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By courier and electronic mail

Alfred M. Pollard
General Counsel
Office of Federal Housing Enterprise Oversight
1700 G Street, NW
Washington, DC 20552

Re: Revised Draft Examination Guidance on Conforming Loan Limit Calculations
72 Fed. Reg. 59,545 (October 22, 2007)

Dear Mr. Pollard:

Freddie Mac welcomes the opportunity to comment on the Office of Federal Housing Enterprise Oversight's (OFHEO) revised draft Examination Guidance, entitled "Conforming Loan Limit Calculations." The revised Guidance would establish new procedures for calculating the conforming loan limits and implementing increases and decreases.

Congress created Freddie Mac to provide liquidity, stability and affordability to the residential mortgage market at all times and in all economic environments. Our role has been particularly vital in light of the recent liquidity problems in the credit markets and has prevented these problems from spreading to the conventional conforming market. For example, as OFHEO recently noted, the enterprises played a critical role in ensuring the liquidity in the conforming loan market during August and September of this year.¹

Freddie Mac does not believe there is any public policy, housing or residential mortgage market reason for reducing the conforming loan limits. Decreases would disrupt the single-family mortgage market and increase costs for the full range of mortgage market participants, including participants in the Federal Housing Administration (FHA), Veterans Affairs (VA) and Rural Housing Service programs that are linked to the Freddie Mac limits. We believe decreases in the loan limits would have the effect of further weakening already declining home prices and would have a negative impact on borrowers seeking to obtain loans at or near the conforming limit.

We appreciate OFHEO's additional solicitation of public comments. We believe the changes OFHEO has made to the revised Guidance help ameliorate some of the adverse effects that would be caused by decreasing the conforming loan limits.

We share OFHEO's goal of assuring clarity in the process for calculating loan limits, providing for smooth market operations and affording certainty to single-family mortgage

¹ 2007 Performance and Accountability Report, Office of Federal Housing Enterprise Oversight, November 15, 2007.

market participants. However, we believe this shared goal could be better achieved by making the following changes to the revised Guidance.

1. Freddie Mac recommends that any decreases in the Federal Housing Finance Board's (FHFB) Monthly Interest Rate Survey (MIRS) should be offset against future increases. This approach would achieve the public policy objective of maintaining a steady, liquid flow of funds to the market in the event of a housing downturn and eliminate any uncertainty and confusion in the mortgage market that would accompany a decline.
2. Should OFHEO decide to require decreases in loan limits, we recommend raising the *de minimis* threshold for such decreases from the proposed three percent to five percent due to the volatile nature of the FHFB's MIRS. We also suggest that OFHEO reserve the authority to defer decreases above the threshold amount beyond the proposed one-year period based on consideration of conditions in the single-family mortgage market.
3. We recommend matching the grandfathering text in the revised Guidance to the principle described in the preamble to the revised Guidance: "...if a loan has been conforming at any time, it cannot become non-conforming by virtue of a subsequent decline in the loan limit."
4. We recommend removing the rounding provision altogether because we believe market participants have the systems capability to implement increases in the conforming loan limit to the nearest dollar. However, should OFHEO determine to adopt a rounding approach, Freddie Mac supports OFHEO's current practice of rounding down to the nearest \$50.

I. Effects of Loan Limit Decreases

Freddie Mac believes that decreases in loan limits could limit our ability to provide liquidity and stability when the residential mortgage market is weak, such as during times of house price depreciation. Decreasing loan limits during these times could exacerbate adverse market conditions, causing house prices to fall even further. This result is inconsistent with Freddie Mac's mission of providing liquidity, stability and affordability to the residential mortgage market at all times.

We believe that a decrease in the conforming loan limits would disrupt the single-family mortgage market and increase costs for mortgage market participants. For example, small lenders would be disproportionately affected because they do not have the ability to amortize the cost of adjusting internal systems to account for decreases over a large book of business. Many of these small lenders rely heavily on Freddie Mac to purchase the loans that they originate. If the loan limits decrease, these lenders would incur additional costs as they would have to develop relationships with new investors.

High-cost markets

The rapid increase in home prices between 2003 and 2006 has generally outpaced income growth and reduced affordability in high-cost areas. As a result, the impact of a decline in the loan limits would disproportionately affect borrowers in these areas, particularly borrowers on the East and West Coasts.

As house prices increased over the past four years, many borrowers obtained loans with higher risk characteristics that offered lower payments such as short-term hybrid adjustable-rate mortgages (ARMs). If the loan limits were to decline, thousands of borrowers, many of whom may be facing payment shock due to ARM resets, would be unable to refinance into conforming mortgages. This effect would be particularly severe in areas that have experienced a period of rapid house price appreciation followed by an almost immediate period of house price depreciation. For example, as Exhibit 1 illustrates, in California, the state with the highest overall housing prices and the second lowest homeownership rate,² many of the counties that saw the fastest gains in home values between 2004 and 2006 are now seeing decreases.³ Many of these counties also have high concentrations of subprime loans and high delinquency rates as shown in Exhibit 2.⁴

Consequently, a decrease in loan limits would have a much greater negative effect on families residing in high-cost areas than it would have on families located elsewhere in the United States. Furthermore, because high-cost areas have historically had below average homeownership rates, more minority households, a higher share of underserved areas and a higher rate of subprime originations,⁵ a decrease in loan limits would likely have a disproportionately negative effect on minority, subprime and low- to moderate-income borrowers.⁶

² California's homeownership rate in 2006 was 58.4 percent, behind only New York (55.3 percent), American Community Survey 2007, U.S. Census Bureau.

³ Based on average changes in median home values year-over-year as provided by the California Association of Realtors.

⁴ Based on data from First American LoanPerformance's ABS Securities database. Data as of June 2007.

⁵ See, Expanding Homeownership Opportunities in California: The Role of Housing Finance, Susan M. Wachter, Working Paper (December 2003). The Home Mortgage Disclosure Act data from 2006 indicate that 23 percent of non-Hispanic white borrowers received loans with interest rates consistent with subprime loans, while 42 percent of Hispanic borrowers and 53 percent of African-American borrowers received such loans. In 2006, 37 percent of loans originated to borrowers in low-income neighborhoods and 28 percent of loans originated to borrowers in moderate-income neighborhoods had interest rates that could be considered subprime. In contrast, 18 percent of loans originated to borrowers in high-income neighborhoods could be considered subprime.

⁶ This projection is true even if one assumes that all borrowers behave statistically identically within the subprime cohort and that any effects promulgated by predatory lending practices are equally distributed across all subprime borrowers. If the incidence of default, fraud or predatory lending practices is higher for minority or low-income families within the subprime segment, then the effects will be even more disproportionate.

Market for new homes

Due to the nature of the construction process, buyers of new homes typically sign purchase contracts up to a year before closing.⁷ In order to facilitate a sale, many builders offer homebuyers an extended rate-lock through an affiliated mortgage lender.

If the loan limits were to decrease between the date of commitment and the date of closing, however, a prospective homebuyer would need to qualify for higher-cost jumbo financing or increase the down payment amount. Homebuyers who could not qualify for a jumbo mortgage or make a larger down payment would need to request significant concessions from the builder or risk being unable to close their home purchase. These circumstances would result in additional costs for the homebuyer and/or the builder, disrupting financing for new homes and potentially further weakening home prices.

Government mortgage programs

Decreasing loan limits would directly affect thousands of participants in federal government mortgage loan programs. The maximum FHA-insured loan limits and the maximum VA guarantee amount are both linked to the Freddie Mac loan limit.⁸ In addition, the Rural Housing Service's loan guarantee program is indirectly linked to Freddie Mac's loan limits.⁹ These three programs have historically served low- and moderate-income families, minority families and military veterans.

We estimated in our comment letter on the initial draft of the Guidance that a five percent decrease in the conforming loan limits would directly affect approximately 20,000 FHA and VA borrowers. We believe that in light of recent adverse market conditions, this figure could underestimate the number of borrowers who would be harmed by a decrease in the loan limits. Further, decreasing loan limits could prevent some borrowers from utilizing the benefits of the FHASecure program and could hamper the ability of future policymakers to respond quickly to mortgage market developments by adopting programs, like FHASecure, that are intended to help foster sustainable homeownership.

⁷ According to the Census Bureau, in 2006 the average number of months from start to completion of a one-family home was seven months, and for a two- to four-family home the average was 11 months. See <http://www.census.gov/const/www/lengthoftimeindex.html>.

⁸ The FHA single-family loan limits are set at the lesser of: (a) 95 percent of the median area home price or (b) 87 percent of the conforming loan limit, but not less than the limit in effect for the area on October 20, 1999 or 48 percent of the conforming loan limit. 12 U.S.C. §1709(b)(2)(A)(ii). The VA maximum guaranty amount is 25 percent of the Freddie Mac conforming loan limit. 38 U.S.C. § 3703(a)(1).

⁹ 7 C.F.R. § 3550.63.

II. Recommendations for Changes to the Revised Guidance

De minimis threshold

The revised Guidance would require cumulative decreases in house prices to reach three percent before a decrease would be implemented.

While Freddie Mac appreciates OFHEO's willingness to adopt a *de minimis* threshold to help reduce uncertainty and unintended consequences, we believe that OFHEO should offset any loan limit decreases against eventual future increases, rather than adopt a *de minimis* threshold for decreases. This approach would achieve the public policy objective of providing ample liquidity and stability to the mortgage market during times of house price depreciation, without which house prices would likely fall even further.¹⁰

If OFHEO decides to adopt a *de minimis* threshold, Freddie Mac believes that five percent is appropriate. We also believe that OFHEO should reserve the right to defer declines above the *de minimis* threshold if warranted by conditions in the single-family mortgage market.

The MIRS is extremely volatile when compared with other house price measures and is far more likely to show a decline in house prices of more than three percent when other measures do not. The Government Accountability Office and the Congressional Research Service have both concluded that even though the MIRS average-price series produces a measure of house-price appreciation that is comparable to other house-price series in the long run, in the short term, the MIRS series produces volatile measures of house price growth.¹¹

In the initial draft Guidance, OFHEO examined the volatility of the MIRS by analyzing the period from 1994 to 2007. This period is unique in U.S. economic history because of the reduced level of Gross Domestic Product volatility and extended period of economic expansion. Freddie Mac believes that this period is unrepresentative of the historical volatility of the MIRS.¹² Exhibit 3 shows the month-to-month change in the 12-month growth rate computed from the MIRS from 1974 to 2007 (through September).¹³ The

¹⁰ Joe Peek and James A. Wilcox, Housing, Credit Constraints, and Macro Stability: The Secondary Mortgage Market and Reduced Cyclicity of Residential Investment, *American Economic Review*, May 2006, pp. 135-140; Secondary Mortgage Markets, GSEs, and the Changing Cyclicity of Mortgage Flows, *Research in Finance*, Volume 20, ed. Andrew H. Chen, 2003, pp. 61-80.

¹¹ See Housing Finance: Implications of Alternative Methods of Adjusting the Conforming Loan Limit, Government Accountability Office, GAO/RCED-95-6 (October 1994); House Finance Debates on the Federal and Related Credit Agencies: The "Conforming Loan" Limits of FNMA and FHLMC, Congressional Research Service Issue Brief (January 27, 1988).

¹² The 1991-2000 expansion was the longest recorded since the National Bureau of Economic Research began to track U.S. business cycles; over the past 153 years, there have been 32 business cycles, with an average expansion of less than 4 years. The expansion starting in 1991 ran a full decade, and the current expansion has entered its seventh year this month. Thus the 13-year period OFHEO examined contains only a 9-month recession, atypical of U.S. economic performance.

¹³ The changes shown in Exhibit 3 record the amount by which the year-over-year difference for a particular month exceeds the maximum increase or the minimum decrease of the two months immediately

horizontal lines at “3%” and “-3%” highlight the band that OFHEO discussed in the Guidance. Exhibit 3 shows that historically the MIRS has been far more volatile than in the 1994 to 2007 period examined by OFHEO. Moreover, the MIRS data show 21 occurrences from 1974 through 2007 where the year-over-year change in home values for a particular month is of opposite sign to the annual change for the month immediately preceding it and the absolute value of the difference is greater than five percentage points.¹⁴

In addition, to further demonstrate the volatility of the MIRS, we have compared several other house price indexes, all of which show less volatility than the MIRS.

National Association of Realtors (NAR) Existing Home Average Prices: As shown in Exhibit 4, historically, the MIRS has had a four percent likelihood of showing an annual decline in average home prices of at least three percent. In contrast, the NAR series has shown a far smaller percentage of such occurrences. For example, the likelihood of the NAR series declining annually by one percent is only 2.7 percent, smaller than the probability of the MIRS declining by three percent. In addition, the NAR series (see Exhibit 5) shows only one month since 1994 where, using OFHEO’s methodology, the month-to-month change in annual growth rates fell below the negative three percentage point threshold. This is in contrast to the 11 percent of occurrences (16 out of 150) that OFHEO reported for the MIRS over the same time interval. In other words, the MIRS was 16 times more likely to exceed the three percent threshold proposed by OFHEO, when compared with the NAR average price series.

OFHEO’s House Price Index (HPI): The lower panel of Exhibit 4 compares the annual growth in the quarterly average MIRS with OFHEO’s HPI as a way of emphasizing the greater uncertainty of house price movements recorded in the MIRS. Quarterly averaging smoothes time series, thus the quarterly MIRS series shows far less annual volatility than its monthly series. Nonetheless, in 1.6 percent of the cases, the annual decline using the quarterly MIRS series was at least three percent, whereas OFHEO’s HPI has no cases of a three percent annual decline.

OFHEO Purchase-Only HPI: Exhibit 6 replicates OFHEO’s analysis for its purchase-only HPI. This series, which is also quarterly, is less volatile than monthly price measures. Over the span of availability, there are no cases where the OFHEO purchase-only HPI has exhibited an annual price change fluctuating by three percentage points or more and, over the sample period used by OFHEO, all changes are less than one percentage point.

surrounding the month of reference. This follows the methodology described in the proposed Guidance, which states, “the 12-month change ending in any month is not within the range of 12-month changes ending in the preceding and succeeding months.” For example, if the reference month is October and the annual October change is five percent, while the annual September change is zero and the annual November change is two percent, then the amount shown by the bar height for October of that year in Exhibit 3 would be recorded at three percent

¹⁴ The most recent example of this type of event occurred in 2004 when the January 2003 to January 2004 change was -0.7 percent while the February 2003 to February 2004 change was 6.2 percent.

S&P/Case-Shiller® HPI: Exhibit 7 replicates the analysis for the S&P/Case-Shiller® HPI for a 10-metropolitan area composite. This index is monthly and purchase-only. Replicating OFHEO's methodology, the analysis shows no months in which the month-to-month change in annual price change differed by more than one percentage point when compared with the preceding and succeeding months.

For these reasons, we recommend a threshold of five percent. We believe a five percent threshold is statistically meaningful and would not produce the volatile results associated with the MIRS series. As Exhibit 3 shows, the MIRS data often exceed the three percent threshold only to reverse the change in following months, potentially leading to decreases in the conforming loan limit due to statistical noise as reflected by the October-to-October change in home values in the survey rather than persistent and sustained trends in home values that are consistent with other data sources.

Grandfathering

Freddie Mac greatly appreciates the efforts of OFHEO to clarify in the preamble that "...if a loan has been conforming at any time, it cannot become non-conforming by virtue of a subsequent decrease in the loan limit." We believe this grandfathering principle will help reduce uncertainty, operational costs and unintended consequences for the full range of residential mortgage market participants. We recommend revising the grandfathering language contained in the revised Guidance to conform to the principle in the preamble for the reasons outlined in our comments on the initial draft Guidance.

Rounding

The revised Guidance would adopt the approach of rounding down to the nearest \$100. We believe market participants have the technological capability to carry out any increases in the conforming loan limits to the nearest dollar. Government programs, such as the FHA, use loan limits that the government has set to the nearest dollar, with no further rounding, and this practice has not caused market confusion or uncertainty.¹⁵ For this reason, we recommend removing the rounding provision altogether. Should OFHEO determine to continue the practice of rounding, we support maintaining the existing practice that has been in place for more than 20 years, of rounding down to the nearest \$50.

III. Analysis of Statutory Provisions

After analyzing the statutory provisions for setting and calculating conforming loan limits, Freddie Mac continues to believe that the plain language requires Freddie Mac to set loan limits and does not provide for decreases. Decreasing the loan limits would also be inconsistent with our statutory mission to provide liquidity, stability and affordability to the residential mortgage market.

We note that in the preamble to the Guidance, OFHEO states that decreases in the conforming loan limits fit within the statutory language as "negative increases" and

¹⁵ For example, the Secretary of HUD established a one-family loan limit for FHA-insured loans of \$290,319 for Washington, DC for 2004; of \$312,895 for Hudson County, NJ for 2005; of \$360,905 for Baltimore, MD for 2006; and \$358,383 for Merced County, CA for 2007.

alternatively, that where a statute is silent, "regulators routinely fill gaps in statutes with rational solutions in line with available statutory intent." In this regard, our charter plainly states that adjustments to the loan limits must be made by, "*adding* to each such amount (as it may have been previously adjusted) a percentage thereof equal to the percentage *increase* during the twelve-month period ending with the previous October..." 12 U.S.C. §1454(a)(2) (emphasis added). Accordingly, we do not believe there is a statutory gap for OFHEO to fill.

* * *

We appreciate OFHEO's significant efforts to address the concerns we raised in our comments on the June 20, 2007 draft Guidance on conforming loan limit calculations. We continue to believe that decreases in the conforming loan limits would be disruptive and costly to the full range of participants in the single-family residential mortgage market.

Please do not hesitate to contact me if you have any questions.

Very truly yours,



Robert E. Bostrom

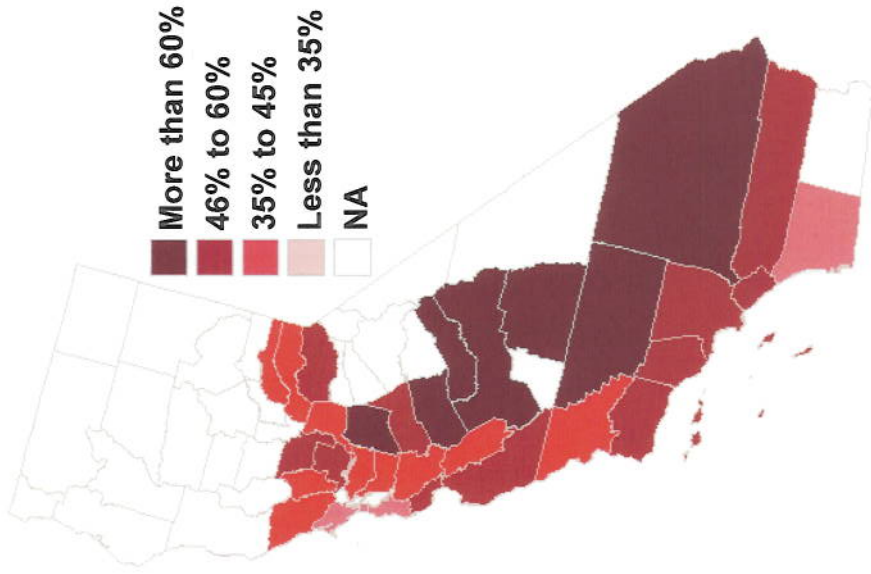
Exhibits:

1. Changes in County Median Home Values (California)
2. Subprime Share of Loans Outstanding (California)
3. Monthly FHFB MIRS Series
4. Distribution of House Price Declines
5. Monthly NAR Average Series
6. OFHEO Purchase-Only House Price Index
7. Monthly S&P/Case-Shiller® 10-Composite Average Homes Series

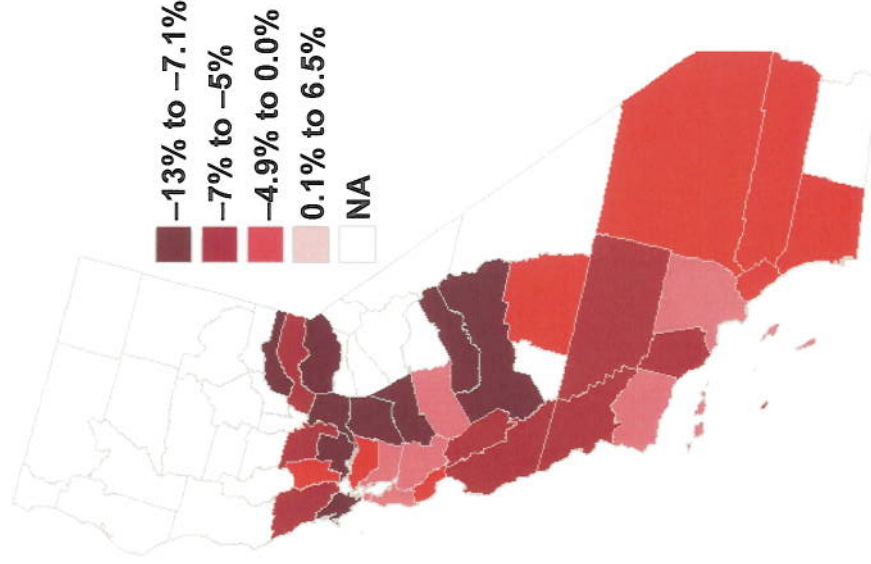
Exhibit 1

California Counties That Saw Most Rapid Home Price Growth in 2004-2006 Are the Most Vulnerable to Loan Limit Changes

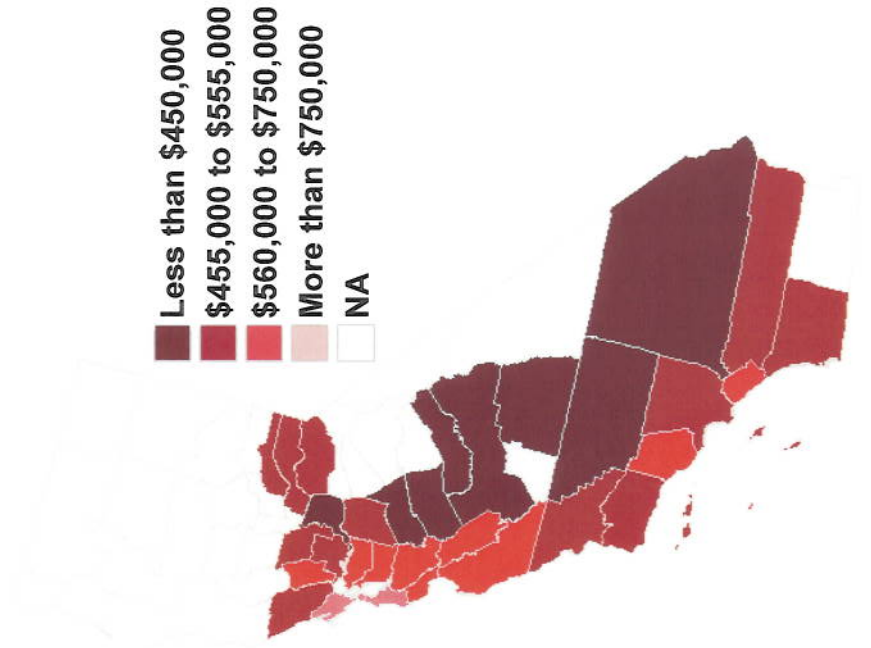
2004 thru 2006 Cumulative Change in County Median Home Values



2007 Annual Change in County Median Home Values Through Sept.



County Median Home Values 4Q 2006



Source: Freddie Mac, California Association of Realtors

Exhibit 2

The Subprime Share of Loans Outstanding Is Highest In Counties With Median Home Values Below \$560,000 Within California

Subprime Share of Loans Outstanding June 2007



Percent of Subprime Loans Outstanding that Are 30 Days or More Delinquent

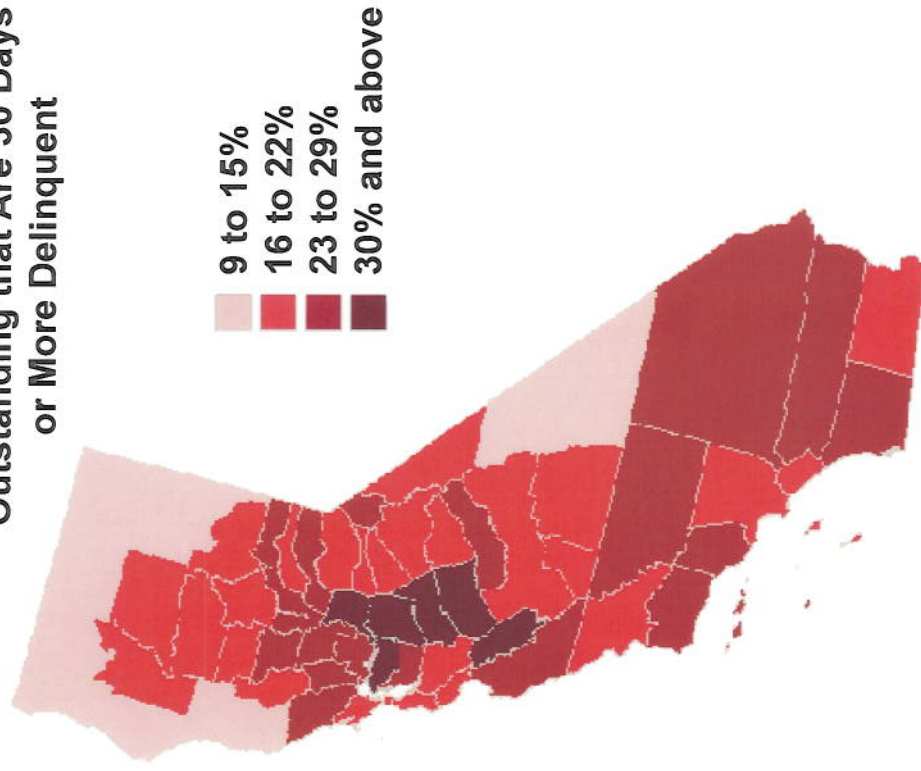
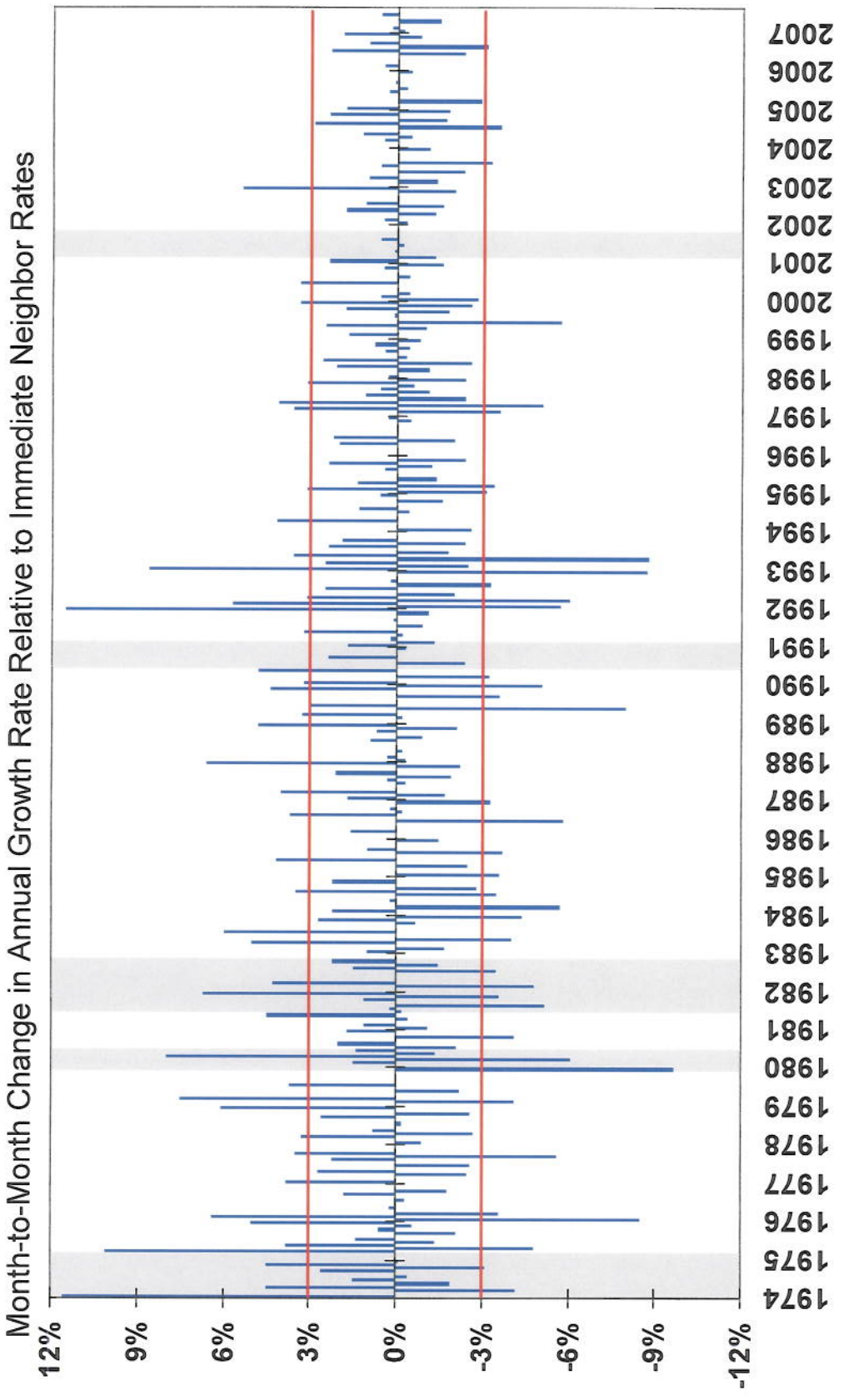


Exhibit 3 Monthly FHFB MIRS Series



- National Recession

Source: Federal Housing Finance Board *Monthly Interest Rate Survey*, Freddie Mac

Exhibit 4

Distribution of House Price Declines

(Percent Change in Home Prices Measured Over Multi-Year Time Intervals)

(Monthly Series, January 1973 - September 2007)

| | Occurrences | | | | | Probability | | | | |
|---|-------------|---------|---------|---------|---------|-------------|---------|---------|---------|---------|
| | 1-Year | 2-Years | 3-Years | 4-Years | 5-Years | 1-Year | 2-Years | 3-Years | 4-Years | 5-Years |
| FHFB MIRS (417 Periods) | | | | | | | | | | |
| 1% Decline | 42 | 29 | 27 | 19 | 12 | 10.4% | 7.4% | 7.1% | 5.1% | 3.4% |
| 2% Decline | 24 | 22 | 20 | 16 | 8 | 5.9% | 5.6% | 5.2% | 4.3% | 2.2% |
| 3% Decline | 16 | 14 | 12 | 11 | 7 | 4.0% | 3.6% | 3.1% | 3.0% | 2.0% |
| 4% Decline | 10 | 10 | 7 | 7 | 3 | 2.5% | 2.5% | 1.8% | 1.9% | 0.8% |
| 5% Decline | 5 | 7 | 4 | 0 | 1 | 1.2% | 1.8% | 1.0% | 0.0% | 0.3% |
| NAR Existing Homes Average (417 Periods) | | | | | | | | | | |
| 1% Decline | 11 | 2 | 0 | 0 | 0 | 2.7% | 0.5% | 0.0% | 0.0% | 0.0% |
| 2% Decline | 6 | 2 | 0 | 0 | 0 | 1.5% | 0.5% | 0.0% | 0.0% | 0.0% |
| 3% Decline | 2 | 1 | 0 | 0 | 0 | 0.5% | 0.3% | 0.0% | 0.0% | 0.0% |
| 4% Decline | 0 | 1 | 0 | 0 | 0 | 0.0% | 0.3% | 0.0% | 0.0% | 0.0% |
| 5% Decline | 0 | 1 | 0 | 0 | 0 | 0.0% | 0.3% | 0.0% | 0.0% | 0.0% |

(Quarterly Series, 1975Q1-2007Q2)

| | Occurrences | | | | | Probability | | | | |
|--------------------------------|-------------|---------|---------|---------|---------|-------------|---------|---------|---------|---------|
| | 1-Year | 2-Years | 3-Years | 4-Years | 5-Years | 1-Year | 2-Years | 3-Years | 4-Years | 5-Years |
| FHFB MIRS (130 Periods) | | | | | | | | | | |
| 1% Decline | 12 | 8 | 8 | 4 | 3 | 9.4% | 6.5% | 6.7% | 3.5% | 2.7% |
| 2% Decline | 4 | 7 | 5 | 2 | 2 | 3.1% | 5.7% | 4.2% | 1.7% | 1.8% |
| 3% Decline | 2 | 4 | 4 | 1 | 0 | 1.6% | 3.3% | 3.4% | 0.9% | 0.0% |
| 4% Decline | 0 | 2 | 1 | 1 | 0 | 0.0% | 1.6% | 0.8% | 0.9% | 0.0% |
| 5% Decline | 0 | 1 | 1 | 1 | 0 | 0.0% | 0.8% | 0.8% | 0.9% | 0.0% |
| OFHEO HPI (130 Periods) | | | | | | | | | | |
| 1% Decline | 0 | 0 | 0 | 0 | 0 | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| 2% Decline | 0 | 0 | 0 | 0 | 0 | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| 3% Decline | 0 | 0 | 0 | 0 | 0 | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| 4% Decline | 0 | 0 | 0 | 0 | 0 | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| 5% Decline | 0 | 0 | 0 | 0 | 0 | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |

Source: Federal Housing Finance Board, National Association of Realtors, Office of Federal Housing Enterprise Oversight, Freddie Mac

Exhibit 5 Monthly NAR Average Series

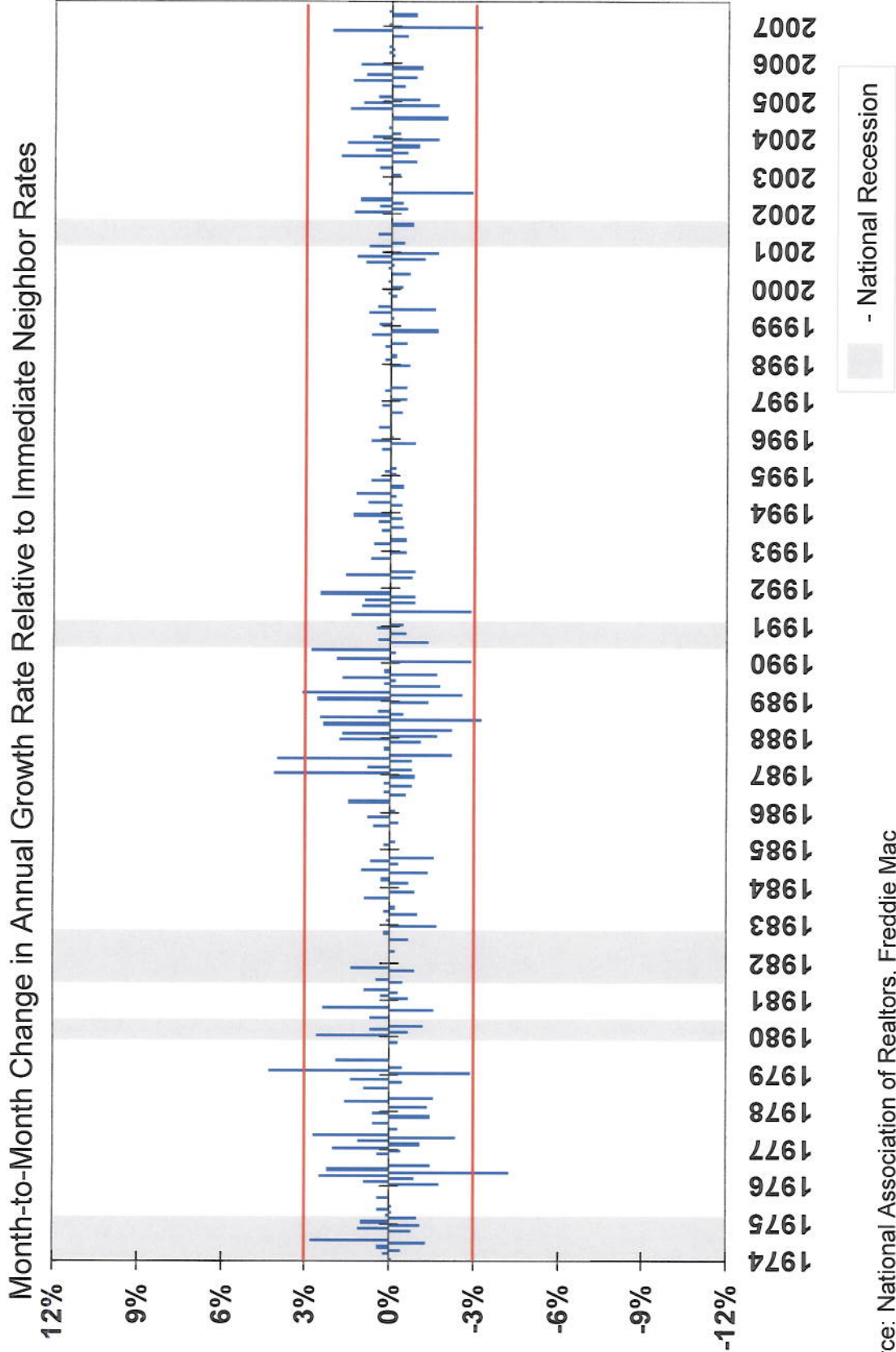
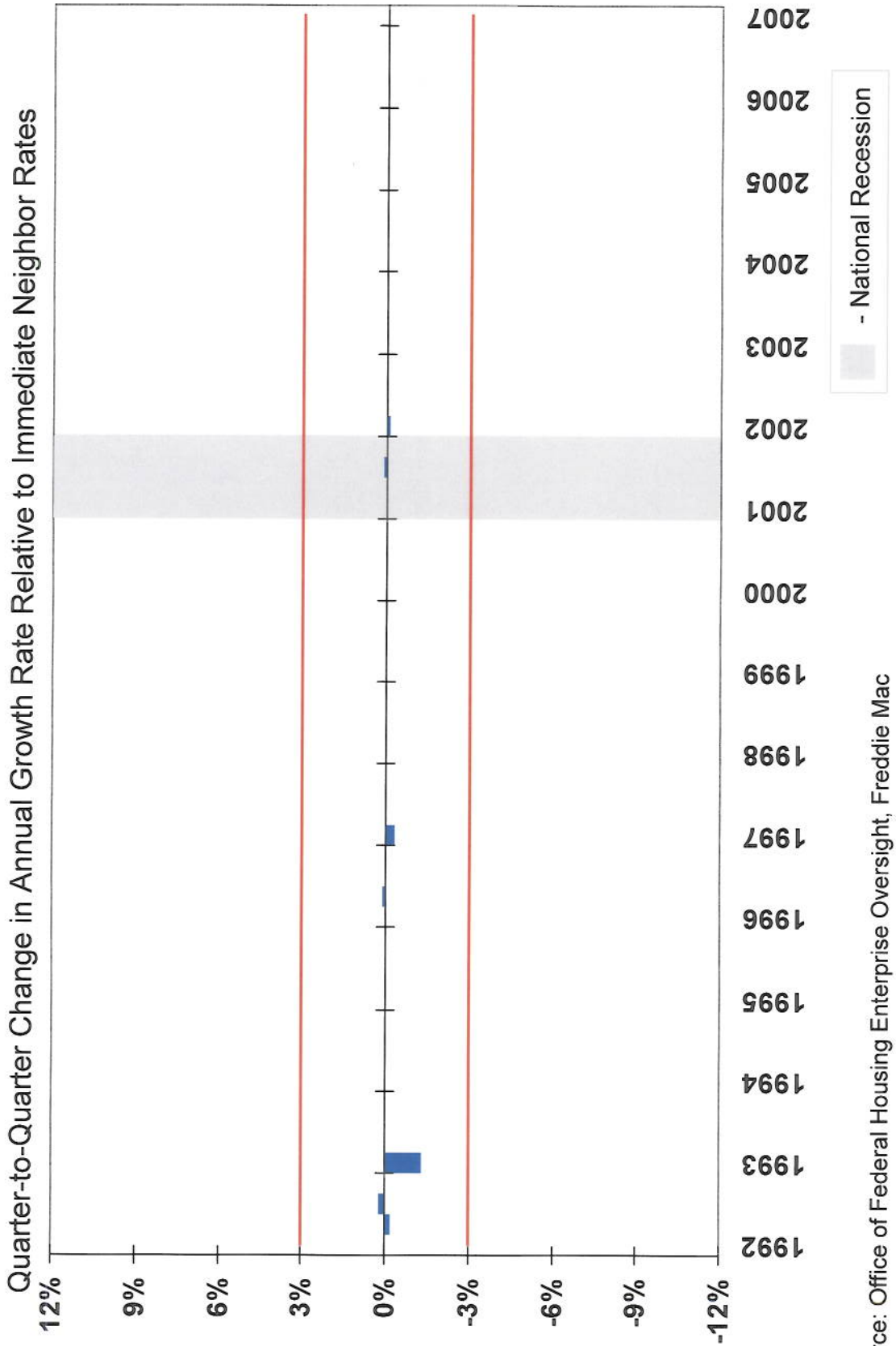
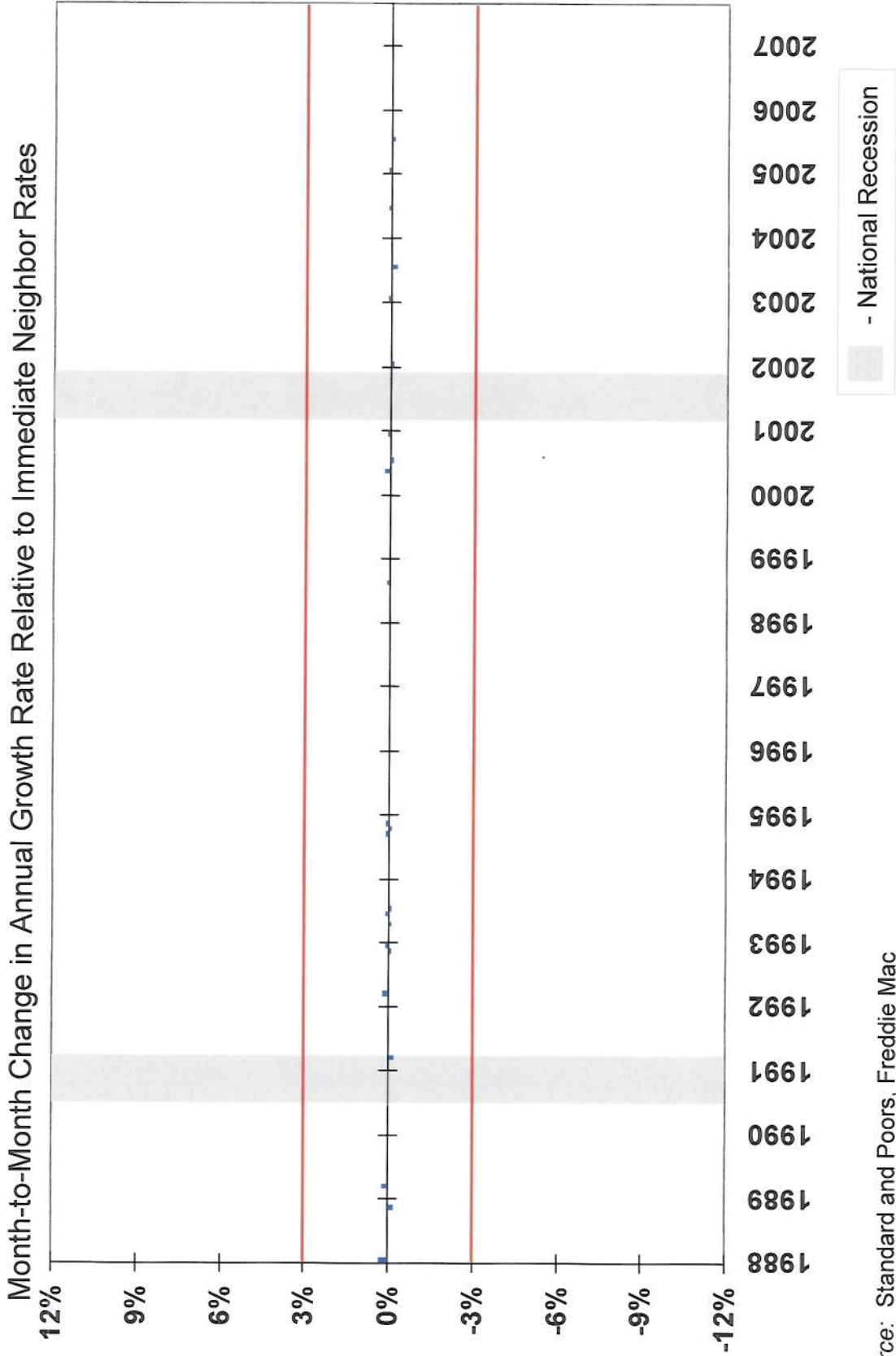


Exhibit 6 OFHEO Purchase-Only House-Price Index



Source: Office of Federal Housing Enterprise Oversight, Freddie Mac

Exhibit 7 Monthly S&P/Case-Shiller® 10-Composite Average Homes Series



Source: Standard and Poors, Freddie Mac