August 31, 2020

Alfred M. Pollard
General Counsel
Attention: Comments/RIN 2590–AA95
Federal Housing Finance Agency
Eighth Floor, 400 Seventh Street SW
Washington, DC 20219

Re: Proposed Rule on Enterprise Regulatory Capital Framework
RIN 2590-AA95

Dear Mr. Pollard,

The CRE Finance Council (CREFC) is pleased to provide comments on the Federal Housing Finance Authority's (FHFA) proposed Enterprise Regulatory Capital Framework (Proposal).[1]

CREFC is comprised of over 300 institutional members representing U.S. commercial and multifamily real estate investors, lenders, and service providers – a market with an estimated $4.6 trillion of commercial real estate (CRE) debt outstanding.[2] CREFC facilitates the development of best practices, industry standards, and federal policy across the commercial real estate markets, all with the goal of promoting strong and liquid debt markets.

We appreciate the opportunity to respond to this Proposal and will focus our comments on two areas of critical importance to our members:

- Capital requirements for multifamily exposures, and
- Credit risk transfer (CRT) transactions.

In addition to our recommendations in these critical areas (detailed below), we request that the FHFA release additional information regarding the data and assumptions underlying the Proposal and provide further opportunity for public comments based on that information.

---

[1]Federal Housing Finance Agency, Notice of Proposed Rulemaking, *Enterprise Regulatory Capital Framework*, 85 Fed. Reg. 39274 (June 30, 2020).
[2] Federal Reserve, as of December 31, 2019.

28 W 44th St. Suite 815, New York, NY 10036
900 7th Street NW, Suite 501, Washington, DC 20001
Tel: 202.448.0850 ● www.crefc.org

Introduction

As stated in the Proposal, the FHFA seeks to ensure that Fannie Mae and Freddie Mac (the Enterprises) are sufficiently capitalized, allowing them, both during and after conservatorship, to operate in a safe and sound manner and fulfill their statutory mission to provide stability and ongoing assistance to the secondary mortgage markets across the economic cycle. We applaud these goals, particularly the aim to protect American tax payers. **In addition, we urge the FHFA to balance imposition of appropriate capital requirements on the Enterprises and any such requirements’ potential impact on the multifamily housing market, particularly on the Enterprises’ affordability mission.**

CREFC Supports Appropriately Sized Capital Requirements. The Proposal would, inclusive of its proposed buffers, require the Enterprises to raise approximately $100 billion in additional capital compared to the FHFA’s 2018 proposal. Under the earlier proposal, the Enterprises would have been required to hold $137 billion in risk-based capital compared to the required $234 billion in risk-based capital under the current Proposal. (As noted in the Proposal and discussed further below, the leverage ratio would serve as the binding constraint and require the Enterprises to hold $243 billion in total capital.[3])

Capital requirements appropriately tailored to institutional and systemic risk and that allow for more even competition across lenders have broad support among CREFC members. However, unnecessarily stringent capital requirements could reduce the return on investor equity, making it that much more difficult to raise the capital needed to exit conservatorship and to ensure each Enterprise’s ability to fulfill its statutory mission across the economic cycle, particularly during periods of financial stress.

Additionally, in order to address this return on equity concern, the Enterprises likely would have to raise guarantee fees, resulting in higher mortgage costs for American borrowers. We therefore urge the FHFA to carefully balance the need for a strong safety-and-soundness approach with potential unintended negative consequences, particularly as it relates to the Enterprises’ core mandate of supporting the availability of affordable housing.

As a general matter, CREFC members believe that any Enterprise capital requirements should be appropriately calibrated for the risk that is held and should be mindful of not creating outsized advantages or disadvantages for the Enterprises relative to private lenders. For instance, some members have raised concerns about the combined effect of the aggressive capital buffer levels, high risk-weight floors, and the high proposed leverage ratio. As acknowledged in the Proposal, the proposed four percent leverage ratio often would be the binding constraint vis-à-vis the risk-based capital requirement[4]. The leverage ratio is calculated based on total assets and, unlike risk-based capital requirements, does not reflect varying levels of risk within that pool of total assets.

Relatedly, to be appropriately tailored to various risks, it is critical that risk-based capital requirements be based on accurate data and assumptions. Again, we urge the FHFA to share additional detail

[3] All estimates are based on calculations as of September 30, 2019.
[4] Including 2.5% Prescribed Leverage Buffer Amount.

regarding the data and assumptions it utilized to determine the capital requirements for multifamily exposures in the Proposal. This will allow market participants to better understand the methodology underlying the Proposal and offer more detailed and supported comments.

CREFC's Core Recommendations:

With the foregoing general considerations in mind and as discussed in further detail below, CREFC urges the FHFA to consider the following recommendations:

- **Rebalance multifamily lending to allow for heightened diversity among lenders, keeping in mind the Enterprises' mission regarding affordable housing.** CREFC members generally support greater diversity in multifamily lending, including increased private-sector participation.
- **Adjust the proposed risk weights**, particularly those for multifamily exposures, to more accurately reflect the risk being addressed.
- **Develop a countercyclical multifamily adjustment**. Given balloon risk at maturity, a countercyclical adjustment is actually more important for multifamily than it is for single family.
- **Rethink the Proposal's approach to CRT transactions**. CRT is a long-standing risk management tool that allows the private sector to participate in the multifamily market and reduces the Enterprises' and taxpayers' risk exposure. We generally encourage the FHFA to avoid unnecessarily penalizing CRTs in order to preserve the helpful outcomes of these transactions.
- **Rationalize the proposed leverage ratio** so that it does not produce unintended consequences, including inappropriately-sized capital requirements or encouragement of riskier activities.

Rebalance Multifamily Lending to Allow for Heightened Diversity among Lenders, Keeping in Mind the Enterprises' Mission regarding Affordable Housing. CREFC members generally support greater diversity among multifamily lenders, including greater private-sector participation. We believe that the role of the Enterprises in ensuring the availability of capital for affordable and other under-served housing sectors is critically important and in keeping with their publicly stated mission. However, the growth in the Enterprises' share of multifamily lending from 18 percent in 2000 to 38 percent in 2019 indicates that there could and should be a more balanced mix of public and private capital in this market. We believe encouraging additional private capital engagement in multifamily lending would further diversify and strengthen the multifamily sector and allow the Enterprises to increase their focus on mission-driven lending.

Many of CREFC's non-Enterprise lenders have expressed their strong desire to increase multifamily exposure in their portfolios and note that their inability to compete with the Enterprises is due to the lower rates offered by the GSEs at least in part because of their lower capital requirements. These non-Enterprise multifamily lenders hold that greater participation by them in this market would provide a heightened level of safety and soundness for all lending institutions given the sector's demonstrated cash-flow stability and high credit-worthiness. It also would provide additional liquidity in the sector – a positive step as the country emerges from the COVID-19 pandemic and related economic stress.

Several of our members question, however, whether aggressive multifamily Enterprise capital requirements alone are the most appropriate or effective manner by which to achieve these objectives. We look forward to working with the FHFA to find some iterative processes that could help gradually arrive at a better balance between Enterprise and non-Enterprise lenders. While we applaud the FHFA's efforts to facilitate the Enterprises' exit from conservatorship in a safe and sound manner, we believe that any new regulatory capital regime for the Enterprises should be accompanied by enhanced policy directives, including higher Enterprise-level targets for affordable and other under-served markets. Ultimately, our goals and the FHFA's are much aligned in encouraging multiple sources of capital liquidity, both public and private, for the multifamily market.

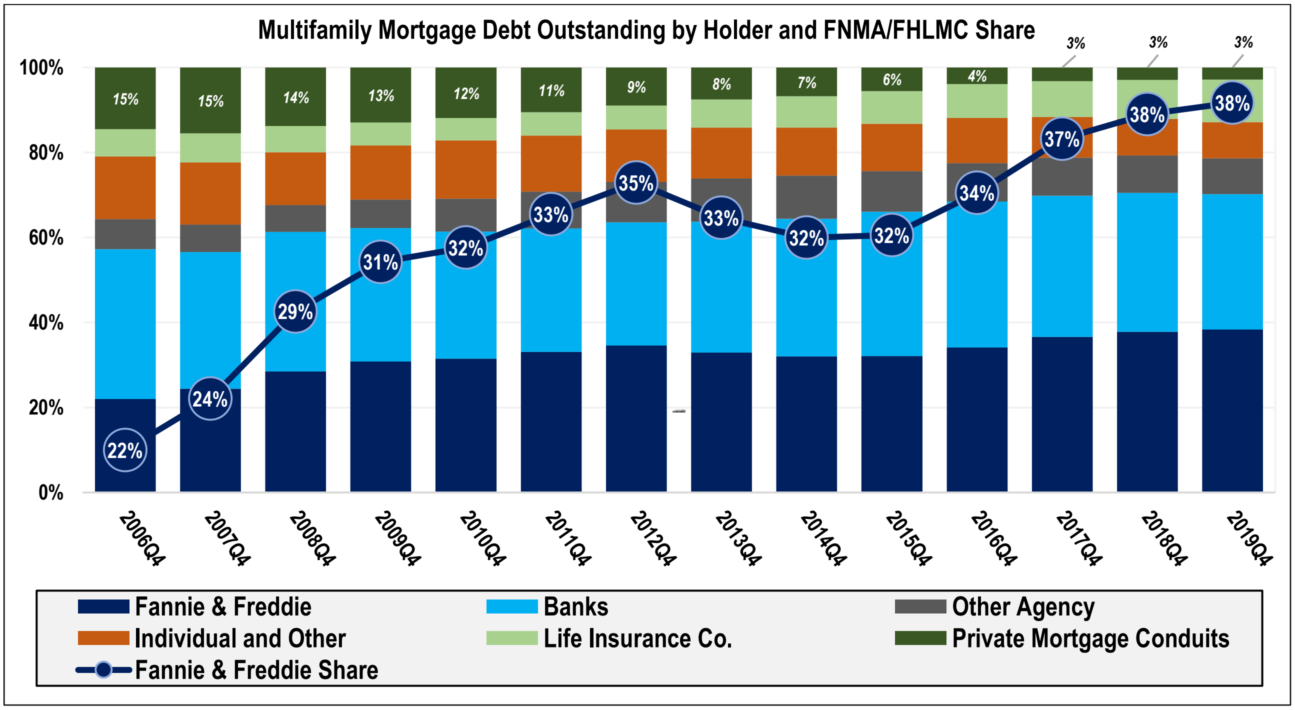
Adjust the Proposed Risk Weights to Reflect Reduced Risk of Multifamily vs. Single Family Lending. This Proposal would require an Enterprise to determine its risk-based capital requirements under two approaches—a standardized approach and an advanced approach—with the greater of the two being the binding requirement. The standardized credit risk capital requirements for both single family and multifamily mortgage exposures would be determined using lookup grids and multipliers that assign an exposure-specific risk weight based on the risk characteristics of the underlying asset and the mortgage exposure. The Proposal also imposes a 15 percent risk weight floor on both single family and multifamily exposures. The advanced approach for credit risk capital requirements would rely on each Enterprise's internal models.

As of September 30, 2019, under the standardized approach, the Enterprises' average risk weights for single family and multifamily mortgage exposures would have been 26 percent and 51 percent, respectively. These average risk weights are determined based on the credit risk capital requirements for single family and multifamily mortgage exposures after adjustments for mortgage insurance and other loan-level credit enhancements but before any adjustment for CRT. After CRT, the risk weights would have been lower at 24 percent for single family exposures (versus 26 percent) and 30 percent (versus 51 percent) for multifamily exposures.

Under the Proposal, again as of September 30, 2019, the capital requirement for multifamily exposures, in absolute terms, would have been nearly $18 billion. As explained in further detail below, the risk weight and required capital amounts for multifamily seem unjustifiably high, particularly when multifamily consistently has experienced lower delinquencies and generally outperformed single family, including during the financial crisis.

CREFC's membership supports an appropriate increase in multifamily capital requirements to promote a more level playing field between Enterprise and private-sector provision of mortgage credit. The graph below demonstrates the Enterprises' steadily expanding share of the multifamily lending market, **growing from 22% in 2006 to 38% in 2019, surpassing even the 35% held in 2012** following the end of the financial crisis.[5]. We would note that the Enterprises further supported the multifamily market from 2003 through 2007 by investing in conduit CMBS multifamily directed (A1A) classes, with investments in these bonds ranging from $6 billion to $41 billion annually from 2004 through 2007.

One result of the Enterprises' growing market share in multifamily could be the migration of private debt capital to other sectors of the lending market, which could have unintended consequences or lead to pricing distortions. All private lenders under CREFC's umbrella voiced their desire to allocate heightened debt capital to the multifamily sector, highlighting the difficulties in competing with the Enterprises on a pricing basis in many cases.

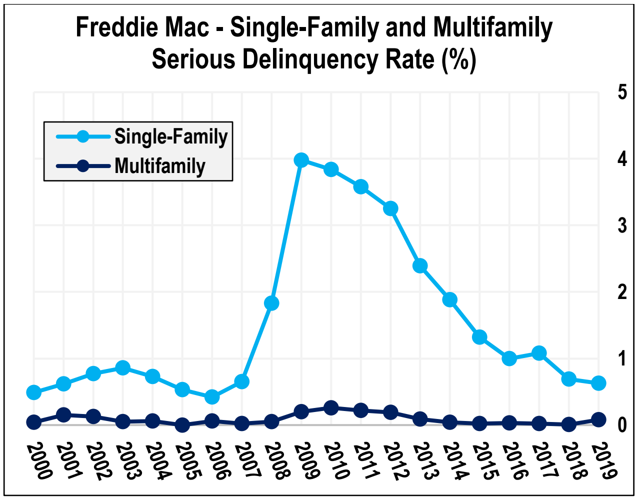


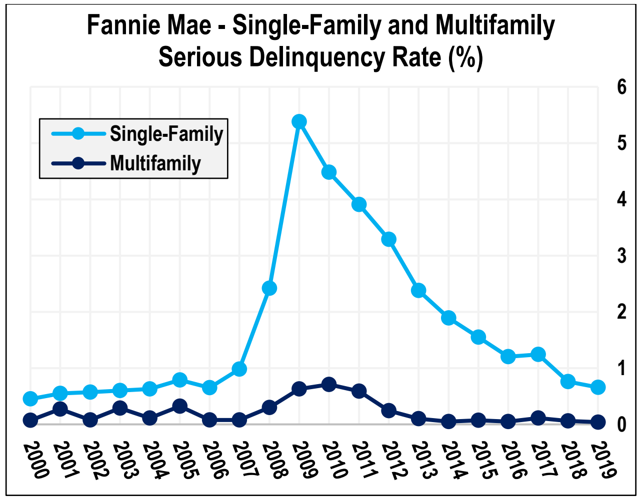
Source: Federal Reserve

Strong Historical Multifamily Loan Performance. The relatively high capital requirements for Enterprise multifamily exposures do not appear to reflect the sector's performance over the past 50 years. Multifamily lending has consistently been one of the safest, best performing sectors since the 1970s, and remained so during the 2008 financial crisis. Multifamily has clearly performed significantly better than single family, as the two graphs below demonstrate. The Enterprise multifamily serious DQ rates over the past 20 years have always been below those of Enterprise single

[5] The share held by the Federal Agencies is close to 46% when unsecured debt is included.

family.[6] Furthermore, during the financial crisis, Freddie Mac's single family serious DQ rate peaked nearly 20 times higher than its multifamily serious DQ rate; in Fannie Mae's case, single family serious DQ rate was nearly nine times higher than its multifamily DQ rate. Given this data, capital requirements for multifamily exposures that are nearly twice that of single family lending appear unfounded.





Source: Freddie Mac and Fannie Mae

CREFC believes, therefore, that the risk weights for multifamily exposure should be adjusted downward appropriately relative to single family. We would ask the FHFA to disclose the data and methodologies underlying these risk weights, allowing for further public review prior to finalizing the GSE capital rule.

Develop a Countercyclical Multifamily Adjustment. The Proposal also seeks input on whether a countercyclical adjustment should be applied to multifamily risk weights, similar to the approach it recommends for single family exposures. CREFC notes that, given balloon risk at maturity, a countercyclical adjustment is actually more important for multifamily than it is for single family, and would be pleased to work with the FHFA to help identify an appropriate approach.

We appreciate the proposed addition of the stress and countercyclical capital buffers to the Enterprise regulatory capital framework, allowing potential market shocks to be evaluated by economic and regulatory experts rather than by simple regression models. Encouraging the Enterprises to release or build capital as needed should provide more stability to the financial system. A more granular, data-

[6] **Freddie Mac serious DQ rates** for single-family are based on the number of mortgages 90 days or more delinquent or in foreclosure. For multifamily, before 2008, rates were based on the net carrying value of mortgages 60 days or more delinquent or in foreclosure and exclude other guarantee transactions. Beginning in 2008, rates were based on the unpaid principal balance of loans 60 days or more delinquent or in foreclosure and include other guarantee transactions. **Fannie Mae serious DQ rates** for single family are based on the number of loans 90 days or more past due or in the foreclosure process. For multifamily, beginning in 1998, data include all multifamily loans and securities 60 days or more past due.

sensitive countercyclical adjustment could provide additional value, but CREFC believes the currently proposed single family model, particularly if it is to be used as the basis for a multifamily model, needs to be revised significantly for a number of reasons:

1. We note that the calculations are based on a simple regression run from 1975 to 2012, but do not understand why the FHFA believes this is the benchmark from which economic shocks should be applied. We would like to gain a better understanding of the economic fundamentals underlying these parameters.
2. The FHFA in essence defined stresses relative to a trend rather than the peak-to-trough movements that should typically underlie capital derivations.
3. There should be a mechanism that neutralizes significant downward movements in the overall market; i.e., the same shock should not be capitalized more than once.

Rethink the Proposed Approach to Credit Risk Transfer (CRT) Transactions. CRT transactions transfer potential credit losses on single family and multifamily mortgage exposures from the Enterprises to private institutional investors – a critical risk management tool that has been effectively deployed by the Enterprises for several years. However, the current Proposal would significantly reduce the associated capital reduction benefit for CRT transactions via a ten percent haircut on capital relief and a ten percent capital floor.

The FHFA notes that under this approach more capital is required than would be if the underlying mortgage exposures were not in a CRT; i.e., this is a departure from capital neutrality. The FHFA argues that this change is necessary to manage the "potential safety and soundness risks of CRT, including…model risk posed by the calibration of the loss-timing and counterparty risk adjustments," but many market participants consider CRT transactions one of the most successful products of the conservatorship. If one of the FHFA's main goals is the exit of the Enterprises from conservatorship, CREFC members are querying why it would seek to diminish the ability of the CRT program to transfer Enterprise credit risk to the private sector. As stated in a 2019 Milken Institute Report, "with the GSEs in conservatorship and well along a path to becoming distributors of mortgage credit risk, there is broad bipartisan agreement that CRT transactions should continue to be a cornerstone of a safe, sustainable housing finance system. The FHFA, in coordination with the GSEs, should continue to evolve CRT mechanisms and market."[7]

In addition to high-level questions related to the future role of CRT, particularly in a post-conservatorship context, CREFC members have market-specific concerns. Many investor members, including banks, asset managers, pension funds, and REITs, have found that CRT allows them to apply their credit expertise to access and invest in the multifamily market in a manner that has become more challenging given the domination of the sector by the Enterprises. These investors are also concerned that if CRT issuance is scaled back, they will be faced with orphan bonds and illiquidity.

[7] https://milkeninstitute.org/sites/default/files/reports-pdf/Blueprint-Admin-Reform-HF-System-1.7.2019-v2.pdf

CREFC notes that the Enterprises utilize various CRT structures, all of which seek to reduce Enterprise credit risk and disperse it among financially sound private sector counterparties. Today's various CRT structures employ different methods of transferring risk, such as selling risk to investors or a combination of sharing risk with lenders, investors, or reinsurers. These different structures exist today as they allow for healthy competition between different approaches to risk dispersal, loss coverage, and cost effectiveness. We would welcome the opportunity to further explore with the FHFA the CRT structures that best protect the Enterprises and the American taxpayer.

Given the differences in CRT structures across the Enterprises, all of which have proven to be an effective means of risk transfer to private institutional investors, CREFC believes that the FHFA should adopt a more nuanced approach to related capital requirements. While the current zero percent risk weight floor might indeed be too low for retained CRT exposure, we believe 10 percent is likely too high. We would also suggest that a one-size-fits-all approach may not be appropriate across the various CRT structures. Instead, we recommend a floor that falls in a range between five and seven percent, which might also encourage greater private sector participation without an outsized impact on affordability. Most importantly, before the floors are finalized, the FHFA should provide the public with a better understanding of how the floors are ultimately derived and allow for another comment period.

While CREFC supports a less onerous, more nuanced approach to CRT capital requirements, we would recommend that the FHFA consider improving and expanding upon current disclosure requirements for CRT counterparties' public financial reports. Greater transparency and consistency in public financial reporting between the two Enterprises could provide comfort around the risks enumerated by the FHFA in the Proposal. As stated in the Milken report cited above,

> "There are certain review and disclosure requirements and practices in post-crisis PLS that do not apply to CRT transactions or, if applicable, are far less robust in CRT transactions relative to PLS. Therefore, even though CRT investors are exposed to losses on loans, they are given much less information about diligence and underwriting exceptions on the underlying assets. The FHFA should direct the GSEs to eliminate these differences…"[8]

Don Layton, former CEO of Freddie Mac, agrees with this recommendation, stating, "This reporting should be a lot better. The FHFA, at some point, can focus on either reporting directly, or mandating that the GSEs do so individually, more complete information in the name of good public policy."[9]

Rationalize the Proposed Leverage Ratio. As noted above, the proposed four percent leverage ratio, inclusive of the 1.5 percent Prescribed Leverage Buffer Amount, often would function as the Enterprises' binding capital requirement. Given that this requirement is based on total assets and does not reflect varying levels of risk within a pool of assets, an inappropriately sized leverage ratio can have serious unintended consequences. If set too high, the leverage ratio could counteract the

[8] https://milkeninstitute.org/sites/default/files/reports-pdf/Blueprint-Admin-Reform-HF-System-1.7.2019-v2.pdf
[9] https://www.jchs.harvard.edu/sites/default/files/harvard_jchs_gse_crt_part2_layton_2020.pdf

guardrails set by appropriately-sized risk-based capital requirements. Further, capital experts have noted for many years that a leverage ratio that is set too high can force institutions to chase higher yielding, and potentially more risky, activities.

The proposed leverage ratio, for instance, could lead to a significant reduction in the number of CRT transactions. As Layton points out, "A minimum leverage ratio, if constructed without adequate thought, has the potential to – with no exaggeration – completely and fully stop cold all CRT transactions."[10] Since the leverage ratio is calculated based on total assets, it would not take into account the reduction of risk afforded by a CRT transaction. Instead, since an Enterprise is paying a CRT investor to take the risk of underlying mortgage exposures, the Enterprise would face a lower profit with no associated decrease to its leverage-based capital requirement.

CREFC recommends, therefore, that the proposed leverage ratio be reduced. One way to accomplish this would be to reduce the size of the 1.5 percent Prescribed Leverage Buffer Amount, bringing the overall leverage ratio closer to a more rational 2.5 percent.

***

We appreciate this opportunity to comment on the proposed Enterprise Regulatory Capital Framework, and look forward to working constructively with the FHFA on this important matter.

Sincerely,

Lisa Pendergast
Executive Director
CRE Finance Council

[10] https://www.jchs.harvard.edu/sites/default/files/harvard_jchs_gse_crt_part3_layton_2020.pdf