CRE Finance Council®
The Voice of Commercial Real Estate Finance

November 23, 2021

Clinton Jones
General Counsel
Attention: Comments/RIN 2590–AB17
Federal Housing Finance Agency
Eighth Floor, 400 Seventh Street SW
Washington, DC 20219

Re: Proposed Rules on Enterprise Regulatory Capital Framework
RIN 2590–AB17

Dear Mr. Jones,

The CRE Finance Council (CREFC) is pleased to provide comments on the Federal Housing Finance Authority's (FHFA) proposed revisions to the Enterprise Regulatory Capital Framework (Proposal) for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac, and with Fannie Mae, each an Enterprise or GSE).[1]

CREFC comprises over 300 institutional members representing U.S. commercial and multifamily real estate investors, lenders, and service providers – a market with an estimated $4.7 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 commercial real estate debt markets.

First and foremost, CREFC and its members were pleased to see the following proposed changes:

- Removal of the overall effectiveness adjustment to an Enterprise's retained Credit Risk Transfer (CRT) exposures;
- Replacement of the prudential floor of 10 percent with a prudential floor of 5 percent on the risk weight assigned to any CRT exposure retained by an Enterprise; and
- The reduction of the Enterprises' Prescribed Leverage Buffer Amount (PLBA).

[1] Federal Housing Finance Agency, Notice of Proposed Rulemaking, *Enterprise Regulatory Capital Framework Rule – Prescribed Leverage Buffer Amount and Credit Risk Transfer*, 86 Fed. Reg. 184 (September 27, 2021).
[2] Federal Reserve, as of December 31, 2019.

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Our comments will focus on the need to modify current multifamily capital requirements so that they more appropriately reflect the actual risk of that sector.

In addition to our recommendations detailed below, we ask that FHFA release additional information regarding the data and assumptions underlying the Proposal and provide further opportunity for public comments based on that information.

Analysis

As stated in the Proposal, FHFA seeks to amend the Enterprise Regulatory Capital Framework (ERCF) by refining the leverage buffer amount and credit risk transfer securitization framework for the GSEs.

We appreciate the opportunity to respond to this proposal, and we applaud the proposed changes related to CRT transactions and the Prescribed Leverage Buffer Amount (PLBA). **We continue to believe, however, that the capital requirements for multifamily exposures, not addressed in the current proposal, are still too high. We would like to take this opportunity to share our members' concerns and outline recommended changes.**

In our response to FHFA's 2020 ERCF proposal, CREFC expressed support for FHFA's overarching goals of appropriately capitalized Enterprises that can 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. In explaining the rationale for the proposed ERCF amendments, however, FHFA expressed concern that:

> *Certain aspects of the ERCF might create disincentives in the Enterprises' CRT programs that may result in taxpayers bearing undue risk for as long as the Enterprises are in conservatorships and excessive risk to the housing finance market both during and after conservatorships.*

CREFC shares FHFA's concerns and therefore supports the proposed changes discussed below.

Reduced Capital Requirement for CRT Transactions

We noted in our previous comment letter that CRT has served as a critical risk management tool and was effectively deployed by the Enterprises for several years. Many market participants considered CRT transactions to be one of the most successful products of the conservatorship. We further inquired why FHFA would seek to diminish the ability of the CRT program to transfer Enterprise risk to the private sector if the exit of the Enterprises from conservatorship was important. As stated in the 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."[3, 4]

In our prior submission to FHFA's 2020 ERCF proposal, we stated that a reduction in the risk weight floor for retained CRT exposure from 10 percent to one that falls in a range between 5 and 7 percent would encourage greater private sector participation without an oversized impact on affordability. CREFC thus supports the Proposal's replacement of the prudential floor of 10 percent with a floor of 5 percent. CREFC also applauds the Proposal's removal of the requirement that an Enterprise must apply an overall effectiveness adjustment to its retained CRT exposures.

ADJUSTMENT TO LEVERAGE RATIO

In our previous comment letter, CREFC noted that the proposed 4 percent leverage ratio, inclusive of the 1.5 percent PLBA, often would function as the Enterprises' binding capital requirement. As this requirement was based on total assets, which do not reflect varying levels of risk within a pool of assets, we believe the leverage ratio would often be too high and function as a binding constraint rather than an appropriately-sized backstop. We also noted that the proposed leverage ratio could lead to a significant reduction in the number of CRT transactions.

Over the years, capital experts have noted that a leverage ratio that is set too high can force institutions to chase higher yielding, and potentially riskier, activities. If the proposed leverage ratio is set too high, it could counteract the guardrails set by appropriately-sized risk-based capital requirements. We recommended a reduction in the size of the 1.5 percent PLBA, which would bring the overall leverage ratio closer to a more rational 2.5 percent, rather than 4 percent.

CREFC supports the FHFA's proposed revision to replace the PLBA equal to 1.5 percent of an Enterprise's adjusted total assets with a dynamic PLBA equal to 50 percent of the Enterprise's stability capital buffer. Basing the leverage ratio on risk-based capital requirements, rather than total assets, better reflects the varying levels of risk within that particular pool of total assets. As of March 31, 2021, Fannie Mae's PLBA would decrease from approximately $62 billion, or 1.5 percent of the prior quarter's adjusted total assets, to approximately $23 billion, or 0.53 percent adjusted total assets. Freddie Mac's PLBA similarly would decrease from $46 billion, or 1.5 percent of the prior quarter's adjusted total assets, to approximately $11 billion, or 0.33 percent of the adjusted total assets.

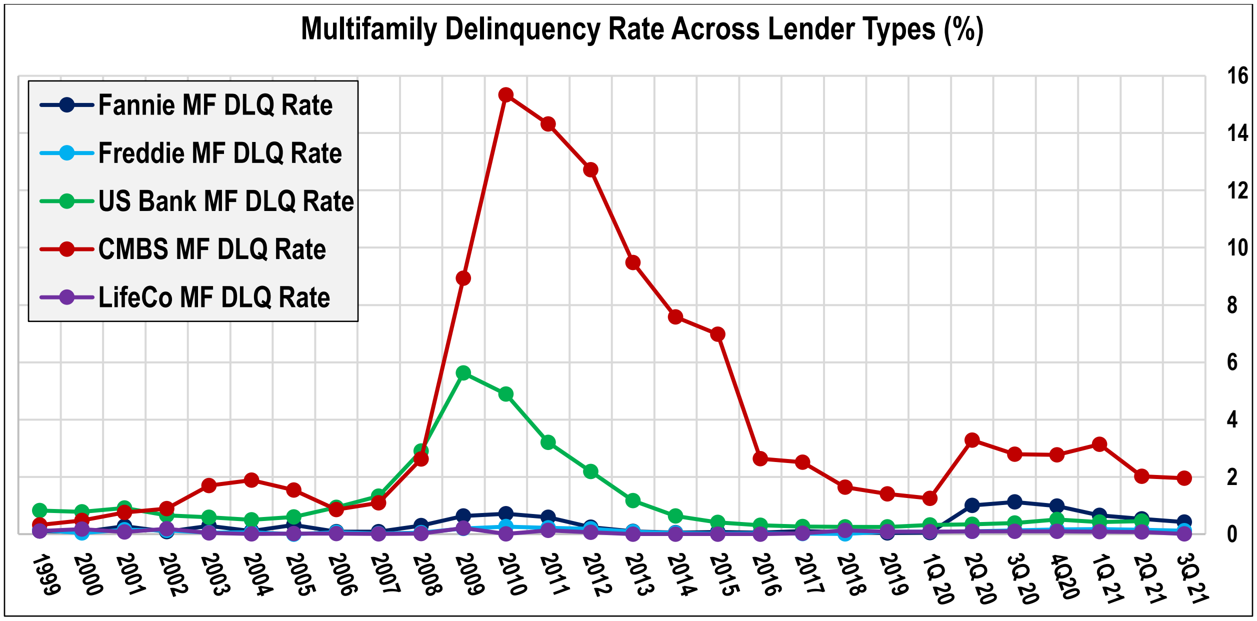
ADJUSTMENT TO MULTIFAMILY RISK WEIGHTS

[3] Milken Institute, *A Blueprint for Administrative Reform of the Housing Finance System*, (Jan. 2019), https://milkeninstitute.org/sites/default/files/reports-pdf/Blueprint-Admin-Reform-HF-System-1.7.2019-v2.pdf

[4] The differences in CRT structures across Enterprises have proven to be an effective means of risk transfer to private institutional investors. Further, the Enterprise Capital Tool spreadsheet[4] shows that a reduction in the CRT tranche floor and removal of the effectiveness adjustment would result in: (1) improvement in DUS Risk-Weighted Assets (RWA) relief by 50 percent, and (2) improvement in Freddie K's RWA relief by 22.23 percent.

CREFC welcomes the proposed CRT and leverage ratio revisions, but we continue to believe that the proposed risk weights for multifamily are too punitive. The risk weights for multifamily exposures should be adjusted to more accurately reflect the risk being addressed. In the past, aggressive loan underwriting practices and significant shifts in the tax treatment of real estate helped propel building boom and bust cycles in real estate in general, including the multifamily sector. Underwriting practices have, however, improved substantially. Underwriting decisions now incorporate more conservative and robust assumptions in analyses of property performance and growth expectations over time and across cycles. Further, as data become more sophisticated, the level of transparency and thus credit insights has grown over the years. The result has been an overall improvement in loan performance.

Multifamily's solid performance across all platforms during the COVID-19 crisis serves to substantiate that view and we provide additional detail in the responses to the below questions.



Source*: Fannie Mae, Freddie Mac, FDIC, ACLI, Intex, and Trepp. Freddie Mac multifamily loans in forbearance are reported as current and not included in the multifamily delinquency rates if the borrower is in compliance with the forbearance agreement. US Bank and CMBS delinquency rates are 30+ days while all others are 60+ days.*

RESPONSE TO QUESTIONS POSED BY FHFA

The below sections are CREFC's responses to the specific questions posed by FHFA in the proposed rule.

1. **What approach that relies only on non-proprietary data or indices should FHFA consider to mitigate the pro-cyclicality of the credit risk capital requirements for multifamily mortgage exposures?**

We appreciate the addition of the stress and countercyclical capital buffers to the Enterprise regulatory capital framework, which allows potential market shocks to be evaluated by economic and regulatory experts over the life of the loan based on real-time data rather than by regression models.

However, given the balloon risk at maturity in multifamily loans, and therefore relatively high level of exposure for the life of the loan, an additional countercyclical adjustment is important for multifamily.

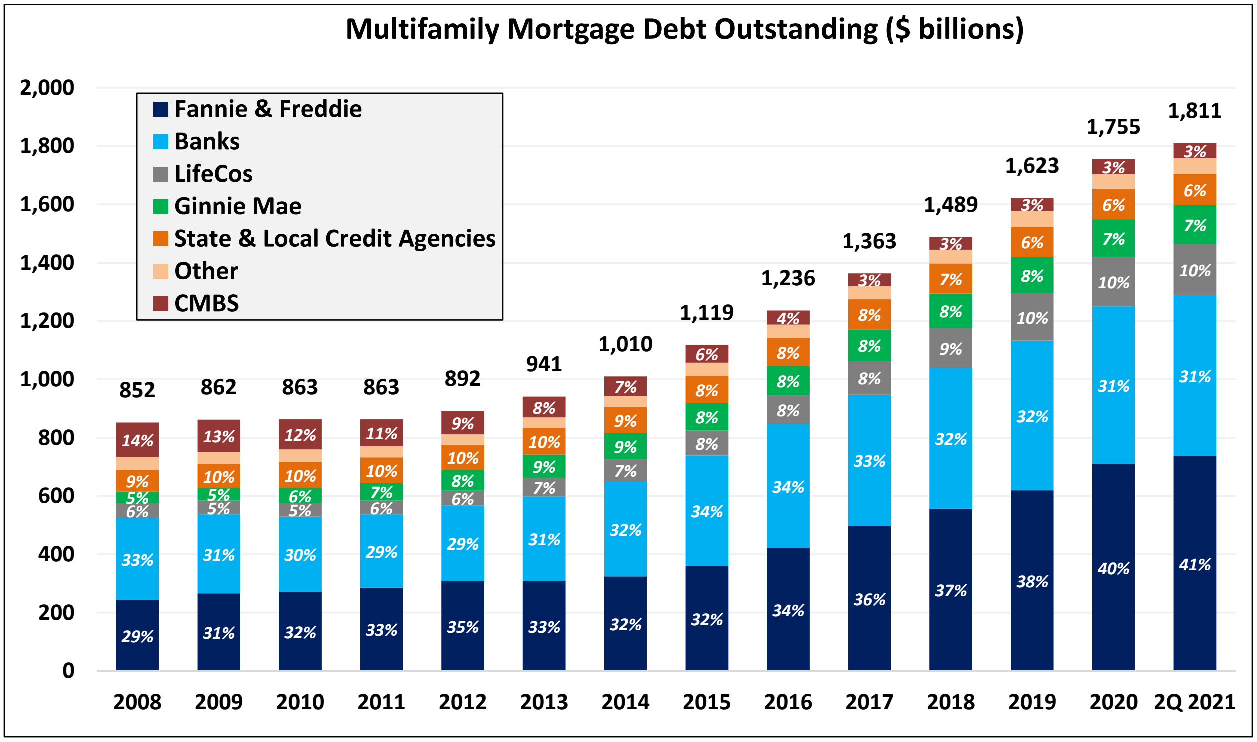
In order to develop such an adjustment, CREFC would recommend using readily available data from the National Council of Real Estate Investment Fiduciaries (NCREIF), which has been producing a property-level return index – NCREIF Property Index (NPI) – since 1978. The index captures investment performance across property types, including multifamily, on a quarterly basis. Specifically, NCREIF publishes a quarterly Apartment Price Index. CREFC would be pleased to work with the FHFA to help identify an appropriate approach.

2. In light of the proposed changes to the PLBA and CRT securitization framework, is the prudential risk weight floor of 20 percent on single-family and multifamily mortgage exposures appropriately calibrated? What adjustment, if any, would you recommend?

CREFC members support greater diversity in multifamily lending, including increased private-sector participation. Further, 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 to remain aligned with their important publicly stated mission.

While the Enterprises are to be applauded for their important role as leaders in the industry, the growth in their share of multifamily lending from 18 percent in 2000 to 38 percent in 2019 suggests that a prudent construct would allow for a more balanced combination of public and private capital in this market. Encouraging additional private capital engagement in multifamily lending would not only diversify the multifamily sector, but also ensure appropriate and targeted levels of liquidity.

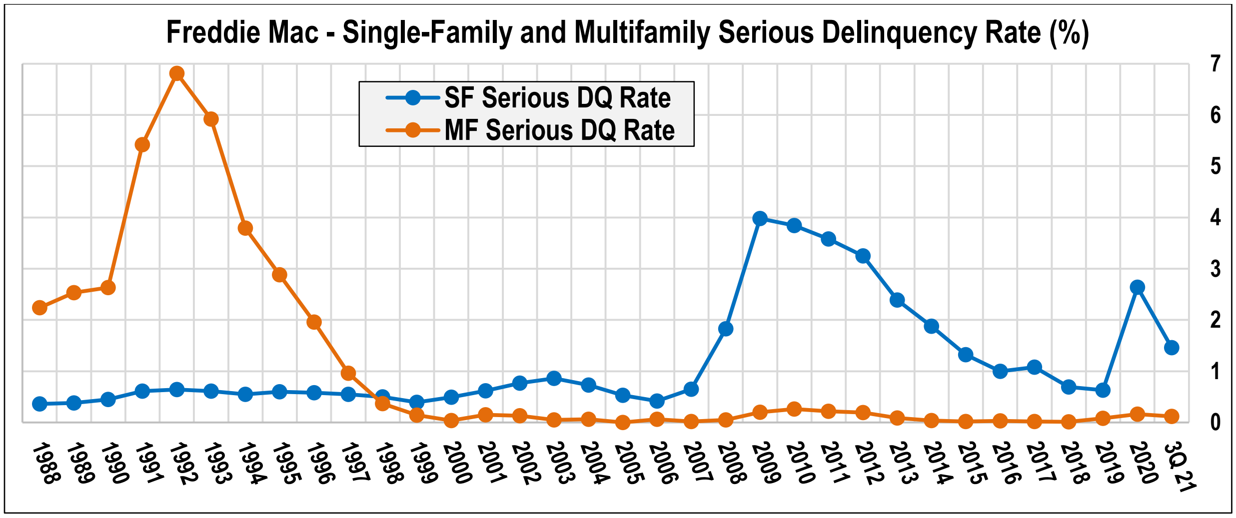
Several of CREFC's non-Enterprise lenders have expressed their strong desire to increase multifamily exposure in their portfolios. They have also voiced that their inability to compete with the Enterprises stems from the lower rates that GSEs can offer. Given the sector's demonstrated cash-flow stability over time, relative to other asset classes that are more subject to macro-economic swings, greater participation in this market from non-Enterprise multifamily lenders would provide an increased level of safety and soundness for all institutions.



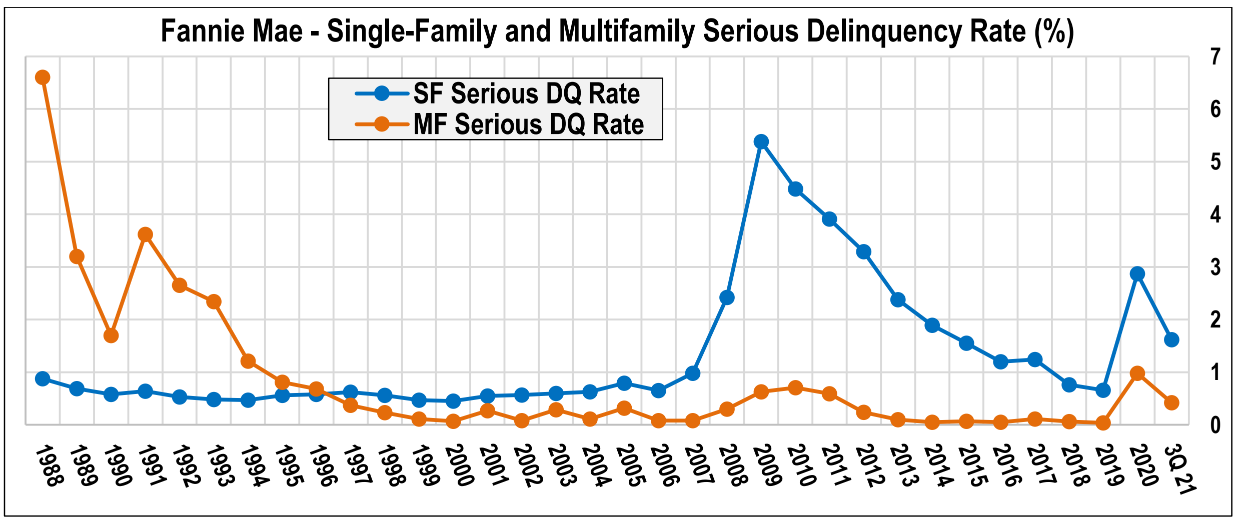
***Source**: Federal Reserve*

Sound Multifamily Loan Performance Overtime. Nevertheless, the relatively high capital requirement for Enterprise multifamily exposures does not appear to reflect the sector's performance over the past 50 years. Since the 1970s, multifamily lending has consistently been one of the safest and best performing sectors. Even though defaults were relatively high in the 1980s, underwriting has grown far more conservative and the sector has experienced positive performance. This remained true during the 2008 financial crisis. Multifamily significantly outperformed single family, as demonstrated by the below graphic. The Enterprise multifamily serious DQ rates over the past 20 years consistently fall below those of Enterprise single-family.[5] During the financial crisis, Freddie Mac's single-family serious DQ rate peaked nearly 20 times higher than its multifamily serious DQ rate. As for Fannie Mae, single-family serious DQ rates were nearly nine times higher than its multifamily DQ rate. Thus, capital requirements for multifamily exposures that are significantly higher than those for single-family lending appear to be detached from actual experience.

[5] 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.



***Source**: Freddie Mac. Single-family loans in forbearance are reported as delinquent during the forbearance period to the extent that payments are past due based on the loan's original contractual terms. Multifamily loans in forbearance are reported as current and not included in the multifamily delinquency rates if the borrower is in compliance with the forbearance agreement.*



***Source**: Fannie Mae*

Given this historical performance, CREFC believes that the risk weights for multifamily exposure should be adjusted downward relative to single-family. We would request that the FHFA disclose the data and methodologies underlying these risk weights, and allow for further public review prior to finalizing the GSE capital rule.

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

Sincerely,

Lisa A. Pendergast

Lisa Pendergast
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CRE Finance Council