April 27, 2023

Federal Housing Finance Agency
Office of the Director
400 7th Street, SW, 9th Floor
Washington, DC 20219

Re: Addition of DTI Element to GSE Single-Family Pricing Framework

Dear Director Thompson:

The Housing Policy Council (HPC)[1] and our member companies appreciate that the Federal Housing Finance Agency (FHFA) signaled to the industry that an update to the GSE pricing matrices was forthcoming in 2023, as highlighted in the 2022 and 2023 Enterprise Scorecards. This type of transparency benefits all market participants and stakeholders, providing advance notice that enables a level of preparation, even in the absence of details. That said, the inclusion of the new debt-to-income (DTI) adjuster as a core component of the new pricing matrices was an unexpected addition that creates risk to the borrower and negatively affects the borrower experience. The GSEs can fulfill the capital requirements established in the Enterprise Regulatory Capital Framework (ERCF) using existing mechanisms, including the base g-fees, loan-level pricing, and underwriting controls built into the Automated Underwriting Systems (AUS). In other words, the FHFA objective to align the capital standards with the pricing does not require the introduction of the DTI feature. In this letter, we present information about the significant negative impact of the DTI element and recommend that FHFA consider an alternative approach, such as an alteration to the loan-level pricing or base g-fees, both more effective and workable solutions to achieve the agency's objectives.

To be clear, HPC supports FHFA's desire to strengthen the GSEs' capital position, to support mission lending, and to promote the financial stability of the housing system. However, we are disappointed that the industry was not engaged in discussions as part of this significant operational and structural change. For example, FHFA had the opportunity to solicit feedback as part of the latest Capital Framework request for input (RFI) released in February, which covers the cross-guarantee (or "Super") fee. Among our concerns is that the new DTI pricing feature will require new processes and practices that will exacerbate the already elevated cost of mortgage origination, which will be passed on to the customer. Further, while the broader loan-level pricing changes can be operationalized within the given timeframe, the DTI-specific loan-level pricing change has multiple and lasting negative impacts for customers and the industry. Therefore, we request that FHFA further pause the August implementation for the DTI pricing adjuster until industry feedback can be fully considered. Should FHFA choose to postpone the implementation, we welcome the opportunity to partner with FHFA to examine alternative solutions.

---

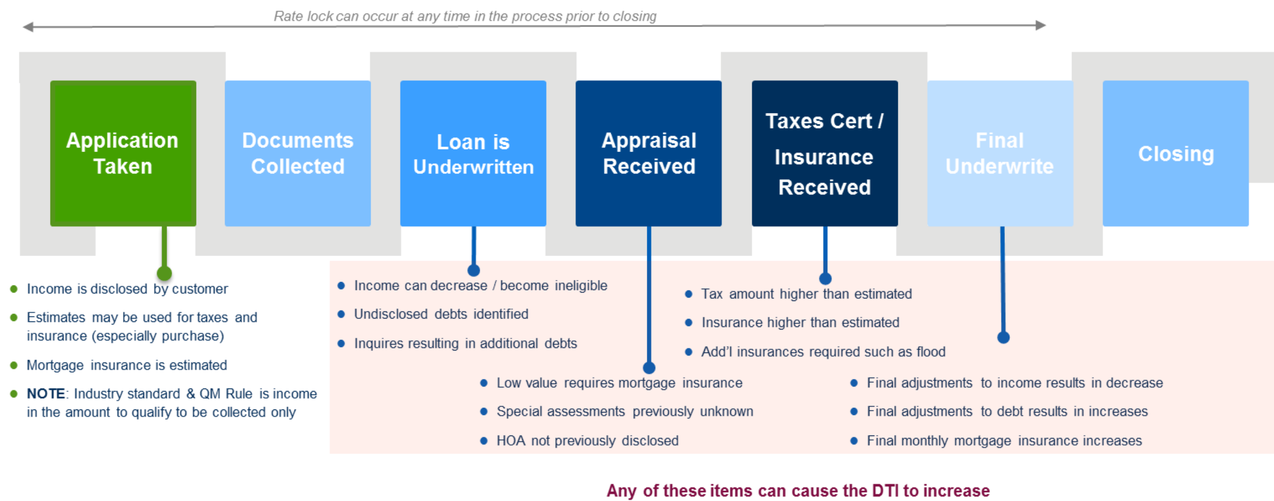
[1] The Housing Policy Council is a trade association comprised of the leading national mortgage lenders and servicers; mortgage, hazard, and title insurers; and technology and data companies. Our interest is in the safety and soundness of the housing finance system, the equitable and consistent regulatory treatment of all market participants, and the promotion of lending practices that create sustainable homeownership opportunities in support of vibrant communities and long-term wealth-building for families. For more information, visit www.housingpolicycouncil.org

Negative Impacts on Customers:

At the current level of mortgages approved by GSE automated underwriting that are not "mission rich" and have debt-to-income (DTI) ratios greater than 40 percent, a substantial percentage of customers will be negatively affected by the proposed pricing increase and by the uncertainty being introduced by the change. DTI ratios reflect a complex set of measurements and judgments. The lender assembles, verifies, and applies specialized treatment to various income types (e.g., when and how to handle commission or seasonal income) to demonstrate continuity and stability of borrower income. The underwriter must also assess the borrower's financial obligations for accuracy, relevance, and treatment, to include in the DTI calculation. This process occurs over a period of weeks; a precise DTI is rarely, if ever, discernable at the time of loan application. This is in stark contrast to the income eligibility check that is used to meet specific affordable lending program standards. Income eligibility determinations are not always obvious either but are far more simple than the DTI calculation.

The proposed DTI element has other serious, negative consequences:

1. *Paradigm Shift Away from Ability to Repay (ATR)*: Today, once ATR has been established, additional income sources are not verified. This is true for manual and digital income verification paths, creating a simpler customer experience, reducing the collection of unnecessary income documentation, and moderating the underwriting judgment required – ultimately reducing the cost to originate.
2. *Reversal of Innovation and Efficiency Gains from Underwriting Digitalization*: Multiple sources of digitally verified income are conservative by nature and have a tendency to underestimate the customer's income. The DTI change will lead lenders to replace digitally verified sources with manual alternatives, reversing the benefits of the GSE investments in automating income verification, that provides a lower cost and more efficient customer experience.
3. *Pricing Uncertainty Poses Transaction Risks and Undermines Consumer Confidence*: DTI can change throughout the loan approval process and, as documentation is received and verified (such as income and debt outstanding), it could cause the customer's loan pricing to change, potentially multiple times (see below graphic for points in process that DTI may change).



4. *Each time customers' DTI changes to above or below the 40% threshold, lenders will be required to issue new disclosures, which may result in:*
   - Frustration over changing closing costs / interest rate

- Customer confusion about the multiple sets of disclosures
- Potential delay in closing timeframe
- Missed rate locks / lock uncertainty
- Contractual violations of Purchase and Sale Agreements

Re-Disclosure Requirement Overview

Changes in DTI >40% and <40%, creates a Change in Circumstance, as the change in DTI would trigger increase/reduction in pricing (potentially multiple times). Risks include:

- If a change in DTI occurs which triggers a loan-level pricing charge, lenders are required to re-baseline the Closing Disclosure (CD). As a result of the re-baseline, the consumer must then receive the closing disclosure no later than three business days before consummation, so a late change in DTI could impact the closing date for purchase customers.
- If lenders are not able to send a re-baselining Loan Estimate (LE) or Closing Disclosure timely, then they may have to "cure" the error without passing the cost on the consumer.
- If the change is on the CD and it causes the APR to change outside of tolerance, the consumer is entitled to an additional three-day waiting period.
- Penalties for violating the law are $4,000 in an individual action and $1M in class action, which add significant financial risk to lenders.

The pricing uncertainty introduced by DTI changes has the potential to not only undermine consumer confidence in the loan officer or lender directly, but may also lead to generalized frustration and inability to have reliable interest rate quotes upfront. This could undermine consumer confidence in the mortgage industry as a whole, and potentially generate complaints to regulators, including the CFPB.

5. *Change Results in Increased Origination Costs, Ultimately Passed on to Customers*: The proposed change will increase the overall cost to originate loans, with a disproportionate negative impact on smaller loan sizes. This is a result of the reduction in digital underwriting and need for repeated underwriting reviews, increased operational cost of managing change in circumstances requiring new system flags for income or debt changes that result in moving above or below the 40 percent DTI threshold and multiple re-disclosures, and increased repurchase risk due to the subjectivity of manual income calculations without the historically allowed 3 percent variance (see box below).

   The end result is that the cost of obtaining a mortgage will increase for all customers, and those customers with DTIs greater than 40 percent will be doubly impacted - once by the proposed change and again by the resulting increase in operational costs to implement the change.

Eliminating 3 Percent Variance: FHFA Setting New Precedent for Subjective Calculation

- Calculating DTI is known to be challenging and subject to judgment, which is why the GSEs established a 3 percent variance (subject to the DTI cap) without requiring loans to be repurchased. This allowance is not permitted for other loan-level pricing factors such as FICO, Purpose, Occupancy, Property Type, number of units, etc.
- The proposed DTI pricing element would assess a loan-level pricing adjustment on a component of a loan that requires judgment and where there is acknowledgement and recognition it will not be consistent, as not everyone has the same judgment.

***Unintended Impact on Equitable Housing Goals*:**

FHFA's recent revisions to the GSE pricing grids attempt to remove the perceived negative impact of risk-based pricing to mission lending by excluding certain lower AMI customers; however, the DTI change may actually have the unintended consequence of harming the efforts to close the homeownership equity gap for Black and Hispanic customers.

An analysis of 2022 HMDA data shows that the Racial Equity Gap persists across income bands: 72% of Black and 76% of Hispanic purchase customers are non-LMI, and 55% of Black and 61% of Hispanic purchase customers have income that exceeds 100% AMI.

HMDA Data Show that Opportunities to Reach Target Populations Increase With Income

A summary of analysis illustrates that the broader implications for minority customers may go even further and that opportunities to reach target populations increase with income:

- Income <$50,000, for every 100 white homeowners, there are ~51 Black homeowners, ~70 Asian homeowners and ~59 Hispanic homeowners
- Income $50,000 to $99,999, for every 100 white homeowners, there are ~68 Black homeowners, ~76 Asian homeowners and ~70 Hispanic homeowners
- Income $100,000 to $149,000, for every 100 white homeowners, there are ~81 Black homeowners, ~80 Asian homeowners and ~80 Hispanic homeowners
- Income $150,000+, for every 100 white homeowners, there are ~88 Black homeowners, ~90 Asian homeowners and ~88 Hispanic homeowners

Source and Full Analysis: Freddie Mac, Urban Institute and Census

Proposed Alternative Solution: Utilize Existing Tools to Minimize Customer Harm:

The GSEs could more effectively use their existing tools to raise additional capital, with options that include loan-level pricing, base g-fees, and AUS approvals to manage product mix, as they do today, including these options individually or in combination:

1) The approach that aligns most closely with current period capital needs of the GSEs would be to socialize or distribute the capital needs across the existing loan-level pricing grid (that is, earn the incremental capital by spreading the cost across all loan-level pricing cells).
2) Utilize a non-mission rich g-fee, which the GSEs have done previously. This increase would be the most customer-centric, as the increase would be negligible and would minimize the negative impact to customers already stretched by affordability. However, we recognize that this approach does not result in immediate capital build in the way that a loan level pricing does and it carries some modest duration risk for that model.
3) Adjust AUS models to further manage risk, loan mix, and non-mission lending.

In a study of agency volume for 4Q22 and 1Q23 quarters,[1] which was split into < > 40 DTI by FICO and LTV bands, an HPC member was able to size the amount of additional capital needed to meet the new DTI pricing requirement (approximately $225 million, based on 1Q23 deliveries). To earn the same amount of capital that would be raised by the proposed change utilizing the existing loan level pricing grid, it would have resulted in an average of 16 bps if socialized across the grid.

The equivalent increase needed in g-fee[2] for non-mission rich customers would be 3.3 bps assuming a duration of 5 years.

Note: The study is an approximation using publicly available data, and may not include all risk multipliers and features only available to the GSEs, but is believed to be substantially accurate

Pros & Cons of Loan-Level Pricing Adjustments **vs. GFee Changes to Meet Capital Requirements**

Consideration	Loan-Level Pricing **Approach**	**Guaranty Fee**
Replacement of Existing DTI Loan-Level Pricing *(Customer view)*	Larger negative impact, as it increases cash to close or rate, affecting affordability and smaller loan amounts	Nominal rate increase[2] with minimal impact as it's spread out over larger population and longer duration
Replacement of Existing DTI Loan-Level Pricing *(GSE view)*	More directly aligns with GSE current period capital build	Not as sufficient for replacement due to (1) time required to build capital and (2) duration risk associated with monthly fee vs. delivery fee
Ease of Implementation For GSEs and Lenders	Low - Simple loan-level pricing table update	Low - Multiple Gfee structures have existed previously
Risk Management Precision (beyond AUS)	Utilizing loan-level pricing grid allows for more precise and immediate revenue adjustments	Less precise management tool spread across non-mission loans, with longer period needed to increase capital

---

Footnotes

1. **Study of GSE Volume for 4Q22 and 1Q23**
   *Charts represent assumed loan-level pricing charges for each quarter if the capital charge is spread over **all o**riginations in each FICO/LTV cell, regardless of DTI.*

1Q23 GSE volume - impact in bps to LLPA by cell based on 40% DTI mix

FICO	LTV Sub 60	60.1-70	70.1-75	75.1-80	80.1-85	85.1-90	90.1-95	95+
780+	0	11	12	17	18	19	20	22
760-779	0	12	13	18	19	20	22	23
740-759	0	14	14	20	21	21	23	23
720-739	0	14	14	22	23	23	24	23
700-719	0	15	15	23	24	24	24	24
680-699	0	15	15	23	24	24	24	22
660-679	0	14	15	24	25	24	23	20
640-659	0	14	16	24	23	24	24	21
Sub 640	0	13	13	22	22	22	19	20

4Q22 GSE volume - impact in bps to LLPA by cell based on 40% DTI mix

	LTV							
FICO	Sub 60	60.1-70	70.1-75	75.1-80	80.1-85	85.1-90	90.1-95	95+
780+	0	11	11	16	17	18	19	20
760-779	0	12	13	18	19	19	21	22
740-759	0	13	13	19	21	20	22	22
720-739	0	14	14	21	23	22	22	22
700-719	0	14	15	22	24	23	23	21
680-699	0	14	15	22	24	22	23	20
660-679	0	14	14	22	24	23	22	18
640-659	0	13	14	22	24	22	22	18
Sub 640	0	12	13	21	19	19	19	14

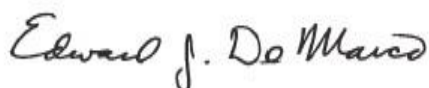
LLPA impact	201.28	$M	23Q1
LLPA impact	236.54	$M	22Q4

2. Potential G-Fee Increase to Cover Capital Requirements

		Duration options		
Vol $mm	**Gfee calc**	**5yr**	**7yr**	**10yr**
122,821	**23Q1**	0.033%	0.023%	0.016%
153,907	**22Q4**	0.031%	0.022%	0.015%

We recognize that the FHFA has indicated that the delayed implementation of the DTI loan level price adjustment is intended to provide the industry with sufficient time to develop new procedures that would be needed to apply this DTI adjustor. However, we do not believe that the DTI feature is workable, even with additional runway to establish alternative practices and controls. As we have described in this letter, the unintended negative consequences conflict with the FHFA's objective and, therefore, we encourage the FHFA to reconsider this approach. As we have also stated in this letter, existing alternatives are readily available: additional refinement to the loan-level pricing grids, increasing base g-fees, or adjusting automated underwriting rules could be used to achieve the FHFA objective. Thank you for your consideration of the points made here. If you or your staff have questions or would like to discuss the concepts that we have presented here, we would be pleased to discuss them with you.

Yours Truly,



Edward DeMarco
President
Housing Policy Council