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Melvin L. Watt
Director
Federal Housing Finance Agency
Constitution Center
400 7th Street SW
Washington, DC 20219

Submitted via: https://www.fhfa.gov/AboutUs/Contact/Pages/Request-for-Information-Form.aspx

Dear Director Watt:

On behalf of the 1.3 million members of the National Association of REALTORS® (NAR), I submit this letter in response to the Federal Housing Finance Agency's (FHFA) notice of proposed rulemaking on *Enterprise Capital Requirements*. NAR applauds the FHFA in its work to further reform of the secondary market for housing finance including this proposed capital framework. However, in striking the right balance between their public missions and protecting taxpayers, NAR believes that the FHFA must allow Freddie Mac and Fannie Mae (the GSEs or the Enterprises) to do more to meet its public mission of supporting liquidity and broad access.

The National Association of REALTORS® is America's largest trade association, including NAR's five commercial real estate institutes and its societies and councils. REALTORS® are involved in all aspects of the residential and commercial real estate industries and belong to one or more of some 1,200 local associations or boards, and 54 state and territory associations of REALTORS®. NAR represents a wide variety of housing industry professionals, including approximately 25,000 licensed and certified appraisers, committed to the development and preservation of the nation's housing stock and making it available to the widest range of potential homebuyers.

REALTORS® believe that homeownership is an integral part of the American Dream. Critical to the future of homeownership is a secondary mortgage market that is a reliable and affordable source of mortgage capital for consumers, in all types of markets.

Updating the Capital Framework

Prior to the crisis, the Enterprises were required to comply with a capital rule that consisted of a bifurcated leverage ratio. The GSEs were required to maintain 2.5 percent capital against assets held in portfolio and just 0.45 percent against assets in trust, such as mortgage-backed securities (MBS) guaranteed by the GSEs.

In its proposed capital framework, the FHFA recommends the GSEs comply with the greatest of three rules. First, the GSEs would have a risk-based capital rule that would be applied to all assets whether in portfolio or in trust. This rule would take into account credit risk, market risk, operation risk, and include a "going concern"

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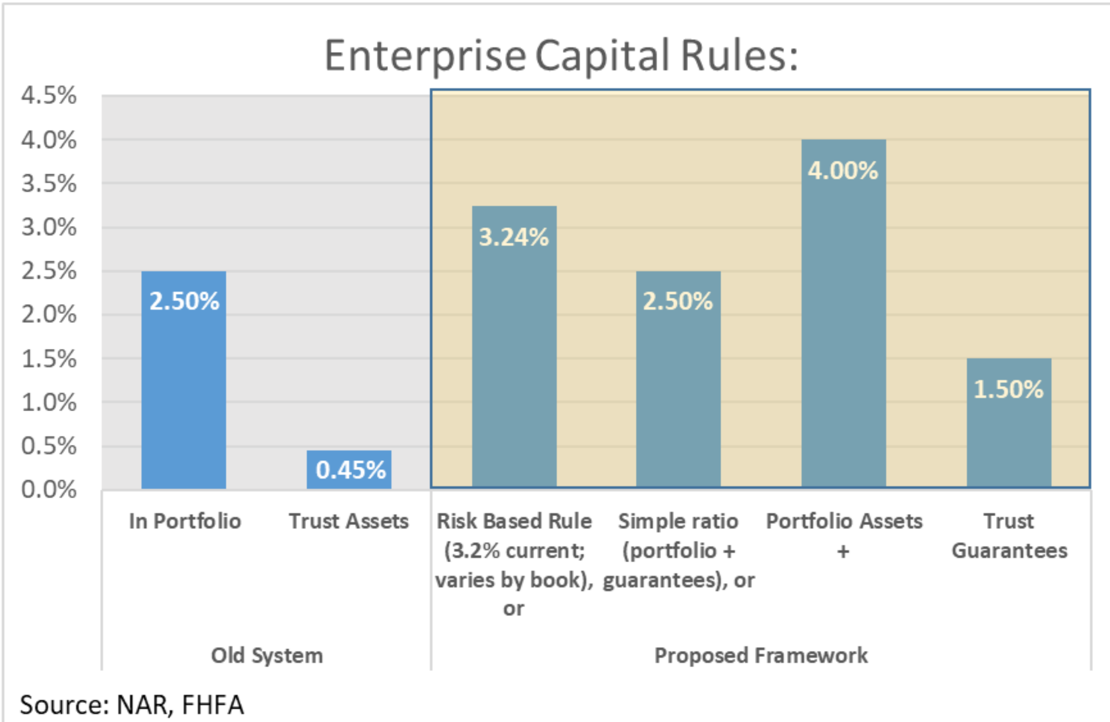
buffer. The going concern buffer is intended to ensure the GSEs have sufficient capital to operate during a stress event.



The GSEs would also be required to comply with two other ratios; a simple leverage ratio of 2.5 percent on all assets and a bifurcated ratio of 4 percent capital for portfolio assets and 1.5 percent for assets in trust. The GSEs would have a binding capital requirement of the greatest of the three ratios. In doing so, the FHFA is attempting to set a floor on capital requirements to ensure stable funding of the Enterprises during varying environments. In particular, the FHFA noted a scenario under the risk-based approach where the enterprises would shed capital late in a housing cycle to reflect strong home price growth, just when the threat of a market decline is greatest. The greatest-of-three rule would prevent the enterprises from sheading capital below some level defined by one of the other more simple ratios.

Pro-cyclical Capital and Public Role

NAR appreciates the FHFA's efforts to solidify the GSEs' ability to serve the market in both strong and stress environments through self-sufficiency. The introduction of a going-concern buffer should help to achieve this outcome by suppling a minimal level of capital for operations during stress. However, NAR is concerned about the new practice of reevaluating the portfolio based on current loan-to-value (LTV) and credit characteristics. As home prices fall in a stress event, LTVs on mortgages in portfolio or in trust will rise. Under the risk based capital requirement, the required capital would rise forcing the GSEs to raise guarantee fees in order to build capital against older vintages of business precisely when "raising new capital during a period of severe stress…would be expensive if not impossible."[1] In a similar vein, the FHFA has proposed to allow the GSEs to create measures evaluating the quality of credit counterparties as well as discounting of the use of future fee income. In so doing, the FHFA appears to limit credit for a source of capital that may be more resilient in an economic downturn.

The pro-cyclicality of pricing is thus likely to have a stronger and potentially detrimental impact on low and moderate homebuyers, as well as first-time homebuyers. Because pro-cyclical nature of this capital structure is likely to affect demand, the impact would spread to the broader market by way of lower price growth.

[1] Federal Register. Vol. 83, No. 127, pp. 33334

The GSEs should consider a counter-cyclical capital buffer or some other structure for supporting the Enterprises countercyclical role in the market. Alternatively, FHFA could lower its leverage ratios to those stipulated in the Safety and Soundness Act. As noted in the request for comment, "the Safety and Soundness Act authorizes the FHFA to set a higher leverage ratio than the minimum required by the statute, and this proposed rule, under either of the proposed alternatives, would do so." Thus, just as the FHFA would have the authority to raise the ratios in a countercyclical manner in advance of a stress event, it could lower to the floor established in the Safety and Soundness act in order to support the market during a stress period. Regardless of how it is achieved, the FHFA should have a clear set of procedures for the GSEs to effectively supporting is countercyclical mission.

Finding the Correct Capital Level

The FHFA has outlined a thoughtful approach to setting both the risk-based rule and leverage ratios. As evidence of the robustness of the proposed rule, the FHFA estimated the required risked-based capital needed for mortgages that were in the GSEs' portfolios during the 3rd quarter of 2007 and which comply with current purchase-eligibility requirements. While this analysis strips out risky products as defined by the Qualified Mortgage (QM) exemption to the Ability to Repay Rule (ATR), it does not eliminate the effect that these risky loans had on eligible loans held in portfolio. Furthermore, this estimation does not take into account increased regulation on the housing ecosystem from Basel III, the Know Before You Owe rule, Regulation AB, as well as the revolution in data sharing and transparency that investors now use to value MBS and insurance products. In not recognizing this impact, the FHFA adds a significant buffer against losses to accompany its own use of a stronger price decline assumption for the modeled stress event as well as excluding future revenues from the capital rule. NAR is concerned that the significant caution taken in creating a conservative rule mutes or may hinder the Enterprises' ability to support their public mission.

Risk-based Capital's Impact and a Public Mission

The Office of Management and Budget (OMB) recognizes that the GSEs have a "public mission to provide stability in and increase the liquidity of the residential mortgage market and to help increase the availability of mortgage credit to low- and moderate-income families and in underserved areas."[2] In updating the capital framework, the FHFA has attempted to create a set of risk-based ratios and leverage rules that provide adequate capital in aggregate to cover risks to the GSEs' portfolio as well as to allow them to continue to operate during a stress event. REALTORS® appreciate this effort but are concerned that in specifying capital for individual borrower profiles, those individual capital profiles will in turn be used to specify guarantee pricing for individual borrowers. Without an accompanying framework to specify how the GSEs should allocate capital or pricing to support the public mission, these risk-based capital standards could increase the cost significantly for borrowers that the GSEs are tasked with supporting.

The framework would also make it difficult for the GSEs to provide capital for innovations in housing finance to support the mission of market liquidity. One solution might be to use the 75 basis point going concern buffer to shift support to particular groups, such as low and moderate income borrowers. Several GSE reform proposals have suggested using a 10 basis point incentive or access fee in such a manner.[3] Thus, supported groups would pay below the average buffer charge of 75 basis points, while others pay slightly more. The 75 basis point buffer would provide more flexibility and greater impact while simultaneously having the advantage that mortgagees likely paying a greater share would be more likely to perform through a stress event and refinance back into the GSEs program, thereby supporting the going concern. Like the countercyclical role, regardless of how it is achieved, the FHFA should have a defined procedure for the GSEs to support this facet of the public mission.

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[2] https://www.whitehouse.gov/wp-content/uploads/2018/02/gov-fy2019.pdf

[3] See Laurie Goodman and Ellen Seidman, "Johnson Crapo GSE Discussion Draft: A Few Suggestions for Improvement". Urban Institute. 2014.

In a similar vein, REALTORS® are concerned the FHFA has chosen to include in its risk factors for single family mortgages, the status of the borrower as single or multiple. With the aging of the U.S. population and decline in first-time homebuyer purchases, the share of single homebuyers has increased dramatically over the last decade and stood at 28 percent in 2018, according to NAR's Profile of Home Buyers and Sellers. The U.S. tax system has striven for years to equate the tax burden for singles to those of married borrowers and vice versa. It would therefore be inappropriate for entities tasked by the U.S. government with a public mission and benefiting from its support, to discriminate between these two groups.

Conclusion

The FHFA's proposed capital framework marks an important step in the continued changes necessary to reform the secondary market for housing finance. However, achieving safety and soundness should be done in such a way as to not jeopardize the Enterprises public mission of liquidity, stability, and broad access. Furthermore, changes to the GSE's capital framework should be flexible enough to accommodate different proposals under the broader GSE reform debate. NAR appreciates the opportunity to provide input and look forward to continuing to work together on these important issues. If you have any questions, please contact me or NAR Senior Policy Representative, Ken Fears, at 202-383-1066 or KFears@REALTORS.org.

Sincerely,

John Smaby
2019 President, National Association of REALTORS®