June 1, 2009

Alfred M. Pollard, General Counsel
Federal Housing Finance Agency
Fourth Floor
1700 G Street, NW
Washington, DC

Re: Comments "Portfolio Holdings IFR/RFC, [RIN 2590-AA22]"

Dear Mr. Pollard:

The Fannie Mae Delegated Underwriting and Servicing (DUS) Lenders Peer Group is writing in response to a request for comments on the interim final rule published in the federal register on January 30, 2009 concerning the portfolio holdings of Fannie Mae and Freddie Mac. The DUS Lenders Peer Group is an association of the 26 companies[1] approved by Fannie Mae to deliver multifamily loans under their Delegated Underwriting and Servicing Program. In 2008, DUS lenders originated $21.8 billion of multifamily loans, including loans on apartments, seniors housing and healthcare facilities, for delivery to Fannie Mae through the DUS program. Almost 90% of the multifamily units financed by Fannie Mae were affordable to families at or below the median income for their communities and approximately 54% of the multifamily units financed served special affordable families.

In general, we believe that it is important for Fannie Mae and Freddie Mac (collectively "the GSEs") to maintain a portfolio to support their securitization activities (e.g., aggregation, incubation, innovation), to accommodate limited amounts for highly structured products not conducive to securitization, to assist in meeting the affordable housing goals and duties to serve currently mandated by statute, and/or to maintain an infrastructure for serving as a liquidity backstop for the market. We believe that portfolio risk should be mitigated by a strong regulator, stricter capital requirements, basic sound underwriting requirements for all loans held in portfolio, as well as some level of credit risk sharing between the GSEs and originators/underwriters of loans being sold to the GSEs.

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[1] The DUS lenders are: Alliant Capital LLC; AmeriSphere Multifamily, LLC; Arbor Commercial Funding, LLC; Bulls Capital Partners, LLC; Capmark Finance Inc.; CBRE Multifamily Capital, Inc.; Centerline Capital Group; Citibank, N.A.; CWCapital LLC; Deutsche Bank Berkshire Mortgage, Inc.; Dougherty Mortgage LLC; Grandbridge Real Estate Capital, LLC; Greystone Servicing Corporation, Inc.; HomeStreet Capital Corporation; HSBC Bank USA, N.A.; ICM Capital, LLC (Sovereign Bank); KeyCorp Real Estate Capital Markets, Inc; M&T Realty Capital Corporation; Oak Grove Capital; PNC ARCS LLC; Prudential Mortgage Capital Company; Red Mortgage Capital, Inc.; Wachovia Multifamily Capital, Inc; Walker and Dunlop, LLC; Washington Mutual Bank; and Wells Fargo Multifamily Capital.

In response to the request for comments, we offer the following responses to the questions posed in the interim final rule. As our members specialize in multifamily financing, we are targeting our comments to that sector of the market.

Question 1: What additional benefits are provided to the secondary mortgage market and the housing sector by Enterprise purchases for portfolio of mortgage loans and MBS, beyond the benefits provided by their securitization activities? What is the magnitude of those additional benefits?

Additional benefits provided to the secondary mortgage markets by GSE portfolio purchases include:

- Providing stability to the housing markets during times of financial stress (e.g., Fall of 1998, Current Crisis). During those periods when private investors exit the market, the GSEs and FHA may fund in excess of 75% of all multifamily loans as no other capital is available. The benefits to renters would be lower rents, as much as 20% of their monthly rental payment, depending on market conditions.
- Providing "non-standard" loan and pool terms not easily salable in the mortgage backed securities (MBS) markets; such terms may include: alternative prepayment structures; flexibility within loan pools; alternative floating-rate indices; "new" products or product types. When new loan products are introduced, the secondary market for those loans is generally very limited. Moreover, certain mortgage products, such as properties with low income housing tax credits (LIHTCs), require long-term debt, which is not readily available from other capital sources. The benefits to homeowners/renters would be loan products not otherwise available.
- Providing aggregation facilities. By being able to accumulate many small loans, or loans from many small lenders, into larger pools or structured transactions, the GSEs can lower borrowing costs and assist underserved markets and small businesses.
- Providing expedited funding of loans prior to securitization. During times when warehouse lending is constrained, the GSEs provide a vital service by allowing lenders to roll loans off warehouse lines quickly. Without the ability of the GSEs to use their portfolios to reduce the length of time loans stay in warehouse with banks, the volume of business would be significantly constrained.

Question 2: Is it possible for the Enterprises to fulfill their mission of providing stability and liquidity to the secondary mortgage market without purchasing mortgage assets for portfolio? If so, how? If not, what types of mortgage assets should they be allowed to purchase for portfolio, and in what amounts?

It is not possible to fulfill the GSEs' market liquidity mission without some type of portfolio capacity. There will always be intervals of time when the demand for securitized paper wanes, and when that happens the spreads on agency paper will widen relative to Treasuries, increasing the cost to borrowers. There needs to be some portfolio capacity to provide stable pricing and liquidity in periods where the securitized market hits speed bumps.

The GSEs should be able to purchase the same assets that they securitize for portfolio. If we think of portfolio use as a way of temporarily warehousing loan inventory until securitization can be accomplished, a reasonable cap on portfolio in a normal operating environment might be 15 – 30% of their annual volume of business (with the rest securitized).

Question 3: Could the U.S. government better ensure the liquidity and stability of the secondary mortgage market other than through Enterprise purchases of mortgage assets for portfolio – for example, through the activities of the Federal Reserve System, mortgage asset purchases by the Department of the Treasury, or the provision of an explicit government guarantee of MBS securitized by the Enterprises?

The public/private GSE model is good, but it was allowed to grow beyond manageable size. The Enterprises should continue to be the primary purchasers of mortgage assets on behalf of the U.S. government, but a strong regulator must oversee all activities of the Enterprises. The Enterprises are structured to issue and manage mortgage-backed securities; except for Ginnie Mae, no other government agency has the ability to effectively and efficiently ensure an active secondary mortgage market.

Other options discussed in this section have issues which would impact their ultimate success or failure:

Activities of the Federal Reserve System: Certainly the size of the Federal Reserve balance sheet, while potentially large, could provide an effective backstop of the majority of the US residential and multifamily mortgage markets. There are three functions necessary in the performance of an effective secondary mortgage market:

- *Effective, Regulated Underwriting:* the diversity and "localized" nature of the mortgage markets create the need for local market expertise. It is uncertain whether the Federal Reserve System would have the resources to ensure proper underwriting on a national scale. A key function for the GSEs is to be a standard-setter for underwriting and pooling loans, as well as for servicing and asset management; as they have done successfully in the multifamily market space.
- *Interest Rate Management:* A primary role of the secondary market has been to separate interest rate risk from credit risk. A diverse group of institutional investors is best placed to evaluate, price and hold interest-

rate risk; as they often have liability structures to offset their asset cash flows.

- *Credit Risk:* The provision of "credit insurance", in whatever form, certainly could be provided by the Federal Reserve System. However, the GSEs have staff underwriting expertise in the multifamily arena that would need to be replicated by the Federal Reserve System.

Mortgage Assets purchased by the Department of the Treasury: The GSEs currently either own on their balance sheets or guaranty MBS totaling approximately $5.5 trillion. While theoretically the US Treasury has infinite capacity to expand its balance sheet, in reality using the US Treasury's balance sheet as a long-term solution for replacement of the GSEs, in light of other current and future needs for capital, seems improbable. In addition, as discussed above, we believe that the GSEs are more appropriate entities to house *Effective, Regulated Underwriting* oversight, *Interest Rate Management* functions and *Credit Risk*.

Provision of an explicit government guarantee of MBS securitized by the Enterprises: We view the uncertain nature of the previous relationship between the Treasury and the Enterprises as unworkable going forward and an explicit guarantee as essential to an effective secondary mortgage market program. However, the delivery system needs to preserve a private/public partnership that requires some level of risk sharing by originators/underwriters of loans.

Question 4: Should the Enterprises' purchases of mortgage assets vary over the mortgage credit cycle or with conditions in the secondary mortgage market? If so, how?

Yes, purchase activities should be governed by market conditions. The portfolio should be viewed as a "safety valve" for providing liquidity when the secondary market conditions are adverse or mortgage credit conditions drive away other lending sources. The answer to how depends upon some estimate of what market share percentage is deemed necessary for the enterprises to support the market in "normal conditions" vs. "unusual conditions". Right now, the GSEs have 85% market share in the multifamily space – clearly without them the market would suffer. During normal credit cycle times, their combined market share was approximately 50%.

The multifamily market was the only segment of the commercial lending business that has functioned properly since the collapse of the conduit business in the summer of 2007. The only reason it has performed well is due to the continued presence of the GSEs in performing their mission to provide liquidity and safe, affordable housing for the nation's apartment rental population. That might not have occurred if caps on GSE multifamily lending had been in place

Question 5: If the Enterprises purchase large volumes of mortgage assets during periods of stress or turmoil in the secondary mortgage markets,

should they be required to sell those assets once that market stabilizes? If so, when and how should the Enterprises conduct such sales?

If the Enterprises purchase large volumes of mortgage assets during periods of stress and turmoil in the secondary mortgage market, they should be encouraged, but not required, to sell those assets (back to third-party investors) once that market stabilizes. The amount of capital required to be held by the GSEs against portfolio loans should serve as an incentive for them to sell portfolio assets once the market recovers. However, there should not be a requirement to sell, because such a requirement could cause the GSEs to overwhelm a recovering market with product.

Encouraging the agencies to sell off assets once markets stabilize makes sense, because it prevents them from becoming "too big to fail". By selling off the assets, they can also replenish capital reserves as a cushion for the next downturn in the credit cycle.

Question 6: Could the benefits of the Enterprises' mortgage portfolio holdings be achieved if the levels of those holdings were substantially lower than current levels? Could the Enterprises carry out their mission of providing stability and liquidity to the secondary mortgage market and of supporting affordable housing without maintaining portfolios of mortgage assets? If so, explain how.

Prior to 2003, the Enterprises' mortgage portfolios were a fraction of what they are currently, and the mortgage markets performed well. Other investment structures provided adequate stability and liquidity to the secondary markets, with pricing to borrowers at similar levels to GSE pricing. We would expect that during "normal" market times, third-party investors would again play a strong role in the markets, either utilizing Enterprise MBS guarantees, or through private-label securities. However, in times of market duress, as in the current market, it is essential that the GSEs be able to portfolio loans as an alternative until third-party investors return to the market.

Without portfolio capacity, many types of multifamily affordable properties could not be financed. The features are nonstandard and the volumes too small on many affordable housing transactions. Restrictions could be placed on the volume of these types of loans or "affordable" could be narrowly defined to include, for example, only properties affordable to families at 60% of area median income or less (to conform to LIHTC definitions). However, with the multifamily special affordable housing goal and duties to serve required under the Housing and Economic Recovery Act of 2008 (HERA), the GSEs would be hard pressed to meet their affordable housing mission without the ability to utilize the portfolio for these types of loans.

Question 7: Aside from reducing the volume or altering the composition of mortgage assets held by the Enterprises, are there other ways in which FHFA can use criteria governing their mortgage portfolio holdings to reduce their exposure to or improve their management of interest rate, credit, operational, and other risks? Is so, what approaches should FHFA take?

Credit risk can be managed through the participation of underwriters and/or originators in the sharing of losses in the loans. Risk sharing provides an alignment of interest among participants. The Fannie Mae Multifamily DUS program is based on shared losses on originated loans. If this type of approach is adopted, perhaps with the ability to reduce the risk sharing over time as the loan ages, credit risk is mitigated for the GSEs by having adequately-capitalized entities servicing the collateral and sharing losses, with capital reserves set aside to backstop their obligations. In that way, credit risk is mitigated through both the GSE lending guidelines and the credit guidelines of the loss-sharing counterparties.

Interest-rate risk, as discussed above, can be mitigated through the sale of the predominant share of GSE guaranteed loans into the MBS market. Interest rate risk can also be mitigated on multifamily loans through yield maintenance agreements.

Transparency can be augmented through additional disclosure of mortgage and credit parameters in the Prospectus, similar to CMSA standards for commercial mortgages.

Question 8: How can FHFA best use criteria governing mortgage portfolio holdings, in conjunction with capital regulations and other supervisory tools, such as prudent management and operations standards established in accordance with section 1313B of the Safety and Soundness Act, to address the Enterprises' exposure to the additional risks posed by such holdings?

The GSEs should be held to similar portfolio capitalization standards as commercial banks, differentiating between loans held on balance sheet (which have both interest-rate and credit risks) and loans sold as MBS (which primarily have credit risk).

Question 9: Should FHFA use criteria governing the Enterprises' mortgage portfolio holdings to mitigate the systemic risk posed by the Enterprises? If so, how? If the mortgage portfolio holdings of the Enterprises were reduced in an effort to mitigate the systemic risk posed by the Enterprises, how would the stability of the mortgage markets and the broader financial

system be affected? What steps could the federal government take to maximize any improvement in stability?

Whether the enterprises hold loans in portfolio or provide credit guarantees, the GSEs still fundamentally have concentrated systemic credit risk. If too many borrowers default, they lose money on their portfolio holdings and/or they have to honor credit guarantees. Either way, excessive leverage will amplify the problem. The enterprises must be adequately capitalized (e.g. banking industry model) to support portfolios. Moreover, there must be flexibility in the size of the portfolios to assure that the GSEs are not forced to liquidate their portfolios into a fledgling private market, adversely affecting that market.

Question 10: Should the size of the Enterprises' mortgage portfolio holdings be limited to a fixed dollar amount, be linked to a market indicator, or be linked to the size of their MBS outstanding?

The regulator should be responsible for portfolio size limitations, depending on market conditions and should be given latitude within a wide range. Of the options provided, the most reasonable approach would be to set the GSEs' portfolio limits as a percentage of their MBS outstanding, but that percentage should vary with market conditions. In a "normal" market, this percentage could be set at 15 -30%. But in an adverse market, the percentage may need to be much higher to provide liquidity.

Question 11: Should the permissible size of the Enterprises' holdings of mortgage assets vary in a manner related to the phase of the mortgage credit cycle or conditions in the secondary mortgage market? If so, how should FHFA monitor that cycle or secondary mortgage market conditions, and how should the permissible size of those holdings vary?

The permissible size of the GSE's portfolios should be bifurcated into "normal" market limits, and "market duress" limits. The determination of "market duress" is a very difficult concept. When it occurs, as it has recently, the GSEs' portfolios should be allowed to expand to a much greater percentage of loans originated during that period. (For instance, FHFA could use barometers such as loan spreads in excess of 2x trailing 1-year spreads, to determine a time of market duress. However, such determinations should be clear and should not add to the market uncertainty/instability as has been the case with the FASB fair value rules.)

Question 12: How could decreases in the Enterprises' mortgage portfolio holdings affect their operational infrastructures? How would changes in their operational infrastructures affect their ability to expand their purchases of mortgage assets for portfolio during times of stress in the secondary mortgage market? Does each Enterprise need a minimum level

of mortgage portfolio holdings to maintain the infrastructure needed to expand its purchases under such conditions?

A minimum size of portfolio is required to provide standby backstop protection. Assuming that the GSEs continue to guarantee the credit risk of their mortgage loans, and sell the majority of loans into the public markets as MBS, the major impact will be seen in the "trading" and "hedging" departments. The GSEs could return their headcount distribution to where they were in the 1990s, when most of their originated paper was sold as MBS. The production, underwriting, credit and asset management functions would remain fairly stable, as those functions would remain largely unchanged. While the retention of a smaller portfolio could conceivably limit their ability to rapidly price and properly hedge higher volumes of portfolio purchases of mortgages in times of market duress, the levels of portfolio retention discussed herein would seem to provide for robust staffing, even if reduced from today's levels, in those areas.

Question 13: Should each Enterprise's minimum capital requirement increase with the size or composition of its mortgage portfolio holdings? If so, how should such increase be imposed? Should a capital surcharge be imposed on each Enterprise if its mortgage portfolio holdings exceed some level? If so, how should such surcharge be imposed?

In a perfect world, the GSEs' capital charges would be based on a framework similar to other financial institutions. Thus their portfolio holdings would be subject to capital requirements for on balance sheet mortgages, and their guaranteed securities subject to off balance sheet capital requirements. As portfolio holdings increase, capital requirements would increase. Stricter capital requirements for loans held in portfolio will provide a natural incentive to the Enterprises to sell assets into the market, if possible.

In addition, a capital surcharge should be paid by firms selling loans to the enterprises, so that funds can be available during market downturns. The corollary is the insurance premiums that banks pay to capitalize the FDIC insurance fund.

Question 14: Should FHFA restrict the types of mortgage assets the Enterprises are allowed to hold to those that are strictly related to specific elements of their mission? If so, how should those assets be defined? For example, should FHFA prohibit or place a limit on each Enterprise's holdings of mortgage-related securities guaranteed by the other Enterprise or Ginnie Mae or its holdings of private-label MBS?

Except as needed during times of illiquidity or as needed to ensure a robust MBS market, there appears to be little rationale for the GSEs to hold in portfolio their own MBS, Ginnie Mae MBS or private label MBS. One of the mistakes made in the past decade was to force the housing goals to a level where the GSEs had to purchase private label RMBS and CMBS that were not prudently underwritten, thus fueling that market and increasing their portfolio risk., The portfolio should be used to meet mission goals that cannot be met via securitization, but caution should be exercised such that mission goals do not override safe and sound lending practices. Additionally, the GSEs should not be forced to sell loans held in portfolio, as previously mentioned.

Question 15: Should FHFA require that assets purchased for the portfolio each year comply with affordable housing goals and sub-goals established for that year?

Clearly, the portfolio is an important vehicle for the GSEs to meet their affordable housing goals and duties to serve underserved markets (as required under HERA). However, the portfolio purchases should not be restricted to these mission-related loans as the portfolio has other benefits to the housing markets, as noted in our response to Question 1.

Question 16: Should FHFA allow the Enterprises to hold, without limit, either whole loans (or securities backed by them) that finance affordable housing not easily securitized because of non-standard features and small volumes of mortgage securities backed by loans that finance affordable housing, where markets for those securities are small or thin? Please provide examples of such loans or securities. Alternatively, should FHFA place a limit on the amount of such loans or securities that an Enterprise can hold? If so, what is an appropriate level?

The GSEs should be allowed to hold unlimited amounts of thinly-traded loans or securities, where an MBS execution is not feasible for purposes of addressing underserved markets as required under HERA. In fact, as discussed, the retention of such loans should be a key function of the GSEs' portfolios. We are concerned that the GSEs will not be able to meet their special affordable multifamily goals and duties to serve required under HERA without access to a portfolio execution. This is particularly critical in times of market duress, such as the current situation.

Question 17: Should FHFA establish criteria governing the Enterprises' mortgage portfolio holdings that specify that the Enterprises adhere to a specific maximum ratio of short-term debt to mortgage assets or minimum ratio of callable debt to long-term, fixed-rate mortgage assets or to total long-term debt?

Assuming that the GSEs remain shareholder-owned companies, subject to minimum equity capitalization ratios and Tier 1 ratios as with other financial institutions, FHFA should not otherwise mandate the composition of the GSEs' liabilities differently than bank regulators do for their regulated institutions.

Question 18: Should FHFA specify criteria that condition Enterprise mortgage portfolio holdings above a certain amount on maintaining measures of the risks – e.g., duration and convexity – associated with those portfolios within specified levels? Should adherence to appropriate limits on such risks be addressed through of prudential management and operations standards in accordance with section 1313B of the Act and FHFA's examination process?

Transparency and prudent management of GSEs' portfolios is critical. The regulator must use necessary tools to manage the size and composition of the portfolios.

Question 19: Should FHFA create incentives for the Enterprises to behave in a counter-cyclical manner through criteria governing their portfolio holdings of mortgage and non-mortgage assets, regulatory capital requirements, or both? If so, how? What are the implications of specifying such criteria for the Enterprises' mission?

FHFA should create "incentives" for the GSEs to act in a counter-cyclical manner by lifting any portfolio caps during times of market duress. The GSEs should obtain higher funding and credit-loss spreads during these times (as they currently are), while exhibiting strong stability and liquidity for the mortgage markets when most needed.

Question 20: What risks and costs are associated with requiring the Enterprises to maintain a portfolio of liquid, non-mortgage assets?

As shareholder-owned entities, the GSEs should maintain balance sheet flexibility in accordance with their capital requirements. Liquid securities maintain an important role in every financial institution's balance sheet; the GSEs should be no different. As with any financial institution, management, under the direction of FHFA, should determine the costs and benefits of maintaining adequate liquidity. In times of duress, the Treasury (or like institution) may be required to place additional, short-term, capital into the GSEs.

Question 21: Is it appropriate to require the Enterprises to hold a large portfolio of highly liquid assets even during periods of market tranquility? If so, why? Should the Enterprises be compensated for holding "excess" levels of non-mortgage assets during periods of market tranquility? If so, what are appropriate incentives?

We do not believe that the GSEs should be required or compensated for holding liquid, non-mortgage assets in excess of what is required to meet sound capital requirements.

Question 22: Should the Enterprises be required to maintain a specific minimum dollar amount of highly liquid non-mortgage assets at all times? If so, what is an appropriate dollar amount? Alternatively, should the level of non-mortgage assets be set at a percentage of an Enterprise's total assets or a specified number of days of liquidity? If so, what is an appropriate percentage factor or number of days?

We do not believe that the GSEs should be required or compensated for holding liquid, non-mortgage assets in excess of what is required to meet sound capital requirements.

Question 23: Should the Enterprises' non-mortgage portfolios grow with the phases of the mortgage credit cycle or counter to that cycle? Should the Enterprises be given incentives for holding large volumes of liquid non-mortgage assets during periods of ample market liquidity? If so, how should such incentives be provided? For instance, after criteria governing holdings of non-mortgage assets are established, FHFA could reduce each Enterprise's minimum capital requirement by, for example, 75% of the amount of non-mortgage assets held to comply with those criteria.

We do not believe that the GSEs should be required or compensated for holding liquid, non-mortgage assets in excess of what is required to meet sound capital requirements.

Question 24: Should the criteria enumerate the specific types of investments the Enterprises should hold in the non-mortgage portfolios. If so, what type assets should be included? Should U.S. Treasury securities represent a specific share of the non-mortgage portfolios? If so, what is an appropriate percentage or dollar amount?

For purposes of capital, but only for such purpose, the Enterprises could hold very liquid and highly rated non-mortgage securities. The criteria should not differ from those specified for banks.

Question 25: What is an appropriate maturity range for securities comprising the non-mortgage portfolios? How should holdings be distributed and according to that range?

No comment.

Question 26: Should FHFA attempt to specify in advance how it might adjust criteria governing Enterprise mortgage or non-mortgage portfolio holdings in specific circumstances?

It would be difficult to identify all possible circumstances under which FHFA might adjust criteria for portfolio holdings. It may be better to give the regulator flexibility to react to different market conditions.

The DUS Lender Peer Group appreciates this opportunity to comment on FHFA's interim final rule on the GSEs' portfolio holdings. Should you have questions, please feel free to contact me at (617)722-5101 or steve.wendel@db.com.

Sincerely,

Steve Wendel

Steve Wendel, Chairman
DUS Lender Peer Group