

January 17, 2002

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

Re: Proposed Changes to the Risk-Based Capital rule for Government Sponsored Enterprises (GSEs)

Dear Mr. Pollard:

I am the Chairman and CEO of Reilly Mortgage Group, Inc., a privately held mortgage banking firm focused on providing financing for multifamily housing throughout the United States. Reilly is both a Freddie Mac Program Plus lender and, through its affiliate Reilly Mortgage Capital Corporation, a Fannie Mae DUS lender. As such, Reilly is directly affected by changes to the Risk Based Capital Regulations. We appreciate the opportunity to comment on the proposed changes to multifamily portion of the September 13th final rule.

First, we would like to thank OFHEO for moving promptly to correct problems with the original rule by addressing many of the concerns expressed by myself and by others in the mortgage banking industry. The proposed corrections more closely align capital requirements with the associated risk of specific programs, while reducing potential competitive disadvantages. We would ask, however, that you consider further improvements to the rule.

In the area of counterparty risk, the proposed haircut and phase-in modifications are appropriate; however, the level of the haircuts remains high relative to the risk. The difference between levels also remains too high. The counterparty default rates were based on the default rates of bonds issued in 1929, 1930 and 1931, during the Great Depression. This is a severe standard and is inconsistent with the stress periods used for other provisions in the rule. We would recommend that OFHEO select bond default and security rates consistent with the stress periods used for the other provisions which would set the counterparty default rates proportionately between the Depression experience and more recent experience.

OFHEO has shown a willingness to take into account factors that would permit a rating higher than BBB for unrated DUS lenders. The rule appears to require fully funded reserve accounts equal to 1% of unpaid balances pledged to the Enterprise as the sole consideration by the OFHEO Director in awarding a higher rating. We would urge OFHEO to also include capital and the value of servicing as support for an improved rating. Fannie Mae DUS servicing rates include a large premium for the shared risk assumed by the lender. This premium would be available to Fannie Mae to support the counterparty risk. Fannie Mae explicitly recognizes this value when computing the lender's required capitalization. Not giving credit to the servicing would ignore a critical source of support for the risk. The current rule would allow Fannie Mae to increase the capital requirements for DUS lenders, which would directly disadvantage privately held companies.

We also support the proposed changes to the ARM flag and the "underwater DSCR" flag in the model. These changes mitigate the punitive level of capital assigned to these loans under the original rule and reduce the volatility of required capital. We would urge OFHEO to continue to examine these capital requirements. The combination of the way these variables are modeled and the decision OFHEO has made elsewhere in the rule on the shape of the yield curve will likely have the effect of sharply curtailing the multifamily ARM market.

Finally, we support OFHEO's effort to account separately for loans to projects for low income households, including loans to projects accepting Section Eight rent subsidies. This housing serves a critical need. The GSEs will continue to be leaders in providing financing to affordable housing as long as the capital requirements are not so harsh as to provide disincentive for this area of lending.

In conclusion, we at Reilly Mortgage firmly support OFHEO in its mission to establish capital standards which accurately reflect the risk of the GSE operations. We also support establishing standards which are fair, consistent and do not create competitive disadvantages for Fannie Mae, Freddie Mac or the many companies that do business with the GSEs.

Reilly Mortgage Group, Inc. is available to work with OFHEO on any policy or data issues on an ongoing basis in order to continue to improve the accuracy of the rule.

Thank you for your consideration.

Sincerely,

Terry C. Havens
Chairman