March 10, 2000

Ms. Anne E. Dewey
General Counsel
Office of Federal Housing Enterprise Oversight
1700 G Street, NW
Washington, DC 20552

Dear General Counsel Dewey:

The National Council of State Housing Agencies (NCSHA) appreciates the opportunity to comment on OFHEO's proposed risk-based capital requirements for Fannie Mae and Freddie Mac.

NCSHA strongly agrees that these government sponsored enterprises must maintain adequate capital, based on realistic risk scenarios. However, risk-based capital standards placed upon them must recognize and be consistent with achieving the mission of providing broader housing opportunity for which Congress created the GSEs in the first place. We urge you to recognize this tension and to balance these dual goals as you prepare your final rule.

NCSHA is a national, nonprofit organization which assists the nation's Housing Finance Agencies (HFAs) in advancing the interests of lower income and underserved people through the financing, development, and preservation of affordable housing. NCSHA's member agencies operate in every state and in the District of Columbia, Puerto Rico, and the U.S. Virgin Islands.

Many HFAs partner with Fannie Mae and Freddie Mac in a variety of ways to provide affordable housing to low and moderate income families. Innovation and affordably priced mortgage products have been the key to making these partnerships work. The success of these partnerships can be seen in Fannie Mae and Freddie Mac's extensive HFA bond and mortgage purchases, credit enhancement products, and special services, such as sharing underwriting and counseling materials with HFAs.

These GSE investments vastly exceed those of any other investor in the work of the nation's housing agencies in providing affordable housing

opportunity. OFHEO must balance marginal increases in safety and soundness against their effect on the capacity Congress intended the GSEs to have to facilitate affordable housing. To the extent new capital requirements not based on reasonable risk scenarios force GSEs to curtail the extent or increase the cost of their investment in affordable housing, the national interest will be disserved.

We have reviewed Fannie Mae and Freddie Mac's analysis of the rule's impact on their affordable housing activity if it were adopted without change. While we cannot independently verify whether their analysis is correct, the adverse consequences Fannie Mae and Freddie Mac predict compel us to call them to your attention and ask that you make every effort to avoid them.

Disincentive to Purchase Mortgage Revenue Bonds

Mortgage Revenue Bonds, such as GSEs buy from state and local housing issuers, provide discount mortgages to more than 130,000 lower income first time homebuyers each year and are a major factor in the financing of all apartment construction affordable to low income renters. The capital treatment in the proposed regulation is significantly at odds with the actual economic risk holding these securities involves. It often hits MRBs with capital charges twice. It substantially and unrealistically discounts payments GSEs receive on MRBs. An AA rated security, for example, is subject to a 20 percent reduction in value by the end of the stress period. Adding the statutorily required 30 percent management and operations risk capital premium, the capital a GSE must hold to invest in a MRB is an astounding and prohibitive 26 percent.

In cases where the underlying securities collateralizing the MRBs are Fannie Mae or Freddie Mac mortgage-backed securities, the GSEs are charged twice, once for the bonds, and again for the underlying securities.

Disincentive to Invest in Low Income Housing Credit Financed Apartments

The GSEs are by far the nation's largest investors in affordable housing partnerships financed by the federal Housing Credit. The regulation's proposed treatment would penalize this investment by failing during the stress period to amortize or convert to cash equity investments in these partnerships. The funding the stress test requires to support these assets would create a significant barrier to such investment for the GSEs.

Impaired Innovation

The Rule's preamble states that the standards should be sufficiently flexible and complete so that the stress test can be applied to new products, investments, instruments, and activities and, by so doing, sufficiently address

and accommodate innovation. Fannie Mae and Freddie Mac both assert, however, that the proposed rule does not meet this standard and that, even if it is substantially simplified, it does not accommodate new products and innovative practices in a timely manner.

Many credit risk management practices, such as loss mitigation techniques and credit scores that better predict borrower behavior, have been in the marketplace for quite a while, but are not yet reflected in the proposed model. Nor is it at all clear how a number of other underwriting experiments aimed at increasing homeownership Fannie Mae and Freddie Mac are undertaking would be treated under the rule. The rule must address the uncertainty as to their capital treatment.

Other aspects of the regulation also threaten GSE affordable housing activity. These include:

- A significant proportion of GSE multifamily investment relates to achieving their mandated affordable housing goals. Both GSEs are concerned that the cost of executing multifamily business will increase dramatically under the rule, reducing their efforts to increase affordable rental opportunity for low and moderate income households. Beyond the higher cost the regulation imposes, its multifamily capital requirements are also very unstable and difficult to predict. Thus, both GSEs would have to hold a sizable capital cushion against unpredictable future requirements.

- Both GSEs argue that many forms of credit enhancement are rendered almost worthless under the rule because the financial haircuts it requires are so extreme and are more stringent than even the worst historical experience. These haircuts may devastate new product development for the affordable housing market since most, if not all, new GSE initiatives depend upon some form of risk sharing.

  The rule imposes a very high penalty on loss-sharing arrangements with Delegated Underwriting and Servicing lenders, many of whom are unrated. Penalties on payments from non-rated lenders are particularly harsh, beginning immediately in the stress scenario and increasing to 80 percent by the end of the ten-year test. This very effective lender relationship accounts for a significant portion of Fannie Mae's multifamily loan portfolio. Thus, the regulation as currently specified will have a significantly adverse affect on its ability to execute multifamily business.

- Low downpayment loans are the lifeblood of many of both GSEs' initiatives targeted to first-time homebuyers and the affordable housing

market in general. The regulation greatly distorts the amount of capital required for low downpayment loans, thus penalizing their participation in this area.

Creating capital requirements which ensure Fannie Mae's and Freddie Mac's financial soundness but emasculate their capacity to meet their affordable housing mission will be a Pyrrhic victory, a public disservice, and frustrate Congress' purpose in creating the GSEs in the first place. We are confident you share this view and will take it into consideration as you prepare the final risk-based capital rule.

Sincerely,

[signed: John T. McEvoy]

John T. McEvoy
Executive Director