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Jan. 21, 2020

Dr. Mark A. Calabria
Director, Federal Housing Finance Agency
Federal Housing Finance Agency
400 7th Street SW, 8th floor
Washington, D.C. 20219

Re: FHFA RFI on Enterprise UMBS Pooling Practices

Nareit is the worldwide representative voice for real estate investment trusts (REITs) and publicly-traded real estate companies with an interest in U.S. real estate and capital markets. Nareit's members are REITs and other real estate businesses throughout the world that own, operate and finance residential and commercial real estate. Nareit's Mortgage REIT (mREIT) Council ("mREIT Council" or "Council"), which includes both residential and commercial mREITs, advises Nareit's leadership on mREIT matters.

On behalf of Nareit, I am happy to transmit this Comment from the mREIT Council responding to the Federal Housing Finance Agency's (FHFA) *Request for Information (RFI) issued by the on Enterprise UMBS Pooling Practices*.

As noted in the RFI, publicly traded mREITs play an important role in the real estate capital markets by investing in, financing and managing Agency RMBS and non-Agency securities. As of Dec. 31, 2019, there were 40 exchange-listed mREITs in the FTSE Nareit Mortgage REITs Index, including 24 that provide financing for primarily residential real estate with a cumulative equity market capitalization of $55.2 billion. Nearly all mREITs, regardless of type, own significant amounts of Enterprise and Ginnie Mae MBS and as noted in the RFI, mREITs held $322 billion in these Agency securities at the end of the second quarter of 2019.

In the attached comment, Nareit's mREIT Council sets forth its perspective on the proposal set forth in the RFI, to incentivize and/or require that future UMBS issuance occur in larger, multi-lender, TBA-eligible monthly pools, posing several concerns and some questions. Notwithstanding its reservations about the RFI proposal, Nareit and its mREIT Council greatly welcome the FHFA's acknowledgment of the important role that mREITs now play in these Agency MBS markets, as reflected in the RFI's proposal to create pools for REITs to accommodate certain current regulatory restrictions.

Today residential mREITs are one of the very few significant sources of private permanent capital solely dedicated to the single-family housing sector. Moreover, mREITs are well positioned to expand their support of the U.S. Housing sector, especially if certain regulatory limitations, which are well-described in the RFI and elaborated upon in the Council's Comment, can be addressed.

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Nareit and its mREIT Council members stand ready to assist the FHFA as it moves forward with efforts to improve the functioning of the Agency MBS markets and the critical task of modernizing housing finance. Please feel free to contact me (swechsler@nareit.com (202) 739-9406), or Victoria Rostow, Nareit's Senior Vice President for Regulatory Affairs & Deputy General Counsel (vrostow@nareit.com; (202) 739-9431) with any further questions that you may have.

Respectfully submitted,

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President and CEO
Nareit

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Jan. 21, 2020

Federal Housing Finance Agency
Division of Conservatorship
400 7th Street SW, 8th floor
Washington, D.C. 20219

Re: FHFA Request for Input (RFI) on Enterprise UMBS Pooling Practices

Dear Sir or Madam:

Nareit[1] is the worldwide representative voice for real estate investment trusts (REITs) and publicly-traded real estate companies with an interest in U.S. real estate and capital markets. Nareit's members are REITs and other real estate businesses throughout the world that own, operate and finance residential and commercial real estate. Nareit's Mortgage REIT (mREIT) Council (mREIT Council or Council), which includes both residential and commercial MREITs, advises Nareit's leadership on mREIT matters. To develop its response to this RFI, Nareit's mREIT Council formed a task force of senior mREIT executives with experience in Agency securities markets, including UMBS markets.

Today, publicly traded mREITs play an important role in the real estate capital markets by providing financing and liquidity through funding mortgage and mortgage-related loans for residential and commercial borrowers and by acquiring mortgages and mortgage-related loans. As of Dec. 31, 2019, there were 40 exchange-listed mREITs in the FTSE Nareit Mortgage REITs Index, including 24 that provide financing for primarily residential real estate and 16 that fund primarily commercial real estate. Nearly all mREITs, regardless of type, own significant amounts of Enterprise and Ginnie Mae MBS. The equity market capitalization of residential mREITs was $55.2 billion, and equity market capitalization of commercial mREITs was $27.8 billion, resulting in a total equity market capitalization of $82.9 billion for the overall mREIT sector. As noted in the RFI, mREITs held $322 billion in Enterprise and Ginnie Mae MBS at the end of the second quarter of 2019.[2]

Nareit's mREIT Council appreciates the opportunity to respond to the Federal Housing Finance Agency's (FHFA) *Request for Input (RFI) on Fannie Mae and Freddie Mac UMBS Pooling Practices*[3]. The RFI details the FHFA's concerns about recent market conditions in the UMBS market, primarily related to the

[1] Through the properties they own, finance and operate, REITs help provide the essential real estate we need to live, work and play. All U.S. REITs own approximately $3 trillion in gross assets, public U.S. REITs account for $2 trillion in gross assets, and stock-exchange listed REITs have an equity market capitalization of over $1 trillion. In addition, more than 80 million Americans invest in REIT stocks through their 401(k) retirement and other investment funds.
[2] RFI p. 6 footnote 12.
[3] https://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/Pooling_RFI.pdf

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different prepayment characteristics of Fannie Mae and Freddie Mac UMBS securities, and sets forth a proposal (UMBS Pooling Proposal) to incentivize and/or require that future UMBS issuance occur in larger, multi-lender, TBA-eligible monthly pools comparable to the Ginnie Mae II mortgage pools[4]. The RFI also raises the prospect of setting aside some pools of whole loans specifically for REIT investors—the number and characteristics of which are unspecified in the RFI—to accommodate the impact of certain regulatory interpretations of the existing legal framework governing REIT RMBS investments.

Nareit's mREIT Council appreciates the FHFA's interest in ensuring a well-functioning UMBS market. Additionally, the Council appreciates the FHFA's implied acknowledgement in the RFI of the important role of mREITs in UMBS markets and its commitment to ensuring the continuing participation of mREITs, as reflected by the discussion of REITs in the RFI. However, after carefully reviewing the RFI, the Council and its members have a number of questions and concerns about the analysis set forth in the RFI and the proposals set forth therein, centering on the following:

- The Council is concerned that the UMBS Pooling Proposal, which calls for significant UMBS market restructuring, would not prove to be an effective means to address the concerns set forth in the RFI regarding the market impact of diverging seller/servicer loan performance and characteristics. Furthermore, the proposal set forth may adversely impact liquidity in both the TBA market and broader MBS markets, ultimately harming mortgage borrowers;

- While it greatly appreciates FHFA's consideration of possible barriers limiting mREIT investments in MBS, the Council questions the feasibility of the concept of segregating and/or setting aside a certain number of "whole loan pools to address the needs of certain investors (such as REITs)". Changes in GSE pooling strategy over the last several years has led to a decline in the availability of whole pools and this proposal would likely further limit the ability of mREITs to deploy capital in the UMBS markets. mREITs serve a unique role in supporting market liquidity with capital singularly dedicated to housing finance, and are beholden to GSE-led pooling strategies when deploying capital in the GSE MBS market.

Accordingly, the Council respectfully requests that the proposals in the RFI be withdrawn and suggests that prior to embarking on far-reaching structural changes in UMBS pooling practices that may give rise to a range of possible adverse impacts, the FHFA should first explore more targeted remedies to address the expressed concerns about origination and servicing practices that give rise to faster mortgage prepayment speeds in some securities.

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[4] RFI at 13.

Because mREITs present many distinctive features, which are often not well understood, in Part I below, we set forth some background on the mREIT sector and its role in U.S. housing finance. Part II sets forth our response to the question set forth in 1.a, p. 14 regarding the types of pools that are beneficial to REITs and Part III sets forth our comments on the UMBS Pooling Proposal more generally.

I. The Role of mREITs in U.S. Housing Finance

Although the RFI refers to REITs generally, mREITs, which most typically invest in Agency mortgage securities, are the focus of this comment. mREITs typically concentrate on either the residential or commercial mortgage markets, although some do both, through investments in the debt required to finance real estate. Some mREITs also originate mortgages and mortgage-related loans. Most public mREITs are listed on the NYSE or NASDAQ, allowing a wide range of investors, including individual investors as well as institutions, to purchase shares of their equity securities. However, some mREITs have shares that are registered with the SEC but are not listed on any stock exchange. These public, non-listed mREITs typically are sold to investors by a broker or financial advisor. mREITs also can be privately held. With regard to Nareit's response to the RFI, all references to mREITs refer to U.S. exchange-listed mREITs.

Residential mREITs, together with many commercial mREITs, currently play a highly consequential role in the single-family and multi-family mortgage arenas and have, to date, financed mortgage loans for 2.5 million homebuyers. They efficiently raise private capital for single-family and multi-family housing without reliance on insured deposits. mREITs raised $88.2 billion in permanent capital for housing between 2005 and 2018. mREITs stand today as one of the very few significant wholly private sources of permanent capital dedicated to the housing sector, contributing to housing affordability by financing mortgage loans, purchasing RMBS and providing first loss capital for private label securitizations. These activities not only finance homes, but also create a broad spectrum of jobs.

mREITs hold mortgages and MBS on their balance sheets and fund these investments with a variety of sources, including common and preferred equity, repurchase agreements, structured financing, convertible and long-term debt, and other credit facilities. mREITs typically use less borrowing and more equity capital to finance their acquisitions of mortgages and MBS than do other large mortgage investors.

The capital formation facilitated by publicly-traded mREITs is an important component of the success and stability of the United States residential real estate market. These mREITs have operated as safe and efficient vehicles for raising private-sector capital for U.S. housing and have proven to be critical to the mortgage markets during recent periods when other traditional holders of mortgages, such as the

Federal Reserve, Treasury Department and Government Sponsored Enterprises (GSEs), have reduced support of the secondary mortgage markets.

II. The Current Regulatory Framework governing mREIT participation in the UMBS Market and the types of Pools that are beneficial to mREITs

Nareit appreciates the FHFA's acknowledgment of the important role of mREITs in U.S. housing finance, and the FHFA's recognition that its UMBS Pooling Proposal would need to be structured to ensure that "whole loan pools to address the needs of certain investors (such as REITs) would continue to be issued by the Enterprises." The RFI specifically requests comment on the "…types of pools that are beneficial to stakeholders, including specific market participants such as REITs…" (RFI p. 14). In response, Nareit's mREIT Council, while grateful for the FHFA's focus on mREIT participation in UMBS issuance, has concluded that it has serious concerns about how this suggestion would work in practice.

Many questions are yet unanswered, including whether whole loan pools will be TBA eligible, the number, size and composition of these pools and who would be permitted to create and compete for them. To the extent that the availability of whole pools is more limited and largely controlled by the GSEs, REITs could be exposed to duopoly pricing on scarce supply of whole pools. REIT-eligible MBS pools may also be less liquid or attractive from a funding perspective. But even setting aside these unknowns, the Council is concerned that, unintentionally, such a plan could have the effect of marginalizing REIT investment in home mortgages over time.

For nearly a half-century, virtually every publicly-traded mREIT has relied on Section 3(c)(5)(C) of the Investment Company Act of 1940 (1940 Act), which provides an exception from regulation as an investment company in certain circumstances. The Section 3(c)(5)(C) exception has permitted the publicly-traded mREIT sector to develop and prosper, has fostered mREIT participation in innovative mortgage financing products that benefit American homeowners, and has provided investors, including retail investors, with a reliable investment opportunity that combines significant dividend yields with the potential for capital appreciation. However, as noted in the RFI, the current SEC staff interpretation of the Section 3(c)(5)(C) exception has constrained the participation of mREITs in Agency MBS issuance, and "create[s] an incentive for REITs to invest in pools that are small enough that they can purchase the entire pool." (RFI p. 6). To understand why, some background is useful.

Section 3(c)(5)(C) of the 1940 Act excludes an issuer from the definition of "investment company" if it is primarily engaged in the business of "purchasing or otherwise acquiring mortgages and other liens on and interests in real estate" and does not issue redeemable securities or similar certificates. In a series of no-action letters beginning in the earliest years of U.S. residential mortgage securitization activity when such securitizations were quite basic, the SEC staff has interpreted the "primarily engaged" requirement of Section 3(c)(5) to mean that at least 55% of a company's assets must be invested in “mortgages, other liens on real estate, or interests in real estate” (collectively “Qualifying Real Estate Assets") and the remaining 45% of a company's assets must consist primarily of either Qualifying Real Estate Assets or so-called “Real Estate-Related Assets.” Further, in these early letters, the SEC staff has classified “whole pool certificates” as Qualifying Interests[5] and “partial pool certificates,” including Agency partial pool certificates such as Agency UMBS, as Real Estate Related Assets.[6] Due to their size and manner of creation, multi-lender UMBS are generally not available in whole pool forms.

Nareit’s mREIT Council and its members have long questioned the analysis underlying this SEC staff interpretation, noting that it is rooted in outdated concepts and definitions of mortgage securities.[7] Moreover, the experience of owning a partial pool certificate, such as a partial pool Agency UMBS, is essentially identical to that of owning a whole pool certificate, in that:

- The interests represent undivided interests in a pool of mortgage loans that are serviced by a GSE-approved servicer and guaranteed for repayment by the GSEs;

- The investor receives principal and interest payments based on the prepayment performance of the underlying mortgage loans and faces prepayment risk from early prepayment of mortgages, just the same as a holder of a whole pool;

- The secondary mortgage market purchaser undertakes the same analysis and underwriting of a GSE partial pool and accounts for them in the same manner as a GSE whole pool; and,

- These pass-through Agency RMBS certificates are issued, purchased and sold through the same channels and in the same manner as Agency whole pools RMBS.

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[5] Premier Mortgage Corp., SEC Staff No-Action Letter (Mar 14, 1983).
[6] Nottingham Realty Securities, SEC Staff No-Action Letter (Apr. 19, 1984).
[7] See infra note 9. Since 2011, the MREIT Council has encouraged the SEC and its staff to update these interpretations relating to the definition of a residential mortgage-backed security (RMBS) to account for the evolution of the RMBS securitization markets and the emergence of new RMBS products. We noted that in 2016 the FHFA updated its own definition of a residential mortgage security to reflect the evolution in RMBS markets. See ***Federal Housing Finance Agency Final Rule: Members of Federal Home Loan Banks, RIN 2590-AA39*** (Jan. 12, 2016) (The final rule replaces the existing reference to a pass-through security with a more general reference to a security representing either: (i) a right to receive a portion of the cash flows from a pool of qualifying loans; or (ii) an interest in other securities representing such a right. The reference to a right to receive a portion of the cash flows is intended to encompass both the rights of a holder of a mortgage pass-through security to an undivided ownership interest in the underlying loans and their principal and interest payments, as well as the rights of a holder “debt-type” instruments that grant the holder the right to a specified portion of the cash flows from the pooled mortgage loans”).

For these reasons, Nareit's mREIT Council has urged the SEC to revisit this interpretation.[8] Regardless, as noted in the RFI, in light of the SEC staff's current interpretation of Section 3(c)(5)(C) of the 1940 Act, to participate in UMBS markets mREITs will favor Agency whole pool certificates, a circumstance that is likely to continue for some time. The Council appreciates FHFA's attention to this constraint on mREITs in its proposal and FHFA's desire to preserve REIT participation in the market for the Enterprises mortgage securities.

Despite good intentions, Nareit's mREIT Council and its members are concerned that attempts to segregate a market specifically for REITs would place artificial constraints on the amount and types of whole pools that are available to mREITs and other investors, impair REIT's portfolio construction and risk management options, and potentially stifle market innovation.

III. The mREIT Perspective on the FHFA Pooling Proposal and its Likely Impacts

Federal housing finance policy has long supported creating and fostering a robust secondary market for home mortgage loans as a critical element in promoting home ownership in the United States. A properly functioning secondary market provides capital, and liquidity for the primary mortgage market, which in turn benefits homeowners through lower rates than would be otherwise available and improved access to financing. These beneficial aims are accomplished in large part through the TBA market, which allows originators to pre-position future originations in GSE MBS pools, thereby hedging their risk and providing certainty of locked rates to borrowers. The deeper and more liquid the TBA market is, the better execution borrowers will have, both in terms of certainty of financing and financing costs.

Nareit mREIT members believe that the UMBS Pooling Proposal—essentially to mandate larger pools—will not advance the FHFA's purpose of enhancing liquidity and depth in the TBA and MBS markets. To the contrary, our members are of the view that it may serve to constrain both liquidity and depth, which will in turn adversely impact investors, originators and mortgage borrowers alike. Like other mortgage investors, mREITs need flexibility to adjust their portfolios to account for market conditions to manage risk. The diversity of investment portfolios and management strategies across mortgage investors is important for proper market functioning because it encourages investors, including mREITs, to take different positions on mortgage pools with different characteristics, resulting in an active and robust market. The market has proven quite efficient in creating pools with attractive characteristics that evolve rapidly as market conditions change. The mREIT Council continues to believe that an unimpeded market

[8] See, e.g., Nareit's 2011 Comment to the SEC responding to the 2011 Concept Release on Companies Engaged in the Business of Acquiring Mortgages and Mortgage-Related Instruments (2011 Concept Release) (Aug. 31, 2011), including its request that partial pool securities be considered qualified real estate assets (pp. 35-37); see, also, Capstead's 2011 Comment to the SEC responding to the 2011 Concept Release, including its request that **Agency partial pool securities** be considered qualifying real estate assets (pp. 3-4); and, MFA's 2011 Comment to the SEC responding to the 2011 Concept Release, including its request that (all) partial pool securities be considered qualified real estate assets (p. 10).

is best positioned to allow pooling practices to develop organically to meet ever changing market conditions and appetite.

We also note that it is currently possible to combine MBS pools into multi-lender “mega” pools or “supers” virtually without cost, and that certain investors often elect to combine positions into a larger pool for their own investment purposes. In the view of the mREIT Council members, this process already functions well for those market participants who desire these larger pools.

The Council, noting recently published technical analysis[9] suggesting otherwise, questions the assumption that larger, multi-lender pools comparable to the Ginnie Mae II mortgage pooling practices would improve market liquidity. Some recent analysis suggests that the Ginnie Mae II TBA market is less liquid than the TBA market for GSE MBS, despite the regulatory advantage Ginnie Mae securities possess due to their explicit government guaranty.[10] In this regard, we note that in the Ginnie Mae II program, almost all CUSIPs now have pay-ups above well-identified multi-lender TBA pools, in contrast to historical TBA issuance which enabled differences in perceived speeds of the deliverable pools to be priced into TBAs. Also, there is evidence that the increasing supply of large GSE major/multi-lender pools, the worst of which clearly represent the TBA deliverable, has led to pay-ups on the majority of specified pools in the conventional market and to a weaker dollar roll market.[11]

The UMBS Pooling Proposal also carries a moral hazard risk. Specifically, a mandate to deliver loans into very large, multi-lender pools is likely to reward lenders/servicers that issue less desirable collateral and penalize lenders with higher quality loan production by treating them essentially equally. This creates perverse incentives and would be a concerning public policy outcome. The solution to the negative implications of “churning” or improper fast prepayment speeds is not to merely “water down” the fast servicers with a larger amount of generic mortgage production, as this just packages a greater percentage of the loans into undesirable pools.

While the RFI suggests that the GSEs would police lenders with fast prepay speeds, we respectfully note that such enhanced monitoring by Fannie Mae and Freddie Mac could be accomplished now in a more direct and transparent manner in the absence of mandated changes to pooling practices and the resulting ripple effect in the TBA market. FHFA and the GSEs have the necessary tools and influence to directly address the underlying source of the prepayment differences and that is the best way to further market liquidity and enhance the benefits the secondary mortgage market provides to borrowers and the housing market more broadly. In the Council’s view, a solution targeted at this specific issue would largely address the concerns identified in the RFI and be far preferable to the fundamental restructuring of the market for GSE mortgage backed securities proposed.

[9] JPMorgan *MBS Market Commentary* (Nov. 15, 2019) pp. 6.
[10] Id. The authors found that GNMA bid/offers in 3% coupon MBS were more than double that of conventional 3s.
[11] See, e.g., Wells Fargo Securities Structured Products Research, Agency MBS Weekly Nov. 8, 2019 at p. 5.

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IV. Conclusion

Nareit's mREIT members appreciate FHFA's recognition of the important role that mREITs now play in MBS markets and their potential to grow this role. Our members have concluded, however, that the FHFA's UMBS Pooling Proposal, however well-intentioned, is unlikely to constructively address the identified concerns regarding the fungibility of GSE MBS securities. Moreover, we fear it may prove deleterious to MBS market participants, including mREITs. For these reasons, we urge the FHFA to instead explore more targeted remedies—including greater alignment of GSE seller/servicer loan performance requirements and monitoring practices—to address the expressed concerns about origination and servicing practices that give rise to faster prepayment speeds in some securities.

We also note with interest and endorse the suggestions made by others[12] that it would be constructive if FHFA and the GSEs convened periodic, organized discussions with UMBS market participants to address developments and concerns regarding market and prepayment performance and related issues. Nareit's mREIT Council would welcome the opportunity to participate in such discussions, which we believe could be constructive in improving and maintaining a well-functioning GSE MBS market.

We hope that the FHFA will look to Nareit and the members of Nareit's mREIT Council as resources as it moves forward on this and related initiatives. Please do not hesitate to contact us, or Steve Wechsler, NAREIT's President & CEO (swechsler@nareit.com or (202) 739-9406), or Victoria Rostow, SVP, Policy & Regulatory Affairs (vrostow@nareit.com or (202) 739-9431).

Respectfully submitted,
Nareit mREIT Council

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Co-Chairman, Byron Boston
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Chairman of mREIT Council Residential Subcommittee, Gary D. Kain
CEO & Chief Investment Officer, AGNC Investment Corp.

[12] See, Joint Trades Comment to FHFA regarding Request for Input (RFI) on Enterprise UMBS Pooling Practices (Jan. 21, 2020) available at https://www.fhfa.gov/AboutUs/Contact/Pages/input-submissions.aspx.