September 8, 2014

Federal Housing Finance Agency
Office of Policy Analysis and Research
400 Seventh Street, SW
Ninth Floor
Washington, D.C. 20024

Filed Electronically

Re: Guarantee Fee Pricing

The Association of Mortgage Investors ("AMI") appreciates the opportunity to comment upon the recent Request for Input concerning "Fannie Mae and Freddie Mac Guarantee Fees" ("g-fees"). For the reasons discussed below, AMI supports the Federal Housing Finance Agency's (FHFA) efforts, pursuant to HERA, to adjust the guarantee fees ("g-fees") such that it enables "Average Americans" purchase a home, protect taxpayers, and allow the Enterprises to charge for mortgages that finance "single family" properties in relation to relevant risk factors (*e.g.*, to recover a portion of the high costs that are incurred in the case of mortgage default arising in certain states).

Introduction

The AMI was organized as the primary trade association representing investors in mortgage-backed securities, including university endowments and pension funds. The AMI was founded to play a primary role in the analysis, development, and implementation of mortgage

and housing policy to help keep homeowners in their homes and provide a sound framework that promotes continued home purchasing. Since its formation, the AMI has been developing a set of policy priorities that we believe can contribute to achieving this goal. We are an investor-only group comprised of a significant number of substantial institutional investors in commercial and residential mortgage-backed and other asset-backed securities.

Background

AMI members are investors which represent a number of public pension, retirement and tax-payer institutions. It is important to note that mortgage finance has been instrumental in reducing housing costs and helping citizens achieve the American dream of homeownership. The advent of the mortgage-backed securities (MBS) market resulted in de-regionalizing or nationalizing real estate investment risk, increasing liquidity to mortgage originators, and lowering barriers to home ownership. Securitization was a key factor in improving regional real estate markets. New York State is a case in point. In the 1970s, most New York depositories were flush with cash but had a hard interest rate limit on mortgages. The result was a flow of California mortgages to New York and a flow of dollars to California. New York was an unattractive and non-competitive local market. With securitization, the New York market became national and mortgage funds were more readily available. Since the 1970s, mortgage-backed securities have increased lending levels, with even state housing agencies benefiting from the mortgage securities structuring techniques. Today, however, we witness the PLS market become frozen, leaving the Enterprises dominating the single-family origination and lending market. Accordingly, we support FHFA's effort to have the Enterprises charge g-fees in a more rational and responsive manner relative to the economic reality among the states. This will help restore an efficient national market, spur home mortgage lending, and bring private capital back to the mortgage market.

Today, the U.S. mortgage market is slowly recovering, but remains fragile. The state of the mortgage market limits credit opportunities and makes lending more expensive, especially for communities of color. This hurts prospective borrowers nationwide. Investors face challenges

from legal and political challenges, as described in the FHFA notice, leading to higher costs and diminishing the availability of credit. Additionally, investors face numerous other legal and economic challenges, such as the ill-conceived use of eminent domain as a foreclosure mitigation tool. FHFA's proposal for state-level g-fee pricing is a common-sense, fair method of allocating costs and risks that are localized by state.

Mortgage investors are aligned with both homeowners and the government in our shared goals of keeping Americans in their homes and rebuilding and maintaining a vibrant real estate market. AMI has testified before Congress and before state entities for consumer fairness on housing finance and mortgage relief matters.[1] However, fairness dictates that the g-fees must be charged so as to correspond with the costs and risk which state policies and legal regimes impose.

[1] Testimony of Vincent A. Fiorillo, *before the* House Financial Services Subcommittee on House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises, *Investor Protection: The Need to Protect Investors from the Government*, 112th Cong. 2d sess. (June 7th, 2012).

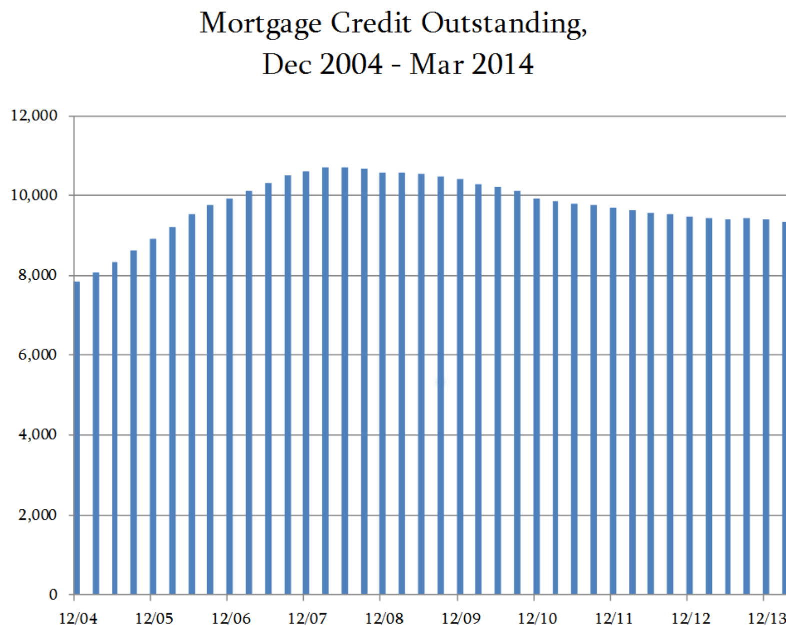
Questions: FHFA Request for Input

Pursuant to the Agency's notice, we wish to address the following questions raised.[2]

1. *Are there factors other than those described in section III – expected losses, unexpected losses, and general and administrative expenses that FHFA and the Enterprises should consider in setting g-fees? What goals should FHFA further in setting g-fees?*

[AMI's answers to Questions 1, 2, and 3 are consolidated.]

Mortgage investors lament the decrease in PLS financing and mortgage availability since the financial crisis. Since the crisis, outstanding mortgage credit has plummeted:



[2] http://www.fhfa.gov/PolicyProgramsResearch/Policy/Documents/GfeeRFI060514F.pdf

We believe that the restoration of the PLS market and wider mortgage credit availability requires FHFA insist that the GSE's focus on their original mandate. This original mandate included the GSE's role as a counter-cyclical sources of lending and of liquidity for the mortgage market. FHFA should support the "average American's" ability to purchase a home, subject to certain conditions, including: a minimum FICO score (*e.g.,* perhaps starting in the 650s), a maximum home price, subject to geographic variability in certain high-cost areas, a down payment requirement (*e.g*, 10-percent), and offering the public a first-loss piece.

We urge FHFA to cease engaging in risk-based lending, as well as, subjecting taxpayers to the risk of anything higher than a 50 LTV loan. Accordingly, we urge entities not to make irresponsible loans.

2. *Risk to the Enterprises increases if the proportion of higher-risk loans increases relative to the proportion of lower-risk loans. This change in mix can occur if lower-risk loans are retained on bank balance sheets instead of being sold to the Enterprises, if more higher-risk loans ae sold to the Enterprises, or if the overall mix of originated loans changes. What alternatives, other than risk-based pricing, should be considered? What are the pros and cons of each alternative?*

3. Currently, target return on capital and the amount of capital largely determine required g-fees. What factors should FHFA and the Enterprises consider in setting target return on capital and amount of capital required? How should the Enterprises allocate capital across risk buckets?

AMI joins with others who wish to bring private capital back to the mortgage market. It has long argued for enhanced underwriting. We urge that the return on capital assumptions must be linked to the credit parameters under which the GSEs guarantee risk. Hence, this dictates that riskier underwriting should imply a higher expected return on capital, while more conservative underwriting should imply a lower return.

4. *At what g-fee level would private-label securities (PLS) investors find it profitable to enter the market or would depository institutions be willing to use their own balance sheets to hold loans? Are these levels the same? Is it desirable to set g-fees at PLS or depository price levels to shrink the Enterprises' footprints, even if this causes g-fees to be set higher than required to compensate taxpayers for bearing mortgage risk credit and results in higher cost to borrowers?*

The return of PLS mortgage capital requires several conditions to be met, including a level playing field with regard to g-fees. Once g-fees are raised to the appropriate levels, we believe that the market will find the appropriate competitive g-fee level for the PLS market.

5. *If the Enterprises continue to raise g-fees, will overall loan originations decrease? That is, will Enterprise loans decline without a commensurate increase in private capital?*

The speculation over loan original volume cannot be properly answered without evaluating additional criteria. These determinations cannot be made in a vacuum. If risk increases, it should not necessarily decrease loan originations. The return of PLS requires a level playing field between agency and non-agency; accordingly, g-fees are solely one factor. The change in g-fees could create more opportunities, such as for otherwise qualified borrowers with FICO scores in the 680s.

6. *Is it desirable for the Enterprises to charge higher g-fees on low credit score/high LTV loans if it causes these loans to be insured/securitized through FHA/Ginnie Mae rather than through the Enterprises?*

Mortgage investors urge FHFA to follow its statutory HERA mandate and ward off the risk on the American taxpayer. FHFA should focus on lending for the Average American with good credit; neither the rich, nor the very risky. Accordingly, we advise that FHFA set a low boundary on FICO scores, to be adjusted over time. The low credit score/high LTV loans should be financed through the private market. Otherwise, this could pose unnecessary risk on the TBA market. We believe that FHA and Ginnie Mae are very expensive financing vehicles in

comparison with the Enterprises; hence, they are not ideal for this category of borrowers. *(Translation: You shouldn't be in that business).*

7. *Is it desirable for the Enterprises to (a) charge higher g-fees on high credit score/low LTV loans if it causes these loans to be insured/securitized through PLS or (b) held on depository balance sheets, rather than guaranteed by the Enterprises?*

Yes. Mortgage investors believe that the cost of lending should mirror the risk. Hence, the charge of higher g-fees is permissible. Further, we have strong concerns about FHFA permitting the Enterprises being in this business line, *inter alia*, the risk to the taxpayers.

8. *What approaches or alternatives should FHFA consider in balancing increased use of risk-based pricing with the HERA mission of (1) liquid national housing markets and (2) acceptability of lower returns on loans made for low- and moderate income housing?*

Investors note that lending in this space will return once the government ceases condoning interventions in the market (*e.g*., the tacit or explicit endorsement of eminent domain as a foreclosure mitigation tool). Once this path is chosen, we believe that the states and private capital will return to support lending in these areas.

9. *Are the ranges of credit score and LTV cells in the proposed credit score/LTV grids (see link above) used to set up upfront delivery-fees and loan level pricing adjustments appropriate? Should any of the ranges be broader and narrower and, if so, why?*

In general, AMI and its members wish to be as resource as you develop the rules and this guidance. In particular, we wish to highlight the following issues which bear on the health and sustainability of the system as we finally move past the worst of the financial crisis. As credit has tightened, illustrated below, it has become more difficult for first-time and average home buyers to enter the housing market. Accordingly, U.S. home ownership rates have dropped,

purchase originations are near a 15-year low and mortgage credit outstanding continues to decline.

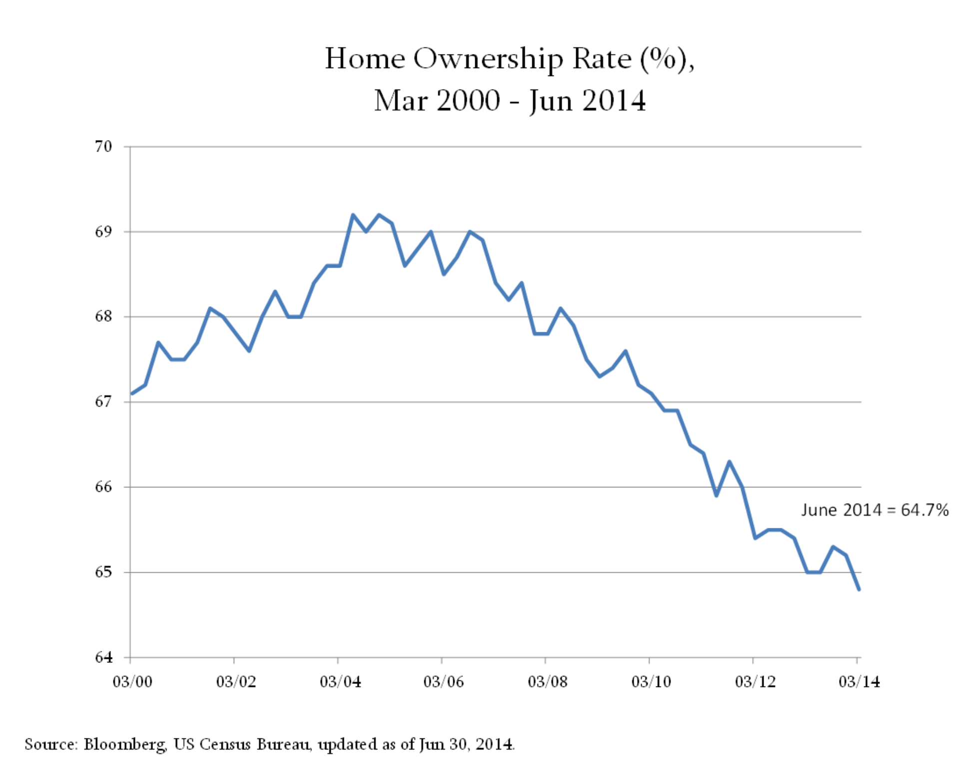


Chart: Home Ownership Rates (2000 – 2014).

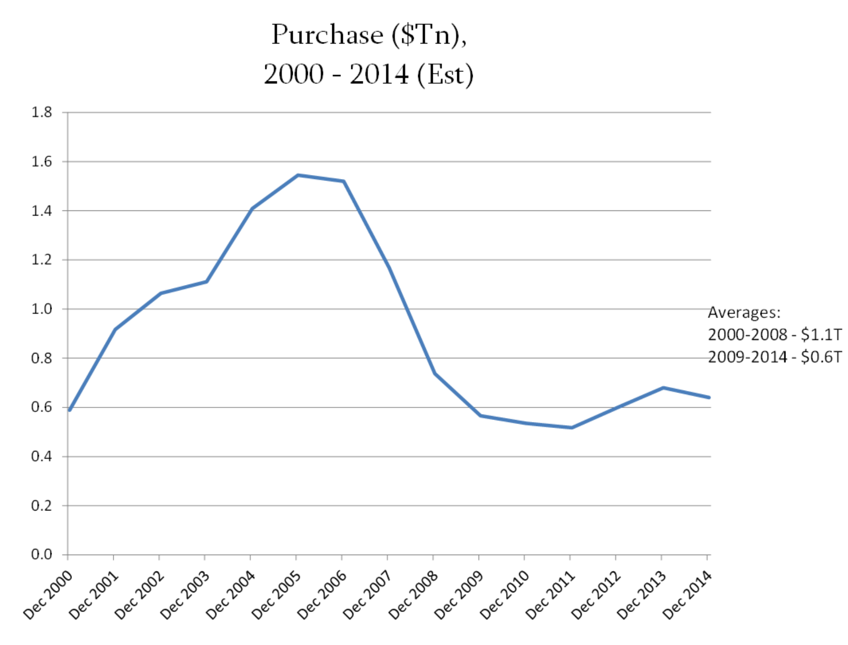


Chart: Single-Family Home Originations.

From 2000 to 2008, the average annual purchase originations were $1.1 trillion. However, from 2008 to 2014(E), the average purchase originations have declined by almost 50% to $600 billion.

Generally, in response to such proposed rules, we wish to make the following global remarks concerning the role of government and the future of private mortgage capital. As the previous charts illustrate, the simple fact is that mortgage credit is at its lowest since the height of the financial crisis. Hence, a poorly constructed g-fee rule can lead to the unintended consequence of making lending more expensive and less available for first-time home borrowers and minorities. We wish to serve as a resource as you act to develop a balance that ensures private capital can return to the market and complement the GSEs traditional counter-cyclical role to achieve long term housing ownership goals.

10. *Should risk-based pricing be uniform across the Enterprises or should each Enterprise manage its own pricing?*

Yes. Mortgage investors believe that there should be uniform risk-based pricing across the Enterprises.

11. *Taking into consideration that FHFA has previously received input on state-level pricing adjustments, do the g-fee changes proposed in December 2013 have any additional implications that should be considered in deciding whether to price for the length of state foreclosure timelines, unable to market periods or eviction timelines? Are there interactions with other pricing components under consideration that FHFA should consider in making decisions on the state-level adjustments.*

On November 21st, 2012, AMI submitted comments to FHFA in support of setting g-fees in accordance to the risks posed by state-by-state factors, such as exceptionally long foreclosure timelines (No. 2012-N-13). This is a logical conclusion when one considers (1) the statutory role of FHFA under HERA as conservator; (2) its responsibility to American taxpayers; and, (3) the additional risks surrounding the disposition of loan collateral throughout these jurisdictions.

We absolutely maintain our previous position. In sum, AMI strongly agrees that the standard deviation basis is a reasonable basis for identifying those states whose policies and legal systems impose significantly higher costs on mortgage finance. However, it is certainly one of several choices, and not the exclusive means, for such a decision. As stated previously, AMI believes that this is an issue of fairness to all stakeholders, including taxpayers, pension plans and retirements systems, and first-time home-owners.

12. *Are there interactions with the Consumer Financial Protection Bureau's Qualified Mortgage definition that FHFA should consider in determining g-fee changes?*

Mortgage investors believe that the standards for g-fees should not change in the case of QM loans.

Conclusion

AMI is comprised of large fixed income institutional investors who support the reemergence of a healthy and balanced U.S. mortgage market, including increased lending opportunities for responsible borrowers. We are very keenly aware through our experience and the mortgage market's performance of the past several years of the need to make the market more rational and fair for all stakeholders. We believe that our comments, if properly implemented, will expedite the return of these critical markets by essentially making the mortgage market a more level playing field, mitigate risk, and more reliably align the consequences for responsible parties and the policies and legal regimes of the respective states.

On behalf of our membership, let us express again our thanks for giving us this opportunity to comment on the proposed approach concerning state-level guarantee fee pricing. Should you or any member of your Staff have any questions with regard to our views, please contact our executive director at either katopis@the-ami.org or 202-327-8100.

Sincerely,

Association of Mortgage Investors