NATIONAL ASSOCIATION OF REALTORS®

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November 26, 2021

The Honorable Sandra Thompson
Acting Director
Federal Housing Finance Agency
400 7th Street, SW
Washington, DC 20024

Dear Director Thompson:

On behalf of the 1.5 million members of the National Association of REALTORS® (NAR), I submit this letter in response to the request for input (RFI), *Amendments to the Enterprise Regulatory Capital Framework Rule – Prescribed Leverage Buffer Amount and Credit Risk Transfer (RIN 2590-AB17)*. NAR appreciates the efforts of the Federal Housing Finance Agency (FHFA) to address problems created by the high leverage rule and onerous treatment of credit risk transfer (CRT) in the enterprise regulatory capital framework (ERCF). However, REALTORS® believe that the ERCF must be further refined: the buffers included in the risk-based rule remains too high; the minimum risk weight for single family loans and the minimum for CRT are too high; the countercyclical buffer is problematic; the FHFA rule does not address the potential impact of an explicit guarantee on the Enterprises' capital requirements; and the FHFA must be address the impact on fees of a risk-based capital rule for entities with charter obligations.

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, along with its availability to the widest range of potential homebuyers.

Homeownership is a central part of the American dream and the Enterprises help nearly half of all American's finance that dream. The Enterprises' congressionally-mandated mission of providing liquidity to real estate investment nationally and in underserved communities is a critical piece in improving homeownership for all Americans. An appropriately-sized ERCF is critical to supporting this mission.

Important Changes

The 2020 ERCF made several problematic changes to the Enterprises' capital structure that would undermine more than a decade of secondary market

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reform. The proposed changes will help resolve two of them. The leverage ratio and CRT treatment in the 2020 ERCF would force the enterprises to take on additional risk, while limiting their incentive to offload risk to private parties. The result is a rule that centralizes risk in two entities that are critical to support the flow of capital to homebuyers and homeowners.

First, the 2020 ERCF adopted the 2018 ERCF's approach of using a "greater of" rule to determine the binding capital constrain. Thus, the greater of a leverage ratio or a risk-based rule would determine the required capital. However, the 2020 ERCF raised the leverage ratio to 4.0%, nearly equal to the risk-based rule. NAR pointed out the problem with this structure in our previous comment. The high leverage ratio would incentivize the Enterprises to take on additional risk rather than lower their risk appetite. The FHFA proposes, and REALTORS® agree, to reduce the prescribed leverage buffer amount (PLBA) from 1.5% to 0.5%. Thus, the binding leverage ratio would fall from 4.0% to 3.0%.

Second, the 2020 ERCF created a minimum risk weight of 10% for retained credit risk transfers and an overall effectiveness risk weight for CRTs. CRT investors and analysts unanimously condemned these changes as undermining the economics of CRT as evidenced by Fannie Mae's pull back from the market. In its place, the FHFA proposes to reduce the minimum risk weight of 10% of retained CRT exposures to 5%. Furthermore, they would eliminate the overall adjustment. REALTORS® agree that CRT is a bona fide means of laying off risk inherent in mortgages and that the Enterprises should be incented to do so. To the extent that these changes restore the Enterprises' incentive to externalize risk in an efficient, safe, and sound manor, REALTORS® agree that these changes are prudent. However, to the extent this risk weight could be further refined to incent the Enterprises to engage in deals with deeper attachment points that are economic, this should be encouraged.

Problems Remain

Under the severely adverse scenario of the 2019 Dodd-Frank Act Stress Test (DFAST), the FHFA determined that the stress losses of Fannie Mae and Freddie Mac would amount to 0.83% of assets if home prices fell by 25% over nine quarters and GDP fell 8.0%. While this scenario is moderately more optimistic than the 30% decline experienced in the subprime crisis, it is very close. Nonetheless, it is prudent to impose a buffer on top of these stress losses to compensate for unforeseen market liquidity, modeling errors, and to allow the Enterprises to operate through a crisis. In the 2018 ERCF proposal, the FHFA proposed a 75-basis point going-concern buffer on top of the risk-based approach. The 2020 ERCF renamed the going-concern buffer to a stress capital buffer and added two additional buffers. The stress capital buffer and new stability capital buffer were then estimated to add $53.3 billion to the GSEs' capital requirement, while the new countercyclical capital buffer is initially set at zero and would rise when "excess aggregate credit growth is judged to be associated with a build-up of system-wide risk".

Recent price growth, though, suggests that the countercyclical buffer could become an issue. The strong home price growth in recent years would result in mark-to-market adjustments that would raise LTVs on loans for capital purposes, which would in turn raise the amount of required capital and could result in higher guarantee fees or LLPAs on new originations. Unlike the strong price growth preceding the subprime mortgage crisis, recent price growth is driven by a significant housing shortage. The current rule based on deviations above and below trend price growth is a good foundation, but the regulator should have more discretion to adjust this collar to reflect the supply and demand relationship that is driving price appreciation. For instance, FHFA could incorporate a scaled adjustment to the upper bound based on deviation of the ratio of housing stock to households from its historic relationship.

The countercyclical buffer includes a lower bound for deviation from the long-term price growth trend. This lower bound allows the Enterprises to reduce capital and pricing in a market with slow price growth. In effect, the countercyclical rule allows the Enterprises to increase market support in a crisis. However, the stability buffer undermines the congressionally chartered mission of the Enterprises to support liquidity in all markets including underserved communities and during periods of stress. Specifically, the stability buffer, which grows in proportion to the Enterprises' role in the market, would rise in a crisis, precisely when the Enterprises should be taking a more supportive role that implies a larger market share. NAR agrees that entities the size of the Enterprises pose a unique risk to the market, but excess capital is no substitute for effective oversight, transparency, and regulation. Thus, the invariant portion of the risk-based approach

would amount to 1.6% in 2019, even with no countercyclical buffer in place, accounting for nearly half of the 3.85% estimated capital required on the 2019 book of business. *The FHFA should reduce or eliminate the stability buffer as it contradicts the Enterprises congressionally-mandate of supporting a national market, particularly under periods of stress.* Furthermore, there is concern that not all lenders and investors may accurately price for risk and return under the new Qualified Mortgage (QM) regime. Thus, to the extent that the Enterprises limit their financing to mortgages that meet the Qualified Mortgage (QM) exemption to the Ability to Repay Rule (ATR the market benefits from their strong pricing ability and standards, which will act as a counterbalance to potential risk taking in the non-agency markets.

Finally, the minimum risk weight on all loans of 15% does not align with risk or the Enterprises' unique charter. The minimum risk weight creates a capital requirement for the least risky borrowers, which could result in excess pricing and a market shift. This pattern can raise the risk of the portfolio by shifting good borrowers away and eliminate an important source of financial support for the Enterprises' charter duties.

The ERCF Should Expand its Scope

Several other factors will either directly or indirectly interact with the capital rule and affect the Enterprises' safety and soundness, their ability to satisfy their charter duties, and the return that potential investors would receive. The FHFA must clarify these factors for the market, investors, and consumers before finalizing the proposal.

The ability of the Enterprises to access low-cost debt in a crisis is a direct function of their currently explicit line of credit with the Treasury and the implicit line of credit before conservatorship. Low-cost debt allows the Enterprises to make low-cost mortgages in a crisis, but Federal backing of the Enterprises' MBS allows the Federal Reserve to purchase these low-cost mortgages in a crisis, just as it did when it stepped into the market during the pandemic. When the Federal Reserve bought the Enterprises' MBS earlier this year, it stabilized mortgage rates and upheld the housing market, while the private market virtually shut down. What's more, Wall Street analysts point to the general government support as evidence of franchise value and have downgraded the Enterprises on news that government support could be diluted. For these reasons, REALTORS® support an explicit, paid-for backstop from the federal government. Potential equity investors need clarity on this support, as do the housing, lending, and construction industries, which account for nearly 20 percent of the economy and which are critical to pandemic recovery efforts.

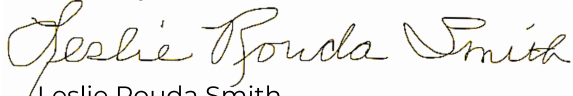
The Office of Management and Budget (OMB) has recognized that the Enterprises have a "public mission to provide stability in and increase the liquidity of the residential mortgage market and to help increase the availability of mortgage credit to low- and moderate-income families and in underserved areas." In this re-proposed ERCF, the FHFA adopted the 2020 ERCF's risk-based rule with multiple buffers and a leverage rule in an attempt to provide adequate capital to cover risks to the GSEs' book of business 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 outline how the Enterprises should allocate rates of return to support the public mission, these risk-based capital standards could result in risk-based pricing that will increase the cost significantly for those borrowers that the GSEs are explicitly tasked with supporting.

Mortgage rates and access to credit have a direct influence on home purchases, homeowners' ability to use equity in their home, and the overall economy. The Consumer Financial Protection Bureau is required by law section 1022(b)(2)(A) of the Dodd-Frank Act, "to consider the potential benefits and costs of a regulation to consumers and covered persons" and shared that analysis with the public in its recent proposal to replace the qualified mortgage standard. While the law does not apply to the FHFA, given the sheer magnitude of the number of consumers that could be affected by this rule and the potential impact to the housing market and economy, the FHFA should provide an analysis on all affected parties, including homebuyers, homeowners, and investors, in addition to the economy.

Further Collaboration

Thank you again for taking the time to hear the concerns of REALTORS®. We appreciate your efforts to right-size the ERCF to improve their safety, soundness, and efficiency, and look forward to collaborating on ongoing support for sustainable homeownership opportunities and shaping the future of the conventional housing finance market. We would greatly appreciate the opportunity to discuss these issues in more detail with you and your staff. If you have any questions or comments, please feel free to reach out to Ken Fears, NAR's Senior Policy Representative at (202) 383-1066 or KFears@NAR.REALTOR.

Sincerely,



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