March 9, 2000

Alfred M. Pollard
General Counsel
Office of Federal Housing Enterprise Oversight
1700 G Street N.W., 4th Floor
Washington, D.C. 20552

Re: OFHEO GSE Capital, proposed rule, RIN 2550-AA02

Dear Mr. Pollard:

WMF urges simplification of the model and correction of distortions related to multifamily risk.

Complexity of model. The model is overly complex in the number of variables used to model risks of multifamily loans and in the treatment of those variables. For example, the model includes prepayment assumptions on loans during the yield-maintenance period. Modeling prepayments in the pre-balloon period adds complexity with little effect on risk. Call protection in the form of yield maintenance and lockout provisions is uniformly used by the GSEs; should a loan prepay, the GSEs receive the equivalent to the lost income in the form of yield maintenance fees.

Distortions. The model also contains a number of distortions.

a) OFHEO realizes that the benchmark period is an anomaly for multifamily loans, and has made a number of adjustments, particularly on default experience in the benchmark period. However, the model uses vacancy rates percentage changes in rents from the benchmark period to update property financials (DCR and LTV) throughout the stress period. The benchmark period includes the early 1980s when many multifamily properties were built for the tax advantages they produced, not the positive cash flows. This resulted in significant over supply of multifamily housing with resulting high vacancy rates and, often, negative changes in rents. The 1986 Tax Act fundamentally changed the economics of multifamily housing resulting in a high level of defaults. However, the overbuilding from the early 1980s caused vacancy and rent change anomalies that took many years to overcome. By using benchmark period vacancy rates and changes in rents, the risk of loans, post 1986 Tax Act, is distorted.

b) We agree with OFHEO's statement that not all loans terminate at or before the balloon point. The model, however, requires that DCR and LTV values be sufficient to qualify for a new mortgage (LTV $\leq$ .80 and DCR $\geq$ 1.20). We believe that this distorts prepayments by assuming that these loans are not extended. If the property has weak financials, lenders are unwilling to initiate foreclosure on loans that have been making payments. In fact, lenders are often reluctant to force a foreclosure unless a default is imminent, e.g. LTV < 100 and DCR < 1.00.

c) The loss severity rates used in the model are excessively high, largely due to the limited data on which they are based. The experience of both companies as well as data published in several academic studies provide support for this comment. We recommend that the actual experience of both companies, and perhaps other financial institutions, be taken into account to set a more realistic rate.

Haircuts. Excessively severe haircuts for counterparty risk are a generic problem with the rule (see Comment 7, part f), but have the potential to impact the Fannie Mae DUS program specifically. The DUS program is Fannie Mae's primary multifamily origination channel and is Fannie Mae's primary channel for multifamily affordable housing finance. Fannie Mae's DUS lenders retain first loss exposure on originated mortgages. WMF is one of 26 Fannie Mae DUS lenders. This retained exposure is a critical element in assuring the credit quality and performance of the mortgages. The success of this approach is reflected in Fannie Mae's experience. Over the 12-year history of the program, DUS mortgages have performed measurably better than non-DUS mortgages.

The proposed rule assumes a "BBB" equivalent standard for unrated counterparties. The haircuts, specifically at the "BBB" level, cause a substantial overcapitalization for credit risk in comparison to financial market standards. In the main, Fannie Mae's DUS lenders are smaller privately held companies that have not been rated and, thus, fall into this category. This overcapitalization creates disincentives and could lead to pricing changes and/or reduction in demand, thereby negatively affecting the supply of multifamily and affordable housing finance.

WMF urges OFHEO to treat Fannie Mae's counterparty exposure to its DUS lenders as a separate category apart from generic counterparty risk.

The DUS program is Fannie Mae's primary origination channel for multifamily finance. Fannie Mae is the largest provider of multifamily finance in the nation, with total originations in 1999 of $12.4 billion. To the extent that the OFHEO rule requires capital in excess of that necessary to cover reasonable risks, it could negatively influence Fannie Mae's interest and willingness to lend in this area, thereby affecting supply.

The generic assignment of counterparty risk in the model does not take into account the many standards and safeguards imposed by Fannie Mae on its DUS lenders to assure coverage for their ability to meet risk-sharing obligations. These include:

- Net worth minimums tied to portfolio growth
- Liquidity standards
- Specific liquidity reserves maintained with a trustee
- Loan loss reserves
- Rigorous oversight and risk monitoring
- Access to servicing portfolio value

The WMF recommends that OFHEO specifically consider DUS counterparty risk separately from other forms of counterparty risk in the proposed rule.

Sincerely,

[signed: Shekar Narasimhan]

Shekar Narasimhan