The GSEs' Equitable Housing Finance Plans

Strengths and Missed Opportunities

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The much-anticipated Fannie Mae and Freddie Mac Equitable Housing Finance Plans (EHFPs) were released on June 8, 2022 (Fannie Mae 2022; Freddie Mac 2022). In September 2021, the Federal Housing Finance Agency (FHFA) directed the two government-sponsored enterprises (GSEs) to submit three-year EHFPs, to be updated annually, charging them with setting goals and undertaking actions to address barriers to sustainable homeownership opportunities to advance equity in housing finance.

This historic if long-overdue step acknowledges the role of the government-designed and government-sponsored housing finance ecosystem in creating and maintaining the racial homeownership gap. We applaud the FHFA for its leadership and the GSEs for their commitments to build a more equitable mortgage system that works better for more people.

In this brief, we discuss the GSEs' inaugural EHFPs, highlighting what we find good about the plans, what we find bad, and what we find lacking. We previously pointed out that the success of this effort depends on focused measurable goals addressing the legacies of race- and place-based housing discrimination, aligned with the GSEs' role in the system, their statutory purpose, and their policy and business motivations, including ensuring the GSEs' safety and soundness (Ratcliffe, Stegman, and Reynolds 2021). Further, we hold that endurance of these efforts depends on integrating the key EHFP elements into the GSEs' business models. We also note the FHFA's essential role in ensuring the effectiveness and durability of this effort.

The GSEs will update the plans soon, and we hope some of our suggestions will be considered.

A Brief Overview of the EHFPs

The GSEs take different approaches. Fannie Mae's plan seeks to dismantle barriers Black households face along three main stages of the "housing journey": (1) housing preparation, including credit building and financial education; (2) shopping for, acquiring, renting, or buying a home using a mortgage; and (3) achieving housing stability, or maintaining homeownership or rentership despite obstacles. Each area generates a set of recommendations, 17 in all, including efforts to enhance homebuyer education, credit eligibility innovations, and housing sustainability programs, with design and implementation steps over the next three years. The plan relies heavily on special purpose credit programs (SPCPs) and pilots to serve specific areas of need and opportunity. Notably, by stating that its next EHFP planning cycle will incorporate actions to serve Latino housing finance needs, Fannie Mae implicitly supports the notion that the government's complicity in creating and perpetuating the Black-white homeownership gap warrants its inaugural EHFP cycle to focus on ways to narrow that gap. Though planned actions will increase access for other underserved groups to varying degrees, the plan also suggests that different groups will experience differential benefits from various measures.

Freddie Mac's plan also includes broad interventions to "address systemic barriers to equitable housing"—including improving fairness in credit scoring, underwriting, and appraisal bias and reducing third-party costs. Freddie Mac's plan has a central role for SPCPs, focusing on a more expansive definition of people of color. Freddie Mac's plan is also substantively broader than Fannie Mae's, touching on housing finance for persons with intellectual or developmental disabilities, technical assistance on renovation financing, down payment assistance tools, and tenant protections and acceptance of housing choice vouchers in Freddie Mac–financed rental housing. Freddie Mac also hopes to develop disclosures and special bond categories to attract social impact investor capital.[1]

The Good

Both GSEs' strategies explicitly call out challenges disproportionately facing households and communities of color in renting and owning homes. This is important and long overdue. The GSEs have maintained plans under their respective Duty to Serve and affordable housing goal regimes, but these plans have never squarely focused on narrowing the racial homeownership gap. In addition to the overall focus on the racial homeownership gap, the EHFPs include several noteworthy provisions.

Support for SPCPs

Support for SPCPs is central to both proposals and strongly aligns with the GSEs' core purpose and "superpowers" of liquidity and standardization. Fannie Mae's objective, a tall order, is to make its purchase of SPCP mortgages as routine as buying any other loans that meet its seller/servicer requirements. The Freddie Mac plan makes "SPCPs a key strategic tool to expand homeownership for these underserved communities" and proposes to design its own SPCP, while partnering with lenders and community organizations through "targeted marketing and outreach to ensure the success of SPCPs" (Freddie Mac 2022, 19).

Although the legal framework for SPCPs has existed for decades, mortgage industry adoption is still tentative and in its early stages, despite official guidance on SPCPs from the Consumer Financial Protection Bureau, financial regulators, and the US Department of Housing and Urban Development. One remaining impediment to wider adoption of SPCPs is originators' uncertainty about secondary market acceptance. Without secondary market outlets, SPCPs will largely be constrained to depository institutions' balance sheets. With secondary market outlets, Fannie Mae and Freddie Mac's embrace of SPCPs will clarify and standardize them, thereby making SPCPs an accepted product, and provide liquidity to lenders who require a secondary outlet for them. Importantly, the likelihood of widespread originator acceptance will be higher if an SPCP loan that is acceptable to one GSE is acceptable to the other. Moreover, SPCP standardization and alignment by the GSEs would also implicitly become a safe harbor that would resonate throughout the industry. We encourage Fannie Mae, Freddie Mac, and FHFA to seriously act on Fannie Mae's tentative 2023–24 plans to, "as appropriate, work with FHFA and Freddie Mac to develop standardized GSE programs" (Fannie Mae 2022, 21).

Many of the equity-advancing innovations in the plans, however—from the boldest (the elimination of loan-level risk-based pricing) to the less bold but still important (counseling for borrowers facing hardship)—apply only to SPCP loans; they are not integrated into the GSEs' routine single-family business practices. Resistance against SPCPs—say, because of fair lending or backlash concerns in spite of a robust secondary market—would neutralize the impacts of these important reforms. Moreover, because SPCPs are embodied in plans lacking statutory authority, a new FHFA director could wipe away EHFP requirements with a stroke of a pen, along with all the innovations that SPCPs generate, unless the GSEs migrate their SPCP guidance into their routine single-family business practices.[2]

Emphasis on Maintaining Homeownership

Another example of how the plans exploit the GSEs' superpowers is by emphasizing not only achieving homeownership but maintaining homeownership. In this arena, the GSEs set standards for servicing loans and preventing foreclosures and home loss. This area has great potential to advance equity as well, because Black, Latino, and other nonwhite borrowers are more likely than white borrowers to experience financial hardships that impair their ability to maintain payments. Moreover, strengthening evidence-based foreclosure prevention measures, particularly on loans to less affluent borrowers, will enable the GSEs to maintain safety and soundness while expanding the credit box.

The GSEs' homeownership stability plans are promising and include deploying postpurchase education and counseling, exploring ways to help borrowers buffer shocks, and developing special servicing provisions and oversight. Given the fragile foundation for EHFPs and their SPCPs, all these innovations should be incorporated into each GSE's seller/servicer guides as part of their mainstream single-family lending business lines.

Though similar, the equity-enhancing servicing plans are not identical and raise an important question for the FHFA that is relevant to but broader than the EHFP exercise and this brief: while they remain in conservatorship, in what areas should the GSEs compete to foster innovation, and when should they coordinate or cooperate through FHFA guidance to create a single national industry standard?

Attention to Rental Housing

Although Fannie Mae and Freddie Mac's main sphere of influence is homeownership, both plans recognize the critical need for high-quality, affordable rental housing and the important role the GSEs play in multifamily finance. These elements respond directly to the goals the FHFA laid out for the GSEs to reduce disparities in rental practices and increasing the supply of affordable rental housing for certain market segments. Freddie Mac, in particular, lays out plans that could boost affordable housing supply by improving financing for affordable multifamily development, rehabilitation, and preservation.

Although, taken together, these plans will have only marginal effects on the overall supply, Freddie Mac's planned initiatives to expand the supply of affordable rental housing are especially welcome because financial engineering alone will not resolve persistent rental affordability issues. Freddie Mac is also extending its Develop the Developer initiative in underserved communities of color from single-family (one to four units) to multifamily homes (five or more units); it is extending its "linked loan" offering that supports emerging developers to allow for the financing of noncontiguous two-to-four-unit properties (Freddie Mac 2022, 59). And both EHFPs plan to explore standardizing best practices to make them fairer, such as tenant protections and housing choice voucher acceptance (Freddie Mac) and security deposits (Fannie Mae), all positive steps leading to broader market adoption of more equitable rental markets.

Freddie Mac is exploring ways to expand its limited rent reporting initiative from newly financed multifamily properties to its entire multifamily portfolio to help tenants build their credit and boost their credit scores through timely rent payments, and Fannie Mae has initiated its own rent reporting program; both GSEs recognize that today's renters, who are disproportionately nonwhite, are tomorrow's potential homeowners.

Research Agenda Based on Information, Facts, and Evidence

Both GSEs based their plans on extensive research. These plans are strengthened by evidence-driven approaches. Freddie Mac (2022, 9) examined several issues to inform its proposal: "From August 2021 through October 2021, Freddie Mac led an extensive research project combining human-centered ethnographic study with quantitative surveys at scale, as well as subject-matter-expert interviews to build a deeper understanding of the equitable housing challenge." Fannie Mae explored the Black housing experience through surveys and discussions and did deep dives on closing costs and security deposit differences. Research on the closing costs different racial and ethnic groups paid was published in December 2021, and Fannie Mae has said additional research on how closing costs affect people of color and low-income populations will be published in 2022 (Mota and Palim 2021). Research projects also included detailed analytic work on appraisal bias and housing supply issues. Freddie Mac's financial research extended into testing the capital markets with its October 2021 issuance of its first single-family Uniform Mortgage-Backed Securities backed entirely by Home Possible loans, as a basis for developing a broader social bond issuance program aimed at environmental, social, and corporate governance investors.

Importantly, both GSEs have committed to continue researching the racial homeownership gap, providing the market with facts and evidence. Fannie Mae is conducting research to understand the Latino homeownership experience and pain points in the housing journey. Freddie Mac is even more expansive in this regard; it has committed to 21 research projects over this three-year EHFP cycle, spanning both homebuying and renting. These projects include further work on the appraisal gap, housing choice voucher availability and efficacy, and trends in student loan debt among future borrowers of color.

We are heartened by the GSEs' data-driven approach to these issues and look forward to seeing their research. In our prior recommendations, we note the power of the GSEs' data to improve equity, not only within the GSEs' practices but to inform industry-wide efforts and make those more effective (Ratcliffe, Stegman, and Reynolds 2021).

The Bad

Neither plan fully owns or articulates the accountability the GSEs have to the historical and ongoing racial homeownership gap nor takes advantage of the full set of levers they possess to directly address practices that perpetuate inequity. There is a tendency to focus on issues outside their sandbox, where there is less potential for the GSEs to advance equity, and a tendency to overlook areas where they have clout. The plans also include items that were under way before the EHFP planning exercise began, where the direct connection to equity is more remote. Although we appreciate this multifaceted strategy, it risks diluting the coherence of a plan that should be focused on a limited number of high-impact equity-enhancing activities. Indeed, with fewer initiatives, it might also be possible to accelerate the timelines for the high-impact changes that are necessary for the GSEs to level the housing finance playing field for communities of color. Moreover, there are few measurable objectives to know whether these plans are working. In these ways, the plans fall short of the essential principles we identified at the outset.

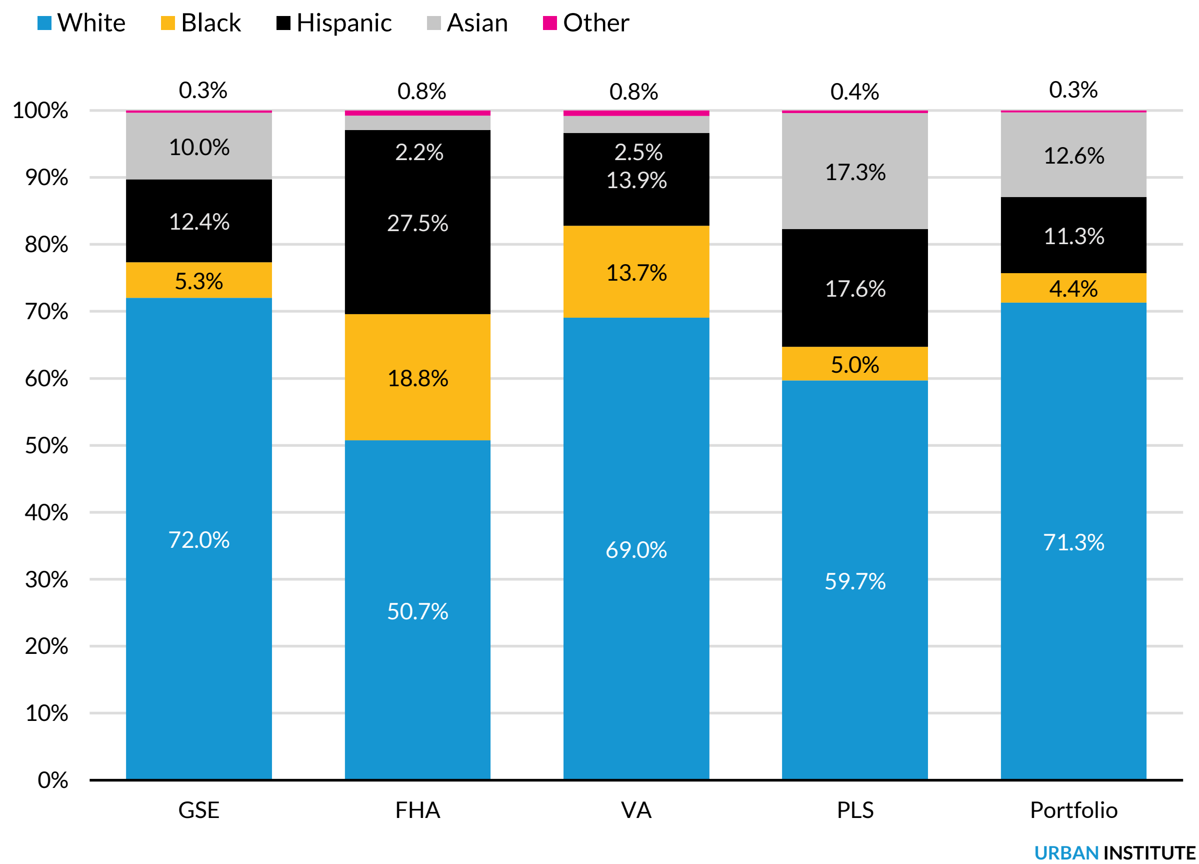
Neither Plan Recognizes the GSEs' Role in the Current Racial Homeownership Gaps

Both plans discuss how historical systemic racial discrimination has led to the homeownership and wealth gaps for people of color, but neither plan has a section on how GSE policies perpetuated these gaps and inequities. Home Mortgage Disclosure Act data confirm the GSEs do less mortgage lending to Black and Hispanic borrowers than the Federal Housing Administration (FHA) and US Department of Veterans Affairs (VA) programs; 2021 Home Mortgage Disclosure Act data show that Black borrowers are 5.3 percent of GSE purchase lending, 18.8 percent of FHA purchase lending, and 13.7 percent of VA purchase lending (figure 1). GSE lending to Hispanic borrowers shows a similar pattern: 12.4 percent of GSE purchase lending, 27.5 percent of FHA purchase lending, and 13.9 percent of VA purchase lending. These numbers were noticeably absent from both reports.

This is yet another reason why concerns about racial equity and redressing historical racial inequities should be a pillar of GSE policies, practices, and processes, not an add-on limited to loans that flow only through SPCPs.

FIGURE 1

2021 Purchase Loan Channel Shares, by Race or Ethnicity



Source: 2021 Home Mortgage Disclosure Act data.
Notes: FHA = Federal Housing Administration; GSE = government-sponsored enterprise; PLS = private-label securities; VA = US Department of Veterans Affairs. Includes purchase loans only. Shares are based on loan counts.

Lack of Focus on Where the GSEs Can Have the Most Impact on Equity

Both plans have elements that involve activities the GSEs do not have a comparative advantage in, do not clearly contribute to advancing equity, or both. The danger is that in trying to initiate activities that are outside their ability to have meaningful impact, effort will be diverted from activities that could have more impact. Fannie Mae and Freddie Mac do particularly well at activities that allow them to take advantage of their scale and the leverage they have over mortgage market participants (originators and servicers, in particular). Earlier, we referred to these as their “superpowers” and cited ways the EHFPs put those to work.

The GSEs are exploring or have already launched in-house activities that have, or rely on, third-party providers. These are noncore activities where the GSEs seem to have less ability to affect equity. Fannie Mae is developing its own first-time homeownership education program. For years, it has relied on others to provide this service. It is not clear how Fannie Mae will do a better job advancing equity than the existing providers, but pushing away these former partnering entities could be a loss to the larger field. Nor is it clear why this action should be an EHFP priority.

In contrast, core to the GSEs' mission is prudently expanding access to safe, affordable credit. Here, the plans could go further. This would include an analysis of how loan-level pricing adjustments, or LLPAs (which are higher for borrowers with low credit scores), disproportionately affect costs for Black and Hispanic borrowers. Although both GSEs plan to examine LLPAs, they appear to limit this to the SPCP pilots, rather than a more comprehensive rebalancing of pricing that could have broader impact by reducing borrowing costs (Goodman et al. 2022). It should also include a more thorough broad-based review of underwriting barriers: Are there obstructions to access to credit in the underwriting algorithms that could be relaxed without meaningfully increasing the probability of default? If the probability of default increases a small amount, how much would that increase the eligible universe, and what percentage of that universe would be borrowers of color?

Another of the GSEs' superpowers that the plans could leverage better is their ability to standardize. Because lack of intergenerational wealth for a down payment is a key barrier for many households of color, the potential equity impact of down payment assistance is significant.[3] But the down payment assistance tool Freddie Mac proposes appears it will be built into Freddie Mac's automated underwriting system and thus not be accessible to other market participants . Indeed, Freddie Mac recognizes a critical need to match borrowers, lenders, and counselors with down payment assistance programs. Working with Fannie Mae to build a standardized platform to meet this need would be more impactful than cementing it into Freddie Mac's automated underwriting system.

An example of initiatives already under way that, while important, appear tacked on to the EHFPs despite lacking robust equity implications, is the climate change elements. Addressing climate change implications for the GSEs and the housing finance system is necessary in its own right and should not simply be shoehorned into the EHFP. To the extent it is included in the EHFPs, there should be stronger and more direct measures to address racial and ethnic disparities. Although it is good to see business-wide concerns woven into the EHFPs with some eye toward racial equity, real lasting impact depends on equity concerns being integral to GSE-wide climate change planning exercises, not the other way around.

Incremental or Tentative Strategies

The EHFPs present an opportunity for real change. But so much in both plans could be described as tentative, not scalable, or far from what is needed, especially given the risk that the EHFP regime may not endure beyond the initial three-year window.

For example Freddie Mac's (2022, 21) plan notes, "We are also exploring pricing changes to incentivize more lending at low loan balances. We will further engage with lenders and conduct deeper analysis to understand how our pricing construct can be better optimized to support more lending to first time homeowners."

Freddie Mac also is setting up a pilot under the SPCP to allow borrowers to make withdrawals against a reserve fund: "If...reserve funds reduce defaults as intended, we will assess whether reserves could be used as an underwriting risk offset, or expand access to credit and/or reduce acceptance-rate disparities" (Freddie Mac 2022, 25).

Rather than assessing and exploring, these items easily lend themselves to piloting equity-enhancing test-and-learn programs with intentional pathways to expanding the ones that provide proof of concept. There is ample evidence that lending is constrained for loans with low balances and that reserve funds reduce defaults.[4] In fact, the latter is so well established that the GSEs have at various times required reserves as a compensating factor if the debt-to-income or the loan-to-value (LTV) ratio was just over a given threshold. The most effective way to move the needle on these items is to set up pilot programs, such as by testing the impact of reserves at origination (not just on the loss mitigation side), tweak it until it is working well, and then expand the program. More study on these issues seems too tentative and unnecessary. Moreover, the GSEs could significantly minimize defaults by simply building forbearance into the standard default prevention protocols (Alexandrov, Goodman, and Tozer 2022).

Likewise, the Fannie Mae plan discusses how important it is to maintain homeownership. Fannie Mae's solution for Black homeowners' challenges with postpurchase maintenance is ongoing education and counseling support through an SPCP. Freddie Mac's solution is this: "Specifically, our equity focus is on leveraging Freddie Mac's leadership position in the industry to provide technical assistance to nonprofits, lenders, real estate professionals and homebuyers to increase renovation financing" (Freddie Mac 2022, 39). A more natural and logical solution to the reality that Black and Latino households are more likely to own older homes would be to improve renovation financing programs, as they are cumbersome and infrequently used. Pilot programs to improve renovation financing would be more effective than technical assistance.

And although we are encouraged that the EHFPs contemplate pilots, particularly with respect to SPCPs, these appear to be discrete, with a lack of clear intention or a pathway to expansion across the mainstream business. Without that, the pilots will not make a meaningful impact.

In short, the actions that are being taken to address some of these problems fall short of Fannie Mae and Freddie Mac's capabilities and lack a sense of urgency. A harder look at improving current programs, some of which are underperforming, would be a better course of action in some instances than new initiatives in areas where the GSEs do not necessarily have a comparative advantage.

No Measurable Goals, No Prioritization, and No Outcome Accountability

The lack of concrete goals relates directly to the concerns discussed above. We have argued for establishing clear, measurable goals to guide the GSEs' activities, and the entire housing finance system's activities, toward a more equitable vision. Neither plan has enough measurable, transparent outcome goals. Instead, most of the plan elements are activity based. But it is unclear how the GSEs, the FHFA, or the public will know whether these steps enhance equity. What type of progress do the GSEs expect to see? How will these results be shared with the public?

It also appears that all the items in these plans cannot be undertaken at once, and thus, they need to be prioritized. We would prioritize the highest-impact items first, but the objectives that would generate this prioritization are missing.

Moreover, it is unclear how the public would know whether these plans are succeeding. For example, Fannie Mae states it will have goals, limits, and evaluation standards for its pilots, but it does not say whether these will be made public. And Fannie Mae does not talk about reporting on how the pilots are performing. It will be valuable to monitor whether the SPCPs are achieving their aims, at a cumulative scale that only the GSEs will be able to track, or whether adjustments are needed to better serve the target market or prevent unintended consequences such as gentrification in the case of place-based SPCPs. Moreover, the FHFA's and the GSEs' pilot transparency portals remain underdeveloped.

For a current example, we need look no further than Fannie Mae and Freddie Mac's forays into using alternative data to establish credit. Fannie Mae allows borrowers with credit scores above 620 who are not approved for a mortgage using the automated underwriting system, but would be approved with 12 months of on-time rental payments, to share bank account data to document rental payments. Fannie Mae plans to expand this to borrowers who do not have a credit score (Fannie Mae 2022).

Freddie Mac is developing a version of its automated underwriting system that "does not rely on third-party credit scores" (Freddie Mac 2022, 52). Freddie Mac will continue its research on the use of alternative data, including bank account data from third-party service providers.

Although these are laudable approaches to expanding access to homeownership, the extent to which they are expected to improve opportunities, especially for people of color, is not clear. Moreover, such activities should be part of Fannie Mae's core business and, like several items in the plans, were in play before the FHFA released its EHFP directive. In Fannie Mae's case, because the rental payments are an overlay, it should be straightforward to see how many people and who (by income and race or ethnicity) are benefiting from this. Because Freddie Mac is rolling out a new automated underwriting system that does not rely on third-party credit scores, it would be useful for the public to see how the old and new systems compare in terms of acceptances and rejections, by income and borrower race or ethnicity. Moreover, both agencies could provide data on performance. But such data have not been shared. Data sharing is critical to being able to assess the plans' effectiveness.

Without objective outcome metrics, and without linking each plan item to goals, it is unclear how the GSEs will be measured and held accountable for these plans' effectiveness. Moreover, better transparency and accountability for each element will enable the GSEs and the FHFA to better identify which activities to invest in and which to drop. This visibility will also improve the likelihood that the overall plans, or at least individual elements, are sustained beyond the three-year window.

Missed Opportunities and Unresolved Issues

There is also a good deal that is not included in these plans that are squarely under the GSEs' control, including an evaluation of how LLPAs and cross-subsidies could aid equitable housing finance, as well as a thorough review of underwriting guidelines and other opportunities ranging from envisioning a more substantial role for housing counseling for first-time homebuyers to linking the plans to executive compensation. Below, we highlight what we regard as the most important opportunities that could move the needle that the plans should address in future iterations.

Leverage the Power of Credit Risk Transfers, Pilots, and the Retained Portfolio to Expand Equity in a Safe and Sound Manner

Three powerful tools are available to the GSEs to expand the credit risk box and test new approaches: credit risk transfers (broadly defined), the more strategic use and formalization of pilot programs, and the use of retained portfolios. Used together strategically, these three tools can spark the equitable housing mission in ways no other entity in the housing finance ecosystem can. Former Freddie Mac chief executive officer David Brickman argues that even though credit risk transfer has historically been used to lay off the existing credit (and taxpayer) risk the GSEs have on their balance sheets, it can be used more expansively to promote affordable housing (Brickman 2022). In particular, credit risk transfer can be used to "enable the GSEs to prudently experiment with new products and catalyze new business activities, key components of their mission."[5] The GSEs can do this both by standardizing the product (e.g., by requiring originators to hold some portion of the risk, either a first loss or pro rata share of the subordinate bonds) and by providing a GSE guarantee on the catastrophic risk piece that would be unlikely to result in a loss.

We also reiterate our recommendation that pilot programs that have the potential to improve equity be encouraged (Ratcliffe, Stegman, and Reynolds 2021). As a matter of policy, the FHFA supports GSE efforts to undertake pilot programs to test and learn and improve permanent policy, but it has done little to elevate and promote such efforts.[6] This has led Fannie Mae and Freddie Mac to create their own skeletal pilot transparency websites.[7] These sites need to be more fully developed. For starters, they should provide greater transparency on program design, operating status, volume and take-up, learnings, stages toward scale, point of contact, and more.

Similarly, strategic use of the retained portfolio can be key to jump-starting a secondary market for SPCPs. It can also be the home for testing and seasoning new product structures before their securitization, which are created as a result of pilot programs. This is especially important as both plans, particularly Fannie Mae's, rely heavily on pilots.

Increase Public Data Disclosure

Just as the GSEs' research is valuable to the broader field, the field would also benefit from access to data that can help people understand obstacles and solutions to racial inequities. Public data such as Home Mortgage Disclosure Act data have been a critical tool for advocates and researchers to advance equity and homeownership opportunities. In our original recommendations, we suggested the FHFA and the GSEs develop an equity finance–focused public use database, which we still believe would be valuable.

At this time, the GSEs have access to a "database of roughly 54 million appraisals to analyze undervaluation that could indicate bias" (Fannie Mae 2022, 29). Although both plans describe a myriad of ways the GSEs will use these data to reduce bias, we note that they are vague at best about whether they will share results and insights with market participants in any way. The GSEs are doing the monitoring and analysis themselves. Giving the public access to more aggregated data and giving market participants more current feedback based on the data would be helpful. Here are examples of how the GSEs should share those data to monitor and prevent valuation bias:

- If an appraisal differs from the GSEs' automated valuation models by more than a certain percentage, the appraiser could be prompted to take another look and justify its number. This would help appraisers over time.
- The GSEs have robust automated valuation models, which have less bias than human appraisers and could function as a public utility. An even more effective approach would be to reengineer the appraisal process to start with the automated valuation model and then have the appraiser look at the property to determine whether it should be worth less (because of structural damage, condition, or noise attributable to its location) or should be worth more because of special enhancements.
- For certain types of structures, such as accessory dwelling units, there is often a lack of comps (i.e., comparable properties). It would be valuable if the GSEs could share information on how much an accessory dwelling unit generally adds to property values.
- Although the GSEs are tracking appraiser bias, it is not clear how the public would know whether the problem is getting better. It would be useful to know what share of the properties in predominantly minority neighborhoods were undervalued in 2021 versus in future years.

Increase Impact through Collaboration between the Two GSEs

One of the strengths of the GSEs is that by working together, they can force standardization on the market. The best example of this is the Mortgage Industry Standards Maintenance Organization (MISMO), which was established in the early 2000s as a collaboration to develop an industry-wide data standard. Industry implementation of MISMO did not begin until 2010, when Fannie Mae and Freddie Mac began requiring MISMO standards for the mortgages they purchased (Kaul et al. 2018). The FHA and VA subsequently adapted MISMO standards for much of their origination process. MISMO took off because the GSEs put their collective weight behind it, creating a major incentive for originators to conform. Today, the use of uniform data standards for delivering loans to the GSEs is nearly universal, enabling fast and efficient transfers of accurate data between originators and the GSEs.

This is not a random history lesson; it can apply to the EHFPs. Standardizing the format of down payment assistance programs, not just within Freddie Mac but across the GSEs, would be useful. Fannie Mae and Freddie Mac both address down payment assistance, but they address it differently. Freddie Mac proposes to create a tool to connect and match down payment assistance programs, lenders, counselors, and borrowers. Fannie Mae proposes to increase SPCP pilots to expand the availability of down payment assistance. Research reports have shown that there are more than 2,500 down payment assistance programs nationwide across more than 1,300 providers (Goodman et al. 2018). Perhaps by working together, the GSEs could standardize the format of the programs so that all parties can better gauge program capacity and better match borrowers with available programs.

SPCPs would also benefit from coordination between the GSEs. In particular, if an institution originates a loan under an SPCP, knowing it could be sold to either Fannie Mae or Freddie Mac would make the originators more comfortable.

Increase Impact through Collaboration between the GSEs and the FHA

Beyond the GSEs, cooperation with the FHA could have big impacts on access to homeownership, though neither plan considers the relationship between the GSEs and the FHA. The FHA serves borrowers with low incomes and low credit scores, though there is overlap. Table 1 shows the distribution of loans with LTV ratios of 95 percent or higher between the GSEs and the FHA. About 40 percent of the loans with FICO scores from 680 to 700 and debt-to-income ratios from 35 to 44.9 percent securitized in May and June 2022 went to the FHA, and the balance went to the GSEs. Those with low credit scores or high debt-to-income ratios are more likely to go to the FHA. This makes sense, as the GSEs do risk-based pricing through their LLPAs; in addition, loans with high LTV ratios require mortgage insurance, and mortgage insurers also do risk-based pricing. In contrast, the FHA's insurance prices are not risk based. As such, it is appropriate that the FHA attracts more risk-layered loans.

TABLE 1

FHA Share of Loans with Loan-to-Value Ratios of at Least 95 Percent, by FICO Score and DTI Ratio

	FICO Score					
DTI ratio	**<640**	**640–680**	**680–700**	**700–720**	**720–740**	**≥ 740**
< 25%	93.1%	69.1%	31.3%	17.1%	8.6%	3.1%
25–34.9%	94.2%	71.7%	33.2%	16.8%	10.4%	4.3%
35–44.9%	95.7%	77.7%	39.8%	21.7%	12.7%	6.1%
≥ 45%	99.0%	93.5%	73.7%	52.9%	36.0%	18.5%

Source: Urban calculations from eMBS data.

Notes: DTI = debt-to-income; FHA = Federal Housing Administration; GSE = government-sponsored enterprise. The share measures the number of FHA loans with LTV ratios of 95 and above divided by the total number of FHA plus GSE loans with LTV ratios of 95 and above. The shaded cells are loans that are more likely to go to the FHA, and the unshaded cells are loans that are more likely to go to the GSEs.

Some of the items proposed in the equity plans will simply move loans from the FHA to the GSEs. Although this would reduce mortgage costs for some borrowers, the moves will have only an incremental effect on overall access to credit. It would have been valuable if the plans enumerated which creditworthy borrowers are missing from the system and the hole in the market the GSEs are trying to plug.

Further, with Fannie Mae and Freddie Mac in conservatorship, at least for the foreseeable future, it makes sense that some of the items the GSEs are piloting could be used to support FHA underwriting and servicing for loss mitigation. For example, Fannie Mae's use of rental payment history to accept borrowers who otherwise would not be eligible for a government or agency mortgage could change the game in the FHA market; the FHA recently announced that its underwriting scorecard will consider positive rental payment history for first-time homebuyers. FHA lenders are responsible for verifying the rental history themselves. The systems behind Fannie Mae's automated rental payment validation are complicated, and the FHA, who cannot implement pilots, would be unlikely to develop this. But thinking about overall access to credit, many borrowers who qualify for a Fannie Mae mortgage, where rental payments made the difference, could otherwise qualify for an FHA mortgage. In contrast, if the FHA had this type of program, it would be more likely to truly expand access to credit. Perhaps in future iterations of these EHFPs, the GSEs could make clear that the goal is overall expansion of credit, and the GSEs allocating resources to help the FHA would "count."

Build a Lasting Commitment to Equity

The GSE affordable housing goals and the Duty to Serve programs are founded in congressional legislation.[8] The EHFP requirement is a directive set by the FHFA, the GSEs' regulator and conservator. But the US president can fire the FHFA director at any time without cause, and a new director could cancel or scale back the EFHPs. Congress is unlikely to codify these plans. The GSEs can, however, build the infrastructure to make these plans more enduring.

We have recommended that efforts to address housing inequities be built into the GSEs' business model and mainstream activities. We also recommend that efforts be aligned with and integrated into the statutory requirements for the GSEs' Duty to Serve, affordable housing goals, and purpose as stated in their charters to provide liquidity and promote access to mortgage credit. Further, the Fair Housing Act requires the FHFA to administer its programs and activities in a manner that affirmatively furthers fair housing by addressing racial disparities, thus creating a foundation for the EHFP agenda. Finally, working with the US Treasury, the FHFA could consider amending the preferred stock purchase agreements to incorporate key equity-advancing reforms into GSE business practices as long as they remain in conservatorship to ensure compliance with their charter-based social mission.

The FHFA's Role and Commitment

The FHFA is key to the success of the EHFP regime, and many of the steps it needs to take to enable and advance these plans remain to be seen. For example, there is no mention of whether the FHFA needs to approve the pilot programs that are part of this plan. If so, would these pilot programs go through an expedited process, as the plans have already been agreed upon? What about pricing decisions? Both GSEs have the same set of LLPAs. If one GSE waived the LLPAs for some borrowers, would the other GSE need to follow? And what role will the FHFA play in monitoring performance and progress? The FHFA will also play a pivotal role in encouraging the kind of data sharing and collaboration we discussed in the previous section.

Although it is still early, there are positive indications of the FHFA's commitment to real and lasting change. Recently, the FHFA announced that the GSEs will require servicers "to obtain and collect fair lending data on their loans."[9] And the FHFA's recent announcement that it will stand up an advisory committee on "Affordable, Equitable, and Sustainable Housing" comprising around 20 members representing diverse sectors and expertise establishes a valuable tool for holding the GSEs accountable to the EHFP and mission objectives.[10]

Conclusion

The EHFPs are an important step in attempting to close the racial homeownership gap, and there is a lot to like in these plans. But the plans have weaknesses, including trying to tackle too many issues, with a lack of focus and no emphasis on measurable outcomes. And several items are missing from these plans, including collaboration between the GSEs, the interaction between the GSEs and the FHA, and steps to insulate these plans from political whims.

The GSEs will submit their 2023 plans later this year or early next year; we hope to see some of our suggestions incorporated.

Notes

1. Fannie Mae recently released a proposed methodology for social disclosures. See Laurel Davis, Devang Doshi, and Nick Sapirie, "Designing for Impact—A Proposed Methodology for Single-Family Social Disclosure," *Perspectives* (blog), Fannie Mae, August 17, 2022, https://www.fanniemae.com/research-and-insights/perspectives/proposed-methodology-single-family-social-disclosure.
2. The US Department of Housing and Urban Development and Consumer Financial Protection Bureau guidance on SPCPs could also be amended administratively.
3. Jung Hyun Choi and Janneke Ratcliffe, "Down Payment Assistance Focused on First-Generation Buyers Could Help Millions Access the Benefits of Homeownership," *Urban Wire* (blog), Urban Institute, April 7, 2021, https://www.urban.org/urban-wire/down-payment-assistance-focused-first-generation-buyers-could-help-millions-access-benefits-homeownership.
4. See McCargo, Bai, and Strochak (2019) for an analysis of small dollar mortgages; and Farrell, Bhagat, and Zhao (2019) for an analysis of how reserves lower default rates. See also Bhutta, Hizmo, and Ringo (2022).
5. Fannie Mae has taken a small step by expanding its credit risk transfers disclosures. See "Fannie Mae to Enhance Its Credit Risk Transfer Disclosures," Fannie Mae, August 31, 2022, https://capitalmarkets.fanniemae.com/credit-risk-transfer/single-family-credit-risk-transfer/fannie-mae-enhance-its-credit-risk-transfer-disclosures.

6 "Pilot Transparency," Federal Housing Finance Agency, last updated June 8, 2022, https://www.fhfa.gov/PolicyProgramsResearch/Policy/Pages/Pilot-Transparency.aspx.

7 "Pilot Transparency," Freddie Mac, accessed September 27, 2022, https://www.freddiemac.com/about/pilots; and "Pilot Transparency," Fannie Mae, accessed September 27, 2022, https://www.fanniemae.com/about-us/what-we-do/pilot-transparency.

8 Don Layton, "The First GSE Equitable Housing Finance Plans: Four Major Issues to Watch," Joint Center for Housing Studies, June 24, 2022, https://www.jchs.harvard.edu/blog/first-gse-equitable-housing-finance-plans-four-major-issues-watch.

9 Federal Housing Finance Agency, "FHFA Announces Update for Servicers to Maintain Fair Lending Data," news release, August 10, 2022, https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Announces-Update-for-Servicers-to-Maintain-Fair-Lending-Data.aspx.

10 Notice of Intent to Establish a Federal Advisory Committee on Affordable, Equitable, and Sustainable Housing, 87 Fed. Reg. 52556 (Aug. 26, 2022).

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