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September 9, 2021

The Honorable Janet Yellen
Secretary
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Sandra L. Thompson
Acting Director
Federal Housing Finance Agency
400 7th Street, SW
Washington, DC 20219

RE: Industry Recommendations Concerning the Senior Preferred Stock Purchase Agreements for Fannie Mae and Freddie Mac

Dear Secretary Yellen and Acting Director Thompson,

The undersigned organizations write to provide recommendations for the U.S. Department of the Treasury (Treasury) and the Federal Housing Finance Agency (FHFA) as they implement – and consider further amendments to – the Senior Preferred Stock Purchase Agreements (PSPAs) with respect to Fannie Mae and Freddie Mac (the Enterprises). These recommendations would improve the health of the housing finance system and align with the stated goals of ensuring that the Enterprises operate in a safe and sound manner while furthering their missions to increase liquidity in support of affordable housing.

Our collective concerns, which previously have been expressed in individual letters from our respective organizations, arise from policy changes incorporated in amendments to the PSPAs that were announced in January 2021.[1] We believe several of these policy changes warrant reconsideration due to disruptions they have caused – or have the potential to cause – to the housing market or frictions they have created for borrowers, renters, lenders, servicers, or investors. These policy changes include those related to:

- Limits on single-family loans with multiple higher risk characteristics;
- Limits on single-family loans secured by second homes and investment properties;
- Limits on the use of the Enterprises' cash windows;
- Limits on multifamily loans; and
- Compliance with a point-in-time regulatory capital framework.

We appreciate the recent steps that both Treasury and FHFA have taken to promote smooth market functioning and assist consumers – including actions related to the

[1] U.S. Department of the Treasury and Federal Housing Finance Agency, "Treasury Department and FHFA Amend Terms of Preferred Stock Purchase Agreements for Fannie Mae and Freddie Mac," January 14, 2021. Available at: https://home.treasury.gov/news/press-releases/sm1236.

implementation of COVID-19 assistance funds for homeowners and renters, as well as the elimination of the Enterprises' Adverse Market Refinance Fee. We believe the additional steps recommended herein for both the single-family and multifamily markets would further ease ongoing pressures and strengthen the nation's housing markets. The recommendations outlined below include near-term actions that could be implemented immediately, as well as intermediate-term actions that are more likely to be completed over a slightly longer time horizon.

Near-Term Recommendations

To reduce the potential for disruptions in the near term, we recommend more reasonable implementation of the product limits included in the recently revised PSPAs. The provisions associated with loans with multiple higher risk characteristics and loans secured by second homes and investment properties did not specify appropriate periods by which the Enterprises needed to manage their businesses to these new limits. In the absence of further guidance from Treasury and FHFA, the Enterprises were forced to take severe actions to bring their businesses into compliance as quickly as possible. This series of events, however, created significant friction in the housing markets.

The immediate implementation of these product limits – particularly the 7 percent cap on loans secured by second homes and investment properties – led to the Enterprises instituting similar limits on a *per-lender basis* in order to rapidly reduce deliveries of these loans. This decision significantly harmed lender pipelines and placed an undue burden on lenders operating in markets with significant shares of these types of properties. Consequently, this policy harms borrowers as lenders pull back from offering these products and the interest rates associated with them rise. With respect to investment properties, higher interest rates will lead to higher rents for tenants in order for property owners to cover their higher carrying costs. If the Enterprises determine they must institute similar limits on acquisitions of loans with multiple higher risk characteristics, it likely will curb their ability to provide liquidity for lending to low- to moderate-income and underserved borrowers. This is an outcome that can be avoided through simple measures taken by Treasury and FHFA.

Direct guidance from Treasury and FHFA is needed to allow the Enterprises to delay and more gradually manage their loan acquisitions below the 7 percent limits with respect to second homes and investment properties and thereby reduce the resulting market pressures. Under a more flexible approach and timeline, the Enterprises could make necessary adjustments to their automated underwriting systems, which would alleviate many of these concerns and better protect against market disruptions. Gradual changes also would provide time for private capital alternatives to develop the operational capacity to serve these market segments. Similar considerations should be granted if the Enterprises are in danger of breaching their limits on acquisitions of loans with multiple higher risk characteristics.

Treasury and FHFA therefore should communicate clearly to the Enterprises that compliance with these PSPA product limits need not be achieved immediately. The Enterprises instead should be instructed to delay or gradually move their businesses below these thresholds – unless and until these provisions of the PSPAs are amended further.

Intermediate-Term Recommendations

While the most recent PSPA amendments contained several policy changes that will serve the Enterprises and the broader market well, the problematic provisions listed above should be removed or modified substantially. These provisions do not further the Enterprises' missions or responsibilities, do not increase safety and soundness, and are inappropriate in contracts governing Treasury's capital support of the Enterprises. We encourage Treasury and FHFA – as soon as possible – to begin the process of amending the portions of PSPAs that stifle and disrupt the smooth functioning of the housing finance system. Specifically, we recommend eliminating or modifying the limits on single-family loans with multiple higher risk characteristics, the limits on single-family loans secured by second homes and investment properties, the limits on the use of the Enterprises' cash windows, the limits on multifamily loans, and the required compliance with the Enterprise Regulatory Capital Framework in its current form.

<u>Product Limits</u>

It remains unclear why Treasury and FHFA included numerical thresholds for single-family loans with multiple higher risk characteristics, or single-family loans securing second homes and investment properties, in the most recent PSPA amendments. Lending in the specific areas restricted by the PSPAs has proven to be a vital part of a well-functioning housing finance system. Loans with multiple higher risk characteristics typically serve low- to moderate-income borrowers. Loans secured by investment properties often are for affordable rental housing and provide subsidies via significant loan-level price adjustments that reduce the cost of other types of lending supported by the Enterprises. Loans secured by second homes provide seasonal rentals and a growing piece of Americans' retirement portfolios.

We recognize the need for FHFA to manage the Enterprises' footprint to ensure they are not acquiring outsized levels of these (or other) specific types of loans, consistent with mission or safety-and-soundness objectives. We acknowledge, for example, concerns that the recent high proportion of investor home purchases may be crowding out first-time homebuyers in certain markets. The current investment property caps, however, are indiscriminate and treat the purchase of a rental home by a "mom-and-pop" investor the same as a purchase by an investor with many such properties. Percent-of-market caps implemented through contracts are inflexible and therefore will not be reflective of changing market conditions. It is unclear, moreover, why the capital support provided by Treasury should be contingent on these particular product limits. Such rationale cannot be found in the PSPAs and has yet to be provided.

We recommend that Treasury and FHFA delay implementation and consider eliminating these product limits to better assess market impacts on first-time homebuyers and underserved groups. Any need for limitations on an Enterprise's business activities with respect to these loans should be undertaken after consultation with impacted parties and addressed through FHFA's supervisory authorities – not through inflexible, backwards-looking caps embedded in PSPA contracts designed to achieve very different objectives.

<u>Cash Windows</u>

Much like the product limits described above, the per-lender limit on the use of the Enterprises' cash windows in the recent PSPA amendments carries several concerns regarding adverse outcomes. This limit of $1.5 billion is set at a level that would capture as many as several dozen lenders – many of which do not maintain the capital markets capacity to engage in mortgage-backed security (MBS) swaps executions. This limit could result not only in increased costs for lenders that need to build MBS swaps capacity, but also increased counterparty concentration risk for the Enterprises, liquidity risk management challenges for lenders that prefer to retain servicing with actual (rather than scheduled) remittances, and greater difficulty for the Enterprises to align prepayment rates and securitization policies in support of the Uniform MBS market.

We recommend that Treasury and FHFA eliminate this cash window limit from the PSPAs. In the absence of complete removal of this provision, Treasury and FHFA should (substantially) raise the $1.5 billion threshold to limit any harmful market impacts.

<u>Multifamily Caps</u>

The multifamily caps included in the most recent amendments to the PSPAs also pose a variety of problems that should be addressed as quickly as possible. First, the volume of each Enterprise's multifamily business is not directly related to the underlying terms and conditions of the PSPAs. If FHFA has determined the appropriate maximum volume of the Enterprises' annual acquisition of multifamily loans or the proportion of those acquisitions that should be "mission driven," whether made by FHFA as conservator or as supervisor of the Enterprises, implementing that decision by way of a contractual agreement with another federal agency under which that agency purchases preferred stock from each Enterprise is a needlessly indirect and cumbersome approach.

Second, the 52-week rolling average methodology for the PSPA multifamily caps may be operationally problematic when applied to the multifamily financing market with a seasonal cycle that can vary from year to year and so could curtail multifamily production for significant parts of the year.

Third, the multifamily caps that have been inserted into the PSPAs are based on certain assumptions as to (1) the size of the multifamily financing market in future years, and (2) the appropriate market share for the Enterprises in future years. Those caps, however, adjust from year to year only by reference to the Consumer Price Index (CPI). The CPI has no relationship to either the size of the multifamily lending market or the Enterprises' appropriate market share, so CPI-based adjustments effectively will be arbitrary as measured against these two factors.

To address these concerns, we recommend that Treasury and FHFA eliminate the multifamily caps from the PSPAs. We believe FHFA instead should implement any decisions limiting the Enterprises' multifamily business volumes or the mission focus of their multifamily business using its supervisory or conservatorship authority and tools. At a minimum, Treasury and FHFA should amend the PSPAs to remove the 52-week rolling average methodology and to establish a means other than the use of the CPI to facilitate adjustment of the multifamily caps on a year-by-year basis (or more frequently if warranted).

<u>Regulatory Capital Framework</u>

The amended PSPAs also include a provision that requires the Enterprises to comply with the Enterprise Regulatory Capital Framework in a manner that disregards subsequent amendments or modifications to the rule establishing this framework. This provision is perhaps the most baffling amendment to the PSPAs, as we are not aware of any other situation in which an agency has explicitly required a regulated entity to ignore any future amendments to a rule that would be promulgated *by the same agency*. If FHFA amends the Enterprise Regulatory Capital Framework in the future, one should expect that it will do so based on a compelling rationale and through a process that is supported by data and evidence. As such, it is entirely unclear why the PSPAs would require the Enterprises to adhere to what would be an outdated capital framework. Indeed, this provision seems to be directed at binding the hands of future FHFA leadership rather than promoting the sound operation of the Enterprises.

The removal of this provision from the PSPAs is of particular importance because we believe FHFA should re-evaluate and modify the Enterprises' capital framework. The finalized framework includes several problematic features that threaten to undermine its effectiveness and limit the Enterprises' ability to fulfill their missions. In undertaking this work, FHFA should provide incentives for the Enterprises to maintain and expand upon positive changes to their business models over the past decade rather than simply operate under their pre-2008 business models (albeit with more capital). Specific adjustments would rectify problems such as the excessive level of capital necessitated by this framework, the excessive frequency with which required capital would be determined by a risk-insensitive leverage ratio, the punitive treatment of credit risk transfer mechanisms, and the treatment of multifamily credit risk that is unsupported by the data and is inconsistent with credit fundamentals. FHFA also should assess whether the complexity embodied in the capital rule is necessary to achieve the objective of calculating regulatory capital levels that are commensurate with risk.

We recommend that Treasury and FHFA eliminate the required adherence to the Enterprise Regulatory Capital Framework in its current form from the PSPAs. FHFA instead should monitor and ensure compliance with any and all capital requirements to which the Enterprises are subject at that time – as is the case for any regulator responsible for a capital framework to which its regulated entities are subject.

* * *

The recommendations described above – both those related to PSPA implementation flexibility and those related to PSPA amendments – would support market stability, liquidity, broad access to sustainable credit, and the safety and soundness of the Enterprises. We thank Treasury and FHFA for considering these recommendations and we look forward to our continued work on this and other critical housing finance issues.

Sincerely,

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