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July 19, 2007

Mr. Alfred Pollard  
General Counsel  
Office of Federal Housing Enterprise Oversight  
1700 G Street NW, 4<sup>th</sup> Floor  
Washington, DC 20552

Dear Mr. Pollard:

Thank you for the opportunity to comment on the proposed guidance for the calculation of the conforming loan limit. We greatly appreciate the collaborative nature of the process that OFHEO has used in this matter.

The conforming loan limit is a matter of central importance to the mortgage markets. It is the frame of reference for all GSE transactions in the secondary market and for most transactions in the primary and mortgage securities markets. Consequently, the procedures for establishing the conforming loan limit should be transparent and predictable, in order to minimize any disruptions in such markets. The proposed guidance generally accomplishes these goals, reflecting thoughtful consideration by OFHEO of concerns raised by Fannie Mae and other interested parties during this process. However, we wish to offer some comments and suggestions.

**I. Grandfather Rule**

The proposed guidance would grandfather any loan within the conforming loan limit at the time of origination. Even if the limit drops at a later date, such a loan would remain conforming for purposes of GSE purchases and securitization. We endorse this principle. However, we suggest that it be extended to any loan that is conforming at the time of origination *or at any time thereafter*, using the principle of “once conforming, always conforming.”

We are authorized by the Charter Act to purchase a loan as long as the maximum original principal obligation of such loan does not exceed the conforming loan limit. Thus, in 2005 when the conforming first lien one-unit loan limit in most jurisdictions was \$359,650, any such loan exceeding the limit was a jumbo and off limits to us. However, when the loan limit was raised in 2006 to \$417,000, all loans within the \$359,651 to

\$417,000 band became conforming. These loans have been securitized, priced and traded in the market as conforming.

Under the proposed guidance, if the conforming loan limit declines, some loans that are now conforming could become jumbos. For example, a loan originated in 2005 with an original principal amount of \$410,000 was nonconforming at origination, but is conforming today. However, if the conforming loan limit declines to \$400,000, the proposed guidance would appear to make the loan a jumbo, because the loan was not conforming at origination. Such a consequence would be extremely disruptive to the market.

We suggest that the grandfather rule be changed to state that any loan that is a conforming loan at the time of origination or at any time thereafter will remain conforming for as long as such loan is outstanding, regardless of any declines in the loan limit in subsequent years.

## **II. Computation Methodology**

OFHEO has proposed to defer the impact of any home price decline on the conforming loan limit for one full year. Thereafter, OFHEO proposes to defer such impact further, to the next year or beyond, unless the cumulative deferred decline exceeds the de minimis threshold of 1%.<sup>1</sup> We welcome these proposals because they seek to minimize disruption to the market caused by decreases in the loan limit. However, we would like to suggest an alternative methodology to the one that appears to be contemplated by the proposed guidance.

The guidance appears to use the sum of annual percentage changes in the house price index in those situations (involving deferred or de minimis declines) where changes must be computed on a multi-year basis. Changes in the conforming loan limit are indexed to the Monthly Interest Rate Survey (MIRS) conducted by the Federal Housing Finance Board (FHFB).

We believe that the simplest and most accurate way to compute the new conforming loan limit is by adjusting the current limit by the percentage change in the MIRS index that has occurred since the last time the loan limit was changed. Following years when the loan limit did not change due to deferred declines, the base value of the MIRS index (the value that was used the last time the loan limit was changed) would be two or more years

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<sup>1</sup> Although the guidance states that declines will be deferred a year, the examples provided at the end of the guidance suggest otherwise. In particular, the last example posits a scenario in which average house prices fall for three years straight – 2006, 2007, and 2008. It concludes:

[If] the cumulative deferred decline of 0.16 percent from 2006 and the decline from 2007 and 2008 totals 1.0 percent or greater, then the conforming loan limit for 2009 will be adjusted downward by the cumulative deferred decline.

(Emphasis added). It is unclear, in this example, why the decline from 2008 is being used to adjust the loan limit for 2009, instead of being deferred automatically for one year.

in the past, but it would still be necessary to use only two values of the index to determine the adjustment factor, rather than having to deal with the sum of a series of interim changes as the guidance appears to require. Two numbers can be used to span several years without reference to intervening years, while still achieving the essential result that OFHEO proposes.

The loan limit would be determined, with appropriate rounding, by the equation:

$$\text{New Loan Limit} = \text{Current Loan Limit} \times \text{Loan Limit Adjustment Factor}$$

In this equation, the Loan Limit Adjustment Factor would be determined according to the following methodology using two variables, End Value (EV) and Base Value (BV):

1. Compare the current October house price value to the previous October house price value, and select the greater of the two as EV.<sup>2</sup>
2. Set BV equal to the EV that was used the last time the loan limit was adjusted.
3. The Loan Limit Adjustment Factor is set equal to 1 or  $EV/BV$ :
  - i. The Loan Limit Adjustment Factor = 1 if  $EV/BV$  is within the de minimis zone<sup>3</sup> (showing either no change in the house price index, or a net decline in the index that is being deferred), with the result that there would be no change to the loan limit.
  - ii. The Loan Limit Adjustment Factor =  $EV/BV$  if  $EV/BV$  is not within the de minimis zone (showing either a net increase in the house price index, or a net decline in the index that is not being deferred).

Various possibilities as to the behavior of the loan limit computation process are illustrated in the charts appended as an Addendum to this letter.

### **III. Size of De Minimis Trigger**

The proposed guidance adopts a de minimis rule that defers the recognition of small declines in the average home price until the aggregate house price decline reaches a critical mass. This is appropriate because it postpones major systems and marketing changes that market participants would have to make to reflect what would be a relatively

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<sup>2</sup> It is necessary to select the greater of the two values in order to effectuate OFHEO's proposal that all declines be deferred for one year. Thus, in a year when the house price value declined, this mechanism selects as the EV the house price value from the previous year.

<sup>3</sup> The de minimis zone is between 1 and 1 minus the de minimis threshold. Thus, if the de minimis threshold is 1%, as OFHEO has proposed, then the de minimis zone is between 1 and 0.99, inclusive. If the de minimis threshold is 5%, as we propose below, then the de minimis zone is between 1 and 0.95, inclusive.

small decrease in the conforming loan limit. Moreover, deferring small decreases recognizes that the FHFB survey, upon which changes to the conforming loan limit are based, provides only a rough approximation of home price activity – as is true of all surveys.

The survey is based upon a five-day end-of-month sampling. It also uses error filters that exclude certain occurrences of mortgage products, such as ARMs with very low initial rates and mortgages on very high-cost properties. In some cases, these observations represent actual transactions rather than survey errors. The erroneously-excluded observations are likely to be more prevalent in areas with rapidly increasing house prices and their exclusion potentially biases the home-price change downward.

More generally, the FHFB survey is based on sampling and like all such surveys is subject to sampling error. To invest resulting point estimates with a presumption of exactness would be to imply false precision. Given the imprecision in the underlying survey and the potential market disruption involved, we suggest that OFHEO adopt a higher de minimis threshold before recognition of a decline in average home price. A higher percentage such as 5% would be less disruptive to the market and, consequently, a more appropriate figure to use.

It is important to note here that a higher de minimis threshold would not introduce permanent differences in the level of the conforming loan limit; rather, any differences would be temporary and simply a matter of timing. A larger threshold may introduce short-term differences in declining house price environments, but would not cause a permanent different level of conforming loan limits over the long run. It is precisely these short-term differences from tight thresholds that are preferably avoided because they are unnecessarily disruptive.

#### **IV. Rounding Down**

We agree with the proposal to adopt a rounding convention for changes in the loan limit. We note that the GSE's practice in the past has been to round down to the nearest \$50. Rounding down to \$100 rather than to \$50 introduces an increased downward bias in the numbers.

However, we recognize that the effect will be small and that there is some benefit, in terms of marketplace convenience and administrative simplicity, in having a conforming loan limit expressed in \$100 units rather than \$50 units. This rounding rule also appropriately reflects the previously-noted imprecision in the MIRS index. As previously discussed, we believe that this imprecision should also be reflected in a larger than 1% de minimis threshold.

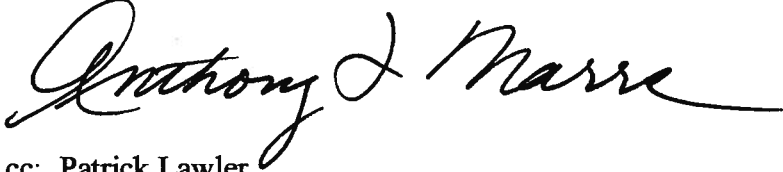
Mr. Alfred Pollard

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If you need additional information or further explanation of our proposals, please let me know. Given the complexity of this matter and its importance to the market, we would be pleased to provide whatever additional information you may need.

Sincerely,

A handwritten signature in black ink that reads "Anthony J. Marre". The signature is written in a cursive style with a large initial "A" and a long horizontal flourish at the end.

cc: Patrick Lawler

**ADDENDUM  
OPERATION OF PROPOSED COMPUTATION METHODOLOGY**

**Scenario I: Increases in Home Prices in MIRS Data, 2007-2011**

	Actual		Hypothetical				
	Oct. '06	Oct. '08	Oct. '07	Oct. '08	Oct. '09	Oct. '10	Oct. '11
MIRS Evaluation Date							
MIRS House Price Value	\$306,800	\$306,300	\$321,600	\$337,600	\$354,400	\$372,100	\$390,700
Change in MIRS Value		-0.16%	5.0%	5.0%	5.0%	5.0%	5.0%
Loan Limit Effective Date	Jan '06	Jan '07	Jan '08	Jan '09	Jan '10	Jan '11	Jan '12
New Loan Limit before Round Down	\$417,000	\$417,000	\$437,116	\$458,846	\$481,631	\$505,653	\$530,873
New Loan Limit with Round Down	\$417,000	\$417,000	\$437,100	\$458,800	\$481,600	\$505,600	\$530,800
Change in New Loan Limit		0.00%	4.8%	5.0%	5.0%	5.0%	5.0%
Date for End Value (EV)			Oct. '07	Oct. '08	Oct. '09	Oct. '10	Oct. '11
Date for Base Value (BV)			Oct. '06	Oct. '07	Oct. '08	Oct. '09	Oct. '10
Explanation for Change (or Lack of Change) in Loan Limit			2008 Increase Offset by 2007 De Minimis Decrease	Loan Limit increases each year by the amount of the increase in the MIRS Index (adjusted for \$100 round down)			

**Scenario II: Decreases in Home Prices in MIRS Data, 2007-2011**

	Actual		Hypothetical				
	Oct. '06	Oct. '08	Oct. '07	Oct. '08	Oct. '09	Oct. '10	Oct. '11
MIRS Evaluation Date							
MIRS House Price Value	\$306,800	\$306,300	\$290,900	\$276,300	\$262,400	\$249,200	\$236,700
Change in MIRS Value		-0.16%	-5.0%	-5.0%	-5.0%	-5.0%	-5.0%
Loan Limit Effective Date	Jan '06	Jan '07	Jan '08	Jan '09	Jan '10	Jan '11	Jan '12
New Loan Limit before Round Down	\$417,000	\$417,000	\$417,000	\$385,389	\$375,460	\$356,515	\$338,566
New Loan Limit with Round Down	\$417,000	\$417,000	\$417,000	\$385,300	\$375,400	\$356,500	\$338,500
Change in New Loan Limit		0.00%	0.0%	-5.2%	-5.0%	-5.0%	-5.0%
Date for End Value (EV)			Oct. '06	Oct. '07	Oct. '08	Oct. '09	Oct. '10
Date for Base Value (BV)			Oct. '05	Oct. '05	Oct. '07	Oct. '08	Oct. '09
Explanation for Change (or Lack of Change) in Loan Limit			2007-2008 Decrease Deferred	2007-2008 Decrease Deferred	2009 Decrease Deferred	2010 Decrease Deferred	2011 Decrease Deferred

**Scenario III: Mixed Pattern of Home Prices in MIRS Data, 2007-2011**

	Actual		Hypothetical				
	Oct. '06	Oct. '08	Oct. '07	Oct. '08	Oct. '09	Oct. '10	Oct. '11
MIRS Evaluation Date							
MIRS House Price Value	\$306,800	\$306,300	\$304,700	\$289,400	\$274,900	\$261,100	\$267,200
Change in MIRS Value		-0.16%	-0.5%	-5.0%	-5.0%	-5.0%	10.0%
Loan Limit Effective Date	Jan '06	Jan '07	Jan '08	Jan '09	Jan '10	Jan '11	Jan '12
New Loan Limit before Round Down	\$417,000	\$417,000	\$417,000	\$417,000	\$393,350	\$373,594	\$380,212
New Loan Limit with Round Down	\$417,000	\$417,000	\$417,000	\$417,000	\$383,300	\$373,500	\$380,200
Change in New Loan Limit		0.00%	0.0%	0.0%	-5.7%	-5.0%	4.5%
Date for End Value (EV)			Oct. '06	Oct. '07	Oct. '08	Oct. '09	Oct. '11
Date for Base Value (BV)			Oct. '05	Oct. '05	Oct. '05	Oct. '08	Oct. '09
Explanation for Change (or Lack of Change) in Loan Limit			De Minimis	No Decrease: 2007-2008 Decrease is De Minimis; 2009 Decrease Deferred	Combined 2007-2009 Decrease; 2010 Decrease Deferred	2010 Decrease; 2011 Decrease Deferred	2010 Deferred Decrease Offset by 2011 Price Recovery

**Scenario IV: Alternative Mixed Pattern of Home Prices in MIRS Data, 2007-2011**

	Actual		Hypothetical				
	Oct. '06	Oct. '08	Oct. '07	Oct. '08	Oct. '09	Oct. '10	Oct. '11
MIRS Evaluation Date							
MIRS House Price Value	\$306,800	\$306,300	\$290,900	\$293,800	\$323,100	\$306,900	\$291,500
Change in MIRS Value		-0.16%	-5.0%	1.0%	10.0%	-5.0%	-5.0%
Loan Limit Effective Date	Jan '06	Jan '07	Jan '08	Jan '09	Jan '10	Jan '11	Jan '12
New Loan Limit before Round Down	\$417,000	\$417,000	\$417,000	\$399,331	\$438,121	\$438,100	\$417,084
New Loan Limit with Round Down	\$417,000	\$417,000	\$417,000	\$399,300	\$438,100	\$438,100	\$417,000
Change in New Loan Limit		0.00%	0.0%	-4.2%	10.0%	0.0%	-5.0%
Date for End Value (EV)			Oct. '06	Oct. '08	Oct. '09	Oct. '09	Oct. '10
Date for Base Value (BV)			Oct. '05	Oct. '05	Oct. '08	Oct. '08	Oct. '08
Explanation for Change (or Lack of Change) in Loan Limit			2007-2008 Decrease Deferred	Deferred Decrease Reduced by 1% Price Recovery	Loan Limit Increases by 9.967%	2011 Decrease Deferred	2011 Decrease; 2012 Decrease Deferred