PENN IUR **WHITE PAPER**

Commentary

Reform of the GSEs' Operation and Structure Must Address the Widespread Affordable Housing Crisis and the Persistent Racial Homeownership Divide

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The current examination of the GSEs is taking place in the midst of the COVID crisis. It is also part of the transition of the GSEs from many years of conservatorship and occurring during the renewed broader recognition that it is critical for the country to address structural racial barriers and reduce the wide racial homeownership gap and the related wealth gap. The proposals for the GSEs must be viewed through this lens and advance these goals. Specifically, the GSE capital rule should be revised to improve, rather than lessen, homeownership opportunities for low-wealth households and families of color. Also, utility structure for the GSEs is essential for them to serve both their overall public mission of support of the housing market and their specific affordable housing and fair lending responsibilities. Finally, the GSEs must do more to further affordable, inclusive housing.

The COVID crisis has reaffirmed the essential role the GSEs play in supporting the housing market. Since the onset of the crisis, the GSEs, along with Ginnie Mae, have extended relief that greatly lessened the impact on homeowners and also benefitted the overall economy. Under the Cares Act, the GSEs offered forbearance of up to 12 months, adding payments to the end of the loans without extra fees or interest rather than requiring lump sum payments after forbearance. The substantial servicer liability for advancing payments that threatened their stability was mitigated by the GSEs assuming that liability after four months of deferred payments. Most other mortgage industry participants would be unable to absorb the cost of these measures, estimated by Director Calabria at $10 billion plus carrying huge amounts of deferred interest. The GSEs also have backed an historic refinancing boom that, as these papers show, saves homebuyers hundreds of dollars a month when they badly need it, though this has gone disproportionately to higher income GSE borrowers. The substantial government support and robust utility like oversight authority under conservatorship enable this GSE support of the market, and it should continue for both future crises and a strong housing market in unstressed periods.

Many, though, have not been able to participate in the robust housing recovery since the 2008 recession. While overall home equity is at record levels and white homeownership has rebounded, many lower wealth households, households of color and particularly black households have yet to recover from the 2008 crisis and they risk falling further behind as a result of the COVID crisis. Black homeownership has fallen to low levels of 50 years ago, and there is a broad affordable housing crisis across the country for homeowners and families who rent. While many factors contribute to this, and likewise progress will require efforts from many, addressing these problems is a core mission of the GSEs and is the basis for the generous government support they receive.

Homeownership is directly tied to the huge racial wealth gap- white median household wealth is currently ten times greater than black household wealth and nine times greater than Latino household wealth, and progress in closing this divide is heavily dependent on closing the racial homeownership gap. The GSE capital rule profoundly affects the prospects for this progress, as does the structure of the GSEs going forward, and they must meaningful advance this overdue equity.

Looking at the capital rule, the cost of this capital is by far the largest component of the fees charged to borrowers, and it thus drives the cost and availability of home loans. It is important to remember the purpose of this capital is an asset beyond the loan reserves held by the GSEs that cover projected loan losses including through business downturns. Rather, it covers losses from catastrophic systemic events like the 2008 crisis or a pandemic, events beyond the control or fault of individual homebuyers. Two major questions are how much of this capital should be required and how the substantial cost of paying investors returns on that capital should be divided among homebuyers. Presently that cost falls overwhelmingly on lower wealth borrowers, who are assessed up to ten times the amount of catastrophic capital as other GSE borrowers and incur the resulting higher fees. To its credit, FHFA in its rule made efforts to spread this cost more evenly, imposing minimum capital charges on the lowest fee loans, and spreading the cost of some capital components evenly among all borrowers. It also eliminated capital surcharges for single borrowers and small balance mortgages. However, the FHFA rule also significantly raised the overall capital levels, and particularly the usually binding leverage ratio, so the total impact of the rule is to unnecessarily raise the cost of these lower wealth mortgages and hinder progress on addressing the racial homeownership gap. The capital level should be reduced to reflect the actual risk of GSEs losses in a catastrophe- closer to two percent as compared to the four percent plus leverage ratio. Spreading of the risk more evenly to reflect its broad systemic causes should also be expanded.

Regarding the structure of the GSEs, they have been governed under conservatorship as de facto utilities, and this should continue when that ends, so they focus on meeting their public mission of serving all lenders and providing access to sustainable mortgage credit for borrowers, and especially borrowers of color. It also ensures that the substantial advantages granted to the GSEs do not result in unfair competition for other market participants. A utility structure furthers inclusive homeownership in two primary ways. First, it directs the GSEs' efforts to the full market, rather than just the most lucrative parts. For lenders, this means providing access to all lenders and at the same price, even though serving small lenders is often more expensive. Similarly, for borrowers, this requires making mortgage credit broadly available and furthering inclusive lending, even when this may not be the most profitable segment of the market. Second, as discussed in the papers, a utility structure delivers a less volatile but lower required return to investors. The cost of the catastrophic capital to borrower fees is determined by the amount of that capital and the annual return paid to investors. In essence, the required return is covered by the return the assets earn in Treasury type safe investments while they are held by the GSEs with the balance made up from borrower fees. As discussed in the papers, the lower utility return greatly reduces the balance that must come from borrowers, and this benefits most the lower wealth borrowers who carry the greatest share of the capital burden.

A final component of advancing inclusive homeownership by the GSEs is through far greater efforts and financial contributions to affordable housing and targeted assistance for households of color, who were for many decades excluded from government supported homeownership programs. This begins with increasing their affordable housing goals and enforcing rather than waiving failures to meet them. While the GSEs support the secondary market and do not directly engage in home lending, they have in the past, such as in the 1990s, significantly expanded sustainable home ownership by operating larger affordable housing programs and providing financing to a broader mix of borrowers compared to the current more restricted credit profile portfolio.

In summary, through all of these aspects of the operation and structure of the GSEs, including the capital rule, choice of utility or other type of operation, and the transition of the GSEs from conservatorship, the public mission of the GSEs, and especially that of affordable, inclusive housing, must be a primary metric used to evaluate and determine the path forward. The excellent papers in this special edition of Housing Policy Debate analyze well the policy options and show how they can further these goals.