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November 21, 2007

Mr. Alfred Pollard
General Counsel
Office of Federal Housing Enterprise Oversight
1700 G Street NW, 4th Floor
Washington, DC 20552

Re: Revised Draft Examination Guidance on
Conforming Loan Limit, 72 F.R. 59545 (Oct. 22, 2007)

Dear Mr. Pollard:

Thank you for providing the opportunity for a second round of comments on the proposed guidance for the calculation of the conforming loan limit ("CLL"). We greatly appreciate OFHEO's demonstrated determination to solicit comments from interested parties on this mortgage-market issue, which is made particularly sensitive by the strain many lenders and borrowers are currently under and by the fragility of the housing industry. We also appreciate the accommodations that OFHEO has already agreed to make – in particular, the year's delay in enforcing any reduction in the CLL, and the increased *de minimis* threshold of 3% (which helps to ensure, but does not guarantee, that disruptive decreases in the CLL reflect genuine, sizable and persisting declines in the average price of houses throughout the country, and do not simply echo "noise" in the survey data). We submit this letter to note a technical issue regarding the proposed grandfathering rule, and to discuss our broader concerns regarding the proposal's potential impact on home buyers, lenders, and the broader economy.

1. **Grandfather Rule**

The preamble to the guidance states that, in line with comments received, OFHEO revised the guidance to provide that "if a loan has been conforming *at any time*, it cannot become non-conforming by virtue of a subsequent decline in the loan limit." While we welcome this language, we do not believe that the stated intent was successfully reflected in the operative language of the revised guidance, which remains unchanged since the July draft. The guidance provides:

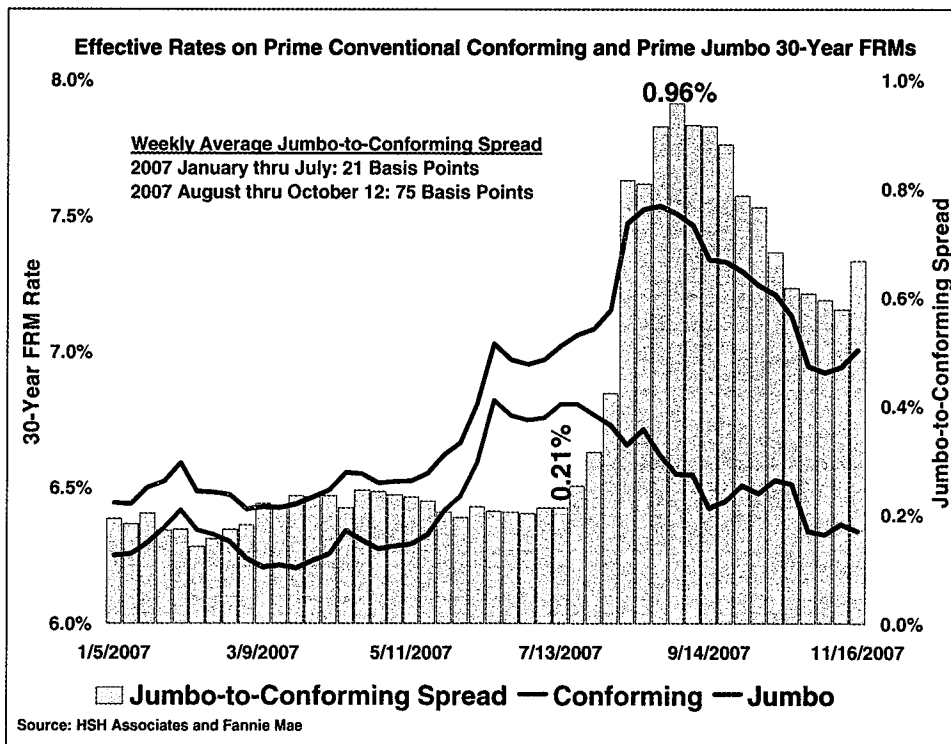
All loans that were within the conforming loan limit *at the time of origination* will continue to be deemed within the conforming loan limit during the remaining lives of such loans, regardless of whether the loan limit for any subsequent year declines to a level below the limit *at the time of origination*.

The preamble's formulation is a "once conforming, always conforming" test, which we support. The guidance language is a "conforming-at-origination" test, which – as explained in our earlier submission – we believe would be disruptive to the market. If OFHEO determines to require decreases in the CLL under defined circumstances, we suggest that the grandfathering language in the guidance be conformed to the descriptive language in the preamble.

2. Practical Implications of Lowering the Conforming Loan Limit

More generally, the welcome attempt to fix discrete parts of the proposal tends to highlight the shortcomings of the proposal as a whole. These have become much clearer as a result of the material deterioration in marketplace conditions since we filed our previous comment letter in July. The turmoil in the mortgage and housing markets that became evident in August provides support for maintaining (rather than decreasing) the CLL level during periods of declining house prices.

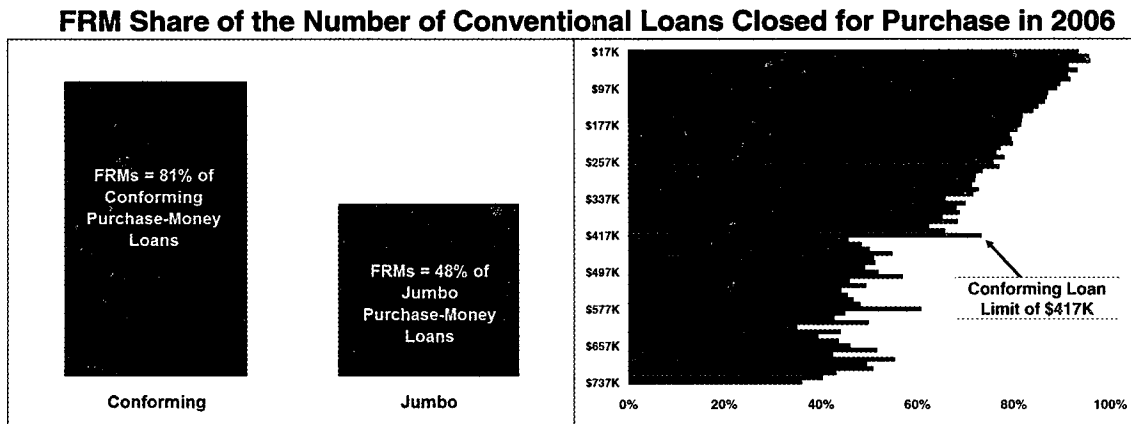
During this period, the prime conforming segment of the mortgage market has been the only relatively stable sector of the market. On September 5, the DowJones Newswire was able to write a report carrying the headline: "Conventional Mortgages Easily Available." And as the following chart shows, the spread between jumbo and conforming mortgages increased from an average of 21 basis points from January through July, to an average of 75 basis points from August through November 16. *In fact, as interest rates on jumbo loans were climbing sharply in early August, rates on conforming loans were actually declining.*



We think it unsound public policy in a period of general instability to reduce the size of the stable part of the market and, correspondingly, increase the unstable part. This is particularly the case since it would make it more difficult for borrowers in the affected price range to acquire

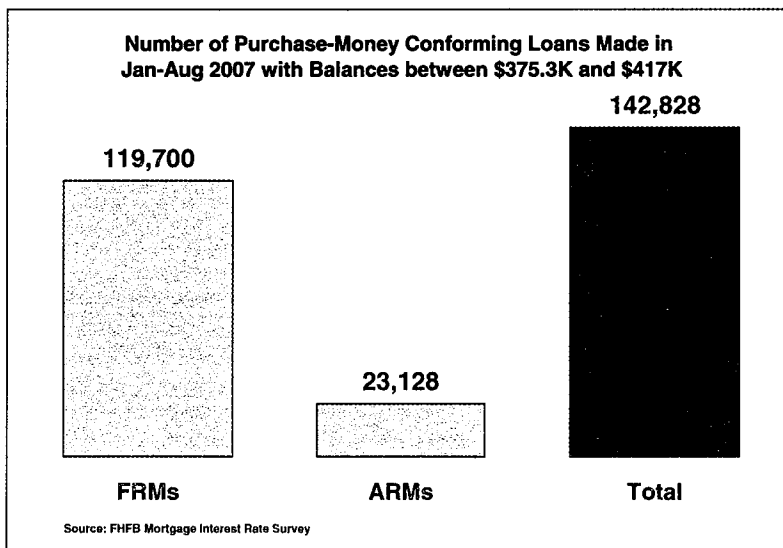
fixed-rate financing, which as Chairman Sheila Bair of the FDIC has said “provide[s] the best opportunity to long-term stability.”¹

As the following charts show, fixed rate mortgages (“FRMs”) are much more prevalent in the conforming market than in the jumbo market and there is a distinct drop-off in the percentage of loans made up of FRMs once the threshold between the conforming and jumbo markets is crossed.



Source: Federal Housing Finance Board - Monthly Interest Rate Survey

To see the potential universe of loans impacted, suppose there was a 10% decline in the CLL as a result of falling house prices. The loan limit would fall from \$417K to \$375.3K. As shown in the following chart, there were almost 143,000 purchase-money loans made from January to August 2007 within the \$375.3K to \$417K price band. Of those, 84%, or 119,700 loans, were FRMs.



¹ Statement of FDIC Chairman Sheila C. Bair before the Committee on Financial Services, U.S. House of Representatives (Sept. 5, 2007), available at www.fdic.gov/news/news/speeches/chairman/spsept0507.html.

It bears emphasis that these were purchase-money loans only; they did not include refinance loans. It is true that, if the CLL were actually to decline in such a fashion, some borrowers would put extra money down to qualify for the smaller size conforming loans. Of course, those borrowers would be the ones who had enough extra resources available to come up with the larger required down payment. It is the borrowers with fewer resources that would be forced from the conventional into the jumbo market where they would face higher rates interest rates and less access to fixed-rate financing.

In their joint July comment letter to OFHEO, the American Financial Services Association, the Consumer Mortgage Coalition and the Financial Services Roundtable opposed any decrease in the CLL as being costly and disruptive. "Considering the disruptions that would occur if the industry and consumers had to contend with a gyrating loan ceiling, the utility of decreasing the ceiling is not worth the cost."² Other commenters, including the Mortgage Bankers Association, the National Association of Home Builders, and the National Association of Realtors, expressed similar concerns.

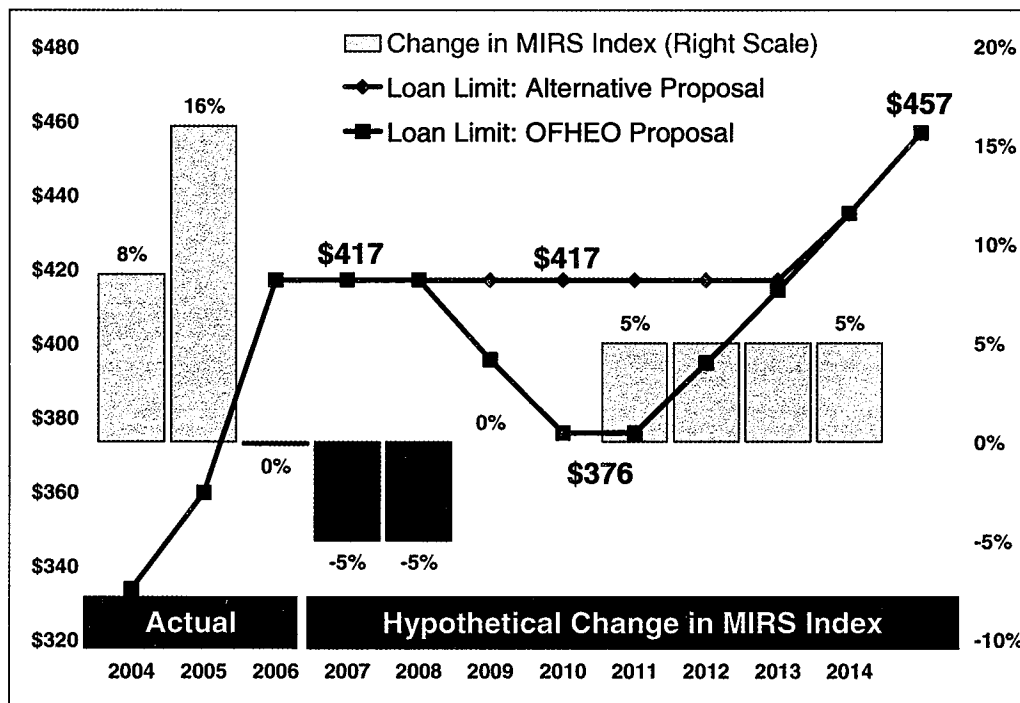
As well as having undesirable effects on the economy, OFHEO's proposed administration of a decline in the CLL introduces a great deal of complexity into the determination of the loan limit that is coincident with the unsettled market condition of declining house prices. This might not be regarded as a major concern since it is OFHEO itself that performs the necessary calculations and has to interpret its own rules for that purpose. However, because there is a lead time in closing mortgage loans, it has become the practice for market participants to try to project what the CLL will be some months in advance of its actual determination and make offers to prospective borrowers based on that projection.

We recognize that much of the complexity is an outcome of OFHEO acceding to commenters' requests (including our own) to try to ensure that any decrease in the CLL causes as little disruption as possible. What it comes down to in the end, though, is that any decrease in the CLL, no matter how it is packaged or timed, in a period of declining house prices is unavoidably disruptive and problematic. It is also unnecessary since there is a simple alternative that otherwise accomplishes the statutory goal of keeping the CLL tied to the long-term level of the Federal Housing Finance Board's housing price index ("FHFB index").

The simple alternative that avoids complexity and the recessionary impact of a CLL decrease is the alternative proposed by the trade associations noted above: Leave the CLL unchanged in years when the FHFB index declines, and resume increases in the CLL when the FHFB index has recovered to its previous maximum level. What this would mean, in practice, is that the CLL would be above the level suggested by the index in a period of house price declines but would come back into line with the index once house prices had rebounded to their previous level. The difference between the actual CLL and that suggested by the index would be a temporary timing difference that would disappear when the housing market recovered.

² This opposition to the proposal is particularly notable given that the signatories to the letter "*have taken this position even though our organizations are continuing to oppose the proposed increase in the conforming loan limit that was included in the House-passed GSE reform legislation, H.R. 1427*" (emphasis in original).

The chart below shows the level of the CLL in one scenario of declining house prices (*i.e.*, two years of hypothetical 5% declines in house prices and two years of subsequent stagnant ones) under the proposal suggested above. The level of the CLL would not be affected over the long term and the intervening recessionary impact of a decrease in the CLL during a housing slump would be avoided, which is presumably desirable.



Given the lack of difference over the long term in the level of the CLL and the potential harmful effects in the short term, the question for OFHEO may be not whether it has statutory authority to enforce a “negative increase” in the CLL but whether the statute *requires* this result; not whether it *can* reduce the CLL temporarily but whether it *should*. Addressing these issues in 1994, the General Accounting Office (“GAO”) determined that maintaining the same CLL when the FHFB index declines “is authorized by law.”³ Given that there is potentially great pain for little gain, it would seem to be the more prudent course for OFHEO not to require a decrease in the CLL when house prices decline.

3. Conclusion

In sum, the CLL administration system outlined above would have three desirable attributes:

- It would be simple and unambiguous, avoiding issues such as the grandfathering question referred to at the beginning of this letter;

³ GAO, *Housing Finance: Implications of Alternative Methods of Adjusting the Conforming Loan Limit*, at 2 (Oct. 1994); see also *id.* at 9-10. In concluding, the GAO agreed with HUD’s suggestion of using a cumulative index, which would produce results identical to those obtained with the procedure we propose above. *Id.* at 14. The GAO reasoned that this approach “would not only ensure that the limit follows the long-term pattern of home price appreciation but also would alleviate any short-term disruption to lenders and borrowers.” *Id.*

- It would not add additional recessionary pressure in a housing downturn; and
- Over the long run, it would keep the loan limit strictly in line with the index to which Congress has tied it.

Thank you for your attention in this matter. If you have any questions about our letter, please let me know.

Sincerely

A handwritten signature in cursive script that reads "Anthony J. Marra". The signature is written in black ink and is positioned below the word "Sincerely".