFFY. Where did you come up with that?

Mr. WATT. The conservatorship statute tells us what authorities we have in conservatorship. It wouldn't be in the Housing Trust Fund statute.

Mr. DUFFY. So it is your testimony that that trumps Section 1337(b)?

Mr. WATT. I think the preferred stock purchase agreements trump (b)(2), yes.

Mr. DUFFY. So you are saying, just to be clear, that Section 1337(b) doesn't really apply, and that you have the authority to fund the Housing Trust Fund. Is that—

Mr. WATT. That is correct, yes. If I hadn't concluded that, I wouldn't have done it.

Mr. DUFFY. Would you mind sending me the legal analysis on that? Because the statute seems pretty clear. And I want to follow the statute for your testimony. So if you would help me out on how you have reasoned—

Mr. WATT. I would be happy do that.

Mr. DUFFY. —that would be wonderful. Just quickly, in regard to the Housing Trust Fund, how is that going to be funded? How is it going to be funded?

Mr. WATT. How is it going to be funded?

Mr. DUFFY. Yes.

Mr. WATT. Out of the profits of Fannie and Freddie.

Mr. DUFFY. Where do those profits come from? Is there any kind of a surcharge or tax or assessment?

Mr. WATT. No, no, no. In fact, the statute specifically says there cannot be a surcharge to fund the Housing Trust Fund. And we have put out a rule that ensures that does not happen.

Mr. DUFFY. Will it increase the cost, do you think, to the end home purchaser?

Mr. WATT. No.

Mr. DUFFY. In the form of—

Mr. WATT. Because the statute says we are not allowed to increase the cost to the borrower.

Mr. DUFFY. I know statutes say a lot of things. But sometimes it is applicable and sometimes not.

Mr. WATT. Sometimes—all the time we try to follow the statute, though.

Mr. DUFFY. I appreciate that. I want to just—Mr. Garrett and I had sent you a letter in regard to the GSEs lobbying. This was sent on December 11th, and we haven't received a response from you yet. Did you receive that letter?

Mr. WATT. Yes. Yes, sir, I did.

Mr. DUFFY. Can we expect a response—

Mr. WATT. Yes.

Mr. DUFFY. —in regard to—

Mr. WATT. Yes, sir, you can.

Mr. DUFFY. Can you give me—

Mr. WATT. You might have gotten it yesterday. But I thought you all would be saying that we were doing it just in response to the hearing.

Mr. DUFFY. We probably would.

Mr. WATT. We take every inquiry we get seriously. And we try to go and get to the bottom of whatever—

Mr. DUFFY. Are you going to continue to—

Mr. WATT. —but we will respond—

Mr. DUFFY. Are you going to continue the ban on GSE lobbying?

Mr. WATT. I beg your pardon?

Mr. DUFFY. Are you going to continue the ban on GSE—

Mr. WATT. Yes.

Mr. DUFFY. —lobbying?

Mr. WATT. Absolutely, we are continuing the ban on GSE lobbying.

Mr. DUFFY. Thank you. I yield back.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Missouri, Mr. Clay, the ranking member of our Financial Institutions Subcommittee.

Mr. CLAY. Thank you, Mr. Chairman. And welcome back, Director Watt. How is the family?

Mr. WATT. The family is good—

Mr. CLAY. Good. Good. Thank you.

Mr. WATT. —growing—

Mr. CLAY. Okay. Thank you for being here. Although there are operational costs involved in requiring the GSEs to update the credit scoring model that they use in their seller service guidelines, the GSEs are still using the FICO classic model in their seller servicer guidelines, despite the fact that newer versions of FICO, including FICO 2008 and 2009 are currently available in the marketplace. Given this, how concerned are you that the failure to compel the GSEs to use their most updated credit scoring models in their seller service guidelines may not be giving the GSEs the best available assessment of whether a borrower is a good credit risk, and may be unnecessarily restricting credit to eligible borrowers?

Mr. WATT. Your question illustrates the difficulty of this. Because to move from FICO classic to FICO 8 or 9 is the same challenge that we have to move from FICO classic to Vantage or some other credit scoring model. So what we have done is in the 2015 scorecards, we have instructed Fannie and Freddie to evaluate both the feasibility and the operational complexity challenges related to using updated or alternative scoring models.

Now, feasibly, are these credit scoring models better than the ones that—than FICO classic? We think they are, but we have to document that. And then operational feasibility relates to what would it take to change not only Fannie and Freddie, but the industry, to using alternative credit scoring models. Because turning that ship is a major task; right?

Mr. CLAY. So have the credit scoring agencies—have they been receptive, or have they pushed these new versions?

Mr. WATT. Yes, they have. FICO has updated its credit scoring model. And Vantage and others are—we are regularly talking to them about this conversation—

Mr. CLAY. Okay.

Mr. WATT. —yes.

Mr. CLAY. All right. Let's move over to HARP. Director Watt, FHFA recently launched an interactive map showing that there are more than 722,000 eligible households nationwide that could still benefit from HARP, a program that allows certain homeowners with GSE-backed loans to refinance into mortgages with lower interest rates, thereby reducing their payments by as much as $200 per month while also reducing risk to the taxpayer by reducing their likelihood to default on their mortgages.

What are you—what is your agency doing to ensure that households are aware of this refinancing program?

Mr. WATT. First of all, we are very proud of that map. Because it gets you to the people who are eligible for HARP refinancing; 3.2, 3.3 million people have already taken advantage of HARP. There are over 700,000 who would still be eligible for it, who would get an advantage of taking advantage of it. And we are trying to get to those people.

Now, let me just emphasize that these are people—every single one of them, all 3.3 million of them, who have no equity in their home. Their homes are underwater. And they have been continuing to pay their mortgage, despite the fact that they are underwater. That takes us back—this notion that you have to have a downpayment, you have to have equity in a house for people to continue to be reliable homeowners and borrowers, it is just in the face of all of that. So we are trying to get to those people. We have done a series of meetings around the country in the highest concentrations where those people are and trying to get them to take advantage of the HARP refinance program.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from South Carolina, Mr. Mulvaney.

Mr. MULVANEY. Thank you, Mr. Chairman. Mr. Watt, thank you for coming back. I also appreciate your dedication to following the law and following the statutes. I hope it is an example you can set for the rest of the Administration.

Regarding the statutes, I think we have talked a little bit today about the statute regarding the suspension. What statute did you rely on in ending the suspensions?

Mr. WATT. The Housing Trust Fund Statute, the Affordable Housing Allocations. That is in HERA. It was reauthorized by Congress in HERA.

Mr. MULVANEY. Correct. Oh, okay. I misunderstood what you are saying. But that is the statute that says when to suspend, correct? Is there—

Mr. WATT. Yes.

Mr. MULVANEY. There is no statutory guidance for you on how to end a suspension, is there?

Mr. WATT. It says the Director shall temporarily suspend. I would assume that the word "temporarily" has an inverse that says you can unsuspend. Technically, you may be right that there is no statute that specifically says—

Mr. MULVANEY. Let's walk through it then.

Mr. WATT. —that you do this if you unsuspend. But you apply the same criteria to suspend and unsuspend, and that is what we did.

Mr. MULVANEY. I think that is fair. But by the same token, the mandate to suspend is not—there is no discretion there. You shall suspend if you find one of these three conditions, correct?

Mr. WATT. Yes.

Mr. MULVANEY. Okay.

Mr. WATT. And I interpret that the same way; you shall unsuspend if you find that these three things don't apply anymore.

Mr. MULVANEY. These things don't apply. Then let's walk through them. It says that they contribute—contribute—to the financial instability of the enterprise, causing—would cause the enterprise to be classified as undercapitalized or preventing it—preventing it from doing their capital restoration plan. But I heard you say something to Mr. Duffy earlier that was new, which is a reference to Fannie and Freddie making a profit. That is not in the statute, right? That is not one of the factors you can consider in making a decision to suspend or end a suspension, is it?

Mr. WATT. Number one says are contributing or would contribute to the financial instability of the enterprises. If you are evaluating the financial stability or instability of the enterprise—

Mr. MULVANEY. Is Fannie stable?

Mr. WATT. —the primary factor you are looking at is whether they are making money or not—

Mr. MULVANEY. Oh, really? So whether a bank is making money is the only issue we look at as to whether or not they are stable? Is that what you are saying? If Bank of America is making a profit, then therefore, they must be stable?

Mr. WATT. I don't make decisions about Bank of America. I am following the statute that was written that applies to the—

Mr. MULVANEY. And I am trying to press you on that.

Mr. WATT. —Federal Housing Finance Agency.

Mr. MULVANEY. Is Fannie stable?

Mr. WATT. We think it is. And we built into the decision to reverse the suspension prudent, reasonable safeguards in the event that—

Mr. MULVANEY. Again—

Mr. WATT. —they go back in the other direction.

Mr. MULVANEY. —and I appreciate that, and I read that in the letter. It says that if we ever have to go back to the Treasury, we will suspend the payments. I get that. Not in the statute, is it? The protection you have supposedly put in the letter is not part of the statutory consideration.

I hear what you are saying, Mr. Watt, and I think it is a good idea. But it is not statutory. You can't take the position that you are following the statute and then say well, really what we are considering is profitability, and don't worry, because we put something in the letter that says if we ever have to go back to the Treasury, we will stop the suspension. You are rewriting the law, aren't you?

Mr. WATT. I am following the conservatorship statute there, Representative Mulvaney.

Mr. MULVANEY. Come with me then to number two, regarding the undercapitalized. Because I think you have taken the position several times that your agreement with the Treasury moots this section. Is that fair?

Mr. WATT. Yes.

Mr. MULVANEY. That—my understanding—and again, I am new to this—is that your agreement with Treasury is an agreement, right?

Mr. WATT. That is correct.

Mr. MULVANEY. How does an agreement trump the law?

Mr. WATT. I think the law got trumped when they went into conservatorship and the taxpayers had to ante up $187 billion and there had—and so an agreement was made. That was before I got there. I didn't negotiate the agreement.

Mr. MULVANEY. But you would agree with me typically—

Mr. WATT. The agreement was in place when I became the Director of this agency.

Mr. MULVANEY. —typically, an agreement between one agency and another department of government cannot trump the law. You can't get around the law—

Mr. WATT. I absolutey agree with that. Right.

Mr. MULVANEY. So if the conservatorship statute doesn't explicitly repeal Section (b)(2), then Section (b)(2) is still valid law.

Mr. WATT. I don't agree with that. But I understand what you are saying. I just disagree with you.

Mr. MULVANEY. Why don't you agree with that? If the conservatorship statute doesn't speak to (b)(2), why is (b)(2) still not good law?

Mr. WATT. It just doesn't apply. I don't—I am not sure—

Mr. MULVANEY. Well, what is your—

Mr. WATT. We are engaging in a legal argument here that—

Mr. MULVANEY. That is what we are supposed to do, though, isn't it?

Mr. WATT. If you all didn't want to fund the Housing Trust Fund, you have the authority to stop the funding of the Housing Trust Fund.

Mr. MULVANEY. And we exercised that authority, didn't we?

Mr. WATT. Don't expect me to disregard the law and do it for you. If you want to do that, that is—

Mr. MULVANEY. I would suggest to you, Mr. Watt, that we did just that. We said look, under these certain circumstances, we don't think we should be funding the trust fund, and all we are asking you to do is follow the law. And if you believe that it is undercapitalized or you believe it is unstable, then you should stop the payments. I yield back.

Chairman HENSARLING. The gentleman yields back. The Chair now recognizes the gentleman from California, Mr. Sherman, for 5 minutes.

Mr. WATT. Mr. Chairman, do you think we could take a 2-minute break?

Chairman HENSARLING. The Chair declares a 5-minute recess.

[recess]

Chairman HENSARLING. The committee will come to order. Members will please take their seats. The Chair now recognizes the gentleman from California, Mr. Sherman, for 5 minutes.

Mr. SHERMAN. Mel, welcome back. The only thing that would be better than seeing you at a distance would be having you close at hand, but I have been—I have taken your advice on so many issues involving financial services, and I am sure to get some more. I look forward to your input over the next 5 minutes.

Good move on the Housing Trust Fund. I want to commend our colleague, Mr. Ellison, for organizing the letter, and unless he objects, I would like to put that in the record of this hearing. And so, I request unanimous consent to put this fine letter in the hearing.

Chairman HENSARLING. Without objection, it is so ordered.

Mr. SHERMAN. And to commend Mr. Watt for his actions.

First, a kind of a technical question. The HUD-1 is being phased out by the new integrated mortgage disclosure form that combines the TILA, or T-I-L-A RESPA forms and is intended to give consumers a better understanding of all itemized line item costs of the home closing. I wonder if you are focused on this rule, and what steps, if any, has the FHFA taken on this rule to make sure consumers are fully informed?

Mr. WATT. I believe that is under the Consumer Financial Protection Bureau's jurisdiction. We haven't been actively involved in it. I do meet regularly with the Director of the Consumer Financial Protection Bureau to make sure that we are not at odds.

And we are also members of the FSOC committee together, which allows us to exchange ideas at that level. But we are not directly involved in that.

Mr. SHERMAN. I am sure that you are focused more on real estate lending than some of the more general folks involved and they benefit from your input. Your predecessor pushed for a lower conforming loan limit. You demonstrated your wisdom in going in a different direction, an action that has done more than anything else to impress me with your wisdom.

Do you see that ugly proposal rearing its head again any time soon?

Mr. WATT. It has to because statutorily it has to be reviewed regularly and so we are almost constantly in the process of reviewing conforming loan limits. And so, yes, it will raise its head again.

Mr. SHERMAN. I look forward to continued wisdom on your part, and I yield back.

Chairman HENSARLING. The gentleman yields back. The Chair now recognizes the gentleman from New Mexico, Mr. Pearce, for 5 minutes.

Mr. PEARCE. Thank you, Mr. Chairman. Thank you, Director. I know that we haven't always agreed but I have always admired your fine language and straightforward responses, and I find myself admiring that today.

So as we look back to the problems that put you into conservatorship, we found that Fannie began, and then everyone began, to expand the number of loans that were given to people who probably shouldn't have gotten them.

And the OIG in 2012 found that Fannie—FHFA was somehow, somewhat responsible because they overlooked the fact that Fannie was beginning to relax its underwriting guidelines. They were beginning to buy loans that they said they wouldn't buy. And they didn't accomplish that with a page in law. They accomplished it with variances.

And so I guess my question is, what are you all doing to see that the agency doesn't go around the rules again? They were being pushed, not by the White House. You said before you are independent from the White House. I just wonder if you are independent from us.

Because as Members of this Congress and this body, we are pushing for the relaxing of those standards so that people could get loans. And I hear some of the same language today.

So what are we doing to make sure this doesn't occur again?

Mr. WATT. First of all, at that point Fannie and Freddie were not in conservatorship, and so the regulatory role was a lot looser than the conservatorship role that we are playing now. We are involved in virtually every decision that Fannie and Freddie make, and we take very seriously our statutory mandate, both to do things safely and soundly, and to do things in a way that will provide liquidity in the housing finance market.

And that is why I said in my opening statement that we are constantly walking that balance. So we would be as responsible for those decisions now as Fannie and Freddie would be because they are in conservatorship, and as part of our conservatorship.

Mr. PEARCE. I understand, but someday they will be out of conservatorship, and so I again wonder about the oversight mechanism that will take a look at what they are doing. Because it was them that facilitated.

If Fannie had not bought those mortgages that were never going to pay off, and people knew they would never pay off—they didn't care because they were able to get rid of them out of the banks and send them on to someone else and let them worry about it. And so as we go through into the future, I worry about that same thing.

I wonder also, so Fannie and Freddie are making a profit and so I guess you were talking about the models that you all have done. Do you have models that tell you at what rate of growth we are going to start experiencing troubles? Should we increase our surveillance? What rate of growth would that be?

Mr. WATT. We don't do it at what rate of growth—

Mr. PEARCE. Well, whatever you have.

Mr. WATT. We do it on a loan-by-loan basis and we set prudential standards that apply to loans so we make sure we never get to determining where you fall off that cliff or don't fall off that cliff. We are nowhere close to the level of risk that was being—

Mr. PEARCE. Let me claim my time. Having run a business with 50 employees, I find it beyond imagination that you can take a trillion dollar portfolio and look loan-by-loan, with all due respect. I appreciate your saying it, but I find that really hard to believe.

Mr. WATT. I apologize. That probably was an overstatement. But we set prudential standards that have to apply to loan-by-loan—

Mr. PEARCE. But those standards existed before.

Mr. WATT. Yes.

Mr. PEARCE. Those standards existed before and under the table or wherever, the people who were getting tremendous bonuses at that period of time began to cheat the system. They began to rig it to where they could get bigger bonuses and so until you re-evaluate human nature.

The last point I think I want to make is that another great pressure in the system was the low interest rates. And so at some point the Federal Reserve, whether they like it or not, is going to have to go up on interest rates. That is going to put more pressure into the housing market.

I see that if we don't have our ship really right when it goes into the troubled waters of lower growth rates, higher interest rates, that we are going to have exactly the same thing, the same problems with an agency that is way undercapitalized.

You have to admit that they are in shaky financial shape as we move forward, and if we get into troubled waters.

With that I yield back my time, Mr. Chairman.

Chairman HENSARLING. The gentleman yields back. The Chair now recognizes the gentlelady from Wisconsin, Ms. Moore, the ranking member of our Monetary Policy and Trade Subcommittee.

Ms. MOORE. Thank you so much, Mr. Chairman, and Ranking Member Waters. It is so good to see the Honorable Director Watt here with us. He is here in really good form. Just the facts. And really it is a relief to have you around. And the chairman just rode off into the sunset.

I would like to start out by just sort of making a comment before I engage the Director in a question. Because much has been said today about the creditworthiness of borrowers with the 3 percent down, and there has been much intimation that lower-income borrowers were the cause of the financial crisis in 2008, so I just would like, Mr. Chairman, to ask unanimous consent to put into the record a report done by Manuel Adelino from Duke University, and Antoinette Schoar of MIT.

Chairman HENSARLING. Without objection, it is so ordered.

Ms. MOORE. Thank you. And Felipe Severino from Dartmouth. And also a seminar from Harvard Business School and MIT.

Chairman HENSARLING. If the gentlelady will suspend, we seem to have a little audio problem here with the gentlelady's microphone. Maybe you ought to hit it once or twice. Try again.

Ms. MOORE. Thank you. This is a 42-page report, Mr. Director, and Mr. Chairman. But its conclusions are that the higher default rates can be attributed to loans made to middle- and upper-income folks but not low-income folks. And so I just wanted to clarify for the one millionth time that the lower-income borrowers were not the primary reason for the financial meltdown.

I don't know if you have any comment about that research, but I would like to enter that into the record.

Mr. WATT. I am glad I don't have to participate in that debate any more.

Ms. MOORE. Thank you. I was looking through your prepared testimony, and you talked about mortgage servicing, and I guess I didn't—it wasn't really clear to me through your testimony what was the product of the—there haven't been any changes in the compensation structure, better aligning of servicers and senses with those of the enterprises.

And I was wondering how that translated into better mortgage servicing for customers?

Mr. WATT. That is a very difficult subject because it is massive. What essentially has happened over time as a result of the meltdown is that servicing went from just collecting money on mortgages to a much, much more difficult process of dealing with people who were in default.

And so that whole industry has evolved, and most of it was done originally by lenders themselves in-house, and much of it now has gone to outside people who specialize in servicing. And that has created a set of issues that we have had to deal with because some of them, even though they might have been better servicers, were not necessarily as financially sound for the long term, so we have had to deal with that.

There is a wonderful study that was just put out by the Urban Institute that talks about that evolution and the costs that have been associated with servicing that, where you could service a performing loan for like $50 a loan, now it is up over to well over $2,000 as a result of the increased responsibilities for nonperforming loans.

But it is a very difficult area, and we internally at FHFA have had difficulty because this whole meltdown has put stresses on the servicing industry. I made a speech over at Brookings where I said it was easy to service when all you had to do was collect money. It is very difficult servicing mortgages now when people are in—

Ms. MOORE. Reclaiming my time, I would assume that—well, I have another question.

Chairman HENSARLING. The gentlelady may have another question. She is just simply out of time, so she can submit the question for the record, and the witness can respond as quickly as possible. The time of the gentlelady has expired.

The Chair now recognizes the gentleman from North Carolina, Mr. Pittenger.

Mr. PITTENGER. Thank you, Mr. Chairman. Mr. Watt, it is good to see my friend from Charlotte.

Mr. WATT. It is good to see you.

Mr. PITTENGER. You seem to be relishing your new job, and we wish you well.

Mr. WATT. Thank you.

Mr. PITTENGER. Frankly, we want you to be successful. And as noted by our comments today, we share—or have the concern that what would come out of the current policies—easy credit, we believe was complicit in the housing crisis that we have just previously experienced.

Mel, as you know, former Acting Director DeMarco proposed these increases for the guaranteed fees that GSE's would charge the lenders. And under your leadership you suspended the implementation of those increases.

This last December the CBO made a public statement, a report that suggested how we should attract new capital into the secondary mortgages, and I could quote them. They stated, "Policymakers should continue to increase the two GSEs' guarantee fees to attract new private capital to the secondary market."

And even a small increase in guarantee fees from the present level would allow private firms to immediately compete for the highest quality loans. You have also stated that you want to find ways to bring additional private capital into the system in order to reduce taxpayer risk.

Now for your own decision, you have chosen to go against the former Director, and you have chosen to go against the thinking of the CBO. If you are not willing to increase the guarantee fees, what additional steps would you recommend to increase the role of private capital, and to decrease the role of exposure of Fannie and Freddie, and frankly, the American taxpayer?

Mr. WATT. Let me just put in perspective one thing. I have never done anything in opposition to the former Acting Director. I have the greatest amount of respect for Acting Director DeMarco and the decisions—

Mr. PITTENGER. Contrary to his proposal.

Mr. WATT. Yes. So I just want to be on record as making that clear. And I have taken some abuse for saying that, but I just have to say it.

The primary means that we are using is to test different risk-sharing models, and they have been very successful. We have tripled, quadrupled the amount of risk-sharing we have done in the 1 year that I have been there.

The enterprise has had a goal of $30 billion in 2013. We increased it in the scorecard to $90 billion and shot right past it before the third quarter of 2014 was over. We have increased it again in the 2015 scorecard. We are encouraging them to look at different risk-sharing alternative models to do it, not just the ones that have already proven successful.

We have encouraged them to look at whether it is practical to even go back and risk-share some of the legacy book of loans. All of this risk-sharing we have done essentially have been with new loans, the more pristine loans. So we are very active in that space.

We are also looking at the g-fee question. The conclusion that you reached that we are not going to change or are going to change I think is premature. We just don't know yet whether we are going to change it or not, and we are taking into account the study that was done, our own study, the input that we got to a series of very cogent questions about how g-fees should be set, what factors should be considered in setting guarantee fees.

And when we come out with our report, hopefully by the end of this quarter, I think we will add a lot of information. In fact, even in the request for input, we put a lot of information out there that people had never known about how g-fees were set.

Mr. PITTENGER. Quickly, may I ask, you have suggested—or you have stated one of your policy changes is that you would allow these downpayments to be as little as 3 percent. And you stated, well, there are offsetting measures that you implement.

Would you give more clarity to what those are? Given that we believe that easy credit—you saw the chart earlier—was a major factor in the current demise.

Chairman HENSARLING. Very brief answer, please.

Mr. WATT. Homeownership counseling, mortgage insurance, private mortgage insurance, higher FICO scores; there are a number of factors that we are taking into account that would offset the lower downpayment.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Minnesota, Mr. Ellison.

Mr. ELLISON. Thank you, Mr. Chairman, and Ranking Member Waters. My colleague, Brad Sherman, beat me to it about putting the letter that we sent you into the record, but I just wanted to say that I was glad to see that we had 61 Members of Congress, including almost half of this committee agree that your action to end the temporary suspension of contributions to Fannie and Freddie to the Housing Trust Fund was the right thing to do. I am so very happy about it. The letter is already in the record so I don't need to enter it in, but I just want to make note of that.

And I also want to comment, too, that it is true that you have to take a lot of questions from folks who believe that the real problem of the crisis of 2008 was GSEs and borrowers. But it is also true that you have to contend with people who think that you ought to be moving faster in the other direction.

And I know that because I have had constituents of mine say, well, why doesn't Director Watt do this and do that and move quicker, things like that.

I think that one of things that your office has done after taking a lot of care, a lot of time, and a lot of research, is decide to review the process of the arm's-length transaction and not doing any arm's-length transactions and reviewing that policy.

I wonder, could you talk about some of the thinking that you entertained as you were reviewing that policy and why it is that you came up the way that you did?

Mr. WATT. There was a concern that if you allowed a borrower to default and then turn around and buy a piece of property at a lower rate that you would be incentivizing that kind of negative behavior. And that had kind of taken hold and was wagging the dog. There probably are 1, 2, 3 percent of the people in the world who could think that far ahead that they would default on the loan and then after foreclosure go back and buy it at a lower price and come out better.

But we thought the moral hazard, which is what people were calling that, we could minimize that by putting some prudential factors around that decision, and so that is what we did. It is not automatic that somebody can do that, go back and buy the home back for a lower price.

And we put a time period on it so that we could test it going forward to make sure that we didn't do something that was irresponsible. But it was a slow, evaluative research process, as are every one of these things.

You kind of put your finger on something. What I found in this position is that there is nothing generally as simple as I thought it was, right? All of these decisions are very difficult and require good research, and that is what we try to bring to every decision.

Mr. ELLISON. Yes, I just want to also say that you have been available to talk to everybody who wants to talk to you. You have met with ordinary homeowners, you have met with policymakers. You have done an exhaustive thing, and I want to commend your staff. Actually, you have a pretty good staff member, Carrie Johnson. She used to work at my office, and she has gone on to bigger and better things, but I am glad she landed in the right place over there.

So could you just talk about why you think it is so important to do all the outreach you have done and consult everybody you have consulted and do all this research you have done?

Mr. WATT. I think one of the Members over here pointed out that he appreciated plain talk. There is a lot of misinformation in this territory, and I think the more you can kind of break things down and explain them in terms that borrowers can understand, that the public can understand, de-mystify this whole process, the better off we are.

But most of the outreach we have done in going out has been about specific things that would benefit borrowers, such as the HARP program, or the neighborhood stabilization initiative in Detroit. I have kept a very, very low profile. I have no interest in being in front of a camera.

Mr. DUFFY [presiding]. The gentleman's time has expired.

Mr. WATT. We have a different approach to it.

Mr. ELLISON. Thank you, sir.

Mr. DUFFY. The Chair recognizes Mr. Rothfus from Pennsylvania for 5 minutes .

Mr. ROTHFUS. Thank you, Mr. Chairman. Can you hear me?

Director Watt, welcome back to the committee, for a couple of hours anyway. I want to talk a little bit about the 3 percent downpayment program.

Fannie Mae, in its 10Q that it filed with the SEC, their third quarter 2014, mentioned the program, and here is what they said. "We also plan to offer a 97 percent LTD ratio product to all customers in 2015. To the extent we are able to encourage lenders to increase access to mortgage credit, we may acquire a greater number of single family loans with higher risk characteristics than we have acquired in recent periods. However, we believe our single-family acquisitions will continue to have a strong overall credit risk profile, given our current underwriting and eligibility standards and product design."

So it seems to me that Fannie Mae, in its filing with the Securities and Exchange Commission, has admitted that the program is going to result in loans with a higher risk. Would you agree with that assessment?

Mr. WATT. I have admitted today too, that that possibility exists if you are not careful, which is exactly why we are being careful. That was a third-quarter analysis, and you notice they didn't announce this until December because we were putting all of these constraints around them to make sure that we minimized that risk.

Mr. ROTHFUS. So if I looked at when they file a 10Q for the quarter we are in right now, I would not expect to see something like that?

Mr. WATT. You may see something similar to that, yes. Because 10Qs, as you know, are designed to give the public and people out there the worst possible case that you could present.

Mr. ROTHFUS. And awareness of the risks.

Mr. WATT. That is right.

Mr. ROTHFUS. The Administration in 2011 released its so-called White Paper entitled, "Reforming America's Housing Finance Market." On page 14 of that document, the Administration recommends that: one, the FHA market share should be reduced; two, FHA should return to its pre-crisis role as a targeted provider of mortgage credit access for low- and moderate-income Americans; and three, FHA mortgage insurance should be increased.

Moreover, the Administration recommends a coordination between Fannie, Freddie, and the FHA to help ensure that the private market, not FHA, fills the market opportunities created by reform.

Do you believe the recent policy announcement by HUD, effective yesterday, to lower FHA annual mortgage insurance premiums by 50 basis points will affect the return of private capital to the markets?

Mr. WATT. I don't have an opinion on that, Representative, because HUD is not under—FHA is not under my jurisdiction and HUD is a part of the Administration. We are an independent regulatory body.

Mr. ROTHFUS. How many new homeowners had you anticipated with the 97 percent LTD program?

Mr. WATT. I'm sorry?

Mr. ROTHFUS. How many new homeowners have you anticipated with the 97 percent LTD—

Mr. WATT. It is a very, very small percentage of the overall portfolio, will be a very small—we anticipate that it will be a very small percentage of the portfolio of both Fannie and Freddie. And we have those numbers. I am not sure I can access them quickly enough to give them to you here—

Mr. ROTHFUS. We will follow up with you on that.

Mr. WATT. —but we will be happy to provide them to you.

Mr. ROTHFUS. When we talk about the 3 percent downpayment, you have been talking a little bit about the creditworthiness of people paying back their mortgage as they are able to pay it back. But we do have an issue out there with people who are underwater.

And one of the concerns I have is, when you have institutions such as Fannie and Freddie and the scale that they are able to influence the market, coming up with a program like this—I read an article just this weekend, and you may have seen it in the Washington Post, about a family in Prince George's County where they have a $550,000 mortgage but the home is worth $480,000.

And while that family may continue to pay on that mortgage, there is really another issue here, and it is families who do not feel as though they are getting ahead, and families who may feel trapped in their house.

And when we have a program that has a chance to encourage this—we saw a significant increase in mortgages that were underwater following the crisis. What would you say to a family like that, who buys into a program?

Mr. WATT. They are in a very difficult situation, and I have been in rooms with them and had discussions with them, and all you can do is tell them you regret that they are in a situation, and we are trying to make sure that future borrowers don't get themselves in that same situation.

Mr. DUFFY. The gentleman's time has expired. The Chair now recognizes the gentleman from Delaware, Mr. Carney, for 5 minutes.

Mr. CARNEY. I hope this doesn't mean I have to sound as smart as Mr. Foster. Mr. Chairman, Ranking Member Waters, thank you for the opportunity to ask a few questions.

Mr. Director, welcome back to the committee. We certainly miss your common sense and straight talk here, and personally I miss your North Carolina drawl over my right shoulder most of the time during the hearings.

You have said several times that you are not going to comment on the specifics of GSE reform; that is a legislative responsibility. But you have made some public comments on whether or not it is necessary.

Could you comment for us now about the sustainability of the current situation, what we should be concerned about and your thoughts on that, without going into any specifics about what we should do?

Mr. WATT. There is nothing worse, I have found, in this area of the market than uncertainty, and the longer this drags out, the more uncertainty there is. So you have that risk and imperative for Congress to do something. And that is not about what they do. It is about providing more certainty.

We have challenges at Fannie and Freddie maintaining an employee base in this environment because they don't know what the future of Fannie and Freddie is. So, there are multiple implications that follow from the failure to do GSE research.

Mr. CARNEY. So would you say it should be a high priority for us, for the Congress, and the Administration to get that done? When I first came here, the former chairman was criticizing the Administration for not doing anything on GSE reform. The former ranking member, Mr. Frank, was criticizing the Republicans for not doing anything on GSE reform.

There have been a lot of proposals. I am part of a team with Mr. Himes and Mr. Delaney that has come up with a proposal that I would like to talk to you about, but do you think it is time for that to get done?

Mr. WATT. I would say there are implications for not doing it. For me to put a priority on it, I think is an inappropriate role for me, because there are a lot of things that Congress deals with that are priorities, and that is just not my role, to set those.

Mr. CARNEY. So one of the things that our legislation does is invite—require private capital to be in a first-loss position over an explicit Federal guarantee, in some ways similar to the White Paper that Treasury presented here in this chamber when you were a member of the panel 4 years ago.

You have done some of that in terms of—my question is, what is the appetite for private capital to enter into this space, and do you have any sense as to what the premium might be for that first-loss position?

Mr. WATT. Private capital, there is an appetite. I don't know that I can assess the magnitude of the appetite, but I think they are playing an important role in the availability of housing finance in this country—private capital, that is—and we are trying to facilitate that role by taking loans off of their books so that they can make more loans. That was the whole philosophy under which Fannie and Freddie were founded in the first place.

And we are facilitating it through transferring risk back to the private sector. But that still does not negate the importance of providing certainty in the future by doing GSE reform.

Mr. CARNEY. Well, thank you. A number of us, as I said, are working on that, and we have had discussions with Members of the Senate, and with Democrats and Republicans both off and on this committee, and hopefully there will be an opportunity in this Congress to move something forward that basically contains a Federal guarantee—I happen to believe—the question was asked to you earlier about the importance of a 30-year fixed mortgage and you had some observations about that.

I happen to believe it is important from an affordability perspective, and the only way to sustain that is through some government guarantee.

Let me just close by thanking you. I was one of the Members who signed Congressman Ellison's letter requesting that you end the suspension of the fee to fund those two, the Housing Trust Fund and Capital Market Fund. I appreciate your decision to do that, and good luck to you.

Mr. WATT. Thank you.

Mr. DUFFY. The gentleman's time has expired. The Chair now recognizes the gentleman from Arizona, Mr. Schweikert, for 5 minutes.

Mr. SCHWEIKERT. Thank you, Mr. Chairman. Is it Chairman Duffy now?

Director Watt, earlier you said something I truly appreciate and I wish everyone had sort of embraced, that your current position is substantially risk management. And I am not sure a lot of folks appreciate that really is the core of your job at this moment.

But I have a handful of things I wanted to run through, and there is never enough time for all the questions. First one, you had an interesting discussion around servicing. I accept that a lot of this servicing can actually be fairly complicated, but a couple of mechanics.

For a low-cost servicer, great. The ability to transfer impaired paper that may need some additional love and touches to a specialty servicer that deals with impairment issues. How is that harmonization of servicing standards that I believe your folks have been working on, do you know where progress is?

Mr. WATT. We are making progress. We encountered a different set of circumstances after the meltdown. We went from a situation where lenders were primarily doing their own servicing to a situation where they wanted to get out of the servicing business—it was either too complicated or because they had to have higher capital requirements if they stayed in it. Various and sundry reasons.

And so a lot of the servicing rights got transferred, and that imposed upon FHFA and Fannie and Freddie the responsibility to look closer at not only the ability to service a loan but what are the longer-term implications of that. Are you capitalized well enough to be in this business for the long haul if things go south?

Mr. SCHWEIKERT. My great hope, and I know it is complicated and a lot of folks don't appreciate that, is that as you work on that harmonization—

Mr. WATT. We are definitely doing that.

Mr. SCHWEIKERT. —for paper or loans that has some difficulties, to be able to be moved easily, efficiently, low costwise, to servicers that will actually do that, reach out to both protect the securitization over here, but also work with those homeowners. Second—

Mr. WATT. Can I just make a point? I think you would be happy with the most recent set of things we have been working on in that area to try to encourage loans to servicers, transfer of loans to servicers who have a history in working well with borrowers. So staying out of foreclosure as opposed to going to foreclosure.

Mr. SCHWEIKERT. The only obligation there on your side is a simple, efficient, low-cost ability to move paper back and forth when necessary.

Second one, and this is more just from a—being from the West. And I know you have said you are working on it. You are working on sort of the risk pricing models and you saw it pop up. For those of us out in the West, we are deed-of-trust States. We are very efficient, we are very low cost, with the ability to do sometimes what is difficult.

Some States are mortgage States that put on lots and lots of consumer protection but have raised the cost. And it is only appropriate, only fair that those different cost structures be priced into the product because for those of us, particularly out West, we often feel like in our pricing, if you have universal national pricing on that risk, that we are subsidizing States that have made it much more difficult to move through that foreclosure process.

So it is just something that is there, and it is math, so hopefully you will treat it that way.

The thing I am most interested in—and some of this I am going to have to give you in writing because we will never have time—is, was it last week you did the STACR deal?

Mr. WATT. Yes. Well, we are regularly doing STACR.

Mr. SCHWEIKERT. But the most recent one, was it the first loss piece that was transferred out? Which is fascinating to me, because in that sort of model you are actually creating a securitization where the GSE ultimately is a catastrophic coverage. Help me understand in the remaining seconds how that works. And in some ways how that may help us drive toward GSE reform.

Mr. WATT. When we started doing risk transfers, we started by having the GSEs, Fannie and Freddie, retain the first loss, transferring risk on some subsequent loss, and then coming back in with the GSEs retaining catastrophic loss.

We are now experimenting and looking at the process of having—transferring the first loss position back to the—

Mr. SCHWEIKERT. Director Watt, I am going to—

Mr. DUFFY. The gentleman's—

Mr. SCHWEIKERT. —submit questions to you in writing, and I thank you for your patience.

Mr. DUFFY. Time has expired. The gentleman yields back. The Chair now recognizes Mr. Kildee from Michigan for 5 minutes.

Mr. KILDEE. Thank you, Mr. Chairman. And at the risk of redundancy, Mel, it is good to have you back. I only got to serve a year with you, but as you can see, in the year that you have been gone, I have become the second ranking member on the Democratic side for the committee. At least for the moment.

Before I ask some questions, I would ask you to comment, I would like to submit for the record some comments from the Homeownership Preservation Foundation regarding strengthening of the U.S. housing finance system through provision of housing counseling services.

And we talked about credit score and downpayment-related risk mitigation factors. And as you have stated, there are other factors to be considered. We had a panel here some months ago, and I think it may have been after you left—you probably heard similar panels where we had a number of representatives from the mortgage industry talk to us in general about mortgage lending and the risks associated with mortgage lending.

We happened to have an individual from an organization that does a lot of affordable housing work, and some of the lenders referenced that if they used the same process—which include a heavy emphasis on homeownership counseling—that they would have default rates that were lower.

Could you quickly comment on that particular point? And Mr. Chairman, if you don't mind, I would like to have these comments entered into the record. And then I have a couple of other questions.

Mr. DUFFY. Without objection, it is so ordered.

Mr. WATT. I don't think there is any question that somebody who gets good homeownership counseling, either pre-ownership, or in some cases post-ownership—it makes them better borrowers. It can't be just any counseling. It has to be good homeownership counseling, but it really has an impact because especially first-time homeowners have little appreciation for the responsibilities that go with homeownership, that are different than being a renter.

Mr. KILDEE. It is a really important point. And I hope that as we move forward on whatever process we engage in, we make sure to consider those factors.

I would like to turn to another somewhat related question, and it has to do with access not just to credit but access to mortgages even for creditworthy individuals in markets such as the markets I represent. I represent Flint, Michigan, my hometown, where the average home price is $47,500.

And for many legitimate borrowers with decent credit—many banks, many mortgage lenders, say that mortgages of that size just don't make economic sense. And I wonder if there is anything that you are working on or could refer to us in terms of the work of FHFA that will make sure that in those markets we still have opportunity for homeownership. Because otherwise we are basically consigning those communities to rent.

And your point about the effect of vacant properties on surrounding values is an important one. But it is also—the percentage of homeownership of those occupied properties that has a similar effect, and I wonder if you could comment on that.

Mr. WATT. We put in the 2015 scorecard an obligation on the enterprises to work with community smaller banks and State housing finance agencies to try to get to those lower-cost areas and underserved areas.

And I think we are going to make some progress on that this year. I think the 97 percent loan product will have some bearing on that, although it is not specifically designed for that category.

Mr. KILDEE. I would agree. And this question—I obviously listened as you answered questions, particularly related to downpayment thresholds. I think we could all sort of agree—you don't even have to bother to answer the question, is if we decided that a 20 percent downpayment standard would be enacted, that we would have a far lower default rate. Or if you had to have a million dollars in net value, net assets in your own personal portfolio, you might have a lower default rate.

The question is, how do we balance these interests so that the maximum number of Americans have the opportunity to achieve homeownership, understanding that there are many, many ways to mitigate risk associated with people who are in a financial condition that does not allow them, because they are dealing with other exigencies in their life every day, to save the kind of money that it takes.

One of the ways, and I would just—you may comment on this. You may not be able to because of the rulemaking process, but the membership standards question for Federal Home Loan Banks is an area of some concern for me because in some ways, by limiting membership standards, we might actually cut off another source of revenue that can be directed to help some of these local community-based organizations that are working on homeownership.

Mr. DUFFY. The gentleman's time has expired. You, Mr. Watt, can respond to Mr. Kildee in writing. The Chair now recognizes Mr. Barr from Kentucky for 5 minutes.

Mr. BARR. Director Watt, welcome back to the committee.

Mr. WATT. Thank you.

Mr. BARR. And congratulations on your confirmation. As you know, the Consumer Financial Protection Bureau has finalized its ability-to-repay qualified mortgage rule, and the purpose of that rule is ostensibly to encourage safe and sound mortgage loans.

But a recent survey of mortgage lenders showed that about two-thirds of respondents would restrict lending because of—directly because of the qualified mortgage rule as defined by the regulators under Dodd-Frank, and about 80 percent of those respondents expected the new regulations to measurably reduce credit availability.

Obviously given your agency's, FHFA's, recent moves, recent policy changes, you appear to share the concern about credit availability and access to affordable mortgage credit. The changes to guarantee fees, the guidelines allowing GSEs to buy loans with ultra-low 3 percent downpayments. And all of this appears to conflict with the Bureau's qualified mortgage rule.

So my question is, is the FHFA pursuing a policy of encouraging mortgage lenders to originate non-QM loans that the Bureau would deem risky?

Mr. WATT. No. We are not. We are not, without prudent compensating factors to take whatever that increased risk might be into account.

Mr. BARR. Wouldn't it make sense that a borrower who can only afford 3 percent down is likely to run into the debt-to-income ratio limitations imposed by the QM rule?

Mr. WATT. Yes.

Mr. BARR. Okay, so I guess—again, I am just curious to understand how the American public is to interpret what the Federal Government is doing sending mixed signals of encouraging more credit availability on the one hand, your policy changes, versus what the Bureau appears to be doing, which is tightening and restricting access to mortgage credit.

Mr. WATT. I think a judgment has been made that because Fannie and Freddie are under conservatorship, during the period that they are in conservatorship we could make those judgments without being subject to the qualified mortgage rules, for a period of time. Now I don't know if that will sustain itself forever, but that is where we are at this moment.

Mr. BARR. Director, I have introduced legislation called the Portfolio Lending and Mortgage Access Act. I am going to be re-introducing that legislation. It has some bipartisan interest in it. It is motivated by the same concern that you have about access to mortgage credit for responsible borrowers.

And the idea would be to modify the QM rule to allow lenders to retain the risk, which was a primary motivating policy in the Dodd-Frank Act, retain the risk, portfolio those loans to get the same safe harbor that other QM loans would get.

And my question is, wouldn't that be a more sensible approach to dealing with these 3 percent loans so that the risk is on the shareholders of the bank and not on the taxpayer?

Mr. WATT. I think that is a judgment for Congress to make. It wouldn't be a judgment for me to make. If you have introduced the legislation, then I am sure Congress will evaluate it.

Mr. BARR. Thank you. Let me just quickly follow up on some of the questions that Congressman Duffy was asking you about the Housing Trust Fund. With roughly $3.3 trillion in assets and $9.5 billion in capital, Fannie Mae is currently leveraged at 341 to 1 and features a leveraged capital ratio of .29 percent.

Freddie Mac has roughly $2 trillion in assets and has a leveraged capital ratio of .64 percent. The typical bank, I understand, is leveraged at about 10 to 1. So the current amount of leverage of Fannie and Freddie is far, far greater than the typical financial institution.

I heard your testimony earlier that you believe that Fannie and Freddie are adequately capitalized and you are just following the statute. Is that right? Given those capital ratios, is that true?

Mr. WATT. I don't think I expressed any opinion about the adequacy of the capital. What I said was that we are operating under a preferred stock purchase agreement that has basically taken capital out of the equation during the period of the conservatorship.

Mr. BARR. My time has expired, but I would suggest that if they are adequately capitalized, I would wonder why they are still in conservatorship.

Mr. DUFFY. The gentleman's time has expired.

Mr. WATT. Chairman Duffy, could I trouble you all for another 2-minute break?

Mr. DUFFY. No objection. The Chair will recess for 5 minutes again. Second time.

[recess]

Mr. DUFFY. The committee now reconvenes. The Chair recognizes the gentlelady from Ohio, Mrs. Beatty, for 5 minutes.

Mrs. BEATTY. Thank you so much, Mr. Chairman. Let me just say to Director Watt what a pleasure it is for me to be here. I notice you looked at me when you saw this thick book and list of questions. In full disclosure, Director Watt was my mentor, and I recall him always saying to me, read everything and always have good questions.

With that said, let me just say on a very serious note how much I appreciate the work that you and your team are doing to protect all of my constituents and constituents across the country with housing and those regulations.

But today I would like to lend my voice to one of the questions that we have heard from both sides that centered around membership in the Federal Home Loan Bank (FHLB), related to the September FHFA issued ruling revising the membership requirement of FHLB.

Of those 1,300-and-some comments that you received, my district was not silent there. So on behalf of my district, the Ohio Capital Finance Corporation, which serves thousands of households, raised concerns expressed by other community development financial institutions.

They hold dearly the affordable housing program. It is one of the most important sources of funding for nonprofit housing communities. So the question is regarding the requirement to meet one and two ratio tests of mortgages to total assets.

And what they want to know is, since they don't hold mortgages—"they" being the Ohio Capital Fund—that range from 1 to 10 percent depends on the type or the asset size, that when that goes into effect it would cause them to terminate their membership with the Federal Home Loan Bank in Cincinnati because it doesn't hold mortgages.

So would you or your team give any consideration to doing an evaluation on the impact of the burden to community development financial institutions of a less severe remedy than loss of membership?

Mr. WATT. We are looking at every aspect of this. We have, as I indicated before, approximately 1,300 comments in response to the proposed rule and we are going through them. Our preliminary analysis indicates that despite the fact that there are 7,500 members of the Federal Home Loan Bank System now, only 50 to 100 of them would be adversely affected by the rule.

And that is not to minimize the value of that 50 to 100, but we—that is definitely one of the factors that we will take into account.

Mrs. BEATTY. Thank you for that. Mr. Chairman, may I ask unanimous consent to have the letter from the Ohio Capital Finance Corporation entered into the record?

Mr. DUFFY. Without objection, it is so ordered.

Mrs. BEATTY. Thank you. The second question I have goes to OMWI. I am very honored that Ranking Member Maxine Waters asked me to be involved and to chair that committee. You certainly know through your organization, having OMWI prior to Dodd-Frank that there are different regulations.

With Dodd-Frank they now have the whole issue of transparency, reporting back to the public on the number. Diversity is very important to me for a whole host of reasons, but can you briefly share with us what you are doing since you came under the Recovery Act, of how you are being transparent in sharing the diversity through OMWI?

Mr. WATT. There are statutory reporting requirements and we obviously are complying with those. But more importantly, what we have done is try to take a look at how to make the OMWI office an important ingredient of our organization, not just keeping numbers but embed them in decisions that are being made.

And in the selection of our Director of the OMWI office we found somebody who had transactional background, not just OMWI background, so that we could get that person involved in the kinds of decision-making that would have some impact on diversity.

Mrs. BEATTY. Thank you.

Mr. DUFFY. The gentlelady's time has expired. The Chair now—yes?

Ms. WATERS. I ask unanimous consent to enter into the record an article that ran in the Washington Post on the disparities in wealth between Black and White.

Mr. DUFFY. Without objection, it is so ordered.

Ms. WATERS. Thank you.

Mr. DUFFY. The Chair now recognizes Mr. Tipton from Colorado for 5 minutes.

Mr. TIPTON. Thank you, Mr. Chairman. Director, thank you for taking the time to be here. I would like to follow up actually on a comment that Mrs. Beatty was just making in regards to our Federal Home Loan Bank.

You made a comment earlier in our conversation here to my colleague from Oklahoma, Mr. Lucas, that we are following statute in regards to establishing some new rules in regards to membership in the Federal Home Loan Banks.

And I would like to follow up with you on that, and looking in through the Bank Act, it does not address a minimum level of mortgage loans. That is not cited. And I guess my concern over this issue is Mrs. Beatty, and I think Mr. Lucas, both spoke to these issues.

In my particular State of Colorado, we have over 200 community banks, credit unions, and insurance companies that are members of the Federal Home Loan Bank. And these financial institutions do responsibly utilize the liquidity that is provided in order to be able to deploy credit out in support of housing, finance, agricultural production, small business formation, and community development. And they do this currently in full compliance with the Federal

Home Loan Bank Act, and the congressional intent, as I read it, through the existing programs.

This proposed rule, issued on September 12th, has the potential to be able to decrease Federal Home Loan Banking System membership. Have you quantified the potential impact that may have on rural America right now? Because while we may have pockets of prosperity in the country, rural America is not feeling it.

Mr. WATT. As I have said in response to Representative Beatty, our preliminary analysis indicates that only 50 to 100 of those 7,500 members would be adversely affected by either the 1 percent requirement or the 10 percent requirement.

There is a statutory requirement. The question is whether it will be applied only when a member becomes a member of the Bank, or whether it will be applied on an ongoing basis. That is really what the rule addresses. The statute clearly says that you will have 1 percent of assets in home mortgage loans. That has been in the past applied only at the time of becoming a member, not on a continuing basis, right?

So we are looking at whether that undermines the purpose, not to require it on an ongoing basis, not just a one-time basis.

Mr. TIPTON. I guess what I would like to be able to express is that often in Washington, a smaller amount is often trivialized. In some of the small communities that I represent—I have 54,000 square miles of Colorado. If one of those banks happens to be in that 50 to 100 that would then be shut down, it would be a reasonable assumption, obviously, that we weren't going to be able to extend credit in that local community because it is going to be a small community.

Mr. WATT. We will certainly take that into account.

Mr. TIPTON. That is going to be critically important, I think, for us, as our communities truly are struggling under those what we feel are over-regulation coming in out of the Federal Government.

So thank you on that, and with that I yield back, Mr. Chairman.

Mr. DUFFY. Do you want to yield to the Chair?

Mr. TIPTON. I will yield.

Mr. DUFFY. Mr. Watt, I just want to follow up on some questions I had for you for the next minute. Is it fair to say that the g-fee is based on risk? It is risk-based, right? The g-fee is risk-based?

Mr. WATT. The question is, what will the g-fee be designed to cover. Will it be only risk, will it be accumulation of capital, will it be—

Mr. DUFFY. Today, is it—

Mr. WATT. But one element is definitely risk.

Mr. DUFFY. But are you charging more than the risk for the g-fee? Some would argue that in our assessment if you have a credit score of 740 and you put 40 percent down, you might be paying a little more for your risk, and if your credit score is 650 and you only put 3 percent down, you get a little subsidy based on the risk of the g-fee. This is actually from your data.

Do you disagree with your data? I can—

Mr. WATT. No, I am not arguing with the data. I am trying to put it in a frame here that—

Mr. DUFFY. I am going to have to gavel myself down in a second. And I guess maybe you could think about this, and maybe we will have a chance to come back to it. Are you charging more on the g-fee than the actual risk? Or are you undercharging for the risk or are you hitting it just right?

Mr. WATT. One of the things that a lot of people on this committee have been advocating is that we charge more than risk so that we can attract private capital. So, you kind of meet yourself in these arguments going and coming.

Mr. DUFFY. I don't want to abuse the gavel. Maybe we can come back to it later. The Chair now recognizes the gentleman from Texas, Mr. Williams, for 5 minutes.

Mr. WILLIAMS. Thank you, Mr. Chairman, and thank you, Director, for being here today. We have covered a lot of ground. I appreciate your service.

I am a private sector guy, I own businesses in Texas, and I am one of those who believes the private sector is the answer, not the Federal Government, to a lot of the issues we have.

I do want to say one thing. You had mentioned earlier that you had a hard time with your employees with Fannie Mae and Freddie Mac because of the fact they weren't sure what their future might be. I heard you say that.

Mr. WATT. Yes.

Mr. WILLIAMS. And I would just say, welcome to the private sector. The private sector is going through that every single day, wondering what their future is as small business owners, moms and dads and so forth. So that feeling is not unique to your group of folks. It is all over our country because of government regulations.

My first question would be this: What is the Treasury doing with the money they get from the GSEs every quarter? If the Treasury spends the money now they get from Fannie Mae and Freddie, won't they have to borrow more or tax more to raise the money in the future to meet the normal losses that could be coming in?

Mr. WATT. I can't answer that, Representative Williams, because I am not at Treasury. We sweep the money to Treasury, it gets applied to the deficit, it gets applied to government operations. I guess the argument is, should it be doing that or should it be building up a reserve, a capital reserve of some kind. That is not a decision that I can make.

Mr. WILLIAMS. I think the concern is that we have such a big deficit and it is going in the hands of the Federal Government. You know where is it going.

Also, just to kind of help me understand a little bit, like I said, we have covered a lot of ground today. What is the average credit score of a 3 percent customer?

Mr. WATT. I don't know that I can tell you that off the top of my head, Representative Williams.

Mr. WILLIAMS. And we may have covered, I heard a figure of 2 percent, but what is the foreclosure rate in your portfolio, percent to the total? I thought I heard a figure of 2 percent. Would that be right?

Mr. WATT. I can tell you that, if you will let me get to—

Mr. WILLIAMS. And while you are looking at that, when do you decide to foreclose? How far behind in payment? How far past due are homeowners before you say we need to foreclose on this piece of property?

Mr. WATT. There is no fixed answer to that. We get concerned if somebody gets 30 days behind in payment. We get more concerned if they get 60 days behind. We get more concerned—at what point you quit working with a borrower to try to get them back current, or alternatively make a decision to go to foreclosure is a very complex set of determinations.

So I don't know that I could give you a rule that would apply across-the-board on that.

Mr. WILLIAMS. What is your foreclosure percent to the total?

Mr. WATT. You got me off on—

Mr. WILLIAMS. I'm sorry. I think I heard 2 percent.

Mr. WATT. Let us provide that information in writing.

Mr. WILLIAMS. Provide that back to us.

Mr. WATT. We have the information about the loans since the meltdown. We have it overall for the whole history. We have it prior to the meltdown. I just—I am not finding it—

Mr. WILLIAMS. That is fine. You can get that to me. And another thing, too. Of course equity is important to everybody. We want everybody to have equity, and of course the bigger the downpayment, the more equity they are going to have going in.

There are some people, though, I guess, who can't afford a home. And do you advise these people as such, that possibly now is not the time for them to buy a house? Maybe they need to go another direction, start renting or something so they can—

Mr. WATT. When I was practicing law, and when I was a Member of Congress, I used to give that kind of advice, but I don't have the opportunity to give that kind of advice, nor is it my role to give that kind of advice. Fannie and Freddie don't make loans. We buy loans off of lenders' books and guarantee them and put them into a secondary market. So there is just not an opportunity for me to be engaged in those kinds of discussions with borrowers now.

But when I was practicing law, there were thousands of people to whom I would say, if you can't afford to make a mortgage payment, you shouldn't be a homeowner. Yes. Homeownership is not for everybody.

Mr. WILLIAMS. I appreciate you being here. I hope that one day we can get the government out of the homeowner business and get it back in the private sector where it belongs.

Mr. Chairman, I yield back.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Maine, Mr. Poliquin.

Mr. POLIQUIN. Thank you, Mr. Chairman. Thank you very much for being here, Director Watt. I understand from your background you spent a little bit of time in New England, and I want to thank you very much in advance for rooting for the Patriots. Not that we will need it, but on Sunday I appreciate that very much. Thank you very much.

Mr. WATT. I'm sorry. I can't make that commitment to you.

Mr. POLIQUIN. I was hoping we would start off on a good foot, Mr. Watt, but that is okay.

Everybody that has been with you today, sir, understands that Fannie and Freddie are in conservatorship, and we of course understand that your organization is the in fact conservator. And I have also heard you say a couple of times today—actually several times—that one of the roles that you are playing in this role, if I am not mistaken, is to be sure to the best of your ability that Fannie and Freddie are safely and soundly managed such that we keep the credit flowing to those who want to buy a home and are able to buy a home, and also to protect our hardworking taxpayers.

Now I am going to be very honest with you, Mr. Watt. I have a little bit of a concern. If you look at Fannie, this is an organization that is connected to our Federal Government, was created by our Federal Government. It is responsible for $3.3 trillion in home mortgages and they use our hardworking taxpayers to backstop those mortgages.

I am also concerned that Freddie Mac is also putting U.S. taxpayers on the hook for an additional $2.2 trillion.

Now my other point I would like to make is that, if I am not mistaken, in 2014 Fannie and Freddie together were responsible for holding 51 percent of all home mortgages in America. That being the case, sir, would you agree with me that Fannie and Freddie are large financial institutions?

Mr. WATT. Absolutely, they are large financial institutions.

Mr. POLIQUIN. Good. Dodd-Frank, as I am sure you know, Mr. Director, requires nongovernment large financial institutions to hold substantial amounts of capital in reserve in the event that something goes wrong.

Now I am not here advocating that those capital requirements for nongovernment entities be increased. However, don't you think it is appropriate, sir, that Fannie and Freddie, especially organizations of this size that are backstopped by the taxpayers, also ought to live by the same rules as our nongovernment financial institutions when it comes to capital requirements?

Mr. WATT. I don't know if that is my decision to make, whether I agreed with it or not.

Mr. POLIQUIN. Well, you are the Director—

Mr. WATT. When I testified in the Senate, I said in response to a question, that I don't have any personal opinions anymore. Every opinion I express now is an FHFA opinion, so I try not to express those personal opinions.

Mr. POLIQUIN. I appreciate that very much, Mr. Watt. But with all due respect, you are in a position of great authority. You are the regulator for the GSEs, and I would like to beg to differ with you a little bit, that your opinion is greatly appreciated.

And what I am trying to get across, if I may, is that we have two very large institutions that do not abide by the same capital requirements as other nongovernment institutions around this country.

I might also add, if I may, that if you are looking at Fannie Mae, with $3.3 trillion in assets—and this has been said here before—they have roughly $10 billion in assets but they are asking the taxpayers to backstop $3.3 trillion in loans.

Now if you are looking at Freddie Mac, they have about $13 billion in assets and are backstopping $2.2 trillion. So I think we could both agree—I hope so—that these organizations are grossly undercapitalized and represent one heck of a risk to the taxpayers if something goes wrong.

Would you agree with that, sir?

Mr. WATT. I have two responses to it, one of which I have already given, which is I didn't set up the preferred stock purchase agreement. I wasn't even there when it was created. So I am living under that. I can't change it without—but the second response is, you all can change that. Everything that you just talked about you can change by doing GSE reform.

Mr. POLIQUIN. Mr. Watt, everybody wants a healthy economy. And the taxpayers in my district in Maine, who are some of the hardest-working, most honest people you could ever meet, they want to make sure they have a government that works for them and not against them.

And I happen to believe that accountability in all stages of government, all levels of government is a good thing. Now I am very concerned about these large institutions that are highly leveraged, with very little capital, that are requiring the taxpayers to backstop then. When we have interest rates at historic lows, with a rise in interest rates that could cause a problem with the housing market and also our economy, wouldn't you agree that it makes sense to take a look at these institutions?

Chairman HENSARLING. The time of the gentleman has expired. A brief answer, please.

Mr. WATT. I think I have already answered your question to the best of my ability to do it, Representative.

Mr. POLIQUIN. Thank you very much, sir.

Chairman HENSARLING. That was brief. The Chair now recognizes the gentlelady from Utah, Mrs. Love.

Mrs. LOVE. Welcome, Director Watt. I appreciate the opportunity to meet you here today.

Mr. WATT. It is nice meeting you.

Mrs. LOVE. I just wanted to say, as a former mayor I have had to ask myself three questions before making any new commitments or changes or going to a certain direction: is it affordable; is it sustainable; and is it my job?

One of the questions I have today is, in your studies did you determine how many people the lowering of this standard was going to help?

Mr. WATT. You are talking about the 97 percent product now? Is that the—

Mrs. LOVE. I am talking about getting the standards to that, to the 3 percent payment. Did you determine how many people this was going to help get into homes, how many people it was going to hurt? Did you have any—

Mr. WATT. We have some projections that it would be a very small percentage of the overall portfolio of either Fannie or Freddie, and I probably have those percentages but not the actual numbers.

Mrs. LOVE. Okay, so a certain—a small percentage this was going to help, bringing down these was actually going to help get into homes.

Mr. WATT. Yes.

Mrs. LOVE. So obviously we talked about some risk and risking the taxpayer dollars. You have no guarantee—is it fair to say that you have no guarantee that the people who are going to get in and borrow will be able to get into homes that they can afford and not default on their loans?

Mr. WATT. I don't think we are ever in a position to guarantee that. We make responsible decisions based on risk assessments, and I can guarantee you that we have made a robust risk assessment. I don't think you could guarantee that anybody could pay a loan that they paid 99 percent down, because something might come up next week that would prevent them from doing that.

So this is not about being able to guarantee it. It is about assessing the risk and likelihood of it, and we have done what we can to minimize—

Mrs. LOVE. Okay, so when I asked those questions, the reason why I asked those questions is because when we get into risk involvement, and asking myself is it affordable, is it sustainable, is it my job, we realize inevitably we have actually taken a lot of the risk out of that decision-making.

I believe, and I believe that Utah believes, and the majority of hardworking Americans believe that if Washington bureaucrats actually asked those same questions, we wouldn't be in the financial crisis that we are in today.

As I witnessed as a mayor, I have actually seen how these heavily-involved government policies have actually hurt many cities in their ability to thrive and to grow. We have watched homes being built and actually seen those homes a year later completely empty. And hardworking families lose their credit and their ability to get into a home.

And so that is why I asked those questions about how does this actually help hardworking Americans get into a home and be able to sustain a future. Too many times I am afraid that these government-backed programs that vow to help and protect hardworking, poor Americans, it has actually done the opposite and hurt those that it vowed to protect.

If the Administration, or as you would say, an independent regulatory agency, goes down this road of bigger government policies and getting involved more in what the free market should be involved in, I just want it on record that as hardworking Americans start losing their homes, that you remember this warning today.

I have been in the trenches of this. I have actually seen this happen. I am not taking a 60-foot view of what has happened. I have actually been a mayor, and I have actually seen my city have a really hard time with the housing market, and I don't want to go back in that direction.

This is an area where I have said, this is not about hardworking Americans trusting you to do the right thing. It is about you trusting hardworking Americans to make decisions and do the right things for their future.

I yield back my time.

Chairman HENSARLING. If you are about to yield, would you yield to the gentleman from Wisconsin?

Mrs. LOVE. Yes, I will yield my time to Chairman Duffy.

Mr. DUFFY. I appreciate the gentlelady for yielding. Mr. Watt, going back to my previous question, the g-fee, which we were talking about was risk-based, basically is to make sure that the GSEs aren't losing any money, right? You are trying to find that balance to go, boom, what does it cost. I am not trying to trick you. This is a pretty simple, straightforward question.

Mr. WATT. It is a straightforward question, but it is inconsistent with the approach that a number of people have used that we should be using g-fees to attract private capital. Because if we raise g-fees to that level, we would be making a bunch more money, but is that an appropriate thing to do—

Mr. DUFFY. My question, Mr. Watt—

Mr. WATT. —an appropriate purpose for g-fees.

Mr. DUFFY. I am not asking anybody else. I am asking what you—are you trying to get the g-fee to hit just right to be able to cover your costs. You are not trying to bring in any extra money, you are not trying to lose any money, you are trying to hit the nail right on the head, hit the g-fees right on.

Or are you trying to make money? Are you trying to lose money when you set the g-fee?

Mr. WATT. We certainly don't want to lose money, that I can assure you.

Mr. DUFFY. Are you trying to make money?

Mr. WATT. But I think it would be more appropriate to wait until we come out with what we are going to do on g-fee, articulate the reasons that we are doing it—

Mr. DUFFY. But this is an important—

Mr. WATT. —and then you will see where we come out. Right now, I don't have an opinion about the things you are asking.

Mr. DUFFY. You don't know if the g-fee, if you are trying to set it a little bit higher than the actual cost or are you trying to hit it right on. You can't tell us today in this hearing how you are—

Mr. WATT. Representative Duffy, if I knew that, we would have—I wouldn't be studying the issue. That is the reason why we are going through this expensive study, to keep from—

Mr. DUFFY. So what is the goal?

Mr. WATT. —applying my own opinion about that.

Mr. DUFFY. Let us say, what is the goal?

Mr. WATT. Our agency is research-based, and we are going to apply the research that we have to that question.

Mr. DUFFY. Is the goal, though—let us take reality aside for a second—to get the g-fee just right? Whether you can or not, in theory you want to get it just right. We are not really making any money and you are not losing any money. You are charging for the services consistent with the risk and other factors that you referenced.

Mr. WATT. One of the purposes is certainly not to lose money. We are not trying to set a g-fee that is going to lose money. Now, are there other factors in addition to covering the risk and breaking even that should go into setting the g-fee? That is a question that we are evaluating in the agency at this point. That is—

Mr. DUFFY. But the intent is to look at all those things and try to hit it just right, correct? Not make any money, not lose any money, but take all those factors and hit the number just right. It is a pretty simple question. I would imagine the answer is yes, that is of course what we are trying to do here. We are trying to get it just right.

Chairman HENSARLING. The gentleman is going to need to wrap up this line of questioning.

Mr. DUFFY. So, very quickly, if you take a sweep for the Affordable Housing Trust Fund of 4.2 percent, right, you are going to sweep that money—it is not a tax, you are saying. But if you hit the g-fee just right but then you sweep 4.2 basis points away to go into the Affordable Housing Trust Fund, you are actually now below the cost of your risk.

And so the taxpayers are going to bear that cost. Or if you go above the actual cost of the g-fee, you are actually charging then the end homeowner an extra fee to drive money into the Affordable Housing Trust Fund. Either it is taxpayers who are going to pay or it is those who have a mortgage who are going to pay. But someone is going to pay.

To come here and say that it is magical fairy dust and no one pays this money isn't really being totally forthright. Taxpayers on the hook or mortgagees are on the hook. I would ask if Mr. Watt agrees with that.

Mr. WATT. I have tried to answer this question as forthrightly as I can. With the size of our portfolio, I don't think we could ever set g-fees to just break even. That could never happen. So if the question is, are you setting it just to break even, the answer is, no, we have to have some margin, even if we don't take anything into account other than risk.

Mr. DUFFY. Mr. Watt, you are a very good lawyer, and I can recognize that and I appreciate it, but you are not answering my question. With that, I yield.

Mr. WATT. I don't understand the question—

Chairman HENSARLING. We will allow the two very good lawyers to perhaps have this conversation online. The Chair now recognizes the gentleman from Washington, Mr. Heck.

Mr. HECK. Thank you, Mr. Chairman. Director Watt, let me add my voice of congratulations to all those that have been expressed here today. Much deserved.

You had indicated in your written testimony, and it has been alluded to, that on the 22nd of December you approved a merger between the Federal Home Loan Banks of Seattle and Des Moines. I believe that is the first, is it not?

Mr. WATT. It is. Yes.

Mr. HECK. I am going to confidently predict it won't be the last. Mr. Lucas also referred to the concerns among many of us in Congress about the new membership rules, which I don't want to relitigate this but I want to state for the record—and you and I had a private—semi-private disagreement about this.

I think both FHFA and Congress are missing an opportunity here to take a step back and reexamine just exactly what the role of the Federal Home Loan Bank should be going forward.

Mr. WATT. To be clear, that is exactly what we are doing in this evaluation process. We received 1,300 comments. We are going through every single one of them before we make a final determination of what the final rule is. So we are in that, taking a step back, looking at all of the input that we have received.

Just because we put out a proposed rule, a proposed rule is not a final rule. So we are doing exactly what you suggest.

Mr. HECK. It is not the specific rule that I am focused on. It is the larger issue of what role do we want the Federal Home Loan Banks to play in this new world that doesn't look like it did when they were created in 1932 or thereabouts.

Mr. WATT. But Congress has made that determination. That is not a determination that I—

Mr. HECK. Which is exactly what you said to me earlier during our semi-private disagreement. I think it is something that you could do to advance to us policy proposals.

I also think that it is an issue that members of this committee could well take up and ask the basic questions. What role do we want them to play? Is it strictly housing, is it liquidity? Are there other ways that it can be constituted, given the way that the whole world—but that is not really my question.

I do have a question. My question does relate to the approved merger—again, which I don't believe will be the last. I had communicated to you in correspondence deep concerns held by people in the region about the continuing commitment of any merged regional bank to invest in housing.

I also communicated to you concerns about governance. And I also communicated to you concerns about operational issues because after all, Director Watt, this is a five time-zone Federal Home Loan Bank region now. And we have repeatedly asked for the letter setting forth the terms and conditions. We have been repeatedly told we cannot have it, we cannot know what those are.

I want you to know that as that relates to sensitive financial matters, I completely understand. But I do not know what compelling public policy good is served by withholding information about how we will proceed with respect to the concerns that had been brought to you by many in the region.

Mr. WATT. But during the pendency of a merger, for us to be putting out information that is still in the process of being discussed and negotiated, I think as an independent regulator would be irresponsible. I am sure every one of these things will be addressed.

But we have a fiduciary responsibility, we have a trust responsibility as regulator here not to put out information that could jeopardize the discussions. And I hope you understand that.

Mr. HECK. I acknowledge and embrace your fiduciary responsibility. Issues relating to housing investment and governance, and operational issues that allow for access I don't personally believe fall within that realm.

Mr. WATT. I can assure you that the merged Federal Home Loan Bank will be held to the same high standards on those issues that we have held the two independent banks to. So we are not going to relax the standard just because—the standards that we expect of them just because they are a merged bank. You can be assured of that.

Mr. HECK. Knowing you as I do, I would expect no less, sir, and I thank you.

One last quick question. Insofar as both Freddie Mac and Fannie Mae are under conservatorship, insofar as you are moving pretty quickly toward a common securitization platform, can you identify any compelling public benefit for these two entities other than it is status quo, to be separate as opposed to one?

Mr. WATT. That is a public debate that I think should be had. There is a value to competition because it makes both enterprises better. We have aligned Fannie and Freddie's practices on a number of issues that were important to the public policy objectives. But I think there is some value to allowing them to compete on things that don't have a public policy imperative to them.

But we have aligned them on a number of issues.

Mr. HECK. I would take it that quality of service would be an example of that.

Mr. WATT. If you talk to one of them as opposed to the other, they will tell you that their quality of service is higher than the other one, depending on which one you talk to. But it is important for them to continue to compete on the quality of the service that they deliver. That is one of the things that it is important for them to compete on—not on a race to the bottom to extend more and more irresponsible credit. There is a whole range of things that we don't want them competing on and there are some things that we continue to allow them to compete on.

Mr. HECK. So it seems arguable to me whether or not that benefit trumps the economies of scale, given that for all practical purposes we—but with that, I yield back the time I do not have and thank the Chair for his indulgence.

Chairman HENSARLING. The Chair now recognizes the gentleman from Arkansas, Mr. Hill.

Mr. HILL. Thank you, Mr. Chairman. Director Watt, once again, it is nice to see you. Thank you for appearing before the committee for an extended period of time.

I think back to one of my favorite engravings in the City of Washington, which is on the National Archives building: What is past is prologue. And so I am having a terrible flashback from a very, very bad movie listening to this discussion today.

In 1984, when I was a staffer over on the Senate Banking Committee staff, Fannie and Freddie had about one in 400 loans that were at a LTV of 3 percent. And when I came back to government in 1990 and was at the Treasury, that had moved to one in 10. And then at the height of the crisis it had moved to one in two-and-a-half, or 40 percent of the loans in their combined portfolios were at that low downpayment.

And at the same time, that same direction took place in the debt-to-income ratios as well. So I just want to be on record with you that I share the concerns of many on this committee about this decision to lower downpayment rates, notwithstanding counseling and FICO scores and mortgage insurance.

My question to you is, I want to turn back to a line of questioning that Mr. Duffy had on this subject of the preferred stock arrangement with Treasury. For you to accrue money for the Housing Trust Fund, pay it out potentially in the Housing Trust Fund, did you seek a waiver from the preferred stock arrangement with Treasury to do that?

Mr. WATT. No, I did not.

Mr. HILL. And so it is purely on your judgment that—from reading the statute that you have taken that money out of the system and not swept it to Treasury?

Mr. WATT. There is no money to sweep unless there is a profit at the end of the year, and there won't be any swept if there is not a profit.

Mr. HILL. Right, but you have made the decision to sweep money if there is a profit to the Housing Trust Fund.

Mr. WATT. You mean put into the—yes. Unless doing that would put them into a deficit situation.

Mr. HILL. But did you seek approval from Treasury to do that?

Mr. WATT. No.

Mr. HILL. And don't you think that since they are the owner of that preferred stock on behalf of all the taxpayers, you should have checked with them first before taking money to the Housing Trust Fund as opposed to sweeping all the profits to the Treasury?

Mr. WATT. No.

Mr. HILL. And tell me again—I know you have covered some of this ground before. Tell me again why you believe that is the case.

Mr. WATT. Why I should—

Mr. HILL. Why you believe you don't have—

Mr. WATT. Why I shouldn't get Treasury's approval?

Mr. HILL. Correct.

Mr. WATT. Because there is nothing in the preferred stock purchase agreement, under which we operate, that addresses the Housing Trust Fund. And so we are not violating the terms of the preferred stock purchase agreement in doing this. We are just simply complying with the law. So there is no reason for me to get Treasury's approval for that.

Mr. HILL. It just seems like when we own the shares of that company as the taxpayers that we should want to have all the proceeds until there is a change, a structural change made all the earnings of the company outside the core business operations, any profit that is left should be sent to the Treasury.

Mr. WATT. That is still the rule. And I keep reminding you, I wasn't there when these preferred stock purchase agreements were negotiated. If they had put it into the agreement then I would be obligated by it. But there is no provision in the agreement that requires me to get approval to fund the Housing Trust Fund, or to comply with any other law that is in existence. So I didn't get the approval.

Mr. HILL. But you were there and made the decision to take money away from the sweep and put it in the Housing Trust Fund. That was your decision to do that.

Mr. WATT. I made the decision to reverse the temporary termination of contributions to the Housing Trust Fund, yes. I was there for that.

Mr. HILL. Thank you very much. I yield back.

Chairman HENSARLING. The gentleman yields back. No other Member is in the room to be recognized. So again, I wish to thank Director Watt for coming to testify before us, our former colleague, and former and still current friend of this committee.

The Chair notes that some Members may have additional questions for this witness, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to this witness and to place his responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

This hearing stands adjourned.

[Whereupon, at 1:58 p.m., the hearing was adjourned.]

A P P E N D I X

January 27, 2015

Statement of Melvin L. Watt
Director, Federal Housing Finance Agency

Before the U.S. House of Representatives Committee on Financial Services

January 27, 2015

Chairman Hensarling, Ranking Member Waters and members of the Committee, thank you for inviting me to testify today about our work at the Federal Housing Finance Agency (FHFA) and for providing my first opportunity to return to this Committee since I left Congress.

FHFA was established by the Housing and Economic Recovery Act of 2008 (HERA) and is responsible for the effective supervision, regulation, and housing mission oversight of the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Federal Home Loan Bank System, which includes 12 Federal Home Loan Banks (FHLBanks) and the Office of Finance. FHFA's mission is to ensure that these regulated entities operate in a safe and sound manner and that they serve as a reliable source of liquidity and funding for housing finance and community investment. Since 2008, FHFA has also served as conservator of Fannie Mae and Freddie Mac (together, the Enterprises).

I am pleased to provide an overview of FHFA's statutory responsibilities and an update on the Enterprises' financial condition, FHFA's activities as regulator and conservator of the Enterprises, the FHLBanks' financial condition, and FHFA's regulatory activities as regulator of the FHLBanks.

<u>FHFA's Statutory Responsibilities</u>

I. FHFA's Regulatory Oversight of the Federal Home Loan Banks, Fannie Mae and Freddie Mac

The Federal Housing Enterprises Financial Safety and Soundness Act (the Safety and Soundness Act), as amended by HERA, requires FHFA to fulfill the following responsibilities in our oversight of the Federal Home Loan Bank System (FHLBank System) and the Enterprises:

(A) to oversee the prudential operations of each regulated entity; and

(B) to ensure that--

(i) each regulated entity operates in a safe and sound manner, including maintenance of adequate capital and internal controls;

(ii) the operations and activities of each regulated entity foster liquid, efficient, competitive, and resilient national housing finance markets (including activities relating to 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);

(iii) each regulated entity complies with this chapter and the rules, regulations, guidelines, and orders issued under this chapter and the authorizing statutes;

(iv) each regulated entity carries out its statutory mission only through activities that are authorized under and consistent with this chapter and the authorizing statutes; and

(v) the activities of each regulated entity and the manner in which such regulated entity is operated are consistent with the public interest.

12 U.S.C. § 4513(a)(1).

II. FHFA's Role as Conservator of Fannie Mae and Freddie Mac

Congress granted the Director of FHFA the discretionary authority in HERA to appoint FHFA as conservator or receiver of Fannie Mae, Freddie Mac, or any of the Federal Home Loan Banks, upon determining that specified criteria had been met. On September 6, 2008, FHFA exercised this authority to place Fannie Mae and Freddie Mac into conservatorships. Subsequently, Fannie Mae and Freddie Mac together received $187.5 billion in taxpayer support under the Senior Preferred Stock Purchase Agreements (PSPAs) executed with the U.S. Department of the Treasury. FHFA continues to oversee these conservatorships.

As conservator of the Enterprises, FHFA is mandated to:

(D) ...take such action as may be--

(i) necessary to put the regulated entity in a sound and solvent condition; and

(ii) appropriate to carry on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity.

12 U.S.C. § 4617(b)(2)(D).

As conservator, FHFA must also fulfill the responsibilities enumerated above in 12 U.S.C. § 4513(a)(1). Additionally, FHFA has a statutory responsibility under the Emergency Economic Stabilization Act of 2008 (EESA) to "implement a plan that seeks to maximize assistance for homeowners and use its authority to encourage the servicers of the underlying mortgages, and considering net present value to the taxpayer, to take advantage of...available programs to minimize foreclosures." 12 U.S.C. § 5220(b)(1).

My goal, as Director of FHFA since January 6, 2014, has been to lead FHFA in meeting the mandates assigned to it by statute until such time as Congress revises those mandates.

FHFA's Actions as Regulator and Conservator of Fannie Mae and Freddie Mac

As regulator and conservator of Fannie Mae and Freddie Mac, FHFA has taken consistent actions in the past year to ensure their safety and soundness, to ensure that they provide liquidity to the housing finance market, to preserve and conserve their assets, and to ensure that they meet their obligations to homeowners under EESA.

I. Financial Performance and Condition of Fannie Mae and Freddie Mac

Since the Enterprises were placed in conservatorship in 2008, their operations have stabilized and their financial performance has improved significantly. Fannie Mae has not made a draw under the PSPA since the fourth quarter of 2011, and Freddie Mac has not made a draw since the first quarter of 2012. Some of the improvement in the Enterprises' performance relates to one-time or transitory items, such as the reversal of each Enterprise's deferred tax asset valuation allowance, legal settlements, and the release of loan loss reserves as a result of rising house prices. Part of the improvement is also attributable to other factors, including responsible business practices, strengthened underwriting practices, rising house prices, and increased guarantee fees.

While steps taken in the conservatorships have helped stabilize the Enterprises' financial condition and the mortgage market, significant challenges remain. Serious delinquencies have declined but remain historically high compared to pre-crisis levels, and counterparty exposure remains a concern. While risks from the Enterprises' mortgage-related investment portfolios are declining as the size of their portfolios shrinks, revenues from these portfolios are also shrinking. Both Enterprises continue to work to maintain and improve the effectiveness and efficiency of their operational and information technology infrastructures. Additionally, under the terms of the PSPAs, the Enterprises do not have the ability to build capital internally while they remain in conservatorship. Attracting and retaining the best qualified workforce in this period in which the future of the Enterprises is uncertain also continues to be a challenge.

Other significant financial and performance highlights about the Enterprises include the following:

Fannie Mae

- For the first nine months of 2014, Fannie Mae reported earnings of $12.9 billion compared to net income of $77.5 billion for the first nine months of 2013, which reflected a number of one-time or transitory items. Calculations have not yet been completed for 2014 and, therefore, comparisons are being made here on the basis of three quarters.

- The cumulative amount of draws that Fannie Mae has received from the Treasury to date under its PSPA is $116.1 billion. Through September 30, 2014, Fannie Mae has paid $130.5 billion in cash dividends to Treasury on the company's senior preferred stock. Under the PSPA, dividends do not offset prior Treasury draws.

- The credit quality of new single-family acquisitions was strong through the third quarter of 2014, with a weighted average FICO score of 743 and a weighted average loan-to-value (LTV) ratio of 77 percent.

- The serious delinquency rate was 1.96 percent for Fannie Mae's total single-family book of business as of September 30, 2014. The serious delinquency rate for loans acquired between 2005 and 2008 was 8.27 percent compared to 0.34 percent for loans acquired since 2009 as of September 30, 2014. The serious delinquency rate for loans acquired prior to 2005 was 3.27 percent.

- Fannie Mae continues to reduce its retained portfolio in accordance with the PSPA. As of September 30, 2014, Fannie Mae's retained portfolio balance was $438.1 billion, which represents a decline of $52.6 billion since the beginning of the year, when the balance was $490.7 billion.

Freddie Mac

- For the first nine months of 2014, Freddie Mac reported earnings of $7.5 billion, compared to net income of $40.1 billion for the first nine months of 2013, which reflected a number of one-time or transitory items.

- The cumulative amount of draws that Freddie Mac has received from the Treasury to date under its PSPA is $71.3 billion. Through September 30, 2014, Freddie Mac has paid $88.2 billion in cash dividends to Treasury on the company's senior preferred stock. Under the PSPA, dividends do not offset prior Treasury draws.

- The credit quality of new single-family acquisitions remained high through the third quarter of 2014, with a weighted average FICO score of 744 and a weighted average LTV ratio of 77 percent.

- The serious delinquency rate was 1.96 percent for Freddie Mac's single-family book of business as of September 30, 2014. The serious delinquency rate for loans originated between 2005 and 2008 was 7.66 percent compared to 0.23 percent for loans originated since 2009 as of September 30, 2014. The serious delinquency rate for loans originated prior to 2005 was 3.12 percent.

- Freddie Mac continues to reduce its retained portfolio in accordance with the PSPA. As of September 30, 2014, Freddie Mac's retained portfolio balance was $413.6 billion, which represents a decline of $47.4 billion since the beginning of the year, when the balance was $461.0 billion.

II. FHFA's Supervisory Activities Related to the Enterprises

FHFA's supervision function evaluates the safety and soundness of the Enterprises' operations. Safety and soundness is a top priority in meeting FHFA's statutory obligations, in execution of Enterprise strategic initiatives and in all business and control functions. FHFA takes a risk-based approach to supervision, which prioritizes examination activities based on the risk a given practice poses to a regulated entity's safe and sound operation or its compliance with applicable laws and regulations. FHFA conducts on-site examinations at the regulated entities, ongoing risk analysis, and off-site review and surveillance. FHFA communicates supervisory standards to the regulated entities, establishes expectations for strong risk management, identifies risks, and requires remediation of identified deficiencies.

In 2014, FHFA issued supervisory guidance to the Enterprises on topics related to operational risk management, counterparty risk management, mortgage servicing transfers, cyber risk management, and liquidity risk management. This guidance articulates FHFA's supervisory expectations related to those matters and informs examination activities. Examples of important guidance issued during 2014 include the following:

Advisory Bulletin 2014-05, *Cyber Risk Management Guidance*, describes the characteristics of a cyber risk management program that FHFA believes will enable the regulated entities to successfully perform their responsibilities and protect their environments. FHFA's key expectations include Enterprise assessment of system vulnerabilities, effective monitoring of cyber risks, and oversight of third parties with access to Enterprise data.

Advisory Bulletin 2014-06, *Mortgage Servicing Transfers*, articulated FHFA's supervisory expectations for the Enterprises with regard to servicing transfers of mortgage loans that they hold or guarantee. Pursuant to contracts with their counterparties, the Enterprises must approve the transfer of servicing operations or servicing rights. FHFA has focused on Enterprise approval processes for these transactions due in large part to the significant recent transfers of mortgage servicing operations from federally-regulated banks to non-bank entities that are generally subject to less regulation and are more concentrated in their operations.

Advisory Bulletin 2014-07, *Oversight of Single Family Seller/Servicer Relationships*, articulated FHFA's requirement that the Enterprises assess financial, operational, and compliance risks associated with their counterparties and develop a risk management framework that can be applied throughout the Enterprise's contractual relationship with seller/servicers.

Standards set by FHFA are also reflected in guidance to our examiners, which is provided in FHFA's Examination Manual. The manual includes twenty-six modules that cover various Enterprise operations and provide background on a range of operational, credit, and market risks. The manual is a valuable tool for implementing FHFA's risk-based approach to supervision of the Enterprises and is available on FHFA's website.

FHFA maintains a team of examiners on-site at each Enterprise, and the examiners receive support from off-site analysts and subject matter experts. Examination teams perform targeted examinations of specific Enterprise operations and conduct ongoing monitoring of risk control functions and business lines. The examination work is performed in accordance with plans prepared annually for each Enterprise, taking into account factors such as analysis of existing risks, changes in business operations and strategic initiatives, and mortgage market developments. Where FHFA's Enterprise supervision team identifies deficiencies, examiners communicate expectations for remedial action. Examiner risk assessments are updated during the year to ensure that emerging risks and Enterprise business changes receive appropriate examination coverage.

Findings from targeted examinations and ongoing monitoring conducted through the course of the year are relied upon by examiners in assigning ratings to each Enterprise under the ratings system adopted by FHFA in 2013. The system, known as CAMELSO, includes separate ratings for Capital, Asset quality, Management, Earnings, Liquidity, Sensitivity to market risk, and Operations. The examination findings are also incorporated into annual Reports of Examination, which capture FHFA's view of the safety and soundness of each Enterprise's operations. Information from the Reports of Examination is included in FHFA's annual Report to Congress.

III. FHFA's Strategic Goals and Scorecard Objectives for the Conservatorships of Fannie Mae and Freddie Mac

During 2014, FHFA defined and worked to further the objectives included in the *2014 Strategic Plan for the Conservatorships of Fannie Mae and Freddie Mac* (2014 Conservatorship Strategic Plan) and the 2014 Conservatorship Scorecard.

FHFA has already published the *2015 Scorecard for Fannie Mae, Freddie Mac and Common Securitization Solutions* (2015 Conservatorship Scorecard), which details FHFA's conservatorship expectations for the Enterprises during 2015 and builds on last year's Scorecard. Both the 2014 and 2015 Conservatorship Scorecards are centered around three strategic goals.

A. MAINTAIN, in a safe and sound manner, credit availability and foreclosure prevention activities for new and refinanced mortgages to foster liquid, efficient, competitive, and resilient national housing finance markets

FHFA's first strategic goal, MAINTAIN, requires the Enterprises to support access to credit for single-family and multifamily mortgages, as well as foreclosure prevention activities. FHFA and the Enterprises have focused on a number of objectives under this strategic goal in the last year, including clarifying the Representation and Warranty Framework, providing targeted access to credit opportunities for creditworthy borrowers, working with small and rural lenders, implementing loan modification and REO strategies in hardest hit communities, and prioritizing affordable housing through multifamily loan purchases. In the 2015 Conservatorship Scorecard, FHFA also expressed an expectation that the Enterprises address other priorities, such as assessing the reliability of and the operational feasibility of using alternate or updated credit score models.

Representation and Warranty Framework

FHFA and the Enterprises made substantial progress on updating and clarifying the Representation and Warranty Framework (Framework) during 2014, and these efforts build on the agency's work over the last several years to refine the Framework. The Framework provides Fannie Mae and Freddie Mac with remedies – such as requiring a lender to repurchase a loan – when they discover that a loan purchase does not meet their underwriting guidelines. In updating and clarifying the Framework, FHFA's objectives are to continue to support safe and sound Enterprise operations, encourage lenders to reduce their credit overlays, and complement the agency's efforts to strengthen the Enterprises' quality control process.

FHFA prioritized providing greater clarity around the life-of-loan exclusions used in the Framework during 2014, and the Enterprises announced further improvements in this area on November 20, 2014. Specifically, those changes 1) limit repurchase requests under the life-of-loan exclusions to significant matters that impact the overall credit risk of the loan; 2) modify the life-of-loan exclusions for misrepresentations and data inaccuracies to incorporate a significance test; 3) clarify the requirements for requesting repurchase related to compliance with applicable laws and regulations; and 4) provide lenders a list of unacceptable mortgage products. The changes provide all parties with greater clarity about when the life-of-loan exemptions apply and when they do not. These revisions also maintain and support safe and sound Enterprise operations and are consistent with FHFA's broader efforts to ensure that the Enterprises' place more emphasis on upfront quality control reviews and other upfront risk management practices.

Earlier in 2014, FHFA and the Enterprises also announced other Framework refinements that included revising payment history requirements, providing written notification of repurchase relief to lenders, and eliminating automatic repurchases for mortgage insurance rescissions.

We also started efforts in 2014 to develop an independent dispute resolution program that could be used as a last step, in certain circumstances, to resolve disputes between lenders and the Enterprises. This would enable lenders to challenge a repurchase request by allowing them to request a neutral third party to determine whether there was a breach of the selling representations and warranties that justifies the repurchase request. Currently, FHFA and the Enterprises are engaged in outreach activities with a variety of lenders and dispute resolution providers to solicit their input on the initial design of the dispute resolution process. Under the 2015 Conservatorship Scorecard, FHFA expects the Enterprises to finalize these improvements to the Representation and Warranty Framework in 2015.

Providing Targeted Access to Credit Opportunities for Creditworthy Borrowers

On December 8, 2014, Fannie Mae and Freddie Mac announced purchase guidelines that enable creditworthy borrowers who meet stringent criteria and can afford a mortgage, but lack the resources to pay a substantial down payment plus closing costs, to get a mortgage with a three percent down payment. These purchase guidelines will provide an important – but targeted – access to credit opportunity for creditworthy individuals and families.

To appropriately manage the Enterprises' risk, the Enterprises' purchase guidelines emphasize strong underwriting standards and do not allow the kind of risk layering that occurred in the years leading up to the housing crisis. First, the purchase guidelines for these loans include compensating factors and risk mitigants – such as housing counseling, stronger credit histories, or lower debt-to-income ratios – to evaluate a borrower's creditworthiness. Second, like other loans purchased by the Enterprises, these loans must have full documentation and cannot include 40-year or interest-only terms. Third, 97 percent LTV loans must be fixed-rate and cannot have an adjustable rate. Fourth, the products will leverage the Enterprises' existing automated underwriting systems. Finally, like other loans with down payments below 20 percent, these loans require private capital credit enhancement, such as private mortgage insurance.

The Enterprises' purchase guidelines for the 97 percent LTV loan product provide a responsible approach to improving access to credit while also furthering safe and sound lending practices. The product focuses on first-time homebuyers and requires borrowers to be owner-occupants. Both Enterprises expect to purchase only a small amount of these loans each year compared to their overall loan purchase volume, and FHFA will be monitoring the ongoing performance of these loans.

Working with Small Lenders, Rural Lenders and Housing Finance Agencies
The Enterprises have also continued efforts to work with small lenders, rural lenders, and Housing Finance Agencies (HFAs) and to strengthen their understanding of how the Enterprises might be able to better serve these entities. This work is important because we know that community-based lenders and HFAs play a vital role in serving rural and underserved markets across the country.

In the first quarter of 2014, the Enterprises issued lender guidance clarifying a number of property and appraisal requirements for dwellings in small towns and rural areas. Further, as part of its ongoing effort to serve the affordable housing market and provide liquidity to small towns and rural areas, Fannie Mae revised its Selling Guide in September 2014 to allow for the delivery of Department of Housing and Urban Development (HUD)-guaranteed Section 184 mortgages and Department of Agriculture Rural Development (RD)-guaranteed Section 502 loans as standard instead of negotiated-only products. Fannie Mae also piloted expanded partnerships with county-level HFAs which go beyond its traditional state-level approach.

FHFA expects the Enterprises to continue outreach and initiatives with small lenders, rural lenders, and HFAs in 2015, including exploring the feasibility of purchasing a greater number of manufactured housing loans that are secured by real estate.

Loss Mitigation and Foreclosure Prevention Activities
Since entering conservatorship, the Enterprises have continued to focus on loss mitigation and borrower assistance activities. As of October 31, 2014, the Enterprises had conducted nearly 3.4 million foreclosure prevention actions since the start of the conservatorships in September 2008.

The 2015 Conservatorship Scorecard provides updated expectations for the Enterprises concerning their loss mitigation and foreclosure prevention activities. This includes expectations for the Enterprises to develop and execute strategies that reduce both the number of severely aged delinquent loans and the number of vacant real estate owned (REO) properties held by the Enterprises. These efforts will leverage and build on activities over the last year, including the Neighborhood Stabilization Initiative. Through this effort, FHFA has selected the City of Detroit and Cook County, IL for pilot programs. In these areas, the Enterprises have worked to improve outcomes in hardest hit markets through developing pre-foreclosure strategies, such as deeper loan modifications, and post-foreclosure strategies that address individual properties.

The 2015 Conservatorship Scorecard expectation that the Enterprises reduce the number of seriously delinquent loans they hold will also draw upon recent experience with non-performing loan (NPLs) sales. FHFA's expectation is that the sale of seriously delinquent loans through NPL sales will result in more favorable outcomes for borrowers, while also reducing losses to the Enterprises and, therefore, to taxpayers. In 2014, Freddie Mac conducted a pilot sale of loans serviced by Bank of America that were, on average, more than three years delinquent at the time of sale. In addition, FHFA is working with both Enterprises to develop additional guidelines for ongoing NPL sales by the Enterprises, with a focus on guidelines that provide more favorable outcomes for borrowers, avoid foreclosure wherever possible and require post-sale reporting to track borrower outcomes. FHFA and the Enterprises plan to release further information about these NPL sale guidelines in early 2015.

FHFA also expects the Enterprises to continue targeted outreach activities to increase consumer awareness of the Home Affordable Refinance Program (HARP). Many borrowers could benefit from the HARP program, but may not fully understand the benefits or that they qualify. In addition, FHFA expects the Enterprises to continue refining and improving other loss mitigation and foreclosure prevention strategies. In 2014, Enterprise activities in this area included expanding the Streamlined Modification program, which addresses documentation challenges associated with traditional modifications, to include deeply delinquent loans. Moving forward, FHFA will continue to review loss mitigation options to help families stay in their homes, stabilize communities, and meet our conservatorship and EESA obligations.

Multifamily

For individuals and families who rent rather than buy, continuing to support affordable rental housing is also an ongoing priority for FHFA and the Enterprises. Fannie Mae and Freddie Mac have historically played a key role in providing financing to the multifamily housing finance market throughout all market cycles and their multifamily portfolios demonstrated strong performance even through the financial crisis.

FHFA's 2015 Conservatorship Scorecard requires each Enterprise to continue multifamily purchases, but not to exceed a volume cap of $30 billion each for these purchases. This continues the approach taken in the 2014 Conservatorship Scorecard. FHFA has also continued to emphasize the Enterprises' critical role in the affordable rental housing market by allowing the Enterprises to provide financing for affordable multifamily properties beyond the volume cap. Through this approach, the focus is to support the financing of affordable housing and the housing needs of people in rural and other underserved areas, including areas that rely heavily on manufactured housing.

On multifamily purchases, we are also requiring the companies to continue to share risk with the private sector, which Freddie Mac does through a capital markets structure and Fannie Mae does through a risk sharing model. Both approaches transfer significant risk in the multifamily business to the private market.

B. REDUCE taxpayer risk through increasing the role of private capital in the mortgage market

FHFA's second strategic goal, REDUCE, is focused on ways to bring additional private capital into the system in order to reduce taxpayer risk. This strategic goal, and the related expectations in the 2015 Conservatorship Scorecard, requires the Enterprises to reduce Fannie Mae and Freddie Mac's overall risk exposure. FHFA's objectives include ongoing requirements for the Enterprises to conduct single-family credit risk transfers, reduce each Enterprises' retained portfolio, and update private mortgage insurance eligibility requirements.

Credit Risk Transfers

FHFA and the Enterprises remain focused on increasing the amount of credit risk transferred from the Enterprises. FHFA increased the targeted levels of single-family credit risk transfers in 2014 and 2015. FHFA increased the 2014 Conservatorship Scorecard target to achieve a meaningful credit risk transfer of $90 billion in unpaid principal balance (UPB), up from $30 billion in 2013. In the 2015 Conservatorship Scorecard, FHFA increased these targets to $150 billion of UPB for Fannie Mae and $120 billion of UPB for Freddie Mac, subject to market conditions. In meeting these thresholds, FHFA will continue to expect each Enterprise to execute a minimum of two different types of credit risk transfer transactions, which includes securities-based transactions and insurance transactions. Additionally, FHFA expects all activities undertaken in fulfillment of these objectives to be conducted in a manner consistent with safety and soundness.

During 2014, the Enterprises executed credit risk transfers on single-family mortgages with a combined unpaid principal balance of over $300 billion. In each transaction, the Enterprises retained a small first-loss position in the underlying loans, sold a significant portion of the risk beyond the initial loss and then retained the catastrophic risk in the event losses exceeded the private capital support. As a result, private capital is absorbing significant credit risk on much of Fannie Mae and Freddie Mac's new purchases, thereby substantially reducing risk to taxpayers from these purchases. Both Enterprises will also continue to utilize and test different risk transfer structures.

Retained Portfolio Reductions

Both Enterprises continue to reduce the size of their retained mortgage portfolios consistent with the terms of the PSPAs, which require them to reduce their portfolios to no more than $250 billion each by 2018. Both Fannie Mae and Freddie Mac have developed plans to meet this target even under adverse market conditions. As their portfolios continue to decline, they are transferring interest rate risk, credit risk on securities and liquidity risk from these portfolios to the private sector. As of September 30, 2014, Freddie Mac's portfolio stood at $414 billion, and Fannie Mae's at $438 billion.

Under the 2015 Conservatorship Scorecard, FHFA is requiring the Enterprises to implement their approved retained portfolio reduction plans in order to meet the PSPA requirements. FHFA's guidelines require the Enterprises to implement these plans even under adverse market conditions while taking into consideration the impacts to the market, borrowers, and neighborhood stability.

Private Mortgage Insurer Eligibility Requirements
FHFA has continued to advance efforts to strengthen Fannie Mae and Freddie Mac's counterparty requirements for private mortgage insurers. When a borrower makes a down payment of less than 20 percent, these mortgages are required by statute to have a credit enhancement – private capital standing behind the loan – in order to qualify for purchase by the Enterprises. Private mortgage insurance has always played an important role in meeting this requirement and it is critical to make sure that private mortgage insurers are able to cover claims both in good times and in bad times. To this end, in 2014 FHFA released a Request for Input on draft Private Mortgage Insurer Eligibility Requirements. Our objective is to have the Enterprises strengthen their risk management by enhancing the financial, business, and operational requirements in place for their private mortgage insurer counterparties, thereby enhancing mortgage insurers' ability to pay claims over the long-term.

FHFA is in the process of reviewing and considering the public input we received as part of our comprehensive evaluation of this issue. Consistent with our statutory mandates, our assessments and policy decisions will take into account both safety and soundness considerations and potential impacts on access to credit and housing finance market liquidity.

C. BUILD a new single-family securitization infrastructure for use by the Enterprises and adaptable for use by other participants in the secondary market in the future

FHFA's final strategic goal is to BUILD a new infrastructure for the Enterprises' securitization functions. This includes ongoing work to develop the Common Securitization Platform (CSP) infrastructure and to improve the liquidity of Enterprise securities. FHFA has established that FHFA's first objective for the CSP is to make sure that it works for the benefit of Fannie Mae and Freddie Mac. We are also requiring that the CSP leverage the systems, software and standards used in the private sector wherever possible, which will ensure that the CSP will be adaptable for use by other secondary market actors – including private-label securities issuers – in the future. In addition, FHFA has worked with the Enterprises to leverage the CSP in order to develop a Single Security, which we believe will improve liquidity in the housing finance markets. FHFA and the Enterprises have made significant progress on both the CSP and the Single Security in the past year, and we expect the Enterprises to continue moving aggressively on these multiyear initiatives in 2015.

Common Securitization Platform
The Enterprises made important progress during 2014 in establishing the organizational infrastructure for the CSP. This includes the announcement of a Chief Executive Officer for Common Securitization Solutions (CSS) – the entity that we expect to house and operate the CSP.

In addition, FHFA and the Enterprises made considerable progress on the design-and-build phase of the CSP. Each Enterprise has designated staff to work on the project at the CSS location, and this team has been developing the technology and infrastructure of the CSP platform during the last year. This includes work to incorporate the Single Security into the development of the CSP. Furthermore, Fannie Mae and Freddie Mac have reorganized their staffs with business operations and information technology experts to develop the systems and processes needed to integrate with the CSP. As this work continues, Fannie Mae and Freddie Mac staff will engage in continuous testing and will develop operating policies and procedures to ensure a smooth transition to the CSP. FHFA, Fannie Mae, and Freddie Mac are committed to achieving a seamless CSP launch, and the actions taken so far are moving us in the right direction toward this multiyear goal.

Single Security
FHFA's top priority in pursuing the Single Security is to deepen and strengthen liquidity in the housing finance markets. In today's market, the mortgage-backed securities issued by Fannie Mae and Freddie Mac trade in separate "to-be-announced" (TBA) markets. The forward-trading that takes place in TBA securities allows borrowers to lock in a mortgage rate. The TBA market also adds efficiencies to the process, which reduce transaction costs and result in lower mortgage rates for borrowers. In today's TBA market, there is a price disparity between Fannie Mae and Freddie Mac securities largely due to greater trading volumes of Fannie Mae securities. This price disparity imposes an additional cost on Freddie Mac – and therefore on taxpayers. We believe that a Single Security can further strengthen market liquidity by reducing the trading disparities between Fannie Mae and Freddie Mac securities.

FHFA issued a Request for Input on FHFA's proposed Single Security structure last year as the first step in a multiyear process. FHFA is working with the Enterprises to process the feedback we received and will move forward in a deliberative and transparent manner. FHFA will release a Progress Report on this initiative in the coming months. As part of the 2015 Conservatorship Scorecard, FHFA established the expectation that the Enterprises would finalize the Single Security structure during 2015 and would begin the process of developing a plan to implement the Single Security in the market. This remains a multiyear process, but we made significant progress during 2014.

IV. Additional Matters and Initiatives Impacting Fannie Mae and Freddie Mac

In addition to the activities outlined above, FHFA continues to work on a number of other matters and initiatives that impact Fannie Mae and Freddie Mac, several of which are highlighted below.

Guarantee Fees

One of the first decisions I made as Director of FHFA was to suspend increases in guarantee fees that had been announced by FHFA in December of 2013. Given the impact of these fees on the Enterprises, the housing finance markets, and on borrowers, I believed that it was critical to do further evaluation and to get feedback from stakeholders. After additional assessment at FHFA, we issued a Request for Input that provided further details on how the Enterprises set these fees and posed a number of questions to prompt substantive feedback about how guarantee fee levels affect various aspects of the mortgage market.

FHFA is now reviewing and considering the input we received as part of our comprehensive evaluation of this issue. Consistent with our statutory mandates, our assessments and policy decisions will take into account both safety and soundness and possible impacts on access to credit and housing finance market liquidity.

Fannie Mae and Freddie Mac Housing Goals

On August 29, 2014, FHFA issued a proposed rule to set the Enterprises' housing goals for 2015 through 2017 for both single-family and multifamily loan purchases. FHFA's proposed rule raised questions for public comment about how best to set Fannie Mae and Freddie Mac's housing goals to encourage responsible lending that is done in a safe and sound manner and that also serves the single-family and rental housing needs of lower-income families as required in HERA. FHFA is in the process of evaluating comments submitted to the agency and finalizing the rule.

Housing Trust Fund and Capital Magnet Fund

Last month, FHFA directed Fannie Mae and Freddie Mac to begin setting aside funds to be allocated to the Housing Trust Fund and the Capital Magnet Fund pursuant to HERA. The statute authorized FHFA to temporarily suspend these allocations, and FHFA informed Fannie Mae and Freddie Mac of a temporary suspension on November 13, 2008. In letters sent to the Enterprises on December 11, 2014, FHFA notified Fannie Mae and Freddie Mac of the agency's decision to reverse the temporary suspension. These letters, copies of which were provided to Members of Congress who had communicated views to FHFA about whether or not the temporary suspension should continue, established prudent safeguards in the event of adverse changes in the Enterprises' financial condition or draws under the PSPAs.

Certain Super Priority Lien Programs and Risk to the Enterprises
During 2014, FHFA has continued to monitor and assess two areas of state-level actions that threaten the legal priority of single-family loans owned or guaranteed by Fannie Mae and Freddie Mac: 1) through certain energy retrofit financing programs structured as tax assessments and 2) through granting priority rights in foreclosure proceedings for homeowner associations.

While FHFA is not opposed to energy retrofit financing programs that allow homeowners to improve energy efficiency, these programs must be structured to ensure protection of the core financing for the home and, therefore, cannot undermine the first-lien status of Fannie Mae and Freddie Mac mortgages. Concerning certain energy retrofit financing programs, such as first-lien Property Assessed Clean Energy (PACE) programs, FHFA has reiterated that Fannie Mae and Freddie Mac's policies prohibit the purchase of a mortgage on property that has a first-lien PACE loan attached to it. This restriction has two potential implications for borrowers. First, a homeowner with a first-lien PACE loan cannot refinance their existing mortgage with a Fannie Mae or Freddie Mac mortgage. Second, anyone wanting to buy a home that already has a first-lien PACE loan cannot use a Fannie Mae or Freddie Mac loan for the purchase. In addition to aggressive enforcement of these existing policies, FHFA is continuing to evaluate or explore other possible remedies and legal actions to protect the Enterprises' lien position.

Additionally, FHFA has taken legal action in some instances in which unpaid homeowners association dues may be deemed under the laws of a state to be senior to preexisting mortgage liens owned or guaranteed by Fannie Mae or Freddie Mac on a homeowner's property. As conservator, FHFA has an obligation to protect Fannie Mae's and Freddie Mac's rights, and will aggressively do so.

FHFA's Actions as Regulator of the Federal Home Loan Banks

The FHLBanks continue to play an important role in housing finance by providing a reliable funding source and other services to member institutions, including smaller institutions that would otherwise have limited access to these services. In addition, the FHLBanks have specific statutory requirements related to affordable housing and, as a result, the FHLBanks annually contribute substantially toward the development of affordable housing.

I. Financial Performance and Condition of the Federal Home Loan Banks

The financial performance and condition of the FHLBank System remain strong. Led by growth in advances, the aggregate balance sheet of the FHLBanks has increased over the past two years, but remains considerably smaller than in peak years. Advances totaled $545 billion as the end of the third quarter of 2014, up from $499 billion at year-end 2013, but down approximately 50 percent from a peak of $1.01 trillion in the third quarter of 2008. The overall decline in advance volume from the peak is a result of increased market liquidity from deposits and sluggish economic growth.

Following are highlights of the financial performance of the FHLBanks:

- The FHLBanks, in aggregate, reported net income of $1.7 billion for the first three quarters of 2014 after earning $1.8 billion in the first three quarters of 2013. All twelve FHLBanks were profitable during these quarters.
- The FHLBanks saw substantial asset growth during the first nine months of 2014, driven by advances to members. As of the end of the third quarter of 2014, aggregate FHLBank assets totaled $883 billion and $545 billion in advances – up from $835 billion and $499 billion at the end of 2013. Advances constituted 62 percent of assets at the FHLBanks in aggregate at the end of the third quarter of 2014, up from 60 percent at the end of 2013.
- Retained earnings have grown significantly in recent years and totaled $13.0 billion, or 1.5 percent of assets, as of the third quarter of 2014.
- Also at the end of the third quarter of 2014, the FHLBanks had an aggregate regulatory capital ratio of 5.6 percent – comfortably above the statutory minimum of 4.0 percent.
- All FHLBanks had net asset values (equity values) in excess of the par value of their members' stock holdings. The market value of the FHLBanks was 142 percent of the par value of capital stock as of the third quarter of 2014, the highest ratio since FHFA started tracking this metric in 2002.

II. FHFA's Supervisory and Regulatory Activities Related to the FHLBanks

FHFA conducts annual safety and soundness and affordable housing program examinations of all 12 FHLBanks and the Office of Finance based on well-defined supervisory strategies. Similar to the approach utilized in supervision of the Enterprises, FHFA uses a risk-based approach to conducting supervisory examinations of the FHLBanks, which prioritizes examination activities based on the risks given practices pose to a regulated entity's safe and sound operations or to its compliance with applicable laws and regulations. FHFA's FHLBank supervision also utilizes the CAMELSO ratings system and incorporates these ratings into each FHLBanks' Report of Examination. Information from the Reports of Examination is included in FHFA's annual Report to Congress.

Over the last few years, FHFA's supervisory work has included assessments of FHLBank mortgage purchase programs, the substantial increase in advances to a few very large member institutions, the FHLBanks' changing capital composition in light of their increasing retained earnings and reduced activity stock requirements, and their management of unsecured credit. We are also currently conducting reviews of FHLBank enterprise risk management structures and approaches to vendor management.

FHFA also provides the FHLBanks supervisory guidance in the form of Advisory Bulletins that outline the agency's regulatory expectations. In 2014, FHFA issued Advisory Bulletins 2014-02, *Operational Risk Management*, and 2014-05, *Cyber Risk Management*. Other Advisory Bulletins applicable to the FHLBanks covered areas such as model risk management, collateral valuation and management, and the classification of risky assets.

FHFA's supervision of the FHLBanks' expanding mortgage programs involves oversight of the operational issues raised by two new products – Mortgage Partner Finance (MPF) Direct and MPF Government MBS. The FHLBank of Chicago expects to begin offering these new products in early 2015, although this could change. Under MPF Direct, participating members may sell non-conforming and conforming, single-family, fixed-rate mortgage loans to the Chicago FHLBank, which would concurrently sell the loans to a third-party private investor that would accumulate the loans for securitization. The Chicago FHLBank expects, at least initially, that loans sold would be "jumbo conforming" loans capped at $729,750 for a single unit in the contiguous United States.

Under the MPF Government MBS program, the Chicago FHLBank would purchase government guaranteed or insured loans, accumulate the loans on its balance sheet as held for sale, and pool the loans in securities guaranteed by the Government National Mortgage Association (Ginnie Mae). The Chicago FHLBank would then sell the securities to other FHLBanks, members approved to participate in the mortgage programs, and external investors.

The mission focus of the FHLBank System is an important component of FHFA's regulatory activities. FHFA has undertaken three recent efforts related to the housing finance mission of the FHLBanks. First, in September 2014, FHFA released a proposed rulemaking involving membership requirements for the FHLBanks. Congress established the FHLBank System in 1932 as a government sponsored enterprise with a focus on housing finance. Over time, Congress has expanded the membership base, expanded the types of assets that are eligible collateral for advances, and made other incremental changes to the System. However, over eighty years later, the FHLBanks are still grounded in supporting housing finance.

Under the current membership rule, institutions may gain access to the benefits of FHLBank membership by meeting a one-time test showing the minimum required housing finance assets at the time of application. FHFA has proposed eliminating this one-time test and, instead, requiring that FHLBank members maintain a minimum amount of housing finance assets on an ongoing basis. In addition, FHFA has proposed defining an insurance company in such a way that captive insurers would no longer be eligible for FHLBank membership. A captive insurance company provides benefits only for its parent company, which itself is often not eligible for FHLBank membership. While captive insurers may in some cases be involved in housing finance, allowing them to have access to the FHLBank System raises a number of policy issues that are discussed in the proposed rule.

The comment period for this proposed rule ended on January 12, 2015, and we received approximately 1,300 comments. FHFA is in the process of reviewing and considering these comments. As I have consistently emphasized since becoming Director of FHFA, getting input and feedback from stakeholders is a crucial part of FHFA's policymaking process, and we will carefully consider comments made by members of this Committee as well as the public in determining our final rule.

Second, FHFA has been in continued dialogue with the FHLBanks about "core mission assets." This also relates to the fundamental issue of how the FHLBanks use the benefits of their government-sponsored status to support their housing finance and community investment mission. In partnership with the FHLBanks, I believe we are making progress in developing a framework to describe the fundamental characteristics of what a FHLBank's balance sheet should look like in order to demonstrate a satisfactory mission commitment.

FHFA's third ongoing effort related to the mission of FHLBanks is a review of FHFA's Affordable Housing Program (AHP) regulation. The AHP program provides funding for both single-family and rental affordable housing -- including housing affordable to very low-income individuals and families. In 2013, the FHLBanks allocated $297 million to their AHPs for the purchase, construction, or rehabilitation of over 37,800 housing units. FHFA is committed to working with the FHLBanks to make this program more efficient by reviewing, and possibly updating, our AHP regulation.

A new area of FHFA's recent regulatory work has involved the merger of the FHLBanks of Des Moines and Seattle, which would be the first merger ever of two FHLBanks. There has been considerable change in our nation's financial system, in the membership base of the FHLBanks, and in market conditions across the various FHLBank districts since the FHLBank System was established in 1932. As a result, the FHLBanks have seen changes in advance demand and membership composition which, in turn, has affected the fundamental franchise values of some of the FHLBanks.

These changes, in part, have led the Boards of Directors of the FHLBank of Des Moines and the FHLBank of Seattle to determine that a combined entity would better serve the needs of their members. The Boards of both FHLBanks voted to approve their merger on September 25, 2014. FHFA reviewed and evaluated the merger application submitted by the FHLBanks of Des

Moines and Seattle to ensure that the merger would be accomplished in a safe and sound manner and would result in a financially strong FHLBank that supports the interests of all its members. FHFA issued an approval of the merger application on December 22, 2014, contingent upon the members of both FHLBanks ratifying the merger and meeting other specified conditions. If ratified, the merger could be finalized as early as the second quarter of 2015.

Conclusion

While I have not focused in my statement on administrative matters at FHFA, I would be remiss if I did not point out that none of the activities or initiatives described in this statement would be possible without the dedication of the staff at the Federal Housing Finance Agency. Since I became Director at FHFA last year, it has been a pleasure getting to know the very qualified staff at FHFA and working with them to reevaluate and pursue FHFA's priorities. I thank them for their service. I also want to recognize the hard work of the boards, management and staffs of Fannie Mae, Freddie Mac and the FHLBanks, who continue to restore and provide critical contributions to our nation's housing finance system.

In the coming year, FHFA will continue to work to meet the agency's statutory mandates to ensure the safe and sound operations of our regulated entities and to ensure that they provide liquidity in the national housing finance market. In addition, FHFA will continue to advance its Office of Minority and Women Inclusion responsibilities, which include furthering diversity in management, employment and business activities at FHFA, as well as at our regulated entities.

Thank you again for having me here this morning, and I look forward to answering your questions.

CUNA
Credit Union National Association

Jim Nussle
President & CEO

601 Pennsylvania Ave., NW
South Building, Suite 600
Washington D.C. 20004-2601

Phone: 202-508-6745
Fax: 202-638-7734
jnussle@cuna.coop

January 26, 2015

Chairman Jeb Hensarling
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

Ranking Member Maxine Waters
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Hensarling and Ranking Member Waters:

On behalf of the Credit Union National Association (CUNA), I am writing in advance of the hearing entitled "Sustainable Housing Finance: An Update from the Director of the Federal Housing Finance Agency (FHFA)" to be held in the Financial Services Committee on January 27, 2015. CUNA is the largest credit union advocacy organization in the United States, representing 6,500 state and federally chartered credit unions and their 102 million members. I ask that this letter and its attachment be included in the record of the hearing.

On September 2, 2014, FHFA proposed regulatory changes to the Federal Home Loan Bank (FHLB) membership rules. These proposed changes would represent a fundamental change to the FHLB system, and CUNA questions the need for any change in FHLB membership for depository institutions at this time. We are particularly concerned that the proposal would apply membership eligibility rules on an ongoing basis, creating uncertainty for Federal Home Loan Bank members and establishing different treatment for similarly sized credit unions and banks. Our comment letter, which is attached, identifies in detail our concerns with the proposal.

We urge the Committee to use tomorrow's hearing as an opportunity to encourage FHFA to withdraw or substantially revise the proposal, including correcting the proposal's disparate treatment of similarly sized banks and credit unions.

On behalf of America's credit unions and their 102 million members, we thank the Committee for holding this hearing and look forward to working with you further on this important issue.

Sincerely,

Jim Nussle
President & CEO

CUNA
Credit Union National Association

601 Pennsylvania Ave., NW
South Building, Suite 600
Washington D.C. 20004-2601

Phone: 202-638-5777
Fax: 202-638-7734

January 12, 2015

Mr. Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
400 7th St. SW, Eighth Floor
Washington, DC 20024

Re: Comments on Proposed Changes to Federal Home Loan Bank Membership Requirements/RIN 2590-AA39

Dear Mr. Pollard:

The Credit Union National Association (CUNA) appreciates the opportunity to submit comments to the Federal Housing Finance Agency (FHFA) regarding its proposal on membership requirements for Federal Home Loan Banks (FHLBs). By way of background, CUNA is the country's largest credit union advocacy organization, representing our nation's state and federal credit unions, which serve over 100 million memberships from around the country.

Summary of CUNA's Comments

CUNA is adamantly opposed to the proposed regulation and urges FHFA to withdraw it. We do not believe the proposed changes are warranted or required to meet statutory requirements. Moreover, we do not believe the agency has provided sufficient analysis as to why the proposed membership requirements are needed. Most important, we are concerned the proposal would require FHLB-member credit unions to make business decisions that may not be in their members' overall best interests. If this proposal does move forward, at a minimum, we urge FHFA to correct the disparate treatment between banks and credit unions as discussed in this letter.

The proposal would require all financial institutions that are FHLB members to hold one percent of their assets in "home mortgage loans" on an ongoing basis. The proposed regulation suggests that FHFA is considering raising this requirement to as high as five percent in the future. While financial institutions currently must meet a one percent-of-assets threshold to become FHLB members, there is no current requirement that FHLB members must maintain the threshold.

All FHLB-member credit unions—but only certain FHLB-member banks—would also be required to hold 10% of assets in "residential mortgage loans" on an ongoing basis. As with the one percent test, the 10%-of-assets threshold would have to be met by the institution in order to become a FHLB member, but there is no requirement now that members must ensure the threshold level is continued in order to remain a member. By statute, for initial membership, the Federal Home Loan Bank Act exempts from the "10 percent" requirement any "community financial institution" or "CFI," defined as FDIC-insured banks with less than $1 billion in average total assets (adjusted annually for inflation) over the preceding three years. Under the proposal, FHFA has decided to maintain the "CFI" exemption without any variation. As a result, no credit union can be considered a "community financial institutions" for purposes of maintaining membership if the rule is adopted as proposed. If this proposal does move forward, at a minimum we urge FHFA to correct the disparate treatment between banks and credit unions.

The Proposed Regulation is Unnecessary, as Financial Institutions are Engaging in Sufficient Mission-Related Lending Under Current Rules

The research and data FHFA provided in the preamble to this proposal show that the vast majority of FHLB members – roughly 98 percent – already comply with the proposed requirement to hold at least 10 percent of assets in "residential mortgage loans" on an ongoing basis. For the remaining two percent, roughly half have more than 9 percent of their assets in mortgages. However, if the proposal is adopted, rather than allowing a commitment to housing to develop organically in the normal course of business, the proposal would require credit unions to constantly monitor their mortgage loan levels and face the loss of FHLB membership if they fail to maintain lending levels that are not required by law.

We believe the existing FHLB structure is sufficient to ensure mission-related lending is always a major priority for member financial institutions. Each credit union must buy stock in the FHLBs, meet the 1% and 10% requirements at the time the institution initially seeks membership, provide "eligible collateral" related to housing when it seeks an advance from its FHLB, and be subject to random selection every two years by FHFA to complete a Community Support Statement.

This structure creates a natural check and balance: if a FHLB member does not make sufficient mission-related loans, or hold sufficient mission-related assets, it will not have collateral to pledge. Further borrowing will not be allowed until that collateral is available. This existing structure does not require on-going tracking, artificial asset tests, and does not create balance sheet management stress for financial institutions, yet still achieves FHFA's overall objective of promoting mission-related lending.

We recognize FHFA has an interest in ensuring that FHLB members maintain a commitment to housing finance. However, we do not believe that this proposal is necessary to achieve that objective, especially since the agency has not demonstrated that the proposed changes are warranted in light of the results the current system has produced.

The Proposal Could Cause Unintended Harm to Credit Unions, the FHLB System, and the Housing Market

There is no way to know with precision what the impact of the proposal would be, and the agency has not provided sufficient analysis regarding the proposal's impact. Our preliminary analysis leads us to conclude that the proposal would have numerous unintended consequences for credit unions, the FHLB System, housing finance and communities.

A. The Proposal Would Require Credit Unions to Needlessly Alter Business Practices

This proposal would create major compliance responsibilities for credit unions, which will be forced to maintain a close watch over their balance sheets to ensure they meet an arbitrary asset requirement on an ongoing basis. Because credit unions will need to continually monitor the amount of assets directed to housing, the regulation would artificially distort balance sheet management practices. The proposal would decrease the flexibility of credit unions to manage their assets and liabilities in response to changing market conditions.

B. The Proposal Would Harm the FHLB Stem and Result in Higher Cost Mortgages

The on-going asset tracking that would result under the proposal would also add regulatory burdens for the Federal Home Loan Banks. Under the proposal, each FHLB would be responsible for ensuring that its members are in compliance with these arbitrary asset thresholds. The FHLB would terminate financial institutions that do not comply. This would change the nature of the relationship between each financial institution and its FHLB from one of cooperation to one of enforcement. More to the point, the compliance costs of each FHLB will undoubtedly be passed along to the financial institutions that borrow from the system. The end result will be higher costs of credit for consumers. Given the still fragile state of the American housing sector, now is not the time to impose further (and unnecessary) hurdles and higher costs on mortgage and housing related lending. This proposal could also cause communities across the country and the housing market to suffer. That is because the net effect of the proposal could be to restrict access to mortgage credit for consumers because access to the low-cost sources of funding provided by the FHLBs for credit unions could be jeopardized.

Uncertainty over a financial institution's continued membership eligibility would harm the entire Federal Home Loan Bank System. The FHLB system requires the purchase of stock by member financial institutions. However, institutions that are unable to meet ongoing requirements will need to redeem their stock. A large number of redemptions at a particular FHLB could change the capital structure at an individual FHLB, potentially destabilizing the bank. In turn, because the FHLB System is joint and several, this could have negative consequences for the entire FHLB System.

This outcome could have important implications regarding the desirability of the FHLB system as a source of liquidity for financial institutions. The possibility that FHLB members may fall in and out of membership—and in and out of their stock contribution—could cause the entire FHLB system to be viewed by the prudential regulators as less stable and reliable. This is not an academic conclusion; our own recent experience with the National Credit Union Administration confirms this is what will happen if FHFA adopts this rule. Credit unions fought for FHLBs to be included as sources of emergency liquidity for credit unions. However, NCUA's emergency liquidity rule, finalized at the end of 2013, did not allow FHLBs to be seen as an acceptable source—precisely because the agency saw them as too uncertain.

C. The Proposal Could Curtail Credit Union Mergers

CUNA is also concerned about the rule's potential impact on credit union mergers. Because the rule proposes arbitrary tests based on an institution's balance sheet for maintaining FHLB membership, credit unions that do not issue mortgages or own mortgage-related assets may be seen as undesirable merger partners for credit unions that are FHLB members—especially if the acquiring institution is close to the asset thresholds. Even though a merger may allow a financial institution to increase its commitment to mortgage finance in the long run, the proposal has the potential to stifle consolidation that would have benefitted credit union members.

The Proposed Regulation is Inconsistent With Other Federal Financial Regulations, and Puts the Safety and Soundness of Financial Institutions at Risk

We note that the philosophy behind this proposed regulation seems fundamentally at odds with regulations from other agencies. NCUA's proposed risk based capital rule and the Basel III-based capital rules for banks both limit concentration in specific asset classes. Here, FHFA is *requiring* concentration in residential mortgages.

While FHLB-member credit unions would presumably retain more than 10 percent of their balance sheets in residential mortgage-related assets in any case—given that over 32 percent of aggregate credit union assets are in first or second mortgages—we think that individual FHLB-member credit unions should have the flexibility to dip below the 10 percent asset threshold without penalty if doing so is necessary for safe-and-sound asset and liability management purposes.

If this Proposal Proceeds, FHFA Must Correct the Unfair and Discriminatory Treatment Between Banks and Credit Unions

If there is going to be a regulation, FHFA should at least provide parity so that community banks and credit unions are treated equally for purposes of maintaining membership. While the FHLB Act does not allow credit unions to be considered "Community Financial Institutions" for purposes of securing FHLB membership, Congress has provided sufficient flexibility to FHFA in setting the requirements for maintaining membership to address this concern. All credit unions should be treated as CFIs for purposes of maintaining FHLB membership.

Conclusion

We urge FHFA to consider the uncertain but likely consequences that could flow from this proposal, and we believe that if the agency does so, it will conclude that it must withdraw the proposal. As then-Chairman Barney Frank of the House Financial Services Committee noted when FHFA first put out an Advance Notice of Proposed Rulemaking (ANPR) on this topic more than four years ago,

> [E]xisting regulations seem to me to be functioning properly, [and] I do not see a reason to change them now. As the FHFA notes in the ANPR, it does not have any evidence that significant numbers of members that were required to hold 10 percent of their total assets in residential mortgage loans in order to join the [FHLB] system have substantially reduced their holdings after becoming members ... The FHLB system plays an important role in helping to provide liquidity in the financial system, and I believe that changes to the membership requirements could have the unintended consequence of disrupting the stability of the FHLB system while our economy is still struggling.

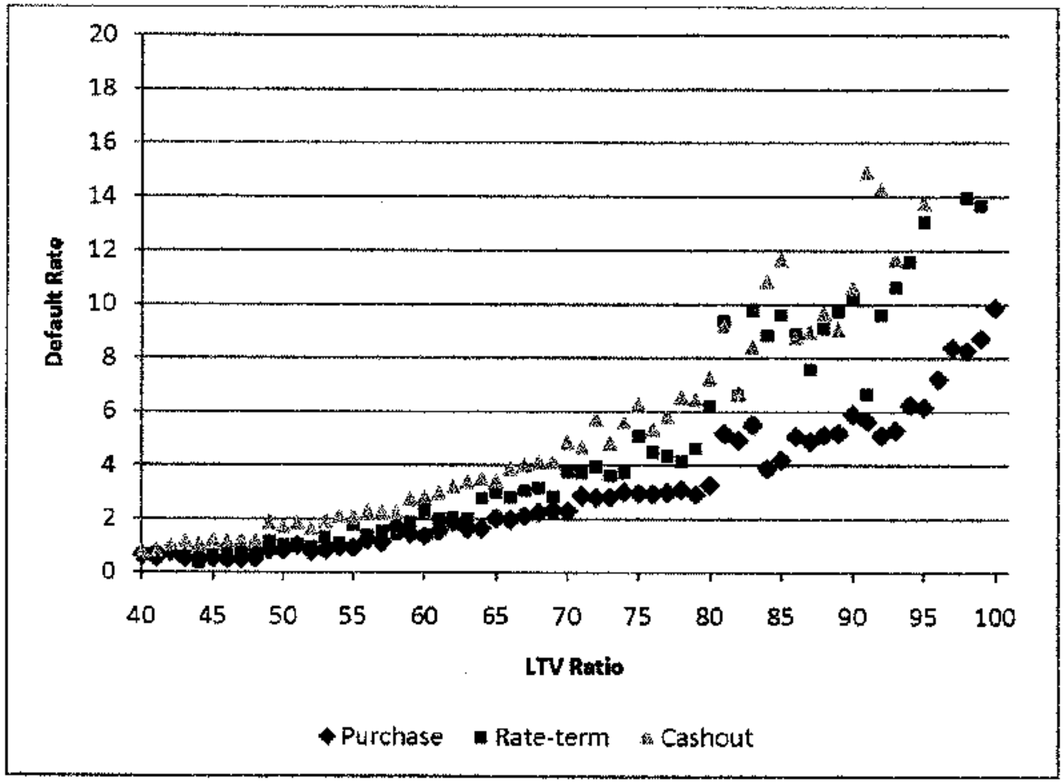
FHLB liquidity was a critical resource during the last financial crisis and the proposed regulation would limit its utility in a future crisis. We hope FHFA will reconsider this proposal, and we look forward to working with the agency to ensure FHLB membership for credit unions is always accessible.

Thank you for the opportunity to express our views on FHFA's proposed rule on FHLB membership eligibility. If you have any questions about our comments, please do not hesitate to contact me at (202) 508-6736.

Sincerely,

Mary Mitchell Dunn

Mary Mitchell Dunn
Deputy General Counsel


Default Rate
20
18
16
14
12
10
8
6
4
2
0
40
45
50
55
60
65
70
75
80
85
90
95
100
LTV Ratio
◆ Purchase ■ Rate-term ▲ Cashout

3138 10th Street North
Arlington, VA 22201-2149
P: 703.842.2234
F: 703.522.0594
chunt@nafcu.org

Carrie R. Hunt
Senior Vice President of Government Affairs
and General Counsel

NAFCU
National Association of Federal Credit Unions | www.nafcu.org

January 26, 2015

The Honorable Jeb Hensarling
Chairman
House Financial Services Committee
United States House of Representatives
Washington, D.C. 20515

The Honorable Maxine Waters
Ranking Member
House Financial Services Committee
United States House of Representatives
Washington, D.C. 20515

Re: Credit Unions and the Federal Housing Finance Agency

Dear Chairman Hensarling and Ranking Member Waters:

On behalf of the National Association of Federal Credit Unions, the only trade association that exclusively represents federal credit unions, I write with respect to tomorrow's hearing, *"Sustainable Housing Finance: An Update from the Director of the Federal Housing Finance Agency."* NAFCU members appreciate the work of Director Watt and FHFA in helping to stabilize the nation's mortgage market as they oversee Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System.

As you know, sustainable housing finance is of great importance to our nation's credit unions. Fannie Mae, Freddie Mac, and the Federal Home Loan Banks (FHLBs) are valuable partners for credit unions who seek to hedge interest rate risks by selling their fixed-rate mortgages on the secondary market. Not only does a safe and sound secondary market allow credit unions to better manage risk, but it also provides credit unions the ability to reinvest funds into their membership by offering new loan products or additional forms of financial services. Without these critical relationships with the Government Sponsored Entities (GSEs) and the FHLBs, credit unions would be unable to provide the services and financial products their members demand and expect. Therefore, NAFCU and our members strongly support a robust FHFA system.

NAFCU would also like to reiterate to the committee the importance of retaining a housing finance system that provides credit unions with unrestricted access to the secondary mortgage market. This source of liquidity is critical in enabling credit unions to serve the mortgage needs of their 100 million members across the country.

Relative to oversight of FHLBs, NAFCU would like to discuss our concerns with FHFA's pending proposal that would make significant changes to the agency's FHLB membership regulation. As the committee is aware, in September 2014, FHFA released a proposed rule that would establish new asset thresholds for both FHLB applications and ongoing membership. Specifically, FHLB members and applicants would be required to keep 1 % of assets in home mortgage loans. Also, current FHLB members would be required to hold at least 10 % of assets in residential mortgage loans on an ongoing basis – a marked change from the current rule, which only requires this 10 percent threshold at the application stage. The proposal would also require FHLBs to evaluate member compliance annually and to terminate membership after two consecutive years of noncompliance.

This proposed rule threatens to severely hamper credit unions' access to the valuable services the FHLBs provide and must be carefully considered for its full impact before moving forward. In 2007, 11.4% of credit unions were members of an FHLB, representing 61.7% of total credit union assets. Today, however, 19% of all credit unions are members of an FHLB, and these credit unions represent 75.8% of the total credit union assets and this number continues to grow. This growth of credit union membership in FHLBs only underscores the need to ensure that the eligibility requirements for membership in FHLBs are set appropriately. Unfortunately, this proposal would disenfranchise over one million credit union member-owners from receiving the benefits of FHLB resources as their institution's membership would be terminated under the newly proposed requirements.

While NAFCU appreciates FHFA's intention of fostering FHLB's housing finance missions, we believe the current regulatory requirements effectively ensure that FHLB members demonstrate ongoing commitments to mortgage lending in their communities. For example, when an FHLB member borrows an advance, it must provide eligible collateral to secure the advance. Nearly all eligible types of collateral, which are determined by Congress, are related to housing. In addition, current members must certify their active support of housing for first-time homebuyers to FHFA every two years through the Community Support Statement. Further, FHFA has failed to provide any data or empirical evidence to support its claims that the FHLB system is at risk because some members may not meet the proposed asset percentage requirements on an ongoing basis. Given the sufficient existing requirements, and the lack of statistical support for the proposed changes, NAFCU does not believe FHFA needs to move forward with the newly proposed "ongoing" membership requirements for depository institutions in this rulemaking.

Further exacerbating this issue for credit unions is the statutory exemption for FDIC-insured banks with under $1.1 billion in assets from the 10% requirement as outlined in the *Federal Home Loan Bank Act*. In addition to seeking changes to the underlying FHFA proposal, NAFCU believes this discrepancy also needs to be addressed to ensure an even playing field between all financial institutions including credit unions on this matter. We would urge the committee to act on this matter and create parity for credit unions.

NAFCU would also like to take this opportunity to discuss FHFA's recent Request for Input on the guarantee fees (g-fees) that Fannie Mae and Freddie Mac charge lenders. The primary goal of FHFA in setting g-fees should be to ensure that Fannie Mae and Freddie Mac remain sustainable, while not raising fees to a level that would significantly drive up the cost of borrowing and reduce lending. In line with that goal, NAFCU appreciates Director Watt's statement that FHFA's strategic goals no longer involve specific steps to contract the Enterprises' market presence, as it could have a negative effect on liquidity. Again, secondary mortgage market access is vital for our nation's credit unions. Fannie Mae and Freddie Mac enable credit unions to obtain the necessary liquidity to create new mortgages for their members by utilizing the secondary market.

Raising g-fees would result in a negative impact on the housing market. The cost of borrowing will greatly increase and lending will inevitably slow down. Rather than increasing g-fees, NAFCU believes reducing g-fees or keeping them at their current level is necessary to the continued recovery and stabilization of the housing market. In NAFCU's August 2014 *Economic and CU Monitor survey*, 81% of NAFCU members polled indicated that the current level of g-fees should remain. Further, loan originations would inevitably decrease if the Enterprises continued to raise g-fees because the rising cost of mortgage lending would either need to be absorbed by the lender or passed on to the borrower, in the form of risk based fees or higher interest rates.

Thank you for holding this important hearing. If my colleagues or I can be of assistance to you, or if you have any questions regarding this issue, please feel free to contact me or NAFCU's Vice President of Legislative Affairs, Brad Thaler, at (703) 842-2204.

Sincerely,

Carrie R. Hunt
Senior Vice President of Government Affairs & General Counsel

cc: Members of the House Financial Services Committee

OHIO CAPITAL FINANCE CORPORATION
88 East Broad Street, Suite 1800
Columbus, Ohio 43215
614.224.8446 (p) 614.224.8452 (f)

January 2, 2015

Alfred M. Pollard, General Counsel
Attention: Comments/RIN 2590-AA39
Federal Housing Finance Agency
400 Seventh Street SW, Eighth Floor
Washington, D.C. 20024

RE: Notice of Proposed Rulemaking, request for comments: Members of Federal Home Loan Banks

Dear Mr. Pollard:

Thank you for the opportunity to respond to the Federal Housing Finance Agency (FHFA) notice of proposed rulemaking regarding revised membership regulations. On behalf of Ohio Capital Finance Corporation ("OCFC"), a certified Community Development Financial Institution (CDFI) of the US Department of the Treasury, I am particularly grateful the FHFA extended the comment period in light of the fundamental membership changes proposed.

OCFC appreciates the FHFA's intent to ensure that the benefits of Federal Home Loan Bank System (FHLBank) membership are being used to further the statutory mission of the FHLBank, however, OCFC disagrees with the proposed threshold tests for members. To the contrary, we are concerned that these new membership rules, as proposed, would undermine the FHLBanks' mission of providing a reliable source of housing finance to its members, like OCFC. It could also unnecessarily prevent new, private capital from supporting the affordable housing finance market.

Since OCFC's certification as a CDFI in 2002, OCFC and its affiliated loan funds; the Ohio Affordable Housing Loan Fund I LLC; the OCFC Loan Participation I, LLC; and the Ohio Preservation Loan Fund, LLC have loaned over $245 million to spur the preservation and creation of over 18,000 units of affordable housing in Ohio and Kentucky. This represents over 370 loans closed which has leveraged over $2.0 billion in funding for affordable housing.

As a CDFI, OCFC obtained membership in the FHLB of Cincinnati on December 27, 2012 following the passage of the Housing and Economic Recovery Act of 2008 and subsequent rules issued on December 23, 2009 by the Federal Housing Finance Agency and the Federal Housing Finance Board.

As a Member of the Cincinnati Bank, OCFC has accessed and received multiple Affordable Housing Program ("AHP") awards for use in the production of affordable housing. Additionally, OCFC served as the replacement Member for one of the top seven largest banks in the United States for an affordable housing project which serves mentally ill and homeless people. The bank removed itself from the project due to the small size, complex nature of the deal structure, and lack of fee revenue that project would generate; leaving the nonprofit developer with an AHP award, but no Member bank. As a mission driven lender, OCFC replaced the bank as the Member and assisted the nonprofit developer in completing the much needed project in Xenia, Ohio. Without OCFC as a CDFI and as a non-traditional member of the FHLB, this project most likely would have failed, and the grand opening would not have occurred on December 19, 2014 providing 6 residents with a home for the holidays rather than spending it in a homeless shelter.

The AHP remains one of the most important, enduring sources of funding available to the non-profit housing community. By having a variety of participants including CDFIs, the 10 percent annual AHP set-aside allows for broad participation to small and large lenders, who serve varied, but equally important roles in affordable housing development. OCFC like other CDFI Members have established long-term and deep relationships in the capital markets by providing access to private capital and leveraging low-income housing tax credits. CDFI Members like OCFC bring an important diversity to the complex funding networks of affordable housing development.

If the proposed rule requiring all FHLB Members to meet one or two ratio tests of mortgages-to-total assets, ranging from one to 10 percent, depending on charter type or asset size, would go into effect, OCFC would be forced to terminate its membership with the FHLB of Cincinnati, as OCFC would not meet this test, because it does not hold mortgages.

The ongoing asset tests fail to recognize the many ways in which Members support housing finance, including pledging mission-assets to borrow advances; selling mortgages into the secondary market; and investing in low-income housing and community investment through the AHP or other targeted investment programs. OCFC's lending is structured primarily through loan pools funded by financial institutions therefore making it more difficult to pledge acceptable collateral to the FHLB. As noted earlier, OCFC is able to utilize the AHP and assist in the creation and preservation of affordable housing.

Thus, OCFC may likely fail to meet the proposed asset ratio test, and its membership would be terminated. Termination of membership appears to be in direct conflict with the intent of the Housing and Economic Recovery Act of 2008. Membership termination is an unacceptable penalty for non-compliance, especially for an organization like OCFC whose mission is to provide affordable housing to those in need.

We thus respectfully ask you to reconsider this set of proposals or, in the alternative, further open the discussion to public debate. Please do not hesitate to contact me at 614.224.8446 or jwelty@occh.org if you have questions.

Regards,

Jon Welty
President

homeownership
preservation foundation

House Financial Services Committee Hearing
Sustainable Housing Finance:
An Update from the Director of the Federal Housing Finance Authority
January 27, 2015

Statement Submitted for the Record by: David Berenbaum, Chief Executive Officer,
The Homeownership Preservation Foundation
dberenbaum@995HOPE.org/ 202.480.2774

Strengthening the U.S. Housing Finance System With Housing Counseling Services

The Homeownership Preservation Foundation (HPF) is honored to help the nation's homeowners navigate the legacy of the housing crisis. We operate the Homeowner's Hope Hotline (888-995-HOPE), which is staffed and ready to assist homeowners every day around the clock. HPF's service began in 2007 at the invitation of the Bush administration and has continued at the invitation of the Obama administration in 2009. We are a non-partisan, independent, national nonprofit.

Since our inception, HPF has responded to over 8 million calls for assistance and provided comprehensive housing counseling to over 2 million homeowners, helping the majority of them to avoid foreclosure and forge a path to a sustainable recovery. HPF is dedicated to guiding consumers on the path of sustainable homeownership and improving their overall financial health.

HPF has worked in a bipartisan manner with all key stakeholders in the U.S. housing finance system including many members of the Congress, Department of the Treasury, Department of Housing and Urban Development and major financial institutions. We also work closely with the Enterprises -- Fannie Mae and Freddie Mac -- and the Federal Housing Finance Agency (FHFA). In addition to supporting our day-to-day operations, the Enterprises have also helped us to operate a national anti-mortgage scam service and provide special post-modification default prevention counseling for homeowners that have received modifications.

HPF applauds FHFA's stewardship of the Enterprises during the housing crisis and its encouragement of the Enterprises to incorporate housing counseling in their risk management activities. Our work with the Enterprises has centered on a component of FHFA's Strategic Plan for 2015 – 2019, Goal 2: "Develop and actively promote home retention and loss mitigation programs." As stated in the FHFA Strategic Plan,

> Home retention initiatives, such as loan modification and refinancing programs, help reduce the number of defaults and foreclosures by allowing eligible borrowers to realize more favorable rates or terms on their mortgages. Such initiatives reduce losses to the Enterprises and contribute to greater stability and liquidity in housing markets and neighborhoods.[1]

We are pleased that the FHFA Strategic Plan calls for the Enterprises to work with us to "improve the effectiveness of pre-purchase and early delinquency counseling . . .," which will extend the benefits of housing counseling to first-time homebuyers. The intensity of the housing crisis is abating but nearly 4.0 million homeowners remain delinquent or in the foreclosure process. They need our help and HPF looks forward to

[1] FHFA Strategic Plan: Fiscal Years 2015-2019

homeownership preservation foundation

continuing to work with the Enterprises, and others, to reduce the number of homeowners who are at-risk. At the same time, we support FHFA's focus on expanding access to credit for credit-worthy, responsible homebuyers.

As FHFA notes in its Strategic Plan, the housing market continues to lag the national economic recovery. FHFA cites "distress sales, fears of future decline in house prices, and homebuyers' concerns about the vitality and sustainability of the economic recovery" as factors. FHFA also cites tight credit standards and weaknesses in the credit profiles and capacity of first-time homebuyers as likely contributors to the housing market's weak recovery.

We are encouraged that FHFA is taking critically-important and prudent steps to expand access to housing credit for qualified borrowers by allowing the Enterprises to offer flexibilities in the underwriting process, such as lower down payments. These changes will facilitate access to homeownership for more first-time homebuyers, which should bolster the recovery of the housing markets and economy.

HPF is turning its attention to ways that we can work with the Enterprises to help aspiring homeowners gain access to these products and be successful in managing the risks and responsibilities of homeownership. Despite the legacy of the crisis, homeownership remains an aspiration for most Americans, which can be facilitated with appropriate products, services and support systems. There are many Americans – disproportionately those in minority and low-to-moderate income communities - whose dreams of homeownership are being shattered due to weaknesses in their credit and financial profiles. HPF is solely focused on serving the needs of homeowners using methodologies and procedures that meet the stringent consumer engagement requirements of our organization and our public and private partners.

HPF's is working to leverage our national platform and the extensive work done during the crisis to ensure that all people have access to life of loan housing counseling and financial coaching. Our organizing theme is "Achieving the Dream," which builds on the aspirations of potential homebuyers and connects them with a high-quality support process designed to facilitate achievement of their dreams.

Our new platform blends HPF's Gold Standard Housing Counseling and Financial Coaching programs with the integration of improved consumer engagement technologies and an expanded network of partners to achieve outcomes that benefit homebuyers, their communities and the entire nation. We look forward to working with FHFA and the Enterprises to develop and deliver these expanded services while we continue our ongoing efforts.

HPF is proud to have served a leading role in delivering support to American homeowners. We envision a nation where everyone has a place to call home and the ability to achieve their financial dreams. We deeply appreciate the support of the Congress, FHFA and other federal agencies, as well as private financial institutions, and look forward to a continued partnership as we serve our nation.

Background:

The use of housing counseling in supporting homeownership has benefited from bipartisan support. In 2013, the Bipartisan Policy Center Housing Commission on recommended use of housing counseling to broaden access to affordable mortgage lending and the Commission encouraged stakeholders to sustain the service for consumers:

homeownership preservation foundation

> The commission believes that housing counseling can improve prospective borrowers' access to affordable, prudent mortgage loans, especially for families that otherwise might not qualify or who may experience other barriers to mainstream lending. There is a wide public benefit from investment in housing education and counseling programs, and the commission therefore supports continued federal appropriations for housing counseling, and recommends that stakeholders who benefit from a borrower's access to counseling services be expected to contribute to the cost of the service. [2]

The Commission's recommendations acknowledge that housing counseling has proven to be beneficial to housing consumers and suggests that integrating counseling more extensively in mortgage origination channels can make an important contribution to expanding the credit box by "mitigating the risk of lending to borrowers on the margins of creditworthiness.[3]" The Commission's perspective reflects the findings of numerous independent studies that document the positive social and financial benefits of counseling in foreclosure mitigation as well as prior to home purchase.

The importance of housing counseling is driven by three key factors:

1. The purchase of a home is the largest financial transaction that most individuals will undertake in their lives, which significantly impacts their financial security, safety, lifestyle advancement and the stability of their communities.

2. Successful homeownership involves management of a series of complex financial matters that can overwhelm the financial capabilities of most Americans; exposing homeowners to increased risk of default and risk-insurers to significant losses.

3. The national housing crisis has left many families struggling to resolve mortgage issues, recover from their difficulties, and rebuild financial security. The legacy of the crisis has resulted in a restrictive lending environment that excludes many prospective homebuyers.

In view of these challenges – the complexity and size of the mortgage transaction; risk of default, and the lingering aftereffects of the housing crisis – America's homebuyers and owners are well-served by having highly-trained, independent, nonprofit housing counselors and coaches who are committed to help them manage the challenges of homeownership. Counselors have proven to be a trustworthy resource delivering candid, detailed assessments of an individual's capacity to take on and resolve homeownership challenges.

The Proven Benefits of Housing Counseling

Extensive, independent research has identified the value and effectiveness of housing counseling. Studies by the Philadelphia Federal Reserve, Freddie Mac and many other independent researchers provide strong evidence that counseling produces significant benefits for mortgage consumers, servicers and mortgage risk holders.

Federal Reserve Chairman Ben Bernanke echoed these research findings in comments in Atlanta, November 2012:

> Although basic knowledge about money management and decision making is extremely useful, it is not practical, of course, for everyone to be a financial expert. Sometimes a professional can help, and people

[2] Bipartisan Policy Center Housing Commission. (2013). *Housing America's Future: New Directions for National Policy*, pp. 32-35.
[3] Ibid.

should not be afraid to seek advice at appropriate times. For example, an individual may be involved in buying a home--a complex and intimidating experience for many people--only once or twice in a lifetime.

That's why advice from a housing counselor at the right point in the process can make all the difference. Nonprofit organizations can help prospective homeowners assess their readiness to purchase. And, by providing useful information about how to search for a home, apply for financing, handle home maintenance, and prevent delinquency, these nonprofits can help aspiring homebuyers find the right home and maintain their mortgage payments.

We have also seen that counseling can help consumers who are facing delinquency or default. Borrowers in trouble who receive foreclosure counseling are relatively more likely to subsequently become current on their mortgage, receive a loan modification, and, ultimately, keep their home.

The Philadelphia Federal Reserve study, completed in 2014, focused on the influence of counseling on consumer financial behavioral outcomes, such as credit scores, total debt, and delinquencies in payments. Results from this study showed that participants in a counseling program achieved significant improvements in credit scores, and reductions in debt and serious delinquencies[4].

The intensity of the housing crisis and extensive federal oversight has bolstered standards of service and quality in the housing counseling industry. In addition, the ability of the counseling industry to operate at national scale has been tested and proven during the housing crisis. The US Treasury's Making Home Affordable initiatives administered through the Enterprises; HUD and National Foreclosure Mitigation Counseling (NFMC) programs have delivered a critical support to homeowners in communities across the nation.

[4] Smith, Marvin M., Hochberg, Daniel, Greene, Williams H., (April, 2014). The Effectiveness of Pre-purchase Homeownership Counseling and Financial Management Skills. Federal Reserve Bank of Philadelphia, PA

CHANGES IN BUYER COMPOSITION AND THE EXPANSION OF CREDIT DURING THE BOOM[1]

Manuel Adelino, Duke

Antoinette Schoar, MIT and NBER

Felipe Severino, Dartmouth

Current version: January, 2015
First version: November, 2014

Abstract

Earlier research has suggested that distortions in the supply of mortgage credit during the run up to the 2008 financial crisis, in particular a decoupling of credit flow from income growth, may have been responsible for the rise in house prices and the subsequent collapse of the housing market. Focusing on individual mortgage transactions rather than whole zip codes, we show that the apparent decoupling of credit from income shown in previous research was driven by changes in buyer composition. In fact, the relationship between individual mortgage size and income growth during the housing boom was very similar to previous periods, independent of how we measure income. Zip codes that had large house price increases experienced significant changes in the composition of buyers, i.e. home buyers (mortgage applicants) had increasingly higher income than the average residents in an area. Poorer areas saw an expansion of credit mostly through the extensive margin, i.e. a larger numbers of mortgages originated, but at DTI levels in line with borrower income. When we break out the volume of mortgage origination from 2002 to 2006 by income deciles across the US population, we see that the distribution of mortgage debt is concentrated in middle and high income borrowers, not the poor. Middle and high income borrowers also contributed most significantly to the increase in defaults after 2007. These results are consistent with an interpretation where house price expectations led lenders and buyers to buy into an unfolding bubble based on inflated asset values, rather than a change in the lending technology.

[1] We thank Nittai Bergman, Andrew Lo, Sendhil Mullainathan, Steve Ross, Andrei Shleifer, Jeremy Stein, and seminar participants at Harvard Business School and MIT for thoughtful comments.

1. Introduction

Understanding the origins of the housing crisis of 2007 to 2009 has been an enduring challenge for financial economists and policy makers alike. One of the predominant narratives that has emerged in the literature is that fundamental changes in the origination technology of lenders significantly contributed to unsustainable levels of borrowing and ultimately caused an acceleration of house prices. This interpretation builds on a key finding by Mian and Sufi (2009) that growth in mortgage credit at the zip code level became negatively correlated with income growth in the run-up to the financial crisis, suggesting that lending was decoupled from income, especially in areas with strong house price growth. As a result, there has been a significant emphasis on understanding the role of the financial industry in providing credit to low-income borrowers, which is often referred to as the credit supply side view of the housing crisis.[2]

In this paper we use mortgage and income data on individual borrowers (rather than the zip code level analysis that has been previously used) to shed new light on the dynamics of loan origination in the run-up to the financial crisis. Our results show that using zip codes as the unit of observation to explain the relationship between growth in lending and income confounds important compositional changes *within* zip codes. By focusing on individual borrowers, we can decompose the growth in total mortgage debt due to the intensive margin (change in the average size of individual loans) from the extensive margin (the number of new loans that are originated in a zip code). Additionally, we distinguish the income of borrowers from the average household income of the residents in an area.

We provide three main new findings about the relationship between credit origination and income in the run-up to the financial crisis. First, when we relate individual mortgage size to income, measured either using borrower income from mortgage applications or average household income from the IRS, we see that the growth in individual mortgage size is strongly positively related to income growth throughout the pre-crisis period. This means that there was never a decoupling of mortgage growth and income growth at the *individual* level, the relevant measure for lending decisions. Second, we show that there was an expansion of credit along the extensive margin: poorer neighborhoods have an increase in the *number* of loans being originated, with modest changes in individual DTI that are similar to those in high income zip codes. This happens because new home buyers had increasingly higher income levels than the average household living in these areas. At the same time, neighborhoods that experienced strong house price growth see a rise in average mortgage size, but again at DTI levels close to previous periods, since the average income of these buyers also went up significantly. Third, we document how aggregate mortgage origination in the U.S. was distributed by borrower income levels. The large majority of mortgage dollars originated between 2002 and 2006 are obtained by middle income and high income borrowers (not the poor). While there was a rapid expansion in overall mortgage origination during this time period, the fraction of new mortgage dollars going to each income group was stable. In other words, the poor did not represent a higher fraction of the mortgage loans originated over the period. In addition, borrowers in the middle and top of the distribution are the ones that contributed most significantly to the increase in mortgages in default after 2007. Taken together, the evidence in the paper suggests that there was no decoupling of mortgage growth from income growth where unsustainable credit was flowing disproportionally to poor people.

Using data on individual mortgage applications from the Home Mortgage Disclosure Act (HMDA) between 2002 and 2006 we distinguish the growth in average household income at the zip code level (from the IRS) and the income of individual borrowers (from HMDA). Following the earlier

[2] Several papers on the consequences of mortgage securitization focus on the expansion of credit to riskier or more marginal borrowers (Nadauld and Sherlund 2009, Loutskina and Strahan 2009, Keys et al. 2010, Demyanyk and Van Hemert 2011, Dell'Ariccia, Igan and Laeven, 2012 Agarwal, Amromin, Ben-David, Chomsisengphet, and Evanoff (2014) or Landvoigt, Piazzesi and Schneider, 2014). We focus, instead, on the relationship between credit and income along the whole distribution of borrowers.

literature, we first look at the relationship between the growth in total mortgage credit at the zip code level (the sum of the mortgage balance of all mortgages originated in a given year) and the two measures of income. We find a strong positive relationship between total credit growth and the individual borrower income growth, but a negative relationship with the growth in average household income at the zip code level (the result highlighted in Mian and Sufi, 2009). This suggests that there was no decoupling of total credit growth and *borrower* fundamentals during this time period. In addition, when we look at a longer time period between 1996 and 2007, we confirm that there was neither a reversal of the sign nor a change in the slope between credit flows and income growth using individual borrower income.[3]

As discussed above, however, the analysis using total mortgage credit at the zip code level combines the effects at the extensive and intensive margins. Since it is important to decompose these dimensions, we separately look at changes in the average mortgage size (the intensive margin) and the number of mortgages (the extensive margin) within a zip code. We show that changes in average mortgage size within a zip are strongly positively correlated with changes in income during the 2002-2006 period. This result is independent of whether we measure income using average household income from the IRS or borrower income from HMDA. We re-run this analysis using individual mortgage transactions (rather than zip code averages) and confirm that these results hold very strongly also at the individual level. In contrast, we find that it is the *number* of mortgages originated within a zip code that was negatively correlated with average household income growth in the zip code, but again positively correlated with the growth in income of the individual borrowers. This means that the increase in total debt levels in neighborhoods with relative declining income was mainly driven by the extensive margin, i.e. more mortgages being originated, but that the debt to income levels of individual buyers did not change differentially for poor and rich households.

The prior analysis has focused on relative changes in mortgage and income growth. To relate those changes to the aggregate housing market, we also look at how mortgage credit origination was distributed across different levels of the income distribution. We find that the dollar value of mortgage origination is disproportionally concentrated in the top income deciles throughout the period, since higher income individuals typically obtain larger mortgages. Interestingly, however, even the rate of growth in mortgage credit was quicker for the top deciles than for the bottom. These results again suggest that there was not a significant reversal in the flow of credit to lower income households. Using data from Lender Processing Services (LPS), we also analyze the contribution of borrowers at different levels of the income distribution to total mortgage dollars in default. We find that zip codes at the top of the buyer income distribution contributed disproportionally to the total dollar amount of mortgages in delinquency in the crisis.

A central concern in interpreting our results about the positive relationship between total mortgage origination at the zip code level and borrower income could be that they are a result of aggressive overstatement of reported income. A number of recent studies have shown that misreporting of borrower characteristics increased significantly during the pre-crisis period (see, for example Jiang, Nelson and Vytlacil, 2014 for a careful analysis of this phenomenon). To rule out that this effect is driving our results, we conduct a number of tests: First, we show that the positive relationship between mortgage growth and new buyer income is equally strong for agency and non-agency loans (i.e., those that were not purchased by one of the government sponsored enterprises, the GSEs). Since loans purchased by the GSEs adhered to stricter underwriting standards even during the boom

[3] Our tests also show that the coefficient of aggregate mortgage growth on zip code income is only negative if we control for county fixed effects (as proposed in Mian and Sufi (2009)). Without the county fixed effects the coefficient on average household income is positive throughout. However, if the aim is to test if credit is increasingly allocated to zip codes with declining incomes, one should not include a county fixed effect. The analysis with county fixed effects only tests if within a given county, zip codes that are growing quicker than the county average are disproportionately receiving more credit. However, all the first order change in credit allocation might happen between counties, which would be lost by this analysis. We show results with and without fixed effects throughout the paper.

period, overstatement is less of a concern for this sample. The same is true when we break out the data by prime and subprime lenders. Second, we test whether IRS income is related to lagged new buyer income controlling for lagged IRS income. If income of the new buyers was high purely due to overstatement there should be no correlation with average household income in the zip code going forward. Instead, we find a positive and significant relationship between IRS income and lagged homebuyer income suggesting that neighborhoods where the new buyers had higher incomes also had higher IRS income in the following year. Finally, we also find that the magnitudes of overstatement that have been documented in the literature are too small to explain our results. The best estimates of the overstatement (Jiang et al, 2014) are around 20% to 25% for low documentation or no documentation loans, themselves a small fraction of all loans originated in this period (about 30%).[4] However, the relevant difference in new buyer income and zip code average income in our analysis is 75% and above. Overall, these tests suggest that income overstatement does not explain the results presented in this paper.[5]

An additional concern could be that by focusing on mortgage debt for home purchases, we are missing an important part of the distortions in housing leverage, such as cash-out refinancing or home equity lines of credit. We re-run our tests using only refinancing transactions from HMDA, as well as data from LPS, which includes cash-out refinances and second liens, and confirm that borrower income growth and these types of credit were positively correlated and this correlation did not change significantly throughout the run-up to the crisis. Also, cash-out refinances and second lien loans were concentrated in middle class and upper middle class borrowers, just like purchase mortgages. This again suggests that even home equity loan growth and income growth did not become significantly decoupled over the pre-crisis period.

Overall, our analysis provides a novel interpretation of the debt dynamics leading up to the crisis. The aggregate increase in debt across zip codes (and nationally) was accompanied by an increase in individual borrower income levels, and was the result of an expansion of credit along the extensive margin: This suggests that home buyers increased the pace of home buying and therefore were holding more recent mortgages.[6] As a result of the increased churning, zip codes as a whole became more levered, since a larger fraction of households held mortgages which had recently been originated. The problem was not that levels of individual DTI at origination were grossly out of line with prior periods, but that a larger fraction of homeowners were levered up to the maximum level of their typical debt capacity. These results are most consistent with an expectations based view of the financial crisis where both homebuyers and lenders were riding the house price bubble and defaulted when house prices dropped.[7] For example, Foote, Gerardi and Willen (2012), Shiller (2014), among many others, argue that buyers as well as investors in the mortgage market had overoptimistic beliefs about house price growth. Similarly, Chinco and Mayer (2014) document an increased inflow of out-of-state buyers who seem to have been buying for speculative purposes. Coleman, LaCour-Little, and Vandell (2008) argue that subprime lending may have been a joint product, rather than the cause of the increase in house prices.[8] Our results are also related and consistent with Haughwout, Peach and Tracy (2008), Foote, Gerardi and Willen (2008), Mayer,

---

[4] See, e.g., Adelino, Gerardi and Willen (2013) Table 3.

[5] Of course, we do not argue that income misreporting was not going on during the run up to the crisis. But we show that it is not a first order factor to explain the composition effects.

[6] In previous research, we show that new mortgages in the years before 2007 tended to be originated at a loan to value ratio of eighty percent or more, see Adelino et al (2013). In addition home ownership levels in the US did not increase during the 2002 to 2006 period.

[7] There is possibly also a complementary channel, namely that banks were becoming more likely to lend to people with more volatile income, even though the DTI and LTV ratios of these mortgages were reasonable at origination. Again, this would suggest that expectations about home prices were affecting lending decisions.

[8] Also Glaeser, Gottlieb and Gyourko (2010) argue that "easier" access to credit cannot explain the increase in house prices during the "boom". On the other hand, Corbae and Quintin (2014) and Kermani (2012) argue that looser credit standards helped feed the boom in housing prices and led to the subsequent bust.

Pence and Sherlund (2009), and Palmer (2014), who suggest that declining house prices were key for explaining increased defaults.

2. Data description

The analysis in this paper primarily uses data from three sources: the Home Mortgage Disclosure Act (HMDA) individual mortgage dataset, income data from the IRS at the zip code level, and a 5% random sample of all loans in the Lender Processing Services (LPS) data. The HMDA dataset contains the universe of mortgages applications in the US in each year. The variables of interest for our purposes are the loan amount, the applicant income, the purpose of the loan (purchase, refinance or remodeling), the action type (granted or denied), the lender identifier, the location of the borrower (state, county and census tract), and the year of origination. We match census tract from HMDA to zip codes using the Missouri Census Data Center bridge. This is a many-to-many match, and we rely on population weights to assign tracts to zip codes.[9] We drop zip codes for which census tracts in HMDA cover less than 80% of a zip code's total population.[10] With this restriction, we end up with 23,385 individual zip codes in the data.

IRS zip code income is obtained directly from IRS and represents the adjusted gross income of households that filed their taxes in a particular year in that zip code. Besides the per capita income, we use the number of tax filings in a zip code to construct an estimate of the population in a zip code in each year.[11]

The house price indices used in the paper are obtained from Zillow.[12] The zip code level house prices are estimated using the median house price for all homes in a zip code in June of each year. Zillow house prices are only available for 8,619 zip codes in the HMDA sample, representing approximately 70% of the total mortgage volume in the US during our sample period.

In order to identify subprime loans, we rely on the subprime and manufactured home lender list constructed by the U.S. Department of Housing and Urban Development (HUD) for the years between 1993 and 2005. This list includes lenders that specialize in these types of loans, and they are identified by a combination of features that include the average origination rate of loans by these lenders, the proportion of loans for refinancing, the share of loans sold to Fannie Mae or Freddie Mac, among others.[13] The data contains lender names, their agency codes, and lender identification numbers and we use these identifiers to match this list to HMDA and identify loans that were originated by subprime lenders.

We also use a dataset provided by Lender Processing Services (LPS, formerly known as the McDash dataset). This is a loan-level dataset that covers approximately 60 percent of the U.S. mortgage market and contains detailed information on the characteristics of both purchase mortgages and mortgages used to refinance existing debt. This dataset is provided by the mortgage servicers, and we use a 5% sample of the data. The LPS data includes not only loan characteristics at origination,

[9] In other words, many zip codes will have more than census tract associated to them, and census tract could potentially overlap with more than one zip code. Missouri census tract to zip code bridge by population are obtained from http://mcdc.missouri.edu/websas/geocorr90.shtml and http://mcdc2.missouri.edu/websas/geocorr2k.html
[10] This drops only 180 zip codes out of 23,565.
[11] IRS zip code information is available at http://www.irs.gov/uac/SOI-Tax-Stats-Individual-Income-Tax-Statistics-ZIP-Code-Data-(SOI). The zip code population is approximated by multiplying the number of exemptions by a factor of 0.9 (this factor is obtained based on 2008 population estimates constructed by adding the number of returns, the number of returns filing jointly, and the number of dependents).
[12] Zillow house prices are available at http://www.zillow.com/research/data/
[13] The whole list, as well as the detailed criteria for inclusion of lenders in the list is available at http://www.huduser.org/portal/datasets/manu.html. Mayer and Pence (2009) provide a detailed discussion on the advantages and disadvantages of the use of this list to identify subprime loans.

but also the performance of loans after origination, which allows us to look at ex-post delinquency and defaults.

Finally, we use the Saiz (2010) supply elasticity measure. This measure is constructed using geographical and local regulatory constraints to new construction and it correlates strongly with house price growth in the period of 2002 to 2007. This measure is available for 269 metropolitan statistical areas that we match to a total of 776 counties using the correspondence between MSAs and counties for the year 1999 provided by the Census Bureau.[14]

3. Descriptive statistics

Table 1 presents the descriptive statistics for the main variables in our sample. The first column reports the average and standard deviation for the full sample, while the next three columns break out the averages for the top quartile, the middle two quartiles, and the bottom quartile of zip code income per capita. In the last three columns (columns 5 through 7) we break out the data by the level of house price growth in a zip code. We report summary statistics for the highest and lowest quartiles and combine the two middle quartiles into one number (labeled "Middle"). The sample is based on the 8619 zip codes that are part of the Zillow house price panel.

The first row shows the zip code average household income based on IRS adjusted gross income reporting as of 2002. The average household income is $50K for our sample of zip codes. The average income in the highest quartile is $84K versus about $31K for the zip codes in the lowest quartile. Interestingly, when we look at the income levels reported for the home buyers in HMDA (row 2), i.e. the individuals in those zip codes who actually took out a loan for buying a house (a purchase mortgage), we see that the average income of buyers is much higher than the average for their zip code, at $92K. This figure is about $143K for the highest quartile and $63K for the lowest quartile, which is almost twice the average income for the total population in these groups. The average original balance of mortgages (as of 2002) is also strongly increasing in the average zip code income. The average original mortgage balance is $155K, but it is $246K in the highest quartile and $97K in the lowest. In addition, the number of mortgages varies across income bins. There are 3.1 mortgages per 100 residents for zip codes in the high income quartile, while there are only 2.1 mortgages per 100 residents for those in the lowest quartile.

Table 1 also reports debt-to-income (DTI) calculated from HMDA as the mortgage amount over the reported income, and loan-to-value (LTV) across zip codes calculated as the average LTV from LPS, in 2003[15], since HMDA does not provide information about the value of the property that is being purchased. The DTI for the highest quartile is 2.26 while the ratio for the lowest quartile it is 1.97. Crucially, the change in DTI (shown in the second-to-last row of the table) between 2002 and 2006 is indistinguishable across income quartiles, which already suggests that there was no differential increase in individual leverage across rich and poor neighborhoods. LTV ratio in the highest quartile it is 0.73 and in the lowest 0.86. The next row shows the fraction of low documentation loans in 2002 across the different income quartiles. Interestingly, we see that buyers in richer neighborhoods (high household income) have a 20% likelihood of obtaining a low documentation loan in 2002, slightly higher than the remaining three (lower) income bins, with about 18% of all loans classified as being low (or no) documentation loans. In the last row on this table we show the change in the fraction of low documentation loans leading up to the crisis. Interestingly, the change in the fraction of low documentation loans was largest in the high income quartile of zip codes (a 21% increase), whereas there was only a 16% increase for the other three

[14] This correspondence is available at http://www.census.gov/population/estimates/metro-city/a99mfips.txt and also http://www.census.gov/population/estimates/metro-city/a99nfips.txt for the New England Metropolitan Area Components used by Saiz (2010).

[15] The value is presented in 2003, given that the coverage in 2002 is not very comprehensive.

quartiles. We also report the Saiz elasticity measure for each of the subgroups. The average elasticity measure for the full sample is 1.7 but it is slightly lower for the highest income quartile at 1.4 and 1.9 for the lowest income quartile. As it has been shown in a number of other papers, the elasticity measure is strongly correlated with house price growth.

The last three columns of Table 1 show that the zip codes that experienced the biggest house price run-ups between 2002 and 2006 had similar household income levels to the other zip codes in the sample. However, buyer income as of 2002 was already higher than the buyer income in any of the other quartiles, and these zip codes already had relatively high average mortgage sizes as of 2002, especially compared to zip codes with small house price increases during this period. Also, already at the beginning of the period there were more mortgages originated per 100 residents in the zip codes that later experienced large house price increases (3.4 compared to 2.4 for the other quartiles). There are no large differences in terms of LTV, DTI or the fraction of low documentation loans between zip codes in different quartiles of house price growth.

In Table 1 we also report the growth rates of the main variables of interest, i.e. mortgages and income. First, we document the (annualized) nominal growth rate of IRS household income between 2002 and 2006. The growth rate of household income is about 4.6% on average, with 6.4% for the high income zip codes and only 3.5% for the lowest income ones. However, when we consider the annualized growth rate of the income reported for the group of home buyers in HMDA, we see that they are relatively similar across household income quartiles. They all hover around 6 to 7%. There are, however, large differences in both household and buyer income growth depending on whether zip codes experienced large or small increases in house prices during this period. In both cases, zip codes with larger house price run-ups have bigger contemporaneous income increases.

We also show the annualized growth rate in the total mortgage credit originated for home purchases by zip code between 2002 and 2006. This growth rate includes the growth in the average mortgage size, as well as the growth in the number of mortgages originated in an area. The growth rate is about 8% in the zip codes in the highest income quartile, while it is double this amount (16%) for the lowest quartile. When we focus only on the change in the average mortgage size, we see that the growth in the highest quartile is about 7.5% while in the lowest quartile it is about 6.9%. This means that the average loan size increased during the 2002-2006 period, but the differential growth rate across higher and lower income areas was relatively limited. In the next row we see a much larger difference across areas when we consider the growth in the number of mortgages. The areas in the highest income quartile only see an annual increase in transactions of about 1%, while the lowest quartile has an increase of almost 10% annually. This suggests that the bulk of the increase in the total amount of mortgages originated in lower income areas is driven by the fact that these saw a steep increase in the number of transactions. In other words, there was a larger impact on the extensive margin than on the intensive margin.[16] As we see in the second-to-last row of the table, this increase in the number of mortgages was not accompanied by a large increase in DTI for the low income zip codes. A similar picture emerges from Appendix Figure 2, where zip codes along the whole distribution show small increases DTI, where DTI comes from LPS and is computed by the lender (rather than by us). It is obtained as the sum of mortgage payments, insurance, and taxes divided by the monthly borrower income. A similar picture is shown in Jaffee (2009), where debt service to income figures show a similar modest rise.

When we consider neighborhoods with different levels of house price appreciation, changes in the average size of mortgages accounts for the bulk of the increase in mortgage credit for zip codes that experience large house price increases (12.4% annual increase in average mortgage size). Average

[16] This increase in the number of mortgages can be the result of new homeowners moving into these areas (as in Guerrieri, Hartley and Hurst, 2013), or of more transactions by existing residents.

mortgage size increased by much less (2.1%) for zip codes with small house price increases, as we would expect.[17] The growth in the number of mortgages is relatively similar across zip codes with high and low house price appreciation.

4. Mortgage credit and income

In Table 2 we analyze the relationship between mortgage growth and income growth at the zip code level. Panel A only includes the zip codes that have non-missing zip code level house prices from Zillow. Following the specification used in Mian and Sufi (2009), we regress the annualized growth in the total mortgage amount used for home purchase at the zip code level from 2002 to 2006 on the growth in the average household income obtained from the IRS in that zip code. The analysis addresses whether mortgage growth became decoupled from income growth in the run-up to the crisis, allowing especially poorer households to obtain credit beyond what their income would justify. However, as discussed above, a more relevant measure of borrower fundamentals is the income of the people who actually bought a property in the zip code during a given year, as opposed to the average household in a zip code. We use individual-level transaction data from HMDA to measure the income growth of the individual buyers, and aggregate up to the zip code level by taking the average for each zip code. The first specification for each dependent variable does not include county fixed effects, since by first differencing the dependent variable and the right-hand side variables we are already taking out zip code specific fixed effects. So, the relationship is estimated comparing changes in income and mortgage growth rates across all zip codes in the U.S. We then include county fixed effects in the next two specifications to follow the approach in Mian and Sufi (2009). However, if the aim is to test if credit is increasingly allocated to zip codes with declining incomes, one should not include county fixed effects. The analysis with county fixed effects only tests if, within a given county, zip codes that are growing quicker than the county average are disproportionately receiving more credit. If all the first order changes in credit allocation happen between counties, this would be lost by this analysis. We show results with and without fixed effects throughout the paper, but we highlight that the sign on the coefficient often is reversed when we do not include the county fixed effects.

The base specification for these tests is:

$$g_{02-06}\,(Mtg)_i = \alpha_0 + \alpha_1 * g_{02-06}(\mathrm{BuyerInc_i}) + \alpha_2 * g_{02-06}(ZipInc_i) + \varepsilon_i$$

Where the left-hand side variable is, in turn, the annualized growth in total mortgage origination in zip code *i*, the annualized growth in the average mortgage size in zip code *i*, or the annualized growth in the total number of mortgages originated in that zip code. Similarly, the two right-had side variables of interest are the annualized growth in average buyer income (from HMDA) and the annualized growth in average household income from the IRS. We also add county fixed effects as discussed.

Our tests also show that the coefficient of aggregate mortgage growth on zip code income is only negative if we control for county fixed effects (as proposed in Mian and Sufi (2009)). Without the county fixed effects, the coefficient on average household income growth is positive throughout. Column (1) of Table 2 shows that between 2002 and 2006 there is a positive relationship between the growth in total amount of credit originated for home purchase in a zip code and the growth in average IRS income. The reported coefficient is 0.150 but insignificant. However, the coefficient on the income growth of the individual buyers is positive at 0.511, and highly significant at the 1% level.

[17] Ferreira and Gyourko (2011) show that income growth has important explanatory power for local housing booms. The relationship between business cycles and real estate prices is an issue of some debate (see, for example, Leamer (2007) and Ghent and Owyang (2010). See Ghysels, Plazzi, Torous and Valkanov for a survey on predictability of real estate prices.

In column (2), we repeat this regression and include county fixed effects. The reported coefficient on the growth in IRS income is -0.224 (significant at the 5% level), which is similar to the magnitude estimated by Mian and Sufi (2009). But, again, the coefficient on the individual buyers' income is strongly positive (0.376) and significant at the 1% level. Finally, in column (3) we add a measure for the growth rate of house prices at the zip code level and the estimated coefficients on the variables of interest do not change.

The dependent variable used in the first three columns measures the change in the total mortgage debt originated yearly at the zip code level. This variable is a combination of the change in the average size of mortgages and the number of mortgages originated. In columns (4) to (7) of Table 2 we now decompose the dependent variable into the growth in the size of the average mortgage and the growth in the total number of mortgages originated in a zip code. The first is a measure of the intensive margin and asks whether leverage increased for the people who buy a home. This is the relevant specification for understanding whether the average buyer's mortgage size changed with buyer income. The second measure captures the extensive margin and asks whether more mortgages were originated in a given neighborhood. In column (4) we regress the growth in the average size of mortgages (the intensive margin) on the change in the average IRS zip code income and the income growth of borrowers, parallel to the regressions in Columns (1). We see that the estimated coefficients on both the average IRS income growth, as well as the income growth for the buyers are positive. The coefficient on the IRS average income growth is 0.372 and significant at the 1% level. The coefficient on the income growth for the buyers is similar in magnitude (0.506) and again very significant. As before, we add county fixed effects in columns (5). The coefficient on the IRS average income growth is 0.208 and significant at the 1% level. The coefficient on the income growth for the buyers is similar in magnitude (0.276) and again very significant. In column (6) we add, as before, a measure of house price growth and the results again are unchanged. These results confirm that mortgage sizes grew proportionally with income throughout the pre-crisis period and were not decoupled from income growth.

In Columns (7) and (9) we repeat the same regressions as before, but use as the dependent variable the annualized growth rate of the number of mortgages originated in a given zip code (the extensive margin). In column (7) we find a negative relationship between the growth in the number of mortgages and the growth in average IRS income (the estimated coefficient is negative 0.227 and significant at the 1% level). So, neighborhoods with rising average income (relative to other zip codes in a county) saw fewer new mortgages, and vice versa for neighborhoods with falling relative income. Along the extensive margin we see a positive but insignificant coefficient on the measure of income growth of home buyers (the estimated coefficient is 0.023). The results are qualitatively unchanged if we add county fixed effects in column (8) or when we control for house price appreciation in Column (9).

Overall, the results of the decomposition of total mortgage growth into average mortgage size and the number of mortgages supports the idea that there was a change in the composition of buyers relative to the existing residents of a zip code in the period before the financial crisis. Since the prior literature focused on zip codes as the unit of analysis, it was not able to differentiate the characteristics of the stock of residents from those of the flow of home buyers. Our results show that even in the run-up to the financial crisis there was a positive and significant relationship between the growth in average mortgage size and income growth of the home buyers, independent of how we measure income. So, there was no reversal relative to previous periods with credit disproportionately flowing to people with (relative) declining income. Below we explicitly test for differences relative to other time periods. Instead, the negative coefficient between mortgage growth and income growth at the aggregate level that has been shown by Mian and Sufi (2009) is driven by the extensive margin: more mortgages were being taken out in zip codes where the existing stock of residents had relative declining income over the pre-crisis period. But the debt-to-income levels did not change differentially for rich and poor borrowers.

4.1. Full sample of HMDA zip codes

In Panel B of Table 2 we replicate the regressions in Panel A, but we use the universe of all zip codes in HMDA. This increases the sample of zip codes by a factor of three. Given the importance of the composition effects we document in the previous section, we want to verify whether the results hold in the larger sample of zip codes. It is important to keep in mind that the majority of the zip codes added in this sample are much less densely populated and have fewer transactions than the zip codes in Zillow. In total, these zip codes make up only 30% of the annual volume of mortgages originated in the US. We follow the same analysis as in Panel A. Odd columns do not include county fixed effects, while even columns do. In column (1) we see that the coefficient from the regression of the growth in aggregate zip code mortgage origination on the growth in average household income is positive and significant using the whole HMDA sample. The coefficient on the income growth of the home buyers is positive and significant as before. Adding county fixed effect in column (2) reduces the magnitude of the coefficient on household income growth from the IRS but does not otherwise significantly change the results. This suggests that, in the wider set of zip codes, the relationship between growth in total mortgage credit and income was positive, independent of how we measure the growth in average income.

As before, we also decompose the aggregate credit growth into the average size of individual mortgages and the total number of mortgages. In columns (3) and (4) the dependent variable is the growth in the average mortgage size in a zip code between 2002 and 2006. The coefficients on both the average household income and the income of the buyers are positive and significant. When we include county fixed effects the coefficient on average IRS income growth drops by about 50%, while the coefficient on buyer income remains unchanged. Finally, in columns (5) and (6) we repeat the same regressions using the growth in the number of mortgages in a zip code as the dependent variable. The coefficients on both the average IRS income and the income of the buyers are positive and significant. These results show no decoupling of mortgage growth and income growth even on the extensive margin.

4.2. Cross sectional variation in house price increases

To understand whether the compositional changes of home buyers across neighborhoods are related to the house price run-up, we sort zip codes into quartiles based on the amount of house price growth they experienced in the period from 2002 to 2006. We repeat the previous regressions for each subgroup of house price growth in Table 3. We report the results for the high, middle and low quartiles, where, as before, the middle group combines the second and third quartiles. Panel A focuses on the aggregate growth in mortgage origination at the zip code level, combining the intensive and extensive margins. Columns (1) and (2) show that the negative relationship between the growth in mortgage origination and the growth in household income is concentrated in the three quartiles that have the highest growth in house prices. The coefficient for the highest and the middle groups are negative 0.332 and negative 0.283, respectively. As before, the coefficient on the growth of the buyers' income is positive and strongly economically and statistically significant. In contrast, the zip codes in the lowest quartile of house price growth show a strong positive relationship between zip code level income growth and mortgage growth (0.370), but a weaker relationship between mortgage growth and the change in income of buyers (0.194).

These findings highlight that the changing composition in the income of all residents relative to that of home buyers within a zip code was prominent in all areas where house prices were going up quickly. However, in neighborhoods where house prices did not go up by much, we do not see the same strong divergence between the stock of residents and the flow of buyers. Of course, from these results we cannot establish a direction of causality: buyers with higher income than the average resident might have pushed up house prices in these areas, or vice versa, the rapid rise in house prices within an area might have caused the change in the composition of buyers, since only people with higher income could now afford to buy properties.

We again break out the aggregate mortgage amounts into the average mortgage size (Panel B) and the number of mortgages in a zip code (Panel C). We find a positive coefficient on the relationship between the growth in average mortgage size and the growth in average IRS incomes at the zip code level across all quartiles of house price growth. In addition, when looking at the growth in the income of the buyers, we again find a positive relationship throughout. However, when we consider the number of mortgages originated within a zip code (the extensive margin), we find a strong negative relationship between the number of mortgages and household income growth at the zip code level for the three quartiles with the highest house price growth (Panel C). But, again, the sign of the coefficient flips and is positive and significant for the lowest quartile. The relationship between the number of mortgage transactions and the growth of the income of the buyers is positive and significant as before.

These results confirm that the divergent growth in the income of the average resident and of home buyers was strongest for areas with rapid house price appreciation, and that the effect runs entirely through the expansion of the number of borrowers (extensive margin). In contrast, the mortgage size for the average buyer within a zip code is still strongly positively and significantly related to the income of the household (irrespective of how we measure income). This is consistent with a changing composition of households within neighborhoods.

4.3. Cross sectional heterogeneity in zip code income

Many observers of the housing market have been concerned that lending to lower income borrowers changed most dramatically over this time period. In this subsection we explore this dimension of cross-sectional heterogeneity in the data. In Table 4 we break out the data into quartiles based on the average income per capita in a zip code as of 2002. The analysis follows exactly the specifications of Table 3. Columns (1) through (3) of Table 4 show that the relationship is not identical across the different zip code income quartiles. Only the top quartile by income (column 1) shows a negative and significant coefficient on the measure of average IRS income growth (-0.110). For the lower three income quartiles in columns (2) and (3) we always find a positive relationship between mortgage and household income growth. The coefficient of total mortgage origination growth on average IRS household income growth in the middle income group (second column) is 0.401 and very significant, and the coefficient for the lowest income group in column (3) is even higher at 0.760 and again significant at the 1% level. The relationship between total mortgage growth and borrower income growth is positive and significant throughout (0.292, 0.247 and 0.528 for the highest, middle and lowest quartiles, respectively). Taken together, we do not find evidence that poorer zip codes were changing their leverage levels disproportionally relative to income growth. In fact, the relationship between credit and borrower income is strongest for lower income zip codes, and the negative relationship between average household income and credit is only negative for the zip codes with the highest income.

Since zip codes with higher house price growth usually also have lower average income (as documented in the descriptive statistics), Appendix Table 2 shows a "horse race" regression between different cross sectional variables interacted with the measures of income growth. This allows us to assess whether income level or house price growth better captures the cross-sectional variation in the relationship between mortgage growth and income growth. We also include interactions with a number of other zip code level variables that have been discussed in the prior literature, such as the Saiz (2010) measure of the elasticity of housing supply, the fraction of low documentation loans in a zip code and the fraction of loans sold to Fannie Mae and Freddie Mac (the government-sponsored enterprises, or GSEs).

In this table we run the standard specification of growth in aggregate mortgage origination at the zip code level on growth in average zip code income and home buyer income, and then interact each of the income variables with the cross sectional measures. Column (1) replicates the same regressions as in Table 3 for the sample of zip codes for which we have the relevant cross sectional information. We see that the results are virtually unchanged relative to the prior sample. When we include the interaction terms in column (2) we see that the direct effect of zip code income growth and buyer income growth are both positive and significantly related to aggregate mortgage growth. However, the interaction terms of the dummy for high income areas with both average household income growth and buyer income growth are negative and very large (and significant at the 1% level). This suggests that, consistent with the previous tables, it is in the high income areas that the relationship between mortgage growth and income growth is weakest. In what follows we will show that this is the result of increased relative income growth in these areas compared to lower income zip codes in the US. We also find a negative coefficient on the interaction of house price growth and average zip code income growth, but a positive and very significant relationship with the growth in buyer income for the intensive margin. This suggests, as before, that in neighborhoods with higher house price growth, mortgage growth became less sensitive to the average zip code income, but it became more sensitive to the income of buyers. In columns (3) to (6) of Appendix Table 1 we again confirm that the change in sensitivity was mainly driven by the extensive margin, i.e. the number of new loans that were originated within the zip codes.

4.4. Longer run correlation

The previous sections show that there is no negative relationship between mortgage growth and borrower income growth, but it is still possible that the *slope* of the relationship was weaker in the pre-crisis period (2002-2006) than in previous periods. As a result, leverage might have become less closely tied to income levels or growth in income, suggesting that credit expansion might have deviated somewhat from fundamentals relative to other periods. To address this question, in Table 5 we explore how the relationship between mortgage growth and income growth changed over time.

In a first step we repeat our main regression from Table 2 but break it out by different time periods. We follow the example of Mian and Sufi (2009) and consider 5 sub-periods: 1996-98, 1998-2001, 2001-2002, 2002-2006 and after 2006. The coefficient from the regression of growth in total mortgage origination on growth in average zip code income, is positive and significant for most time periods before the financial crisis, and it turns negative in the 2002 to 2006 period. However, as we have argued before, this is not the relevant income measure for assessing borrower fundamentals. When we look at the coefficient of mortgage growth on the growth in the income of the buyers, the coefficient is positive and significant across all the time periods, and, importantly, it does not become flatter in the pre-crisis period. If anything, the coefficient goes from 0.178 in the 1998-2001 period to 0.376 in 2002-2006, which means that the sensitivity of mortgage growth to income growth actually increased prior to the crisis. In Panel B of Table 5 we repeat the same regressions for the full HMDA sample. When we consider all zip codes in the data, the coefficients on both the buyer income and the average zip code household income are remarkably stable over time, with somewhat lower magnitudes in 1998-2001, but otherwise very similar across time periods.

4.5. Panel data specification

We now go a step further and expand the previous regression set up to a full panel specification. So far, we have related mortgage growth over the 2002 to 2006 period to contemporaneous growth in income. Here we turn to the full annual panel of zip code level mortgage origination to look at the relationship between mortgage growth and annual measures of household and buyer income. This is an alternative way to assess whether the slope of this relationship changed over time.

In Table 6 we now use the following specification,

$$\mathrm{Ln}(Mtg_{it}) = \alpha_0 + \Sigma_i \alpha_i \left[\mathrm{Ln}(BuyerInc)_{it} * Y_t \right] + \Sigma_j \alpha_j [\mathrm{Ln}(ZipInc)_{it} * Y_t] + FE_t + FE_i + \varepsilon_{it}$$

The independent variables are the logarithm of the income of buyers interacted with a full set of dummies for all years in the sample (denoted Y_t), the logarithm of the average income of households in the zip code also interacted with a set of year dummies, FE_t is a year fixed effect, and FE_i a zip code fixed effect. Including zip code fixed effects and interactions of the variables of interest with year dummies allows us to test how changes in the sensitivity of mortgage levels to income levels changed within zip codes over time.

In columns (1), (3) and (5) we simply include the logarithm of the income variables (and not the full set of interactions with the year dummies) to compare the results in this panel setup to the previous tables. The dependent variable in column (1) is the aggregate mortgage origination in a zip code in a given year. The results show that the coefficients on the income of buyers and on the IRS average income is positive and significant, and very similar in magnitude to our prior results. As before, we break out total mortgage origination into the average mortgage size by zip code and year (column 3) and the number of mortgages in a given zip code and year (column 5). The results confirm that average loan size is strongly positively related to buyer income but also to the income of existing buyers in a zip code. The effects are slightly less significant but go into the same direction when using the number of loans per zip code and year.

Given the panel structure of our data we can now analyze the dynamics over the run-up to the financial crisis, i.e. whether the sensitivity between mortgage level and the income variables changed over the run-up to the financial crisis. The omitted year is 2002, which is the base year in our sample. Column (2) shows an interesting pattern. While the direct effect of mortgage growth and existing IRS income is positive and significant, the interaction terms with the year dummies are negative and significant in all years. This means that the relationship between the growth in mortgage origination and the growth in average household income from the IRS became flatter over time. However, the relationship between aggregate mortgage origination and buyer income in a given zip code is strongly positive and the interactions with the year dummies are positive and significant. This means that the combined effect increases from 0.231 in the base year (2002) to about 0.434 in 2005 and back to 0.271 in 2006. This finding reinforces our earlier findings that the growth in zip code leverage became more closely tied to the change in the income of the buyers (and less to that of the average household in a neighborhood).

We again decompose this effect into the average mortgage size and the number of mortgages. Column (4) shows that the estimated relationships are very similar to the ones for the aggregate mortgage levels when we use the average mortgage size as the dependent variable. The relationship with buyer income becomes stronger over the time period and, in contrast, the relationship with zip code level household income becomes weaker over that time period. The effect on the extensive margin (the number of mortgages, shown in column 6) is much noisier and again we see that the number of new mortgages in an area becomes more negatively correlated with household income over time.

5. Individual leverage

5.1. Aggregation by income deciles

The zip code-level analysis shows that credit did not disproportionately flow to *borrowers* with declining income, but rather that along the extensive margin *zip codes* where the average household income saw a relative decline there was an increase. Ultimately, however, it is not neighborhoods who obtain (and are responsible for) loans, but rather individual home buyers. We now consider how this compositional change we document across neighborhoods affects where credit built up in the US during the 2002-2006 period. For this purpose, we use individual transaction level data from HMDA (rather than the aggregates at the zip code level).

Panel A of Table 7 shows the average size of mortgages obtained by borrowers in each income decile based on applicant income. The table shows that mortgage size grew significantly over this time period for all income groups. At the bottom of the income distribution, we see that the average mortgage balance at origination went from around $74K in 2002 to $85K in 2006 for the lowest income decile. Similarly, in the middle income deciles average loan amounts grew during the same period from $146K to 183K (decile 6). For the top decile, the average size of purchase mortgages went from $351K to a remarkable level of over $442K. This breakdown of the data highlights an interesting fact that has not received enough attention, which is that the largest increases in the size of mortgages were in the middle income and, in particular, the high income borrowers, not for the lower income buyers.

In Panel B of Table 7 we calculate the average debt-to-income ratio (calculated as the mortgage balance divided by applicant income) for mortgage holders in each of these income deciles across time. We compute debt-to-income as the ratio of the mortgage balance at origination divided by the applicant income. Not surprisingly, when we look across income deciles, we see that poorer households are significantly more levered than richer ones even in 2002. The average household in the lowest decile (1) has a first mortgage DTI of 3.0 while the average mortgage holder in the top income decile (10) only has a DTI of 1.32. In line with our prior analysis, we see that DTI levels measured in HMDA do not change much over the time period from 2002 to 2006. In deciles (2) through (10) the DTI is virtually constant or even slightly declining, e.g. from 2.17 to 2.01 in income bin (5). In the lowest income group the DTI went slightly up, but even there it moved from from 3.07 to 3.24. Importantly, DTI did not become differentially higher for low income borrowers than for high income ones. The same data is plotted in Panel B of Figure 1, where it is immediately obvious that DTI levels are remarkably flat between 2002 and 2006. In Appendix Figure 2 we show the debt-to-income measure typically used in the industry, namely a measure of recurring mortgage payments divided by monthly borrower income. This includes payments on interest, second liens, insurance, and taxes. Consistent with the results in Table 7, the figure shows that the increase in DTI is relatively modest, and that borrowers at all income levels move in lockstep.

In Panel A of Figure 1 we break down the total dollar volume of mortgages originated for home purchase in each year (from HMDA) by the decile that each borrower falls into based on their applicant income (the same data is shown in detail in Panel C of Table 7). We sum the mortgage amounts of all the households within an income decile and divide this number by the total amount of mortgage debt originated in the US in a given year. This picture dramatically highlights the idea that credit was flowing predominantly to richer household: the proportion of mortgages originated is strongly monotonically increasing in income, and it is very stable over time between 2002 and 2006. The highest income borrowers (those in the top decile) account for about 21 to 22% of the total mortgage credit, whereas the bottom decile accounts for about 5%. In total, the top 3 income deciles (8) through (10) contributed almost half (46%) of mortgages in 2002, about the same number as in

2006 (49%). This again clearly shows that there was no significant decoupling of the distribution of credit from applicant income throughout this period.

5.2. Individual level mortgage origination regressions

The zip code level regressions show that the negative correlation between zip code income growth and mortgage growth between 2002 and 2006 is driven by the extensive margin, i.e. the relative increase in the number of buyers in places where income grew less (relative to the county average). This regression also shows that there was no decoupling between average mortgage amount and income – the intensive margin. In this section we consider the intensive margin using individual transactions, which allows for even finer geographic controls than before. To this end, in Table 8 we use the following specification:

$$\mathrm{Ln}(Mtg_{it}) = \alpha_0 + \alpha_1 \ \mathrm{Ln}(BuyerInc)_{it} + \alpha_2 \, \mathrm{Ln}(Census\ Tract\ Inc)_{it} + FE_t + FE_{census\ tract} + \varepsilon_{it}$$

Where i indicates an individual borrower. FE_t is a year fixed effect and $FE_{census\ tract}$ is a census tract fixed effect, the finest geographic breakdown available in HMDA. The independent variables are, again, the logarithm of the buyer's reported income and the logarithm of the average income of households in that tract. Because we do not have data on the average household income by tract, we use the same zip code to tract population-weighted bridge as before (from the University of Missouri Census Data Center) to impute average tract income based on zip code household income. Including census tract fixed effects allows us to test how the sensitivity of mortgage levels to income levels changed within census tract over time.

Table 8 shows the results for this loan-level specification. Consistent with the zip code level regressions, both the coefficients on buyer income and census tract income are positive and significant, and the result is unchanged when we replace county fixed effects with census tract fixed effects (column 3). Columns 2 and 4 show that the sensitivity of mortgage size to buyer income increases over time during our sample period (2002-2006), whereas the sensitivity to average household income either decreases or does not change. Overall these results reaffirm the conclusion drawn from the zip code level analysis, and are supportive of the idea that credit supply did not decouple from income during the boom period.

6. Robustness

6.1. Misreporting of applicant income

One important consideration in the run-up to the financial crisis was that lenders started to misreport income levels of prospective borrowers in order to justify higher leverage levels than these borrowers would normally be able to afford. It is important for the purposes of our study to rule out that changes in the reporting of income itself could be the source of the strong relationship between buyer income and total mortgage growth we find in all specifications, as this might hide a de facto increase in household leverage levels.[18]

---

[18] There is also evidence of other forms of misreporting during this time period, including the value of transactions (Ben-David, 2011), or mortgage quality in contractual disclosures in the secondary market (Piskorski, Seru and Witkin, 2013 and Griffin and Maturana, 2014). These forms of misrepresentation do not, however, influence the analysis in this paper.

We use a few different approaches to analyze whether this is a first order concern for our findings. First, in Panel A of Table 9 we break out our sample into different quartiles based on the fraction of mortgages originated and sold to Fannie Mae and Freddie Mac (the government-sponsored enterprises, or GSEs) in the zip code, as well as the fraction of loans that were originated by subprime lenders based on the subprime lender list constructed by the US Department of Housing and Urban Development (HUD, see section 2 for details). Loans that were sold to (and then guaranteed by) the GSEs had to conform to higher origination standards than those sold to other entities, and thus were less likely to have unverified applicant income.[19] The idea in these tests is to see whether zip codes with a lower fraction of loans sold to the GSEs are the ones that exhibit a stronger relationship between mortgage growth and buyer income. Similarly, loans originated by subprime lenders were much more likely to have low or no documentation status, and, if the correlations shown above were driven by misreporting, we would expect the splits based on this fraction to generate meaningful variation in the estimated coefficients.

For both measures of quality of origination we do not find that coefficients on buyer income vary significantly. In fact, the coefficient on buyer income growth is very similar in magnitude and significance levels across all quartiles of both the GSE origination fraction and the fraction originated by subprime lenders (if anything, the coefficient is smaller for the zip codes with a relatively low fraction of GSE loans).

In Panel B we repeat the individual-level regressions in Table 8 split also by loans that are later sold to the GSEs, and also by loans originated by subprime lenders versus those originated by non-subprime lender. Again, the coefficient on buyer income is very stable and statistically identical across all subsamples, consistent with the notion that buyer income misreporting is not driven the results.

Finally, in Panel C of Table 9 we consider the correlation between lagged buyer income and lagged IRS household income, to see if buyer income is a predictor of future IRS income. We find that there is a positive and significant correlation, which once more suggests that buyer income reflects meaningful increases in local income. We can therefore rule out that our results are primarily driven by inflated borrower incomes and as a result hid a de facto increase in household leverage.

6.2. Refinancing

While the focus of the previous results linking income and mortgage origination has been on loans used for home purchase, it is possible that refinancing transactions, and especially cash-out re-financing transactions, became more important over the pre-crisis period and could have altered the indebtedness of low income relative to high income households. Increasing house prices and a growing willingness of lenders to provide such refinancing arrangements made it easier to unlock equity that borrowers had in their homes. It is possible that this happened disproportionately to income over this period, so it is important for us to consider this margin. The downside of using HMDA data for this analysis is that we only have an identifier for whether a transaction is a refinancing transaction (as opposed to a purchase transaction) but we do not know if it was used to change the existing mortgage level on the property (i.e., a cash-out refinance) or just to reset the interest rate without any change in the loan size. Only a cash-out refinancing would increase the leverage level of the household, so we would ideally want to restrict the analysis to cash-out loans only.

---

[19] Previous work, including Pinto (2010) have noted that origination standards for the GSEs dropped between 2002 and 2006, but we find similar results when we split the sample directly by the fraction of loans originated by subprime lenders.

In Panel A of Table 10 we repeat the regressions in Panel A of Table 2, but we focus on the growth in the income of borrowers who are engaged in refinancing transactions. The picture that emerges is very similar to the new mortgage transactions. In column (1) we consider the growth in aggregate refinancing credit and find a negative and significant coefficient on the change in zip code level income (-0.579), but an economically and statistically large and positive effect on the change in buyer income (1.113). In columns (3) and (4) we decompose the aggregate effect into the average mortgage size and the number of mortgages as before. The estimated coefficient on IRS income and borrower income growth are positive and significant when we look at the change in the average mortgage balance without fixed effects, and negative but very small when county fixed effect are included. The results for the number of transactions is very similar to purchase mortgages: we find negative coefficients on IRS income growth, and positive but smaller coefficients on the borrower income growth.

Panel B of Table 10 implements a zip code level panel regression similar to the one in Table 6, but only for refinancing transactions. The coefficients show that the relationship between refinancing mortgage growth and borrower income becomes steeper (not flatter) for the later years (2004, 2005 and 2006), and that it becomes progressively flatter for the IRS income measure. Almost all of this variation in the slope of these relationships is coming from the extensive margin (the number of transactions) rather than from changes in the average mortgage balance.

Because HMDA does not distinguish between regular refinancing transactions and cash-out refinancing, we turn to data from LPS and run loan-level regressions similar to the ones in Table 8.[20] We measure zip code income using IRS data, and we use the average borrower income obtained from HMDA (LPS does not include borrower income information, so we merge borrower income at the zip code and year level). Table 11 shows these regressions for both purchase mortgages and cash-out refinancing transactions. The first message from the table is that the results using LPS data are very similar to those using HMDA shown in Table 8. Both borrower income and average household income are strongly positively correlated with mortgage size, and this relationship becomes weaker over the 2002-2006 period for IRS household income, but it becomes stronger for borrower income. The second message from the table is that the results are almost indistinguishable for cash-out refinancing transactions. Both income measures are strongly positively associated with the size of cash-out refinancing transactions, and that relationship evolves in a similar way as for purchase transactions over time.

7. Distribution of mortgage delinquency

In this final section we consider how the distribution of mortgage credit compares with that of mortgage delinquency. Much of the prior literature has focused on the fact that delinquency rates are higher for lower quality borrowers, but here we show simple summary statistics on the dollar volume of credit that is past due (as opposed to the rate of loans that are delinquent as a fraction of the loans that are originated).

Panel A of Figure 2 uses data from LPS to again show the distribution of mortgage origination by applicant income decile (similarly to Figure 1 that uses data from HMDA). Because LPS does not provide individual level income, we use the average of applicant income from HMDA by zip code to create these figures. As before, the distribution of credit stable, and the proportion by quintile closely matches the proportions shown in Figure 1. Panel B shows the contribution by applicant income quintile to the total dollar value of mortgages that are 90 days delinquent or more during the subsequent three years by origination year. The dollar value of delinquent mortgages is simply calculated as the sum of the origination amount for mortgages that become delinquent. Contrary to popular belief, it is the middle and top quintiles of zip codes based on applicant income that

[20] We only have access to a 5% sample of the LPS data, which makes the data unsuitable for zip code level analysis.

substantially increase their weight in the pool of delinquent mortgages over time. Of course, the total dollar value of mortgages that are delinquent went up dramatically for mortgages originated in 2006 relative to those originated in 2002, but clearly this is not driven primarily by low income borrowers.

Figure 3 focuses on 2006 and compares different types of mortgages: first mortgages taken out with the purpose of purchasing a home, second liens, and cash-out refinance loans. The purpose of this figure is to ask whether the message from Figure 1 and Figure 2 is likely to be very different for mortgages other than purchase mortgages.[21] Panel A shows that the dollar distribution of all three product types are remarkably similar when we break zip codes out by quintiles based on borrower income. The second and third highest quintiles shows 4 and 2 percentage points higher weights respectively for second liens and cash-out refinances relative to purchase mortgages, but this is mostly due to a lower weight of the very highest quintile. The weight of the lowest two quintiles is very similar throughout, and, if anything, the poorest applicants seem to account for a lower weight in second liens and cash-out refinances relative to purchase mortgages. When we consider the distribution of delinquent mortgages (measured in dollars), the distribution again looks very stable for all products, again with a higher weight of the richest borrowers. This strongly suggests that the conclusion of the previous tables that origination and delinquency was concentrated among high and middle income borrowers also applied to mortgages other than purchase mortgages.

8. Conclusion

This paper shows that there was no decoupling of mortgage credit growth and income growth during the period before the financial crisis. Instead, mortgage credit and income move in the same direction when we focus on individual mortgage growth and income growth. Additionally, we document that total mortgage credit moved in line with borrower income throughout the pre-crisis period. However, borrower income was becoming increasingly higher than the zip code level average, and especially neighborhoods with increasing house prices also saw significant increases in borrower income. This suggests that changes in borrower composition are important in understanding the relationship between credit growth and borrower fundamentals during this time period. The fact that DTI did not change differentially across rich and poor borrowers suggests that there were no severe distortions towards poor or low-income people in the way banks allocated capital at loan origination.

Instead, our results show that the dramatic rise in credit before the financial crisis was mainly driven by increases along the extensive margin, and that credit increased proportionally across all income levels, so that the distribution of mortgage credit across income deciles was stable. This means that even in 2006 high and middle income borrowers accounted for the overwhelming majority of credit that was originated in the mortgage market, since these middle-class borrowers take out much larger (and more) loans than the poor. The increased house buying activity (churning) led, in the aggregate, to a larger fraction of potential buyers to be levered up to their maximum level of DTI and possibly LTV. Once the crisis hit, we see that high and middle income borrowers accounted for the majority of dollars of credit in delinquency, especially in areas where house prices dropped. Since these borrowers have much larger mortgages, a small increase in their default rate has large impact on the amount or dollars in delinquency. These delinquencies were then exacerbated in zip codes with a large fraction of owners that are highly levered, since there is less financial slack to buy homes from people who have to sell. As a result, there might have been an asset fire sale type of externality that led to (downward) pressure on prices. In this sense, the main change in the financial market was not that low income individuals became unsustainably levered relative to higher income borrowers. But

[21] Our sample of LPS is limited, so it does not allow us to reliably show the evolution of either origination or delinquency by year for second liens and cash-out refinance loans.

rather that lenders and borrowers bought into high house price expectations and ignored potential equilibrium effects from a large fraction of borrowers being levered to their maximum DTI. A significant fraction of these home buyers later sold or foreclosed on mortgages when the option value of higher house price appreciation was not realized.

REFERENCES

Adelino, M., Gerardi, K., and Willen, P. S. 2013. Why don't Lenders renegotiate more home mortgages? Redefaults, self-cures and securitization. Journal of Monetary Economics, 60(7), 835-853.

Agarwal, Sumit, Gene Amromin, Itzhak Ben-David, Souphala Chomsisengphet, and Douglas D. Evanoff. "Predatory lending and the subprime crisis." Journal of Financial Economics 113, no. 1 (2014): 29-52.

Ben-David, Itzhak, 2011, "Financial Constraints and Inflated Home Prices during the Real-Estate Boom." American Economic Journal: Applied Economics 3(3), 55–78.

Chinco, A., and Mayer, C. 2014. Misinformed Speculators and Mispricing in the Housing Market.

Coleman IV, Major, Michael LaCour-Little, and Kerry D. Vandell, 2008, "Subprime lending and the housing bubble: Tail wags dog?" Journal of Housing Economics 17.4 (2008): 272-290.

Corbae, Dean, and Erwan Quintin, 2013, "Leverage and the foreclosure crisis". Journal of Political Economy, forthcoming.

Dell'Ariccia, G., Igan, D., and Laeven, L. 2012. Credit booms and lending standards: Evidence from the subprime mortgage market. Journal of Money, Credit and Banking, 44(2-3), 367-384.

Demyanyk, Y., and Van Hemert, O. 2011. Understanding the subprime mortgage crisis. Review of Financial Studies, 24(6), 1848-1880.

Ferreira, Fernando, and Joseph Gyourko, 2011, "Anatomy of the beginning of the housing boom: US neighborhoods and metropolitan areas, 1993-2009." National Bureau of Economic Research working paper No. 17374.

Foote, Christopher L. , Kristopher S. Gerardi, and Paul S. Willen, 2008, "Negative Equity and Foreclosure: Theory and Evidence." " Journal of Urban Economics, 64(2): 234 – 45

Foote, Christopher L. , Kristopher S. Gerardi, and Paul S. Willen, 2012, "Why Did So Many People Make So Many Ex Post Bad Decisions: The Causes of the Foreclosure Crisis"

Glaeser, Edward L., Joshua D. Gottlieb, and Joseph Gyourko, 2013, "Can Cheap Credit Explain the Housing Boom?" Housing and the Financial Crisis (2013): 301.

Ghent, Andra C., and Michael T. Owyang. 2010. "Is housing the business cycle? Evidence from US cities." Journal of Urban Economics 67, no. 3 (2010): 336-351.

Ghysels, Eric, Alberto Plazzi, Walter N. Torous, and Rossen Valkanov. 2012. "Forecasting real estate prices." Handbook of Economic Forecasting 2.

Griffin, John and Gonzalo Maturana, 2014, "Who Facilitated Misreporting in Securitized Loans?" Journal of Finance, forthcoming.

Guerrieri, Veronica, Daniel Hartley, and Erik Hurst, 2013, "Endogenous gentrification and housing price dynamics." Journal of Public Economics 100 (2013): 45-60.

Haughwout, Andrew, Richard Peach, and Joseph Tracy, 2008, "Juvenile delinquent mortgages: Bad credit or bad economy?," Journal of Urban Economics, 2008, 64 (2), 246 – 257.

Jaffee, Dwight M., 2009, "The US subprime mortgage crisis: issues raised and lessons learned." Urbanization and Growth (2009): 197.

Jiang, W., Nelson, A. A., and E. Vytlacil, 2014, "Liar's loan? Effects of origination channel and information falsification on mortgage delinquency." Review of Economics and Statistics, forthcoming.

Kermani, A. 2012. Cheap Credit, Collateral and the Boom-Bust Cycle.

Keys, B. J., Mukherjee, T., Seru, A., and V. Vig, 2010, "Did securitization lead to lax screening? Evidence from subprime loans," Quarterly Journal of Economics, 125(1): 307–362.

Landvoigt, Tim, Monika Piazzesi, and Martin Schneider, 2014, "The housing market (s) of San Diego." American Economic Review, forthcoming.

Loutskina, E., and Strahan, P. E. (2009). Securitization and the declining impact of bank finance on loan supply: Evidence from mortgage originations. The Journal of Finance, 64(2), 861-889.

Leamer, Edward E. 2007. "Housing is the business cycle." Proceedings - Economic Policy Symposium - Jackson Hole, Federal Reserve Bank of Kansas City, pages 149-233.

Mayer, Chris, and Karen Pence, 2009, "Subprime Mortgages: What, Where, and to Whom?" in Glaeser, Edward L., John M. Quigley eds., Housing Markets and the Economy: Risk, Regulation, and Policy. Cambridge, MA: Lincoln Institute of Land Policy.

Mayer, Christopher, Karen Pence, and Shane M. Sherlund, 2009, "The Rise in Mortgage Defaults", Journal of Economic Perspectives Vol. 23 (1), pages 27–50

Mian, A., and Sufi, A. 2009. The consequences of mortgage credit expansion: Evidence from the US mortgage default crisis. The Quarterly Journal of Economics, 124(4), 1449-1496.

Nadauld, T. D., and Sherlund, S. M. 2009. The role of the securitization process in the expansion of subprime credit. Divisions of Research & Statistics and Monetary Affairs, Federal Reserve Board.

Palmer, C. 2014. Why Did So Many Subprime Borrowers Default During the Crisis: Loose Credit or Plummeting Prices?

Pinto, Edward J. 2010. "Government Housing Policies in the Lead-up to the Financial Crisis: A Forensic Study" Discussion draft, American Enterprise Institute, Washington D.C.

Piskorski, Tomasz, Amit Seru, and James Witkin. 2013. "Asset quality misrepresentation by financial intermediaries: Evidence from RMBS market." National Bureau of Economic Research working paper w18843.

Saiz, A. 2010. The geographic determinants of housing supply. The Quarterly Journal of Economics, 125(3), 1253-1296

Shiller, Robert J. 2014. "Speculative asset prices." American Economic Review 104.6 (2014): 1486-1517.

Table 1. Summary Statistics

This table reports summary statistics for all counties in the sample that have nonmissing zip code level house prices from Zillow. Column 1 shows the summary statistics for the entire sample. Columns 2 to 4 show the summary statistics for the zip codes in the highest quartile of average income per capita in 2002 (High), second and third quartiles of average income per capita (Intermediate), and lowest quartile of average income per capita (Low). Columns 5 to 7 do a similar split by house price growth in the zip code between 2002 and 2006. For each variable we show the average and standard deviation (in parenthesis). *Zip code income* is the average adjusted gross income per capita by zip code from the IRS. *Buyer Income* is the average applicant income by zip code from HMDA. *Average mortgage size* is the total mortgage amount originated in a zip code used for home purchase in 2002. *Number of mortgages originated per 100 residents* is the average number of mortgages originated per 100 residents by zip code. Debt-to-income is the zip code average ratio of the mortgage balance at the time of origination over applicant income from HMDA. *Loan to value* is the average loan to value (LTV) in a zip code calculated from LPS. *Fraction of low documentation loans* is the fraction of low documentation loans originated in a zip code from LPS. *Population* is the average zip code-level population estimated from IRS returns. *Elasticity of housing supply* is the Saiz (2010) measure of housing supply elasticity at the MSA level.

Zip code income growth refers to the percentage change between 2002 and 2006 in household adjusted gross income by zip code from the IRS. *Buyer income growth* is the percentage change in average applicant income by zip code from HMDA. *Growth in total mortgage origination* refers to the percentage change in total mortgage credit originated in a zip code used for home purchase between 2002 and 2006 calculated using HMDA. *Growth in average mortgage size* refers to the percentage change in the average balance of individual mortgages in a zip code between 2002 and 2006 (also calculated using HMDA). *Growth in number of mortgages originated* is the percentage change in the number mortgages originated between 2002 and 2006. *Change in debt-to-income* and *Change in loan to value* is the change in Debt to Income and LTV by zip code between 2002 and 2006.

	Whole sample	Zip code household income, 2002			Zip code house price growth, 2002-2006		
		High	Middle	Low	High	Middle	Low
	N =8619	N =2086	N =4346	N =2185	N =2020	N =4407	N =2192
Zip code household income (USD thousands), IRS, 2002	50.93 (28.24)	84.81 (39.42)	44.75 (5.92)	30.85 (3.92)	47.40 (25.45)	54.44 (30.41)	47.13 (25.08)
Buyer income (USD thousands), HMDA, 2002	92.16 (67.26)	143.75 (98.40)	82.27 (46.87)	62.62 (24.85)	99.83 (70.94)	95.11 (70.58)	79.24 (53.87)
Average mortgage size (USD thousands), 2002, purchase mortgages only	154.93 (86.70)	246.37 (113.33)	139.95 (46.49)	97.33 (36.46)	160.97 (76.74)	166.79 (95.63)	125.50 (67.57)
Number of mortgages originated per 100 residents, 2002, purchase mortgages only	2.60 (2.16)	3.09 (3.12)	2.64 (1.78)	2.07 (1.52)	3.38 (3.42)	2.36 (1.53)	2.37 (1.47)
Debt to income, 2002	2.13 (0.38)	2.26 (0.35)	2.16 (0.35)	1.97 (0.41)	2.18 (0.36)	2.17 (0.39)	2.03 (0.36)
Loan to value, LPS, 2003 (N=13,555)	0.80 (0.11)	0.75 (0.10)	0.82 (0.09)	0.86 (0.09)	0.80 (0.10)	0.79 (0.11)	0.83 (0.10)
Fraction of low documentation loans, LPS, 2003 (N=13,555)	0.18 (0.23)	0.20 (0.25)	0.18 (0.23)	0.17 (0.24)	0.20 (0.22)	0.18 (0.24)	0.17 (0.23)
Population (000s), IRS, 2002	142.13 (113.67)	152.90 (110.27)	141.77 (114.96)	132.55 (113.44)	166.16 (128.36)	132.44 (109.75)	139.45 (103.37)
Elasticity of housing supply (N=11887), Saiz (2010)	1.72 (0.88)	1.41 (0.71)	1.78 (0.88)	1.93 (0.93)	1.24 (0.51)	1.65 (0.84)	2.22 (0.91)
Zip code income growth (annualized), IRS, 2002-2006	0.046 (0.028)	0.064 (0.035)	0.042 (0.022)	0.035 (0.021)	0.053 (0.029)	0.047 (0.027)	0.036 (0.025)
Buyer income growth (annualized), HMDA, 2002-2006	0.065 (0.061)	0.068 (0.063)	0.062 (0.059)	0.068 (0.064)	0.108 (0.066)	0.062 (0.050)	0.032 (0.052)
Growth in total mortgage origination (annualized), 2002-2006, purchase only	0.121 (0.148)	0.078 (0.141)	0.119 (0.143)	0.168 (0.151)	0.170 (0.165)	0.123 (0.138)	0.074 (0.136)
Growth in average mortgage size (annualized), 2002-2006, purchase only	0.067 (0.054)	0.075 (0.052)	0.062 (0.051)	0.069 (0.059)	0.124 (0.042)	0.063 (0.040)	0.021 (0.038)
Growth in number of mortgages originated (annualized), 2002-2006, purchase only	0.055 (0.129)	0.007 (0.131)	0.057 (0.124)	0.096 (0.121)	0.046 (0.144)	0.059 (0.126)	0.054 (0.119)
Change in debt to income, 2002-2006	-0.004 (0.286)	0.008 (0.275)	-0.011 (0.280)	-0.001 (0.306)	0.063 (0.293)	0.016 (0.274)	-0.107 (0.276)
Change in loan to value, 2003-2006	-0.017 (0.100)	0.008 (0.100)	-0.022 (0.099)	-0.034 (0.096)	-0.036 (0.095)	-0.010 (0.104)	-0.013 (0.093)

Table 2. Mortgage origination and income

The Table shows OLS regressions of annualized growth in total mortgage credit, the average mortgage size and the number of mortgages originated at the zip code level on the annualized growth rate of average household income (from the IRS) and the annualized growth rate of average buyer income in the zip code (obtained from HMDA). The data only includes mortgages for home purchase. Panel A also includes zip code house price growth from Zillow as a control. Panel A includes zip codes with house price data from Zillow, and Panel B includes all zip codes in the HMDA data. Standard errors are clustered by county. *, **, *** indicate statistical significance at the 10%, 5%, and 1% levels, respectively.

Panel A. Sample with house price data (Zillow sample)

	Growth in total mortgage origination			Growth in average mortgage size			Growth in number of mortgages originated		
Zip code income growth	0.150	-0.224**	-0.214***	0.372***	0.208***	0.212***	-0.227***	-0.417***	-0.411***
	(0.101)	(0.088)	(0.079)	(0.029)	(0.023)	(0.021)	(0.084)	(0.075)	(0.071)
Buyer income growth	0.511***	0.376***	0.349***	0.506***	0.276***	0.266***	0.023	0.130***	0.116***
	(0.045)	(0.047)	(0.047)	(0.034)	(0.015)	(0.015)	(0.050)	(0.040)	(0.040)
Zip code house price growth			0.559***			0.198***			0.281**
			(0.139)			(0.023)			(0.122)
County FE	N	Y	Y	N	Y	Y	N	Y	Y
Number of observations	8,619	8,619	8,619	8,619	8,619	8,619	8,619	8,619	8,619
R2	0.05	0.35	0.35	0.41	0.73	0.74	0.00	0.32	0.32

Panel B. All zip codes in HMDA

	Growth in total mortgage origination		Growth in average mortgage size		Growth in number of mortgages originated	
Zip code income growth	0.499***	0.227***	0.193***	0.087***	0.266***	0.110*
	(0.064)	(0.063)	(0.017)	(0.015)	(0.057)	(0.056)
Buyer income growth	0.591***	0.551***	0.436***	0.338***	0.128***	0.189***
	(0.033)	(0.032)	(0.014)	(0.011)	(0.030)	(0.027)
County FE	N	Y	N	Y	N	Y
Number of observations	27,385	27,385	27,385	27,385	27,385	27,385
R2	0.05	0.33	0.26	0.61	0.01	0.29

Table 3. Mortgage origination and income by house price growth (2002-2006)

The Table shows OLS regressions of annualized growth in total mortgage credit (Panel A), the average mortgage size (Panel B) and the number of mortgages (Panel C) at the zip code level for purchase mortgages only on the annualized growth rate of average household income (from the IRS) and the annualized growth rate of average buyer income in the zip code (obtained from HMDA). Zip codes are separated into quartiles based on the growth in house prices between 2002 and 2006 in the zip code. The "high" column includes the top quartile, the "middle" column includes the second and third quartiles, and "low" includes the lowest quartile. Standard errors are clustered by county. *, **, *** indicate statistical significance at the 10%, 5%, and 1% levels, respectively.

Panel A. Growth in total mortgage origination

	House price growth, 2002-2006			House price growth, 2002-2006		
	High	Middle	Low	High	Middle	Low
Zip code income growth	-0.332	-0.283***	0.370**	-0.121	-0.144	0.639***
	(0.213)	(0.107)	(0.187)	(0.181)	(0.121)	(0.194)
Buyer income growth	0.428***	0.402***	0.194**	0.330***	0.422***	0.263***
	(0.091)	(0.069)	(0.094)	(0.070)	(0.062)	(0.085)
County FE	Y	Y	Y	N	N	N
Number of observations	2,020	4,407	2,192	2,020	4,407	2,192
R2	0.29	0.40	0.43	0.02	0.02	0.03

Panel B. Growth in average mortgage size

	House price growth, 2002-2006			House price growth, 2002-2006		
	High	Middle	Low	High	Middle	Low
Zip code income growth	0.209***	0.198***	0.247***	0.235***	0.256***	0.301***
	(0.037)	(0.033)	(0.052)	(0.046)	(0.031)	(0.050)
Buyer income growth	0.244***	0.330***	0.206***	0.305***	0.408***	0.224***
	(0.031)	(0.019)	(0.028)	(0.037)	(0.018)	(0.024)
County FE	Y	Y	Y	N	N	N
Number of observations	2,020	4,407	2,192	2,020	4,407	2,192
R2	0.52	0.61	0.50	0.28	0.31	0.14

Panel C. Growth in number of mortgages originated

	House price growth, 2002-2006			House price growth, 2002-2006		
	High	Middle	Low	High	Middle	Low
Zip code income growth	-0.511***	-0.462***	0.099	-0.342**	-0.393***	0.306*
	(0.181)	(0.100)	(0.169)	(0.155)	(0.118)	(0.172)
Buyer income growth	0.197**	0.110*	0.036	0.038	0.049	0.072
	(0.079)	(0.063)	(0.073)	(0.069)	(0.058)	(0.070)
County FE	Y	Y	Y	N	N	N
Number of observations	2,020	4,407	2,192	2,020	4,407	2,192
R2	0.30	0.41	0.40	0.00	0.01	0.01

Table 4. Mortgage origination and income by IRS household income in 2002

The Table shows OLS regressions of annualized growth in total mortgage credit (Panel A), the average mortgage size (Panel B) and the number of mortgages (Panel C) at the zip code level for purchase mortgages only on the annualized growth rate of average household income (from the IRS) and the annualized growth rate of average buyer income in the zip code (obtained from HMDA). Zip codes are separated into quartiles based on the average household income. The "high" column includes the top quartile, the "middle" column includes the second and third quartiles, and "low" includes the lowest quartile. Standard errors are clustered by county. *, **, *** indicate statistical significance at the 10%, 5%, and 1% levels, respectively.

Panel A. Growth in total mortgage origination

	Zip code household income (IRS), 2002			Zip code household income (IRS), 2002		
	High	Middle	Low	High	Middle	Low
Zip code income growth	-0.110	0.401***	0.760***	0.124	1.169***	1.375***
	(0.134)	(0.128)	(0.264)	(0.128)	(0.135)	(0.193)
Buyer income growth	0.292***	0.247***	0.528***	0.252***	0.370***	0.777***
	(0.091)	(0.076)	(0.090)	(0.081)	(0.057)	(0.069)
County FE	Y	Y	Y	N	N	N
Number of observations	2,088	4,346	2,185	2,088	4,346	2,185
R2	0.41	0.40	0.56	0.02	0.07	0.16

Panel B. Growth in average mortgage size

	Zip code household income (IRS), 2002			Zip code household income (IRS), 2002		
	High	Middle	Low	High	Middle	Low
Zip code income growth	0.174***	0.200***	0.234***	0.242***	0.450***	0.639***
	(0.029)	(0.035)	(0.083)	(0.041)	(0.050)	(0.074)
Buyer income growth	0.347***	0.251***	0.242***	0.493***	0.511***	0.496***
	(0.034)	(0.019)	(0.032)	(0.048)	(0.029)	(0.051)
County FE	Y	Y	Y	N	N	N
Number of observations	2,088	4,346	2,185	2,088	4,346	2,185
R2	0.75	0.79	0.76	0.42	0.42	0.38

Panel C. Growth in number of mortgages originated

	Zip code household income (IRS), 2002			Zip code household income (IRS), 2002		
	High	Middle	Low	High	Middle	Low
Zip code income growth	-0.307**	0.171	0.433*	-0.129	0.658***	0.549***
	(0.120)	(0.115)	(0.228)	(0.116)	(0.115)	(0.154)
Buyer income growth	0.003	0.035	0.274***	0.175**	-0.112**	0.251***
	(0.085)	(0.065)	(0.071)	(0.083)	(0.052)	(0.082)
County FE	Y	Y	Y	N	N	N
Number of observations	2,088	4,346	2,185	2,088	4,346	2,185
R2	0.42	0.36	0.49	0.01	0.01	0.03

Table 5. Mortgage origination and income for alternative time periods

The Table shows OLS regressions of annualized growth in total mortgage credit at the zip code level (purchase mortgages only) on the annualized growth rate of average household income (from the IRS) and the annualized growth rate of average buyer income in the zip code (obtained from HMDA). The Table shows the regressions for the five time periods shown in the first row. Panel A includes zip codes with house price data from Zillow, and Panel B includes all zip codes in the HMDA data. Standard errors are clustered by county. *, **, *** indicate statistical significance at the 10%, 5%, and 1% levels, respectively.

Panel A. Sample with house price data (Zillow sample)

	1996-1998	1998-2001	2001-2002	2002-2006	2007-2011
Zip code income growth		0.236***	1.023***	-0.224**	
		(0.072)	(0.162)	(0.088)	
Buyer income growth	0.260***	0.178***	0.262***	0.376***	0.341***
	(0.033)	(0.023)	(0.031)	(0.047)	(0.029)
County FE	Y	Y	Y	Y	Y
Number of observations	8,597	8,596	8,604	8,619	8,550
R2	0.57	0.43	0.54	0.35	0.48

Panel B. All zip codes in HMDA

	1996-1998	1998-2001	2001-2002	2002-2006	2007-2011
Zip code income growth		0.079**	0.288***	0.227***	
		(0.036)	(0.081)	(0.065)	
Buyer income growth	0.544***	0.340***	0.467***	0.551***	0.297***
	(0.040)	(0.021)	(0.033)	(0.032)	(0.017)
County FE	Y	Y	Y	Y	Y
Number of observations	28,306	27,964	27,894	27,385	30,998
R2	0.60	0.55	0.47	0.33	0.56

Table 6. Mortgage origination and income, panel specification, 2002, 2004-2006

The Table shows OLS regressions of the logarithm of total mortgage credit at the zip code level (purchase mortgages only), the logarithm of average mortgage size, and the logarithm of the total number of mortgages on the logarithm of average household income (from the IRS) and the logarithm of average buyer income in the zip code (obtained from HMDA). The Table shows the regressions for the average treatment effect in columns 1, 3 and 5. In columns 2, 4 and 6 the income variables are interacted with indicator variables for each year in the sample. Standard errors are clustered by county. *, **, *** indicate statistical significance at the 10%, 5%, and 1% levels, respectively.

	Ln(Total mortgage origination)		Ln(Average mortgage size)		Ln(Total number of mortgages)	
Ln(Buyer income)	0.313***	0.231***	0.322***	0.166***	0.018	0.089**
	(0.033)	(0.041)	(0.029)	(0.018)	(0.030)	(0.035)
Ln(Buyer income) x Year 2004		0.195***		0.192***		0.007
		(0.028)		(0.021)		(0.031)
Ln(Buyer income) x Year 2005		0.203***		0.270***		-0.063
		(0.036)		(0.026)		(0.044)
Ln(Buyer income) x Year 2006		0.040		0.259***		-0.216***
		(0.040)		(0.023)		(0.042)
Ln(Zip code income)	0.277***	1.004***	0.339***	0.345***	-0.074	0.651***
	(0.077)	(0.090)	(0.027)	(0.031)	(0.070)	(0.075)
Ln(Zip code income) x Year 2004		-0.267***		-0.118***		-0.155***
		(0.030)		(0.019)		(0.027)
Ln(Zip code income) x Year 2005		-0.380***		0.160***		-0.224***
		(0.034)		(0.023)		(0.035)
Ln(Zip code income) x Year 2006		-0.399***		-0.189***		-0.214***
		(0.040)		(0.021)		(0.037)
Zip code and year FE	Y	Y	Y	Y	Y	Y
Number of observations	36,299	36,299	36,299	36,299	36,299	36,299
R2	0.97	0.97	0.98	0.98	0.97	0.97

Table 7. Summary statistics by buyer income decile and year, 2002, 2004-2006

The Table shows mean and standard deviation of a tabulation of loan size (Panel A), debt-to-income (Panel B) and the fraction of overall mortgage credit originated (Panel C) for purchase mortgages by decile of buyer income and year. Buyers are sorted yearly into deciles based on the applicant income from HMDA. Debt-to-income is defined as the mortgage amount divided by the applicant income. The fraction of mortgage credit originated is calculated as the sum of total mortgage amount in each decile divided by the total mortgage amount originated in each year shown in HMDA. The first row in each year shows averages and the second row shows standard deviations.

Panel A. Loan size (USD thousands)

	Applicant income decile									
Year	1	2	3	4	5	6	7	8	9	10
2002	70.5	91.6	105.3	117.6	129.9	143.7	158.9	178.6	209.6	316.8
	36.5	40.4	46.8	54.2	61.0	69.6	79.8	95.3	121.2	263.4
2004	73.1	99.9	114.4	129.4	144.8	162.2	184.3	211.0	250.7	377.2
	42.7	50.0	59.0	68.7	78.7	89.9	104.3	123.9	154.3	323.8
2005	79.8	101.4	115.8	132.2	149.0	169.0	193.2	223.5	269.1	405.5
	45.5	55.8	65.9	77.2	88.3	102.0	118.9	141.0	176.9	361.1
2006	82.4	104.7	119.5	132.8	149.5	168.8	190.6	220.9	265.8	412.3
	47.2	56.9	68.3	78.3	90.8	104.4	121.2	144.2	180.5	383.0

Panel B. Debt-to-income

	Applicant income decile									
Year	1	2	3	4	5	6	7	8	9	10
2002	3.07	2.58	2.43	2.29	2.17	2.06	1.95	1.83	1.67	1.32
	6.05	1.13	1.08	1.05	1.02	0.99	0.98	0.97	0.96	0.94
2004	3.19	2.62	2.45	2.32	2.23	2.17	2.10	2.01	1.85	1.46
	5.13	1.30	1.26	1.23	1.21	1.20	1.19	1.17	1.13	1.05
2005	2.95	2.47	2.30	2.19	2.12	2.07	2.01	1.93	1.78	1.38
	4.59	1.35	1.30	1.27	1.25	1.25	1.24	1.21	1.16	1.06
2006	3.24	2.42	2.24	2.10	2.01	1.94	1.86	1.78	1.64	1.30
	10.50	1.35	1.28	1.24	1.22	1.19	1.18	1.16	1.11	1.01

Panel C. Fraction of mortgages originated per year

	Applicant income decile									
Year	1	2	3	4	5	6	7	8	9	10
2002	0.051	0.057	0.071	0.078	0.084	0.100	0.099	0.118	0.135	0.207
2004	0.047	0.058	0.062	0.085	0.071	0.093	0.107	0.120	0.142	0.216
2005	0.049	0.049	0.069	0.073	0.076	0.093	0.105	0.121	0.150	0.215
2006	0.048	0.059	0.062	0.069	0.084	0.090	0.100	0.120	0.145	0.223

Table 8. Mortgage balance and income, loan-level, 2002, 2004-2006.

The Table shows OLS regressions of the logarithm of mortgage size at the individual level on the logarithm of average household income in the census tract (inferred using zip code household income from the IRS) and the logarithm of buyer income (obtained from HMDA). The unit of observation is an individual loan in HMDA. The table shows the regressions for the average treatment effect in columns 1 and 2. Columns 2 and 4 shows the effect interacted with a linear trend. Standard errors are clustered by county. *, **, *** indicate statistical significance at the 10%, 5%, and 1% levels, respectively.

	Zillow Sample				Whole sample			
Ln(Buyer income)	0.403***	0.366***	0.340***	0.313***	0.393***	0.365***	0.333***	0.312***
	(0.008)	(0.008)	(0.006)	(0.007)	(0.007)	(0.008)	(0.006)	(0.007)
Ln(Buyer income)		0.015***		0.012***		0.012***		0.009***
x Linear trend		(0.002)		(0.002)		(0.002)		(0.002)
Ln(Census tract household income)	0.382***	0.409***	0.313***	0.302***	0.374***	0.403***	0.250***	0.251***
	(0.012)	(0.015)	(0.024)	(0.030)	(0.012)	(0.015)	(0.023)	(0.032)
Ln(Census tract household income)		-0.011***		-0.004		-0.011***		-0.005
x Linear trend		(0.004)		(0.004)		(0.004)		(0.004)
Year FE and county FE	Y	Y	N	N	Y	Y	N	N
Year FE and census tract FE	N	N	Y	Y	N	N	Y	Y
Number of observations	17,220,064	17,220,064	17,220,064	17,220,064	23,943,309	23,943,309	23,943,309	23,943,309
R2	0.30	0.30	0.33	0.33	0.32	0.32	0.35	0.35

Table 9. Misreporting of income: robustness

Panel A shows OLS regressions of annualized growth in total mortgage credit at the zip code level on the annualized growth rate of average household income (from the IRS) and the annualized growth rate of average buyer income in the zip code (obtained from HMDA). Results are split by the proportion of loans sold to Fannie Mae and Freddie Mac (the GSEs) as of 2006, and by the proportion of loans originated by subprime lenders as of 2006 (subprime lenders are defined by the HUD subprime lender list). Panel B shows OLS regressions of the logarithm of mortgage size at the individual level on the logarithm of average household income in the census tract (inferred using zip code household income from the IRS) and the logarithm of buyer income (obtained from HMDA) for tract within our Zillow sample. Results are split by subprime and prime lenders, as well as GSE or non-GSE loans. Panel C shows a regression of contemporaneous household IRS income on lagged household income and lagged average buyer income at the zip code level. Standard errors are clustered by county. *, **, *** indicate statistical significance at the 10%, 5%, and 1% levels, respectively.

Panel A. Zip code-level

	High GSE Fraction	Med GSE Fraction	Low GSE Fraction	High Subp Fraction	Med Subp Fraction	Low Subp Fraction
Zip code income growth	-0.092	-0.011	-0.489**	-0.191	-0.077	0.065
	(0.171)	(0.117)	(0.194)	(0.220)	(0.160)	(0.136)
Buyer income growth	0.299***	0.384***	0.289***	0.443***	0.318***	0.327***
	(0.093)	(0.063)	(0.112)	(0.108)	(0.068)	(0.105)
County FE	Y	Y	Y	Y	Y	Y
Number of observations	2,203	4,355	2,061	2,119	4,326	2,174
R2	0.47	0.44	0.38	0.42	0.41	0.51

Panel B. Loan-level

	GSE loan	Non-GSE loan	Subprime lenders	Prime lenders
Ln(Buyer income)	0.305***	0.313***	0.342***	0.306***
	(0.005)	(0.008)	(0.011)	(0.007)
Ln(Buyer income) x Linear trend	-0.001	0.016***	0.004	0.012***
	(0.001)	(0.002)	(0.004)	(0.002)
Ln(Census tract household income)	0.213***	0.307***	0.307***	0.281***
	(0.026)	(0.034)	(0.043)	(0.030)
Ln(Census tract household income) x Linear trend	-0.016***	-0.008*	-0.012	0.000
	(0.003)	(0.004)	(0.007)	(0.003)
Year FE and county FE	N	N	N	N
Year FE and census tract FE	Y	Y	Y	Y
Number of observations	3,804,113	13,415,951	2,338,973	14,881,091
R2	0.53	0.33	0.29	0.35

Panel C. Forecasting IRS Income Growth

	Ln(Zip code income t, 2006,2005,2002)			
Ln(Zip code income t-1)	0.994***	0.994***	0.919***	0.920***
	(0.002)	(0.003)	(0.006)	(0.006)
Ln(Zip code income t-1) x Linear Trend			0.021***	0.020***
			(0.001)	(0.001)
Ln(Buyer income t-1)	0.017***	0.024***	0.017***	0.026***
	(0.002)	(0.003)	(0.006)	(0.006)
Ln(Buyer income t-1) x Linear Trend			0.001	0.001
			(0.001)	(0.001)
County FE	N	Y	N	Y
Number of observations	28,562	28,562	28,562	28,562
R2	0.98	0.98	0.98	0.99

Table 10. Refinancing mortgage origination and income

Panel A shows OLS regressions of annualized growth in total mortgage credit between 2002 and 2006, the average mortgage size and the number of mortgages originated at the zip code level on the annualized growth rate of average household income (from the IRS) and the annualized growth rate of average buyer income in the zip code (obtained from HMDA). The data only includes mortgages used for refinancing. Panel B shows OLS regressions of the logarithm of total mortgage credit at the zip code level (refinancing mortgages only), the logarithm of average mortgage size, and the logarithm of the total number of mortgages on the logarithm of average household income (from the IRS) and the logarithm of average buyer income in the zip code (obtained from HMDA). The Table shows the regressions for the average treatment effect in columns 1, 3 and 5. In columns 2, 4 and 6 the income variables are interacted with indicator variables for each year in the sample. Standard errors are clustered by county. *, **, *** indicate statistical significance at the 10%, 5%, and 1% levels, respectively.

Panel A. Zip code cross-sectional regression, 2002-2006

	Growth in total mortgage origination		Growth in average mortgage size		Growth in number of mortgages originated	
Zip code income growth	-0.579***	-1.300***	0.283***	-0.013	-0.746***	-1.100***
	(0.145)	(0.123)	(0.053)	(0.024)	(0.110)	(0.094)
Refinancing borrower income growt	1.113***	0.705***	0.793***	0.424***	0.424***	0.370***
	(0.084)	(0.069)	(0.057)	(0.022)	(0.060)	(0.052)
County FE	N	Y	N	Y	N	Y
Number of observations	8,622	8,622	8,622	8,622	8,622	8,622
R2	0.09	0.57	0.37	0.81	0.04	0.49

Panel B. Zip code panel regression, 2002, 2004-2006

	Ln(Total mortgage origination)		Ln(Average mortgage size)		Ln(Total number of mortgages)	
Ln(Buyer income)	0.691***	0.621***	0.488***	0.260***	0.259***	0.423***
	(0.062)	(0.080)	(0.041)	(0.028)	(0.045)	(0.067)
Ln(Buyer income) x Year 2004		0.014		0.133***		-0.118**
		(0.071)		(0.035)		(0.053)
Ln(Buyer income) x Year 2005		0.031		0.242***		-0.208***
		(0.069)		(0.042)		(0.054)
Ln(Buyer income) x Year 2006		0.085		0.300***		-0.228***
		(0.069)		(0.037)		(0.061)
Ln(Zip code income)	-0.216*	1.214***	0.257***	0.306***	-0.475***	0.913***
	(0.127)	(0.127)	(0.027)	(0.039)	(0.113)	(0.101)
Ln(Zip code income) x Year 2004		-0.498***		-0.086***		-0.416***
		(0.062)		(0.031)		(0.046)
Ln(Zip code income) x Year 2005		-0.612***		-0.140***		-0.476***
		(0.066)		(0.038)		(0.049)
Ln(Zip code income) x Year 2006		-0.772***		-0.202***		-0.566***
		(0.063)		(0.032)		(0.052)
Zip code and year FE	Y	Y	Y	Y	Y	Y
Number of observation	36,265	36,265	36,265	36,265	36,265	36,265
R2	0.96	0.97	0.97	0.97	0.96	0.97

Table 11. Mortgage balance and income, loan-level, purchase and cash-out refinancing mortgages (LPS data)

The Table shows OLS regressions of the logarithm of mortgage size at the individual level on the logarithm of average household income in the zip code (inferred using zip code household income from the IRS) and the logarithm of average borrower income (obtained from HMDA). The unit of observation is an individual loan in the LPS dataset. The first four columns include purchase mortgages, and the last four include cash-out refinancing mortgages. Standard errors are clustered by county. *, **, *** indicate statistical significance at the 10%, 5%, and 1% levels, respectively.

	Purchase mortgages				Cash-out refinancing mortgages			
Ln(Borrower income)	0.371***	0.054**	0.305***	-0.023	0.348***	-0.017	0.358***	-0.146***
	(0.026)	(0.027)	(0.027)	(0.016)	(0.032)	(0.047)	(0.030)	(0.040)
Ln(Borrower income) x Linear trend		0.091***		0.096***		0.087***		0.099***
		(0.005)		(0.005)		(0.006)		(0.007)
Ln(Zip code income)	0.405***	0.654***	0.352***	0.527***	0.356***	0.609***	0.172***	0.260***
	(0.023)	(0.028)	(0.034)	(0.037)	(0.028)	(0.043)	(0.052)	(0.054)
Ln(Zip code income) x Linear trend		-0.070***		-0.072***		-0.060***		-0.057***
		(0.005)		(0.005)		(0.007)		(0.006)
Year FE and county FE	Y	Y	N	N	Y	Y	N	N
Year FE and zip code FE	N	N	Y	Y	N	N	Y	Y
Number of observations	436,059	436,059	436,059	436,059	155,466	155,466	155,466	155,466
R2	0.59	0.59	0.64	0.64	0.54	0.54	0.61	0.61

Figure 1: Mortgage Origination and Debt to Income by Applicant Income Decile

This figure shows the fraction of total dollar volume of purchase mortgages in the HHMDA dataset originated by decile of applicant income, as well as the average debt-to-income for individuals in each decile.

Panel A: Mortgage origination

Panel B: Debt-to-Income Ratio

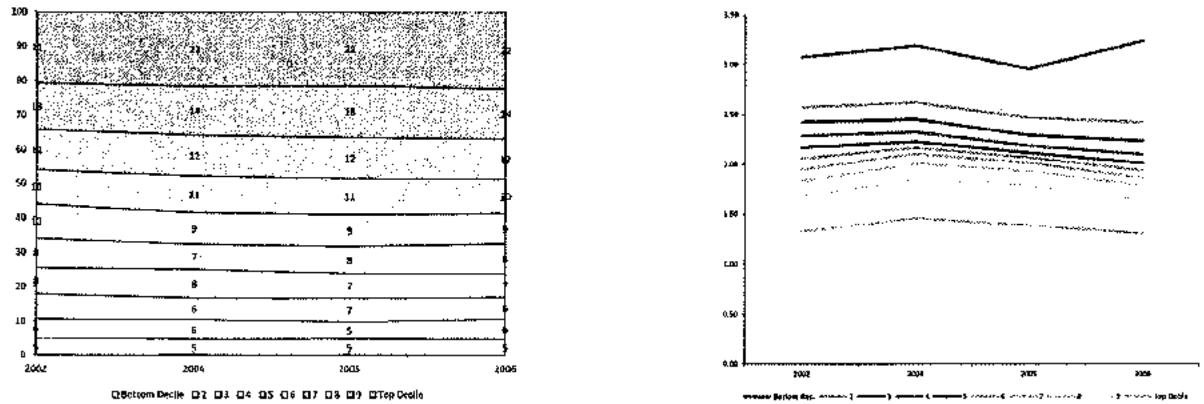


Figure 2: Mortgage Origination and Delinquency by Quintile of Buyer Income

This figure shows the fraction of total dollar volume of purchase mortgages in the LPS dataset originated in each quintile of average zip code applicant income, as well as the total volume of mortgages more than 90 days delinquent at any point during the subsequent 3 years.

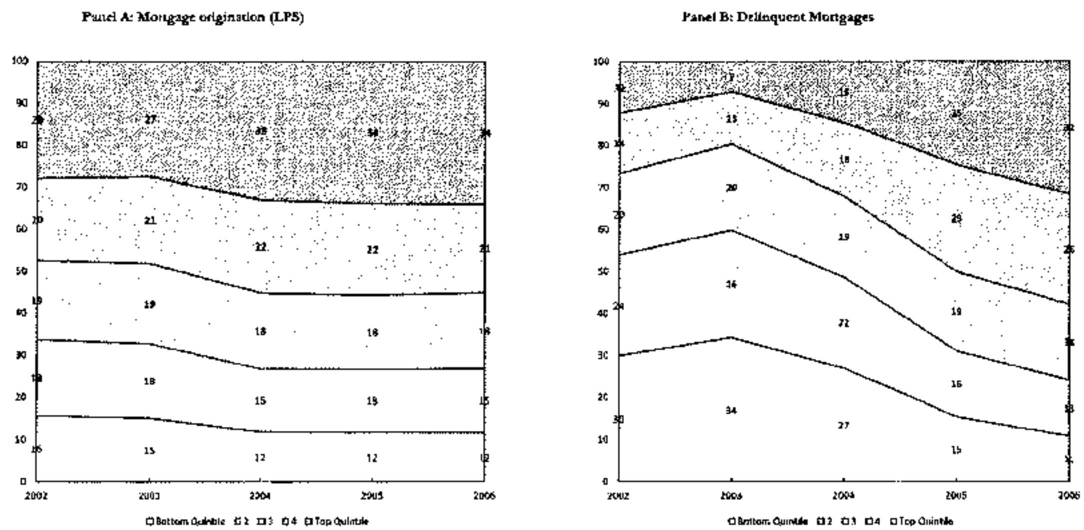
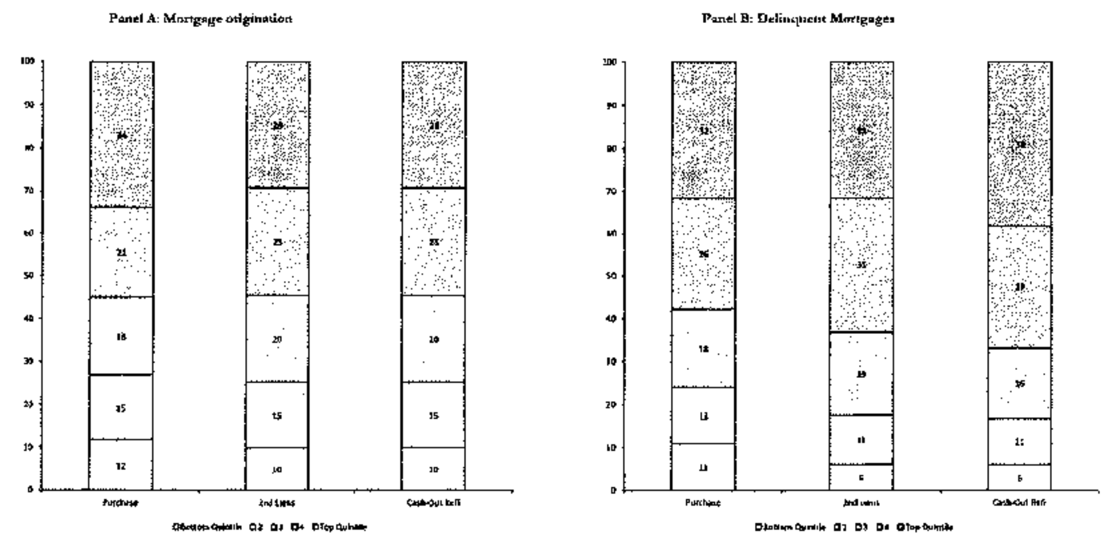


Figure 3: Mortgage Origination and Delinquency by Product Type and by Borrower Income
This figure shows the fraction of total dollar volume of purchase mortgages, 2[nd] lien mortgages and cash-out refinance mortgages in the LPS dataset originated in 2006 in each quintile of the average applicant income at the zip code level, as well as the total volume of mortgages more than 90 days delinquent at any point during the subsequent 3 years.



APPENDIX

Appendix Table 1: Heterogeneity of the Effect. Horse Race between Income, Elasticity, GSE fraction and House Prices Growth.

	Growth in total mortgage origination		Growth in average mortgage size		Growth in number of mortgages originated	
Zip code income growth	-0.250**	0.470**	0.208***	0.370***	-0.440***	0.070
	(0.098)	(0.208)	(0.027)	(0.065)	(0.080)	(0.188)
Zip code income growth x High Income		-0.730***		-0.043		-0.638***
		(0.213)		(0.057)		(0.202)
Zip code income growth x High Elasticity		0.303		-0.143*		0.387*
		(0.228)		(0.074)		(0.202)
Zip code income growth x High Low Documentation Loans		0.071		0.000		0.075
		(0.138)		(0.034)		(0.129)
Zip code income growth x High HP Growth		-0.132		-0.140***		0.020
		(0.165)		(0.050)		(0.140)
Zip code income growth x High GSE Fraction		0.156		-0.046		0.189
		(0.160)		(0.045)		(0.141)
Buyer income growth (annualized), HMDA	0.390***	0.492***	0.243***	0.204***	0.172***	0.275***
	(0.056)	(0.120)	(0.017)	(0.030)	(0.047)	(0.099)
Buyer income growth x High Income		-0.406***		0.004		-0.353***
		(0.096)		(0.026)		(0.079)
Buyer income growth x High Elasticity		0.055		-0.021		0.070
		(0.117)		(0.035)		(0.106)
Buyer income growth x High Low Documentation Loans		-0.043		-0.013		-0.015
		(0.068)		(0.018)		(0.060)
Buyer income growth x High HP Growth		0.206		0.030		0.157
		(0.137)		(0.032)		(0.114)
Buyer income growth x High GSE Fraction		-0.022		0.078***		-0.066
		(0.091)		(0.025)		(0.078)
County FE	Y	Y	Y	Y	Y	Y
Number of observations	6,210	6,210	6,210	6,210	6,210	6,210
R2	0.34	0.36	0.74	0.75	0.30	0.32

Standard errors are in parenthesis and are clustered by county. *, **, *** indicate statistical significance at 10%, 5%, and 1% levels, respectively.

Appendix Table 2. Summary Statistics using full HMDA sample

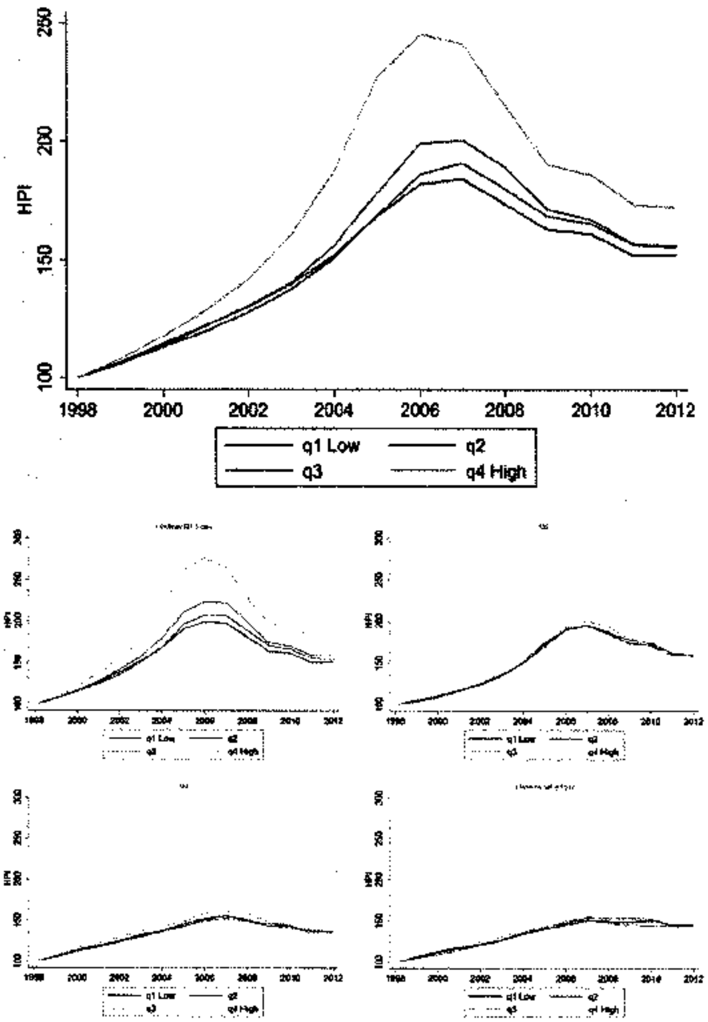
This table reports summary statistics for all zip codes covered in HMDA. Column 1 shows the summary statistics for the entire sample. Columns 2 to 4 show the summary statistics for the zip codes in the highest quartile of average income per capita in 2002 (High), second and third quartiles of average income per capita (Intermediate), and lowest quartile of average income per capita (Low). Columns 5 to 7 do a similar split by house price growth in the zip code between 2002 and 2006. For each variable we show the average and standard deviation (in parenthesis). *Zip code income* is the average adjusted gross income per capita by zip code from the IRS. *Buyer Income* is the average applicant income by zip code from HMDA. *Average mortgage size* is the total mortgage amount originated in a zip code used for home purchase in 2002. *Number of mortgages originated per 100 residents* is the average number of mortgages originated per 100 residents by zip code. Debt-to-income is the zip code average ratio of the mortgage balance at the time of origination over applicant income from HMDA. *Loan to value* is the average loan to value (LTV) in a zip code calculated from LPS. *Fraction of low documentation loans* is the fraction of low documentation loans originated in a zip code from LPS. *Population* is the average zip code-level population estimated from IRS returns. *Elasticity of housing supply* is the Saiz (2010) measure of housing supply elasticity at the MSA level.

Zip code income growth refers to the percentage change between 2002 and 2006 in household adjusted gross income by zip code from the IRS. *Buyer income growth* is the percentage change in average applicant income by zip code from HMDA. *Growth in total mortgage origination* refers to the percentage change in total mortgage credit originated in a zip code used for home purchase between 2002 and 2006 calculated using HMDA. *Growth in average mortgage size* refers to the percentage change in the average balance of individual mortgages in a zip code between 2002 and 2006 (also calculated using HMDA). *Growth in number of mortgages originated* is the percentage change in the number mortgages originated between 2002 and 2006. *Change in debt-to-income* and *Change in loan to value* is the change in Debt to Income and LTV by zip code between 2002 and 2006.

	Whole sample	Zip code household income, 2002			Zip code house price growth 2002-2006		
		High	Middle	Low	High	Middle	Low
	N =27385	N =6936	N =14126	N =6323	N =2020	N =4407	N =2192
Zip code household income (USD thousands), IRS, 2002	39.41	63.57	34.16	24.63	47.40	54.44	47.13
	(24.68)	(39.10)	(3.65)	(3.41)	(25.45)	(30.41)	(25.08)
Buyer income (USD thousands), HMDA. 2002	74.21	111.06	64.11	56.33	99.83	95.11	79.24
	(56.34)	(84.89)	(34.21)	(34.54)	(70.94)	(70.58)	(53.87)
Average mortgage size (USD thousands), 2002, purchase mortgages only	110.47	182.26	93.10	70.53	160.97	166.79	125.50
	(70.44)	(93.37)	(36.33)	(32.51)	(76.74)	(95.63)	(67.57)
Number of mortgages originated per 100 residents, 2002, purchase mortgages only	1.91	3.06	1.69	1.14	3.38	2.36	2.37
	(6.08)	(8.49)	(5.73)	(2.39)	(3.42)	(1.53)	(1.47)
Debt to income, 2002	1.83	2.16	1.79	1.55	2.18	2.17	2.05
	(0.48)	(0.38)	(0.42)	(0.48)	(0.36)	(0.39)	(0.36)
Loan to value, LPS, 2003 (N=13,555)	0.82	0.78	0.85	0.87	0.80	0.79	0.83
	(0.11)	(0.10)	(0.10)	(0.10)	(0.10)	(0.11)	(0.10)
Fraction of low documentation loans, LPS, 2003 (N=13,555)	0.16	0.18	0.16	0.13	0.20	0.18	0.17
	(0.25)	(0.23)	(0.27)	(0.26)	(0.22)	(0.24)	(0.23)
Population (000s), IRS, 2002	72.71	127.48	62.92	34.50	166.16	132.44	139.45
	(98.49)	(114.94)	(88.18)	(72.04)	(128.30)	(109.75)	(103.37)
Elasticity of housing supply (N=1887), Saiz (2010)	2.04	1.76	2.27	2.25	1.24	1.65	2.22
	(1.18)	(1.00)	(1.25)	(1.32)	(0.51)	(0.84)	(0.91)
Zip code income growth (annualized), IRS, 2002-2006	0.043	0.051	0.039	0.045	0.053	0.047	0.036
	(0.031)	(0.035)	(0.025)	(0.036)	(0.029)	(0.027)	(0.025)
Buyer income growth (annualized), HMDA, 2002-2006	0.058	0.062	0.055	0.059	0.108	0.062	0.032
	(0.072)	(0.064)	(0.065)	(0.090)	(0.066)	(0.050)	(0.052)
Growth in total mortgage origination (annualized), 2002-2006, purchase only	0.164	0.110	0.172	0.204	0.170	0.123	0.074
	(0.210)	(0.166)	(0.197)	(0.261)	(0.165)	(0.138)	(0.136)
Growth in average mortgage size (annualized), 2002-2006, purchase only	0.066	0.065	0.063	0.076	0.124	0.063	0.021
	(0.063)	(0.054)	(0.058)	(0.081)	(0.042)	(0.040)	(0.038)
Growth in number of mortgages originated (annualized), 2002-2006, purchase only	0.092	0.046	0.104	0.117	0.046	0.059	0.054
	(0.180)	(0.150)	(0.169)	(0.220)	(0.144)	(0.126)	(0.119)
Change in debt to income, 2002-2006	0.074	0.004	0.086	0.122	0.063	0.016	-0.107
	(0.341)	(0.289)	(0.318)	(0.422)	(0.293)	(0.274)	(0.276)
Change in loan to value, 2003-2006	-0.017	-0.007	-0.025	-0.038	-0.036	-0.010	-0.013
	(0.108)	(0.102)	(0.113)	(0.111)	(0.095)	(0.104)	(0.093)

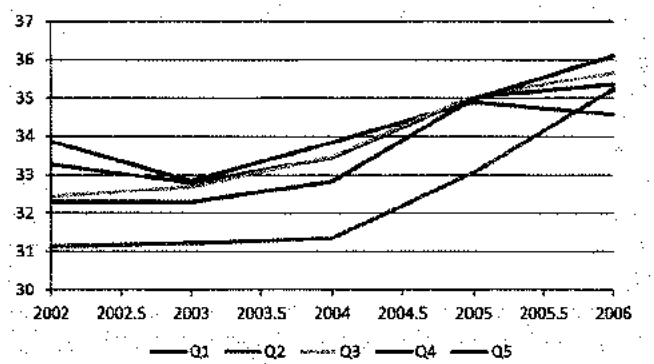
Appendix Figure 1. House Prices Time Series based on Percentage Difference between Buyers Income and IRS Income in 1998

Quartiles based on Percentage Difference between Buyers Income and IRS Income in 1998

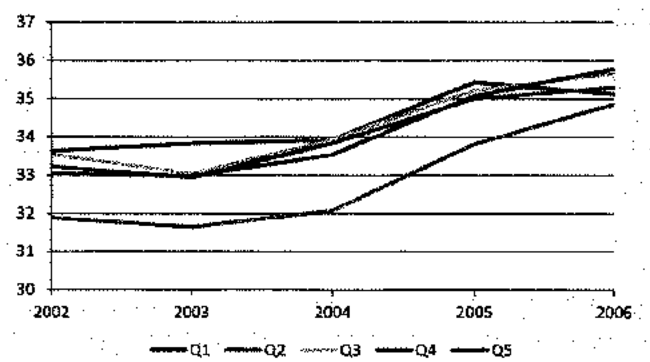


Appendix Figure 2. DTI measured in LPS (recurring mortgage debt payments divided by monthly income)
Quintiles based on buyer income and IRS Income

Panel A: Zip codes split into quintiles based on borrower income (from HMDA)



Panel B: Zip codes split into quintiles based on IRS income (from IRS)



Sections

The Washington Post WP

Dashed Dreams

The American Dream shatters in Prince George's County

More black homeowners are underwater

PERCENT OF HOMEOWNERS WITH NEGATIVE EQUITY

SOURCE: Washington Post analysis of data from the Federal Reserve Survey of Consumer Finances.

A shattered foundation

African Americans who bought homes in Prince George's have watched their wealth vanish

Story by Michael A. Fletcher
Photos by Michel du Cille
Graphics by Darla Cameron, Samuel Granados, Ted Mellnik
Published on January 24, 2015

African Americans for decades flocked to Prince George's County to be part of a phenomenon that has been rare in American history: a community that grew more upscale as it became more black.

The county became a national symbol of the American Dream with a black twist. Families moved into expansive new homes, with rolling lawns, nearby golf courses and, most of all, neighbors who looked like them. In the early 2000s, home prices soared — some well beyond $1 million — allowing many African Americans to build the kind of wealth their elders could only imagine.

DASHED DREAMS: This is the first part in a series looking at the plight of the black middle class, particularly in Maryland's Prince George's County, the nation's highest-income majority-black county.

Part 2: Half of the loans on newly constructed homes in one Prince George's County subdivision during the housing boom in 2006 and 2007 wound up in foreclosure.

Part 3: The plight of the Boateng family, who face more than $1 million in debt, shows how some of the people swallowed up by the easy credit era have yet to reemerge.

But today, the nation's highest-income majority-black county stands out for a different reason — its residents have lost far more wealth than families in neighboring, majority-white suburbs. And while every one of these surrounding counties is enjoying a strong rebound in housing prices and their economies, Prince George's is lagging far behind, and local economists say a full recovery appears unlikely anytime soon.

The same reversal of fortune is playing out across the country as black families who worked painstakingly to climb into the middle class are seeing their financial foundation for future generations collapse. Although African Americans have made once-unthinkable political and social gains since the civil rights era, the severe and continuing damage wrought by the downturn — an entire generation of wealth was wiped out — has raised a vexing question: Why don't black middle-class families enjoy the same level of economic security as their white counterparts?

The impact of the financial devastation of the past several years is hardly visible along the quiet, well-tended streets of many Prince George's neighborhoods. The county has the highest foreclosure rate in the District region, yet few houses appear to be abandoned.

Instead, the slow-motion crisis operates mostly in private, limiting people's options, constricting their vision and forcing a seemingly endless series of hard choices. Having your wealth vanish means making pivotal life decisions — about where to send your children to school, saving for college, making home improvements and setting aside something for retirement — knowing you have no financial leeway.

"This big gorilla on your back, it changes you," said Fred Bryant, 40, who lives with his wife and two daughters in a brick-front Colonial featuring a one-acre lot, high ceilings, an impressive two-story foyer and a mortgage far higher than the house is worth. "Sometimes you find yourself boiling mad when you shouldn't be."

Bryant and his wife, Jennifer, made it to the middle class after being raised on the edges of poverty. But whatever wealth they had built is gone.

Jennifer Bryant grew up in Prince George's County, living in a Seat Pleasant apartment complex with her mother and brother. "All I ever experienced was apartment living," she said. "We moved from one part of the complex to another." Her father died when she was just 5, and her mother was a homemaker who poured her energies into seeing to it that her children had it better than she did.

Fred's parents were separated, and his father was disabled and unable to help financially. His mother worked odd jobs in the tobacco fields near his hometown of Maysville, N.C., and other times she relied on public assistance. She raised Fred and his brother in a subsidized two-bedroom apartment that Fred remembers as being little bigger than his current living room and dining room.

$560,000

What Jennifer and Fred Bryant owe on their Prince George's County home.

$480,000

Estimated value of their home.

$3,900

Monthly payment on the home, which has more than doubled since they moved in.

Still, Jennifer and Fred managed to graduate college, although their mothers could lend only moral support. Today, she works as a supervisor in the federal workforce. He is a manager for a sports memorabilia firm.

The problem is not their income but their home. Once a source of wealth, it is now their biggest financial burden.

The Bryants owe just over $560,000 on their house, which they estimate is worth about $80,000 less than that. Since they moved in 2001, their monthly payment has more than doubled to nearly $3,900 a month — a predicament that arose because of an ill-advised refinancing into a loan whose terms the federal government now deems predatory.

The couple have never missed a mortgage payment. But now they are struggling to hold on. They have pulled their two pre-teen daughters out of private school. They bought inexpensive used cars. Instead of going on vacation last summer, they took the girls to Six Flags America, a nearby amusement park. They have little saved for college or retirement.

"We're paying and paying, but we can't get ahead," Jennifer said.

Wealth in black and white

The recession and tepid recovery have erased two decades of African American wealth gains. Nationally, the net worth of the typical African American family declined by one-third between 2010 and 2013, according to a Washington Post analysis of the Federal Reserve's Survey of Consumer Finances, a drop far greater than that of whites or Hispanics.

The top half of African American families — the core of the middle class — is left with less than half of the typical wealth they possessed in 2007. The wealth of similarly situated whites declined by just 14 percent.

Overall, the survey found, the typical African American family was left with about eight cents for every dollar of wealth held by whites.

Not only is African American wealth down, but the chances of a quick comeback seem bleak. Just over a decade ago, homeownership — the single biggest engine of wealth creation for most Americans — reached a historic high for African Americans, nearly 50 percent. Now the black homeownership rate has dipped under 43 percent, and the homeownership gap separating blacks and whites is at levels not seen in a century, according to Boston University researcher Robert A. Margo.

"There was never a period in American history where the wealth gap was not enormous, but after this most recent recession, the wealth gap went from dismal to even worse," said Darrick Hamilton, a professor of economics and urban policy at the New School in Manhattan.

For a substantial number of African Americans who remain homeowners, their properties only hurt their net worth. According to the Fed survey, 1 in 7 owed more on their mortgages than their homes were worth in 2013, a sharp increase from 2010.

By comparison, just 1 in 18 white homeowners was underwater, an improvement from 2010. Also, African Americans own fewer businesses, stocks and other equities than whites — assets that have all recovered sharply since the recession.

Many researchers say the biggest portion of the wealth gap results from the strikingly different experiences blacks and whites typically have with homeownership. Most whites live in largely white neighborhoods, where homes often prove to be a better investment because people of all races want to live there. Predominantly black communities tend to attract a narrower group of mainly black buyers, dampening demand and prices, they say.

Residents of Maryland's Prince George's County have seen the housing crisis destroy their wealth. Click for more photos.
In places such as Prince George's County, where many people chose to live at least in part because of the comfort and familiarity they felt in a majority-black community, that meant their home brought them less wealth than if they had purchased elsewhere, economists say.

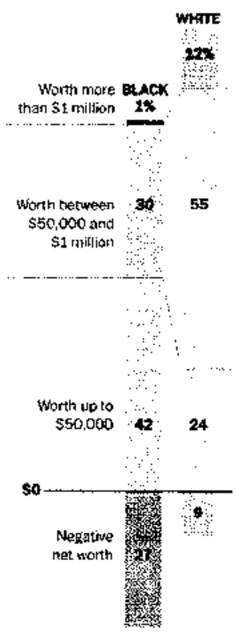
Scholars who have studied this dynamic and real estate professionals who have lived it say the price differences go beyond those that might be dictated by the perceived quality of schools, or the public and commercial investment made in particular neighborhoods. The big difference maker, they say, is race.

Mark E. Alston, who has worked for more than two decades as a real estate broker in Los Angeles and serves as political action chairman for the National Association of Real Estate Brokers, a trade group, noted that View Park, a mostly black and upper-middle-class community in Los Angeles featuring spacious Mediterranean and Spanish Colonial style homes not far from downtown, draws few white home buyers. Not coincidentally, he said, prices there are lower than in otherwise comparable Los Angeles neighborhoods.

"Regardless of geography, if you own a home in a majority-minority neighborhood, you are going to get less value out of it than if you own a home in a homogeneous white neighborhood," said Dorothy A. Brown, an associate vice provost and law professor at Emory University, who has studied the impact of race on home prices. "This transcends class."

Distribution of wealth

The greatest differences in black and white wealth are among the richest and poorest families.



Source: Washington Post analysis of data from the Federal Reserve 2013 Survey of Consumer Finances

Tale of two zip codes

A Washington Post analysis of housing values in two suburban Washington Zip codes — one in a mostly black Bowie, Md., neighborhood of Prince George's County and the other in a mostly white area of Reston, Va. — sketches a vivid picture of how African Americans have been hit harder by lagging home prices in the recession's wake.

Average values in the two communities were virtually identical between 2000 and 2005, though prices in Bowie peaked at more than $620,000 in 2006, while home prices in Reston topped out a year earlier at $520,000.

Then the bust came. In 2009, Reston prices bottomed out at $360,000. In Bowie, they fell much farther, dropping to about $330,000 in 2012 — nearly half.

By 2014, Reston prices bounced back to within $65,000 of their peak, while prices in the Bowie Zip code were still nearly $300,000 below their high point.

A long history of inequality

The economic deck has been stacked against African Americans from the start. The vast majority of blacks emerged from slavery with no money. New Deal worker protections, from the Fair Labor Standards Act, which set a minimum wage, to Social Security, initially excluded the many African Americans who then labored as domestic workers and tenant farmers. The Federal Housing Administration's loan policies excluded many of them from the homeownership deals that allowed many whites to move to the suburbs, helping them create wealth. Similarly, most African Americans were excluded from the GI Bill benefits that followed World War II.

Even as the nation made astounding social progress that led to significant African American educational gains and the election of thousands of African

American political leaders in offices up to the White House, economic progress has mostly lagged.

African Americans were able to build some wealth as they moved to suburbs in large numbers beginning in the 1980s. That migration helped transform Prince George's from a semi-rural, predominantly white county into a center of black political power and a magnet for a fast-expanding black middle class. The county became home to thousands of black-owned businesses, including many government contractors, and for the past two decades its political leadership has been largely African American.

Fast-rising home prices that accompanied the housing boom seemed to herald a new day. But those gains proved to be short-lived.

Denise Watson visits the clubhouse where the swimming pool and tennis courts have been boarded up and filled in. Watson bought the two-bedroom townhome in the Villages of Marlborough in Upper Marlboro, Md., in 2005, but the community has since fallen on hard times.

'I feel stuck'

African Americans were disproportionately targeted for predatory loans, which only intensified the financial damage caused by the downturn. Now the old housing market dynamics have returned, with relatively few blacks getting home loans, trimming housing demand in African American communities and putting a clamp on prices.

That has harmed even the most responsible home buyers.

Denise Watson bought a two-bedroom townhome in the Villages of Marlborough in 2005. The deck off her kitchen overlooked the 11th fairway of the neighborhood golf course. Nearby were a tennis court and community swimming pool.

She saw the home, which cost $315,000, as a good first step to building some equity as the years wound down on her 24-year Air Force career. Watson, who works for the Department of Veterans Affairs, had hoped to eventually trade up to a detached home.

But now that plan is on hold indefinitely because the investment she thought would help her build wealth has left her nearly $100,000 in the hole. The dizzying downturn and weak recovery have caused many of her neighbors to simply walk away even as Watson and her husband have made every mortgage payment.

Investors have swooped in, snapping up homes and transforming them into rentals. Meanwhile, the golf course has gone out of business, the neighborhood pool is being filled in and the tennis courts are unusable.

"I feel stuck, which hurts after you have worked so hard and done everything that society says you are supposed to do to grab your piece of the American Dream," she said. "I would never have thought that in all my years this would happen."

It is a burden that real estate professionals say confronts homeowners in many heavily African American neighborhoods.

Emerick A. Peace, operating partner of Keller Williams Preferred Properties in Upper Marlboro, said that homes in the county are undervalued. But that will not change, he said, until more people of all races show interest in moving there. Demand from only African Americans in effect puts a lid on prices, he said.

"We haven't gotten to that place in Prince George's County where the people who can drive up the price of housing have decided to move here," he said.

Jayla, 10, left, and Harmony Bryant, 13, converse in the kitchen of their home on Hillrod Lane in Kettering, Md., in August.
The Bryants did not care who else was interested in living in the county when they were weighing whether to buy a new house. They looked in Northern Virginia and elsewhere in the region but decided to focus their search in Prince George's, where they concluded that they could get more for their money.

The search ended when they saw plans for their Upper Marlboro home. They were drawn by the spacious lot, the quiet streets and the knowledge that many neighbors would be like them: black and middle class. They were sold when they learned they could make their nearly $20,000 down payment in installments as the house was being constructed.

Still, knowing they had good income but little cash, they were wary of overspending. They had been married only a couple of years and were juggling college loans. Also, Jennifer was pregnant with their first daughter, Harmony. So they worked hard to sift through the possible amenities. Should they finish the basement? What kind of tile should they go for in the kitchen?

"We tried to make decisions consciously," said Jennifer, 45, who earned her undergraduate degree at Strayer University and holds a master's degree from the University of Maryland.

"We tried to put a lot of thought into what we were doing."

They ended up paying $336,000 for the 3,600-square-foot home, which left them with a manageable monthly payment.

Fred, 41, visited the home site nearly every day to watch the family investment take shape. He took pictures as excavators dug out the basement. He watched the masons lay brick for the facade. And he called the builder to intervene when workers told him they could not make the driveway wide enough to accommodate two cars.

The Bryants moved in on Dec. 18, 2001. They spent the first night there on the floor of the master bedroom, wrapped in a blanket. They had never been happier.

Things went well early on. The house increased in value, and the Bryants felt confident that buying the house was the right move. Their second daughter, Jayla, was born in 2004, and not long after that they decided to send Harmony to private school.

Later, Jayla followed her sister to private school. But the bills became a strain, even with the family's income, which was well into six figures. With their home's value rising, they took a home equity loan. Then after receiving a phone solicitation, they refinanced into an adjustable-rate mortgage that offered a teaser rate that gave them the option of making smaller monthly payments. Little did they know at the time, but that deal increased the size of their loan if, as was often the case, they made only the minimum monthly payment.

That decision created a financial problem that would have solved itself had their home's value gone up. Instead, it crashed — and has yet to fully recover. Meanwhile, the Bryants can only hope that will change sometime soon.

"This has become a faith walk for us," Fred said, his arm around his wife as they sat on their living room couch. "Literally, we are surviving by God's grace."

Database editors Steven Rich and Ted Mellnik contributed to this report.

Credits

Story by Michael A. Fletcher
Photos by Michel du Cille
Graphics by Darla Cameron, Samuel Granados, Ted Mellnik

ABOUT THE SERIES

The plight of the black middle class in the wake of the housing crisis.

Representative Andy Barr

Many of my constituents either live in manufactured housing or are involved in the manufactured housing industry. You emphasized in your opening remarks that FHFA has set a goal of ensuring the housing needs of people in rural and underserved areas are met, including in areas that rely heavily on manufactured housing.

1) *What have Fannie Mae and Freddie Mac - and FHFA - been doing over the last few years to ensure loans for manufactured homes are available?*

The Enterprises are active investors in single-family manufactured housing mortgages that are secured by real estate. According to the Public Use Database of the Federal Housing Finance Agency (FHFA) for Fannie Mae and Freddie Mac (the Enterprises) loan purchase data, the Enterprises have grown their volume of single-family purchases as follows:

ENTERPRISE ANNUAL PURCHASES: SINGLE-FAMILY MANUFACTURED HOUSING LOANS				
	Fannie Mae	*Freddie Mac*	*Fannie Mae*	*Freddie Mac*
	Loan Count		*$ Unpaid Principal Balance*	
2010	*9,282*	*4,396*	*929,287,000*	*442,057,000*
2011	*9,245*	*4,197*	*901,396,000*	*434,116,000*
2012	*10,633*	*6,706*	*1,101,096,000*	*700,474,000*
2013	*15,133*	*7,663*	*1,595,522,000*	*796,810,000*

Together, the Enterprises provided financing for 22,796 single-family manufactured homes in 2013.

Both Enterprises also provide permanent financing programs for manufactured housing rental communities. Fannie Mae has purchased blanket loans for over 10 years, financing about $1 billion in permanent financing for manufactured housing communities annually. Freddie Mac began offering a blanket loan program in mid-2014. Freddie Mac financed $246 million in manufactured housing blanket loans last year. The Enterprises' blanket loan programs finance both age restricted (55 and older) and family communities.

2) *What is your specific goal for 2015 with respect to manufactured housing, whether in terms of policy or within the market? What are your long-term goals?*

Our *2015 Scorecard for Fannie Mae, Freddie Mac and Common Securitization Solutions* (2015 Conservatorship Scorecard) requires the Enterprises to continue to explore the feasibility of greater purchases of single-family loans on manufactured housing secured by real estate. FHFA expects the Enterprises to continue to aggressively pursue opportunities to serve these markets, consistent with the need for safety and soundness and for sustainable homeownership. The *2014 Scorecard for Fannie Mae, Freddie Mac and Common Securitization Solutions* (2014 Conservatorship Scorecard) and 2015 Conservatorship Scorecard impose annual loan production caps on the Enterprises' multifamily businesses; however, manufactured housing blanket loans are excluded from these caps. This exclusion is intended to encourage the Enterprises to provide liquidity to this segment of the market, given that manufactured housing often serves families of modest means and underserved parts of the housing market.

FHFA is also working to develop a proposed rule concerning the Enterprises' Duty to Serve obligations, which includes a focus on manufactured housing. FHFA expects the Duty to Serve regulatory requirements to be in effect in 2016. FHFA anticipates that it will provide Congress with its first evaluation of the Enterprises' performance of their Duty to Serve obligation in 2017.

3) *What actions are being undertaken to achieve these goals regarding manufactured homes?*

As mentioned above, FHFA issued the 2015 Conservatorship Scorecard, which describes these actions. FHFA will oversee and work with the Enterprises throughout the year on the priorities outlined in the 2015 Conservatorship Scorecard. Additionally, FHFA continues its work this year to develop a proposed Duty to Serve rule.

4) *When can we expect the FHFA and the GSEs to demonstrate or quantify progress made in achieving these goals for manufactured housing?*

As noted elsewhere, the 2015 Conservatorship Scorecard supports manufactured housing in two ways. First, it directs the Enterprises to explore the feasibility of greater purchases of single-family loans on manufactured housing secured by real estate. Second, it exempts blanket loans for manufactured housing communities from FHFA's cap on new multifamily business by the Enterprises.

FHFA monitors the Enterprises' progress on the Conservatorship Scorecard quarterly. At year end, FHFA makes an assessment of the Enterprise's compliance with the Conservatorship Scorecard. Moreover, FHFA staff works with the Enterprises on the development and evolution of their mortgage products to help adjust them to market needs.

Regarding FHFA's regulatory mandates, FHFA is developing its Duty to Serve regulation and expects to publish a proposed regulation in 2015.

Representative Stephen Fincher

Throughout your testimony before the Committee, you emphasized you are ensuring FHFA is following statutory directive. While your written testimony said that you "expect" the Enterprises to look into the feasibility of purchasing a greater number of manufactured housing loans, the statute directs you to help the Enterprises establish such a program. Specifically: the 2008 HERA statute identified manufactured housing as an "underserved market," where the GSEs are required to "provide leadership to the market in developing loan products and flexible underwriting guidelines to facilitate a secondary market for very-low, low-, and moderate income families." Further, the FHFA Director is required by the statute to annually evaluate compliance of each GSE with each Duty to Serve (DTS) area and rate their performance in each area, taking into consideration: (1) the development of loan products, (2) more flexible underwriting standards, (3) innovative approaches to providing financing, (4) extent of outreach to qualified loan sellers, and (5) the volume of loans purchased. The 2008 HERA statute also includes a provision that states that FHFA may consider both real property and personal property loans in evaluating compliance. However, since adoption of HERA, there continue to be no GSE personal property loan purchases and your written testimony states that you are expecting the Enterprises to only look into purchasing manufactured home loans secured by real estate.

QUESTION: What are the specific steps you plan to take to ensure compliance with the 2008 HERA statute with respect to manufactured homes? When can we expect to see these plans implemented? What are your plans with respect to personal property loans, which make up more than 60 percent of manufactured loan financing?

While FHFA proposed a Duty to Serve regulation on June 7, 2010, a final rule was not issued. FHFA is developing its Duty to Serve regulation and expects to re-propose a regulation in 2015. When finalized, FHFA will monitor the Enterprises' progress on an on-going basis and will conduct annual examinations. Through this process, FHFA will rate and evaluate the Enterprises' performance and report this to Congress annually. FHFA expects the regulatory requirements to be in effect in 2016. As a result, FHFA anticipates that it will provide Congress with its first rating and evaluation of the Enterprises' performance of their Duty to Serve obligation in 2017.

The Housing and Economic Recovery Act of 2008 (HERA) provides that the FHFA Director may consider manufactured housing loans secured by both real and personal property for Duty to Serve credit. As part of this rulemaking process, FHFA is reviewing and evaluating a number of issues, including the treatment of manufactured housing secured by personal property lending. We look forward to receiving comments on this important issue when we publish our proposed rule. We have included a requirement in the 2015 Conservatorship Scorecard that the Enterprises work to prepare themselves to implement these requirements when FHFA has released a final rule.

Although the regulation for this provision of HERA has not yet been finalized, both Enterprises are already actively engaged in providing permanent financing for manufactured housing rental communities and purchasing single-family loans secured by real estate.

As noted in our response to Representative Andy Barr above, the Enterprises have grown their volume of single-family purchases of manufactured loans as follows:

ENTERPRISE ANNUAL PURCHASES: SINGLE-FAMILY MANUFACTURED HOUSING LOANS				
	Fannie Mae	*Freddie Mac*	*Fannie Mae*	*Freddie Mac*
	Loan Count		*$ Unpaid Principal Balance*	
2010	*9,282*	*4,396*	*929,287,000*	*442,057,000*
2011	*9,245*	*4,197*	*901,396,000*	*434,116,000*
2012	*10,633*	*6,706*	*1,101,096,000*	*700,474,000*
2013	*15,133*	*7,663*	*1,595,522,000*	*796,810,000*

Together, the Enterprises provided financing for 22,796 single-family manufactured homes in 2013.

FHFA expects the Enterprises to continue to aggressively pursue opportunities to serve these markets, consistent with the need for safety and soundness and for sustainable homeownership. FHFA's 2015 Conservatorship Scorecard requires the Enterprises to continue to explore the feasibility of greater purchases of loans on single-family manufactured housing secured by real estate. The 2015 Conservatorship Scorecard also exempts loans for manufactured housing rental communities from the cap on new multifamily business to encourage the Enterprises to provide as much liquidity to this segment of the market as is feasible. FHFA will assess the Enterprises' fulfillment of this requirement for 2015.

Representative Gwen Moore

1) *As you know, the Federal Housing Administration (FHA) reduced what it charges for mortgage insurance. It is a policy that I support, but it does raise questions for FHFA. Specifically, I would be interested in your thoughts on how FHA's news pricing impacts the upcoming Private Mortgage Insurance Eligibility Requirements (PMIERs) rulemaking and will the FHFA work to balance FHA and other GSE counterparty requirements?*

The private mortgage insurer eligibility requirements (PMIERs) are intended to ensure that mortgage insurers (MIs) doing business with the Enterprises have an adequate ability to pay claims when claims are made. FHFA in conjunction with the Enterprises determine guarantee fee levels using each Enterprises' credit model, which take into account counterparty risk, including the ability of counterparties to pay claims. We are currently evaluating the Enterprises' guarantee fees and the Enterprises' counterparty requirements for private mortgage insurers, including considering the responses to our Requests for Input.

The ultimate impact of PMIERs on guarantee fees is part of our work to finalize these requirements. In determining the guarantee fee level or PMIERs we are not considering how pricing changes may impact the respective market share of the Enterprises in comparison to the Federal Housing Administration (FHA). We are, however, considering how pricing and PMIERs changes might change the profile of loan characteristics the Enterprise purchase.

2) *What are loan-level pricing adjustments and are they still being applied? Would they continue to serve a function once the Private MI Eligibility Requirements (PMIERs) are finalized and adopted?*

The Enterprises charge two types of guarantee fees to cover the costs of assuming the credit risk on acquired mortgages. The first category covers base (Fannie Mae) or anchor (Freddie Mac) guarantee fees that are based on the product type (e.g. 30-year fixed-rate mortgage (FRM), 15-year FRM, 5/1 adjustable-rate mortgage (ARM)). The second category covers loan level pricing adjustments (LLPAs) (Fannie Mae) or delivery fees (Freddie Mac) that are based on the risk characteristics of a loan. The risk-based fees in the second category are for features such as the loan-to-value ratio (LTV)/credit score group of a loan (e.g., LTV between 80.1-85 and credit score between 680-699) and other risk-based factors (e.g., investor property, multiple unit property, condominium, cash-out refinance). These are important adjustments to the base guarantee fee to properly account for the Enterprises' cost of bearing the credit risk on their loans.

FHFA is now reviewing and considering the feedback we received from the June 2014 Request for Input as part of our ongoing comprehensive evaluation of guarantee fee policy. Consistent with our statutory mandates, our assessments and policy decisions will take into account both safety and soundness and possible impacts on access to credit and housing finance market liquidity.

3) *Historically, Fannie and Freddie have purchased 97 LTV loans. I understand that steps have been taken to return to again purchase 97 LTV loans, but I would be interested in knowing more about your thinking on how these loans may be handled in the future?*

The Enterprises announced 97 percent LTV programs in December 2014, with Fannie Mae implementing this program into their automated underwriting system in December 2014 and Freddie Mac is scheduled to follow in March 2015. The primary purpose of the program is to provide responsible lending to qualified borrowers who can afford a mortgage but whose greatest obstacle to homeownership is paying a substantial down payment plus closing costs. The qualification process leverages credit counseling for first-time homebuyers and utilization of the Enterprises' automated underwriting for credit decisions. The Enterprises expect volume to remain a small percentage of their overall loan deliveries. The Enterprises and FHFA will continue to monitor the program as it evolves in the future, and how these loans will be handled in the future will depend on the results of that monitoring.

Representative Steve Pearce

Many of the individuals commenting on your proposed rule concerning Federal Home Loan Bank membership expressed concerns about the impact of the proposed asset tests on community banks and credit unions, and the burden of meeting them on an on-going basis. Will your agency conduct an evaluation of these impacts and these costs associated with the proposal before issuing a final rule imposing these requirements?

Yes. FHFA performed a preliminary analysis on the number of members that would be affected by the ongoing asset tests of the proposed rule and determined that the vast majority of current Federal Home Loan Bank (FHLBank) members would not only meet the new requirements, but would significantly exceed the required asset ratios. Consequently, the overwhelming majority of members should experience no new compliance burden associated with the proposed rule. Because the proposed rule requires the FHLBanks to monitor member compliance in the first instance using call report data, most members would not need to do anything new or more onerous than what they do now to ensure compliance. Only that small number of institutions that are below or only slightly above the asset ratio thresholds would need to monitor their holdings or add more housing finance-related assets to their balance sheets.

As part of our assessment of the proposed rule, we will review the many comment letters received for further information about costs and impacts. We will also update our analyses with current data and consider three-year averages so that we have a more precise projection of the number of institutions that are likely to be affected by the proposed rule. This evaluation will take place before we issue a final rule.

Representative Ed Royce

1) *Last year, you announced plans to develop a common securitization platform; a move I strongly supported. Do you expect this platform to be up and running before the end of 2015? Will the FHFA issue a progress report on the development of the platform before July 1, 2015? How will you include all market participants in the planning and implementation of the common securitization platform?*

   The Common Securitization Platform (CSP) will not be up and running before the end of 2015. Developing the CSP is a complex task that requires multiple years to complete given the complex nature of the initiative. However, substantial progress has been made on building and testing the CSP itself. Some of the more challenging parts of this project involve the system and process changes required at the Enterprises to enable them to successfully connect to and use the CSP. On Monday, March 16, 2015 FHFA issued a Progress Report on the initiatives outlined in the 2014 Conservatorship Scorecard, including development of the CSP.

   While the *2014 Strategic Plan for the Conservatorships of Fannie Mae and Freddie Mac* (2014 Strategic Plan) requires the Enterprises to build the new infrastructure for use by both companies, it also requires that the CSP be adaptable for use by additional market participants in the future. To accomplish this, the Enterprises and CSP team will continue to focus on leveraging industry-standard interfaces, industry software, and industry data standards where possible.

   As part of our ongoing work to develop the CSP, FHFA has regularly met with – and sought input from – a wide range of market participants on the CSP. FHFA will continue to meet with and regularly update market participants on the CSP. In addition, FHFA has issued a number of progress reports on the CSP to provide updates to the public and stakeholders on this initiative.

2) *When do you expect your agency to finalize the private mortgage insurer eligibility requirements ("PMIERs") and the resulting new capital standards for private mortgage insurance companies? Will similar standards be developed for other counterparties of the GSEs?*

   FHFA expects Fannie Mae and Freddie Mac to publish the final PMIERs early in the second quarter of 2015.

   The Enterprises currently have similar standards in place for their other major counterparties. These standards are periodically updated in response to changes in the housing finance market. For example, FHFA recently released proposed Minimum Financial Eligibility Requirements for Seller/Servicers, which are available at http://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Proposes-Minimum-Financial-Eligibility-Requirements-for-Fannie-and-Freddie-Seller-Servicers.aspx. No other updates to counterparty standards are currently under development.

3) In an August 28, 2014 letter to Gene Harrington from the National Pest Management Association, which I have included for the record, you responded to questions about Freddie Mac's policy related to repairs and inspections of Real Estate Owned (REO) properties caused by termite damage. Specifically you stated that the same vendor can perform both termite inspections and fumigations, and submit bids for repair items listed on the termite report. Is this policy widely-known in the real estate community? Is there a way to ensure that this policy has been circulated?

Freddie Mac policies and procedures for repairs and inspections of their REO properties are generally not publically available. However, policies and procedures are available to approved vendors, including brokers, working on behalf of Freddie Mac. Freddie Mac does not have termite vendors in its approved vendor network. As such, Freddie Mac does not directly communicate with the pest control industry. Instead, Freddie Mac relies on their network of approved brokers to select and communicate with termite vendors about how to address termite infestation and repair of minor items outlined in the inspection report.

Representative Brad Sherman

1) *Director Watt, during the hearing on the 27th of January, there was a great amount of discussion over the Guarantee or "G fees," and whether or not they would be changed. There was also some discussion as to the Private Mortgage Insurers Eligibility Requirements or PMIERs. I would like to follow up with a question related to this issue. I understand that as a result of the yet-to-be-released PMIERs final rule, the most likely effect for mortgage insurers will be that their costs, and thus the costs of obtaining private mortgage insurance (PMI) will go up. At the same time, just this month it was announced that the Federal Housing Administration (FHA) will be lowering their insurance premium. It is not unreasonable then to assume we may very well see an increase in FHA loans, despite neither of these policies having that goal. Will you order Fannie and Freddie to lower their fees as well to ensure they are correctly priced to capture their traditional market share? This is especially important since they insure much less risk since these loans have private mortgage insurance which covers 25 -35% of any loss in the first instance.*

The PMIERs are intended to ensure that mortgage insurers (MIs) doing business with the Enterprises have an adequate ability to pay claims when claims are made. FHFA in conjunction with the Enterprises determine guarantee fee levels using each Enterprises' credit model, which take into account counterparty risk, including the ability of counterparties to pay claims. We are currently evaluating the Enterprises' guarantee fees and the Enterprises' counterparty requirements for private mortgage insurers, including considering the responses to our Requests for Input.

The ultimate impact of PMIERs on guarantee fees is part of our work to finalize these requirements. In determining the guarantee fee level or PMIERs we are not considering how pricing changes may impact the respective market share of the Enterprises in comparison to FHA. We are, however, considering how pricing and PMIERs changes might change the profile of loan characteristics the Enterprise purchase.

Representative Kyrsten Sinema:

1) *As you are aware, most condominium properties and homeowner associations have common areas – sometimes club houses, stairwells, lobbies, or parks – that must be insured. Many Home Owner Associations (HOAs) purchase insurance for these common areas through an umbrella policy that covers multiple properties. However, in October 2013, Fannie Mae issued guidance (SEL 20013-08) which would disallow these umbrella master insurance policies. Each HOA will now have to purchase insurance individually, potentially at a higher rate. The 26 units at Brighton Heights condos in Phoenix, AZ is just one of approximately 20 communities, or 872 homeowners, in my district that will be affected by this change. QUESTION #1: Mr. Watt, I appreciate your concerns regarding increased risks and potential exposure to under-insured loss for HOAs covered by these policies, but I would like to know if there is an alternative solution. Can you tell me if providing individual coverage limits would make these policies more transparent and ensure that HOAs are afforded the rights and coverage necessary to mitigate these risks?*

Fannie Mae currently allows umbrella policies, more commonly referred to as blanket policies, on affiliated projects. Blanket policies cover the project's buildings, common areas, elements and amenities from named perils and other hazards. Condominium projects, for example, purchase master policy hazard insurance either as a stand-alone policy or a blanket policy that covers an affiliated project. Affiliated projects are those projects that share common elements and amenities. Individual condominium unit owners (homeowners) purchase individual unit owner policies. Unit owner's policies generally cover the individual unit only and include such coverages as contents and loss of use.

Fannie Mae does not permit blanket policies on unaffiliated projects. Blanket policies on unaffiliated projects can insure unrelated projects that may span across state lines and include insurance for commercial risks. Moreover, beneficiaries on blanket policies can be opaque; they often list management companies as the "named insured" with project HOAs noted as other or additional insured. It is difficult for lenders, underwriters and mortgage servicers to verify coverage and coverage limits for individual projects when the "named insured" is a management company. The opaqueness around policy beneficiaries creates an unnecessary barrier to access of information regarding policy conditions, limits, coverages and claim status as well as direct notifications in the event of policy changes or cancellations, as insurance carriers are not obligated to notify additional insured parties.

Due to the inherent risks associated with covering unaffiliated projects under a single blanket insurance policy, Fannie Mae's decision to exclude these unaffiliated blanket insurance products from eligibility aligns with the policies of both the FHA and Freddie Mac and represents the best interests of all housing industry stakeholders, including homeowners and the broader housing market. Fannie Mae and FHFA have been in contact with insurance carrier stakeholders regarding this issue but, to date, the insurance providers have not developed a product that adequately addresses these identified risks.

nor provided data to support the assertion that without blanket policies for unaffiliated projects, insurance costs to HOAs would significantly increase.

2) *Manufactured housing is a key form of affordable housing in my district, particularly in rural and underserved communities. More than 290,000 families in my district live in manufactured homes. Manufactured homes provide an affordable housing choice for many low- and moderate-income families in Arizona. Through the Housing and Economic Recovery Act of 2008 (HERA) Congress created a duty for Fannie Mae and Freddie Mac to serve three specific underserved markets, including manufactured housing. The duty to serve is a new obligation for the Enterprises and a new oversight responsibility for FHFA. Mr. Watt, you testified that the FHFA will finally look to complete a rulemaking on this important duty to serve provision by the end of 2015. Can you explain what action FHFA is considering with respect to the duty to serve provision as it relates to manufactured housing, including loans secured by personal property? While I appreciate that FHFA encourages the Enterprises to purchase more manufactured housing loans secured by real property, manufactured home-only loans - i.e. loans secured by personal property - comprise between 60 to 70 percent of all manufactured home financing. Can you tell me what FHFA is doing to ensure secondary market access for manufactured home loans secured by personal property?*

Manufactured housing provides very low-, low-, and moderate-income families with an important housing option. The overall costs for manufactured homes are far below those for site built homes, even taking into account the differences in square footage. Moreover, manufactured housing borrowers generally have significantly lower incomes on average.

Today, the Enterprises purchase blanket loans on manufactured housing communities, which provide sites for manufactured housing units titled as personal property. Fannie Mae has purchased blanket loans for manufactured housing communities for over 10 years, financing about $1 billion in permanent financing annually. Freddie Mac began offering a blanket loan program in mid-2014. Freddie Mac financed $246 million in manufactured housing blanket loans last year. FHFA's 2014 and 2015 Conservatorship Scorecards impose annual loan production caps on the Enterprises' multifamily businesses, but manufactured housing blanket loans are excluded from these caps. The exclusion is intended to encourage the Enterprises to provide as much liquidity to this segment of the market as is feasible, given that manufactured housing often serves families of modest means and underserved parts of the housing market.

Additionally, the Enterprises purchase single family manufactured housing loans secured by real estate, and the Enterprises purchased 22,796 of these manufactured housing loans in 2013.

While FHFA proposed a Duty to Serve regulation on June 7, 2010, a final rule was not issued. FHFA is developing a re-proposed rule concerning the Enterprises' Duty to Serve obligations. HERA provides that the FHFA Director may consider manufactured housing loans secured by both real and personal property for Duty to Serve credit. As part of this rulemaking process, FHFA is reviewing and evaluating a number of issues, including the treatment of manufactured housing secured by personal property lending. We look forward to receiving comments on this important issue when we publish our proposed rule. We have included a requirement in the 2015 Conservatorship Scorecard that the Enterprises work to prepare themselves to implement these requirements when FHFA has released a final rule.

Representative Roger Williams

1) *One area that has experienced stability over the years is property and casualty insurance- as it applies to condominium properties and homeowner associations. Most of these properties have common areas--sometimes club houses, stairwells, lobbies, or parks-- that must be insured. Many of these homeowner associations purchase such insurance through an umbrella policy covering multiple properties. This has allowed the insurer to charges reasonable rates. However, in October 2013, Fannie Mae issued guidance (SEL 20013-08) which would disallow these umbrella master insurance policies. Each condominium association or homeowner association will now have to seek insurance individually. I am not sure who will benefit from this (maybe the lender), but it is certainly not the homeowner or condominium owner. Purchasing individually will almost certainly cause an increase in homeowner's insurance rates. And nearly 1 in 4 homeowners live in properties that are governed by a homeowner association of some kind. How does reducing consumer choice, raising rates without a reduction of risk to Fannie Mae further the goals of homeownership? I am also concerned that Fannie Mae is turning a deaf ear to attempts to address their concerns by providers who have offered up fixes to ensure that such programs meet Fannie Mae requirements. I would be interested in your thoughts on both these matters.*

Fannie Mae currently allows umbrella policies, more commonly referred to as blanket policies, on affiliated projects. Blanket policies cover the project's buildings, common areas, elements and amenities from named perils and other hazards. Condominium projects, for example, purchase master policy hazard insurance either as a stand-alone policy or a blanket policy that covers an affiliated project. Affiliated projects are those projects that share common elements and amenities. Individual condominium unit owners (homeowners) purchase individual unit owner policies. Unit owner's policies generally cover the individual unit only and include such coverages as contents and loss of use.

Fannie Mae does not permit blanket policies on unaffiliated projects. Blanket policies on unaffiliated projects can insure unrelated projects that may span across state lines and include insurance for commercial risks. Moreover, beneficiaries on blanket policies can be opaque; they often list management companies as the "named insured" with project HOAs noted as other or additional insured. It is difficult for lenders, underwriters and mortgage servicers to verify coverage and coverage limits for individual projects when the "named insured" is a management company. The opaqueness around policy beneficiaries creates an unnecessary barrier to access of information regarding policy conditions, limits, coverages and claim status as well as direct notifications in the event of policy changes or cancellations, as insurance carriers are not obligated to notify additional insured parties.

Due to the inherent risks associated with covering unaffiliated projects under a single blanket insurance policy, Fannie Mae's decision to exclude these unaffiliated blanket insurance products from eligibility aligns with the policies of FHA and Freddie Mac and represents the best interests of all housing industry stakeholders, including homeowners and the broader housing market. Fannie Mae and FHFA have been in contact with insurance carrier stakeholders regarding this issue but, to date, the insurance providers have not developed a product that adequately addresses these identified risks, nor provided data to support the assertion that without blanket policies for unaffiliated projects, insurance costs to HOAs would significantly increase.

Representative Randy Hultgren

1) *Director Watt, you have consistently said that it is not your intention to get ahead of Congress about what to do regarding Fannie and Freddie and instead will wait for Congress to act. I appreciate your restraint but wonder why you are not taking the same approach with respect to the FHFA's proposed rule on Federal Home Loan Bank (FHLB) membership? Congress has always decided which entities should be eligible to be FHLB members. Over the 82 years since Congress created the FHLBs, it has consistently expanded the group of eligible entities to better allow the FHLB to promote not only affordable home buying but also economic development that benefits small businesses, job creation and other productive activities. While Congress has never contracted FHLB membership, the FHFA's current proposal would do just that by restricting membership and even kicking out certain types of members. The proposed rule goes well beyond simply implementing the statute. Why do you believe it is appropriate for a Federal agency to make such a determination?*

   The Federal Home Loan Bank Act (Bank Act) sets eligibility requirements for FHLBank membership. See 12 U.S.C. § 4511(b)(2). In recent years, the agency has noted a number of instances in which institutions that either have little or no connection to housing finance or, if they have such a connection, are not subject to adequate inspection and regulation, have been able to take advantage of regulations drafted in a different era to gain access to the benefits of FHLBank membership. In publishing the proposed rule on FHLBank membership standards, FHFA is seeking to determine how best to implement the existing statutory membership eligibility requirements that Congress has established. The primary purpose of the Bank Act is to support the nation's housing markets by establishing and maintaining a system of financially sound FHLBanks to provide wholesale funds to their member institutions for the purpose of financing those members' residential mortgage lending activities. As the regulator of the FHLBanks, FHFA has a responsibility to consider whether changes in the types of institutions becoming members of the FHLBanks are consistent with the statutory framework.

   Getting input and feedback from stakeholders and this Committee is a crucial part of FHFA's policymaking process, and FHFA is currently reviewing the over 1,300 comments we received.

2) *You have said the FHLB proposal would adversely affect less than 100 members. However, isn't it true that every single FHLB member would be affected because each would be required to continually monitor, and possibly adjust, the assets on their balance sheets in order to remain in compliance with the rule. Each member would need to create a compliance system, or at the minimum, a compliance plan to ensure they meet the rule at all times. Given this burden, has your agency done a cost-benefit analysis on the impact to these members?*

   While FHFA's proposed rule does not have a cost-benefit analysis, and the agency is not required to complete one by statute, we are very mindful of the impact of this proposal on FHLBank members and have undertaken an analysis to assess the number of institutions that would be affected by the proposed rule and are aware of the impact of this proposal on FHLBank members. FHFA analyzed the number of members that would be affected by the proposed rule and determined that the vast majority of current FHLBank members would not only meet the new requirements, but would significantly exceed the required asset ratios. Because the proposed rule requires the FHLBanks to monitor member compliance in the first instance using call report data, most members would not need to do anything differently than they do currently. Only that small percentage of institutions that are at or near the asset ratio thresholds would need to actively monitor their holdings or consider whether to add more housing finance-related assets to their balance sheets to remain eligible for FHLBank membership.

Based on information obtained from the December 31, 2013 regulatory financial reports filed by existing FHLBank members, FHFA estimated that between 52 and 103 (or 0.7 percent - 1.4 percent) of the 7,433 FHLBank members for which data were available would have been out of compliance with the proposed requirement that members hold at least one percent of their assets as "long-term home mortgage loans." This estimate is as of the reported time period and based on assets held at that point in time (as opposed to a three-year average, as proposed in the rule). By member type, the number that would have been out of compliance broke down as follows: between 29 and 47 (or 0.5 percent - 0.8 percent) of 5,976 bank and savings association members; between 5 and 14 (or 0.4 percent – 1.2 percent) of 1,204 credit union members; and between 18 and 42 (or 7.1 percent - 16.6 percent) of 253 insurance company members. The number of members failing to meet those hypothetical ratios might be lower still if average data from the preceding three year-ends had been used. In a similar fashion, of those institutions that would fail to meet the above quantitative requirements, some are only slightly below the particular threshold, which suggests that they could readily comply with an ongoing quantitative requirement by modestly adjusting their balance sheets.

We will review the comments provided by the public and this Committee in order to fully consider these and other issues in developing the final rule.

3) *The proposal rule would discourage FHLB member community financial institutions (CFIs) from merging if the assets of the resulting entity exceed the CFI threshold. Has your agency done any analysis of the potential impact on community institutions? Has your agency consulted with the primary Federal and state regulators of CFIs, including the FDIC and OCC?*

The definition of a CFI – an FDIC-insured institution with inflation adjusted assets of $1 billion or less – is statutory, as are the principal benefits of CFI status, which provide enhanced access to advances. Under current law, if two CFI members were to merge and result in a continuing institution with assets in excess of the CFI threshold, that institution would lose access to new CFI advances immediately, although it could retain any outstanding advances secured by CFI collateral and also could obtain new advances by posting other types of eligible collateral. That such mergers among CFI members do occur, notwithstanding the loss of access to CFI advances, suggests that loss of CFI status does not prevent CFIs from merging. We will carefully review the comment letters, however, to assess whether the rule would impact such mergers.

FHFA assessed the likely effect of the proposed rule on CFIs and estimated that, with respect to the requirement that members hold at least 1 percent of their assets as "home mortgage loans" that only between 27 and 43 (or 0.5 percent - 0.8 percent of the approximately 5,400 CFI members, as of December 31, 2013) would not have met the requirement. Because the requirement to hold 10 percent of assets as "residential mortgage loans" would not apply to CFIs, we did not assess whether they would meet that requirement. Based on a preliminary analysis, at several FHLBanks a significant number of CFIs (about 10 to 15 percent) hold less than 10 percent of their assets in residential mortgage loans, although most of those members did hold at least 5 percent of assets in residential mortgage loans. Whether a merger of two CFI members would cause the surviving institution to fail to meet the 10 percent requirement is impossible to determine without knowing the identity of the two merging members. We will continue to analyze this issue further in our review of the proposed rule.

We discussed the proposed rule with our Oversight Board, which consists of the Secretaries of Treasury and Housing and Urban Development (HUD), the Chair of the Securities and Exchange Commission (SEC) and the Director of FHFA, prior to publishing it in the Federal Register. FHFA did not discuss the proposed rule with the Federal Deposit Insurance Corporation (FDIC) or the Office of the Comptroller of the Currency (OCC), but will do so before issuing a final rule.

4) *Many of community banks and credit unions in Illinois which have submitted comment letters are concerned about the potential disruption of the FHLBanks as a primary source of their liquidity. Did your agency consult with the primary regulators of these institutions on the potential safety and soundness effects of the proposal before issuing the proposal? Will you consult with them before issuing a final rule?*

FHFA recognizes that the FHLBanks provide an important source of liquidity for housing finance and took care and effort in crafting the proposed rule to ensure that it would not adversely affect members' access to liquidity via FHLBank advances. For example, the proposed rule was designed to require only a minimal level of home mortgage loans – one percent – to demonstrate compliance with the statutory requirements. Moreover, the proposed rule would require that a member be out of compliance for two years before its membership would be terminated. That provision was intended to ensure that members would have sufficient time to come into compliance with the rule if it wanted to retain its membership and access to FHLBank liquidity. As stated in response to your third question, we did not discuss the proposed rule with FDIC and OCC, but will do so before issuing a final rule.