January 17, 2002

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

Re: RIN 2550-AA23, Risk-Based Capital

Dear Mr. Pollard:

On behalf of the more than 800,000 members of the NATIONAL ASSOCIATION OF REALTORS®, I am pleased to submit comments to the Office of Federal Housing Enterprise Oversight (OFHEO) regarding proposed amendments to Appendix A Subpart B of 12 CFR Part 1750 Risk-Based Capital. The NATIONAL ASSOCIATION OF REALTORS® represents real estate professionals involved in all aspects of the industry. Our membership includes professionals involved in residential and commercial real estate as well as the ancillary real estate services that are critical to delivering quality service to our clients and business partners. The NATIONAL ASSOCIATION OF REALTORS® is dedicated to fulfilling our nation's policy objective of providing housing opportunities that meet the full range of housing demands.

The NATIONAL ASSOCIATION OF REALTORS® recognizes that OFHEO's proposed amendments to the Risk-Based Capital regulation is a continuation of its intention to review the operation of the Enterprises stress test and its components and to evaluate the need for revisions on an ongoing basis. We support OFHEO's commitment to this effort. Though REALTORS® are not directly affected by the regulation, we maintain a keen interest in the consequences of the Risk-Based Capital rule and its affects on Fannie Mae and Freddie Mac. REALTORS® consider the role of these government-sponsored enterprises (GSEs) as fundamental to meeting the demand for homeownership and housing.

As REALTORS® consider the proposed amendments to the Risk-Based Capital regulation, two principal issues stand out. The first issue is the differential in haircuts between AA- and AAA-rated mortgage insurance. The second issue is the treatment of the multifamily model. Our specific comments address these issues. Our comments will not delve into the technical aspects of OFHEO's modeling, but will focus instead on the potential consequences of the modeling.

Proposed Changes to Counterparty Haircuts

The Risk-Based Capital regulation requires Fannie Mae and Freddie Mac to hold capital against mortgages that carry mortgage insurance. The amount of capital required varies according to the rating of the mortgage insurance provider. As proposed, Fannie Mae and Freddie Mac would be require to hold two and one-half times as much capital against mortgages insured by AA-rated mortgage insurance companies as compared to mortgages insured by AAA-rated mortgage insurers – a multiple unrelated to differences in risk.

The NATIONAL ASSOCIATION OF REALTORS® is pleased to note that OFHEO proposes revisions to the risk-based capital regulation that narrow the disparate treatment of AAA- and AA-rated mortgage insurance companies. OFHEO is now proposing to reduce the haircut differential between AA- and AAA-rated mortgage insurance from 10 percent to 5.25 percent, to lengthen the phase-in period for the haircut from five to ten years, and to utilize recovery rates in calculating the final capital haircut. While these steps move the regulation in the right direction, they are not complete.

The differential in capital requirements between AA- and AAA-rated insured loans will result in higher capital costs for all mortgages. The burden of these higher costs will affect some borrowers more than others. Those most likely to be affected are borrowers trying to achieve homeownership with a low downpayment and borrowers who have low or moderate incomes.

REALTORS® are concerned that the higher capital requirements will reduce housing opportunities and ultimately homeownership. This unintended consequence contradicts the long-standing commitment of the U.S. government and the real estate industry to expand affordability and housing opportunity for homebuyers that would have high loan-to-value (LTV) mortgages, or who are among the growing number of low- and moderate-income borrowers.

The capital differentials raise the prospect of a significant advantage for AAA-rated mortgage insurers over AA-rated mortgage insurers. The anticipate concentration of pricing power into the two AAA-rated insurers will increase the cost of homeownership. There is the real prospect that contraction within the mortgage insurance industry will be accelerated as a result of the proposed amendment. The higher capital requirements for AA-rated mortgages provide a natural incentive for the GSEs to shift their business from lower cost AA insurers to higher cost AAA insurers. REALTORS® believe this is an unacceptable consequence of the proposal.

The NATIONAL ASSOCIATION OF REALTORS® is one of several organizations that support an industry comment letter addressing this aspect of the Risk-Based Capital regulation amendments. REALTORS® direct your attention to the industry letter because it addresses more fully our concern, and the concern of many others, about the availability of affordable mortgage loans for homebuyers. We would note that the NATIONAL ASSOCIATION OF REALTORS® chose to join in the industry letter to highlight the fact that our primary concern is the proposed regulation’s consequences for homeownership opportunity.

REALTORS® urge OFHEO to adopt amendments that would eliminate the differential between AA- and AAA-rated mortgage insurance companies. In additional, REALTORS® support the 10-year phase-in of the capital haircuts.

Proposed Multifamily Model Changes

OFEHO proposes technical changes and adjustments in the treatment of multifamily loans that refine the measurement of risk for Fannie Mae and Freddie Mac when these GSEs invest in multifamily loans. Specifically, OFHEO proposes reducing the BBB or unrated lender haircut from 40 percent to 28 percent and increasing the phase-in from five years to ten years. Initial changes in the vacancy rate, making the underwater debt service coverage flag operative only after the Debt Coverage Ratio (DCR) falls below 0.98, and flattening the default curve are refinements to the assumptions that would reduce the artificial volatility of risk-based capital over the life of a loan.

The proposed amendment retains the impact of a separate "ARM Flag" in projected defaults, which assumes that ARM borrowers are much more likely to default than fixed rate borrowers, even if interest rates do not increase. There remain inherent assumptions about ARM products, perhaps driven by the statute establishing the stress test, that anticipate differences between ARM and fixed-rate (FRM) loans beyond interest rate risk. The default rate assumptions in the up-rate scenario are high and uneconomic in relation to the level of risk-based capital required to be held against the ARM product. We would note that federally regulated banks and thrifts do not have such capital standards based on such high expected-default levels as 40 percent to 45 percent.

Treatment of ARM and FRM borrowers is an important consideration as Fannie Mae and Freddie Mac address recourse transactions and their efforts to meet affordable housing goals. A central concern is that the multifamily amendments may create or exacerbate market distortions as the GSEs work to comply with the regulation.

OFHEO's commentary explaining the decision to retain the ARM Flag is instructive. "OFHEO believes that, given the Enterprise data, the proposal handles a very complicated issue fairly and with statistical soundness and good judgment. If, in the future, Enterprise data show no difference between ARM and FRM risk, other than the adverse effect of rising interest rates on ARM payment and ARM DCR, OFHEO may revisit this issue." REALTORS® would urge OFHEO to continue working on this issue, and postpone punitive differentials until the data support firm conclusions. The matter of treating risk associated with ARM borrowers should be considered further.

Conclusion

The proposed amendments to the Risk-Based Capital regulation are testament that the regulation is a work in progress. We believe that the proposed refinements to the regulation are made with the best intentions to hold the GSEs accountable and to make the regulation workable. REALTORS® commend OFHEO for taking into account a number of arguments and insights about its regulation. Most evaluations by those much more intimately knowledgeable about OFHEO's modeling and the amendments concur that the proposed changes make the regulation better, though there is still work needed.

For REALTORS® the overriding concern about the Risk-Based Capital regulation and its amendments is how will the cost of housing and homeownership be affected. When considering the potential impact on the amount of capital that the GSEs must hold for loans insured by AA-rated mortgage companies versus those insured by AAA-rated companies, REALTORS® must conclude that there are undesirable consequences. The immediate impact is that housing costs for high LTV and less affluent borrowers will increase. A secondary effect is the GSEs themselves will be forced, over time, to alter their relationships with AA-rated mortgage companies that could result in a contraction of business and limitations on the financing choices available to homebuyers. REALTORS® urge OFHEO to reject the propose amendments that would have these results.

While the proposed technical changes and revisions to underlying assumptions about multifamily loans raise the prospect that the differing adjustable and fixed rate loan products will be treated more even-handedly, there is still work to be accomplished. REALTORS® urge OFHEO to proceed with caution in making revisions to the multifamily model. Reexaminations of the basic assumptions about risks associated with multifamily investment are certainly appropriate. We believe that OFHEO should keep its dialogue with Fannie Mae and Freddie Mac open and constructive regarding multifamily risk measurement.

It is my hope that the perspective of the NATIONAL ASSOCIATION OF REALTORS® will be considered as OFHEO proceeds to finalize the proposed amendments to the Risk-Based Capital regulation.

Sincerely,

Martin Edwards, Jr., CCIM