July 19, 2007

Alfred Pollard, Esquire
General Counsel
Office of Federal Housing Enterprise Oversight
1700 G Street, NW
Washington, DC 20552 VIA Electronic Mail

Re: *Proposed Guidance on Conforming Loan Limit Calculations*

Dear Mr. Pollard:

The members of the Mortgage Bankers Association[1] (MBA) appreciate the opportunity to submit these comments in response to OFHEO's *Proposed Guidance on Conforming Loan Limit Calculations,* released on June 20, 2007 (the Proposed Guidance). The Conforming Loan Limits (CLL) set the maximum principal amount of mortgages which Fannie Mae and Freddie Mac (the GSEs) can purchase, securitize and sell. As such, the CLL is a figure of major significance for our industry with broad implications for consumers and lenders.

The issue OFHEO addresses in the Proposed Guidance is how to adjust the limit if there is a decrease in housing prices. OFHEO proposes that the CLL should be adjusted downward consistent with decreases in the Federal Housing Finance Board's October level for its survey of national average home prices (the FHFB Survey), the GSE charter mandated reference index.[2] In response to industry concerns about adverse implications for consumers and for the industry, OFHEO has included a one percent threshold for decreases and a one-year deferral of implementation.

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 500,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 3,000 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

[2] The Fannie Mae Charter Act states at Section 302 (b)(2), in pertinent part, "Each such [annual] adjustment shall be made by adding to each such amount…a percentage thereof equal to the percentage increase during the twelve-month period ending with the previous October in the national average one-family house price in the monthly survey of all major lenders conducted by the Federal Housing Finance Board." See also Section 305 (a)(2) of the Freddie Mac Charter Act. 12 U.S.C. 1717(b)(2) and 12 U.S.C. 1454 (a)(2). We note that the resulting index value is the result of one month (October year-over-year) experience, and, in fact, represents only five days of data for that month. As we point out below, the October price levels can vary from those of other months during a particular year, contributing to the lack of reliability of the FHFB Survey for October as the appropriate index.

Prior to the issuance of the Proposed Guidance, MBA staff and members discussed with OFHEO staff the issues surrounding downward adjustment of the CLL. We appreciate the time you spent with us and with other industry participants and representatives on this subject. We also sent a letter of May 18, 2007, to summarize our views and we attach a copy of that letter.[3]

Nonetheless, it is MBA's position, reiterated here, that the CLL should not be decreased below its current level of $417,000.[4] We base our position on our views that,

- Statutory authority for OFHEO to decrease the CLL is unclear at best; a plain reading of the statute is that it contemplates increases, but not decreases;
- Due to the volatility of the FHFB Survey data and the usage of prices for only one month (October) of any year, the charter mandated survey data does not serve as a reliable annual indicator of home prices for purposes of decreasing the CLL; We believe the current system should not be used for decreases;
- There is not a safety and soundness justification for decreasing the CLL;
- There are strong public policy reasons not to decrease the CLL; harm to consumers, the businesses of Fannie Mae and Freddie Mac, and the lending industry could result from a decrease in the CLL; and
- The government loan programs of the Federal Housing Administration (FHA) and the Veterans Administration (VA), which are tied to the CLL, also would be limited, resulting in curtailment of government loans to borrowers who need assistance most, and resulting in a loss of funds generated by those programs and by Ginnie Mae.

Background

The GSEs are required under their charters to operate within limits for the maximum original principal obligations of mortgage they purchase, the Conforming Loan Limit (referred to in the Proposed Guidance and in this letter as the CLL), a loan amount limit set by statute[5] and subject to an annual adjustment. The adjustment is made by "adding to each such [prior] amount"[6] (emphasis added) a percentage equal to the percentage yearly increase as of the end of October in the national average single family home price as reflected in data surveyed by the Federal Housing Finance Board (FHFB). The current CLL is $417,000, set in November, 2005.

As OFHEO has noted in Supervisory Guidance,[7] there have been only three occasions in recent years when the average house price declined from October to October (1989,

[3] See letter, attached, dated May 18, 2007, from Jonathan Kempner to Director Lockhart.
[4] On one technical point, MBA believes it would be preferable if the rounding convention used were rounding down to the nearest $50, which we believe has been the practice to date, rather than rounding down to the nearest $100, as called for in the Proposed Guidance.
[5] 12 U.S.C. 1717(b)(2) and 12 U.S.C. 1454 (a)(2).
[6] Ibid.
[7] See letters, dated February 20, 2004 from Armando Falcon, Jr., Director of OFHEO, to Franklin D. Raines, Chairman and CEO of Fannie Mae, and to Richard F. Syron, Chairman and CEO of Freddie Mac, and Supervisory Guidance, SG-04-001, "Conforming Loan Limit Calculations," also dated February 20, 2004.

1993 and 1994).[8] In 1990, the GSEs lowered the maximum amount of a mortgage they would purchase by $150, and in the other two years, they kept it at the CLL, consistent with their legal authority. Thus, there is a precedent for lowering the conforming loan limit on a voluntary basis at the option of the GSEs and also for not lowering the conforming loan limit.

I. OFHEO Does Not Have Clear Statutory Authority to Decrease the Conforming Loan Limits

The GSE charters govern the adjustment of the CLL. The charters provide for an annual adjustment to the CLL by "adding" to the maximum ceiling limit "increases."[9] The charters are silent on deductions in the CLL to reflect a decrease in the FHFB Survey, but clearly contemplate increases to accommodate increases in housing values. Therefore, there is no indication that Congress intended to have the CLL come down when home prices fall.

We think it much more likely that the drafters wanted to be sure that the GSEs could provide more rather than less liquidity to the market within the constraints of the reference survey used to assess housing prices. The extent to which the GSEs serve to provide liquidity for the mortgage market is a policy question unless there is a safety and soundness concern.

In the absence of statutory clarification, the maximum limits allowable for the CLL should be subject to increase but should not be decreased.

II. There is No Safety and Soundness Reason that Justifies OFHEO Action to Decrease the CLL in the Face of Contrary Statutory Authority.

In the Proposed Guidance, OFHEO bases its authority for making annual decreases on OFHEO's safety and soundness mission. Despite our support for strong safety and soundness regulation, we must submit that we see no relationship between safety and soundness and whether the CLL is $417,000 or, for example $407,000. We are not aware of any evidence that the GSEs suffer significantly higher rates of delinquency or higher losses on loans with higher principal amounts, particularly where, as here, we are talking about modest differences in the principal amounts.

Even if safety and soundness were at issue, we believe any such concerns should be construed in light of the more specific provisions of the charter adjustment language.

III. Congress Recognizes the Need for Clarification of the Regulator's Authority to Decrease the CLL and the Need for Improvement in the Index Used to Set the CLL.

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[8] Supervisory Guidance, Section 3.
[9] See 12 U.S.C. 1717(b)(2) and U.S.C. 1454(a)(2).

Two bills applicable to the question of OFHEO's authority to adjust the CLL are under consideration in Congress, H.R. 1427, and S. 1100. The House bill, in Section 133, amends current law to specify that the regulator would have the authority to increase and decrease the CLL. We think that this legislation indicates that the bill's drafters believe that regulatory authority to decrease the CLL is unclear at present.

The House bill clarification indicates that there is support for giving the GSE regulator new authority to decrease the CLL. It also provides for the regulator to develop an index on which to base such adjustments in recognition of the fact that there are limitations to the way current law provides for the regulator to assess housing price changes. The two aspects of Section 133 go together. If the regulator is to have authority to decrease the CLL, it needs a good index on which to assess fluctuations in housing prices.

Critical Deficiencies in the Current Index

OFHEO is under statutory mandate to utilize as its base for assessment of housing price changes the percentage equal to the percentage yearly increase each October in the national average single family home price as reflected in data surveyed by the Federal Housing Finance Board (FHFB) (again, the FHFB Survey).[10] We attach a copy of its results for the last 20 years to demonstrate the intra-year volatility of the monthly prices.

The FHFB Survey has indicative value but it is surely not a reliable basis for determining an industry standard as significant as the CLL. The data excludes FHA-insured and VA-guaranteed mortgages, refinancing loans, and balloon loans. It is confined to conventional purchase-money mortgages and represents only the last five working days of the month.[11]

The October year-over-year value, which is the only monthly value that matters for purposes of assessment of housing prices, varies from the number in other FHFB Survey months in the same year by a significant amount. In some years the October number is higher and in some years it is lower than the amount showing for other months. The amounts are significant, on the order of $10,000, between the lowest and highest months in a year.

For the current year, the month with the highest price value was March with a level of $305,300. However, the most recent month (May) had a level of $297,000 for May. Both of those numbers represent a decrease from the October 2006 level of $306,300, but the reality is that thousands of borrowers would or would not be able to receive conforming loans based on an arbitrary one-month swing in the pricing levels.

[10] Ibid.
[11] Federal Housing Finance Board. See the technical note attached to each monthly announcement of Mortgage Interest Rates.

As already noted, the FHFB Survey is also limited due to the low level of participation from lenders and the fact that not all loans are included in it. When the system in place now was developed, housing prices tended to be flat. We now have price variability and the use of the October amount, representing only five days of business activity by a minority of lenders, has become arbitrary and unreliable as a reflection of changes in housing prices. Increases do not cause significant problems to borrowers and to the housing finance system, but decreases actually do.

Because the use of the FHFB Survey October average price results in an arbitrary price level that might or might not reflect annual fluctuations, OFHEO should not rely on it as a basis for decreases in the CLL which cause difficulties for consumers and the industry.

IV. Decreases in the Loan Ceiling Cause Significant Costs to the Industry and Limit Borrower Financing Options; Mortgagees Will Not be Able to Refinance Loans Made at the GSE CLL if the CLL Is Later Reduced.

MBA member companies of all sizes report that the annual adjustment of the GSE conforming loan ceiling requires systems adjustments throughout their companies. Every department from loan origination and secondary markets to servicing and quality assurance is affected. However, increases have no adverse impact on existing loan commitments.

Decreases to the loan ceiling, on the other hand, while requiring systems changes, will also have significant adverse business implications and potentially negative results for borrowers. In particular, construction loan commitments to individuals and refinance loans tend frequently to be made at approximately the level of the CLL, and construction loan commitments can extend beyond a 12-month period. Although the one-year deferral in the Proposed Guidance reduces the impact of decreases, it does not entirely resolve the construction loan commitments problem.

Just as importantly, decreases jeopardize those borrowers who receive a loan at the CLL, and then two years later want to refinance that loan for any reason. For example, a borrower who received a loan for $417,000 early in 2007 could wish to refinance in 2009 into a GSE mortgage at a lower rate or from an ARM to a fixed-rate mortgage. If the CLL had decreased to an amount below the outstanding principal balance of the borrower’s mortgage, then the borrower might not be able to refinance using a conforming mortgage.

Some consumers’ costs of borrowing for refinancing, new mortgages and construction loans will increase if GSE financing availability is limited through a reduction of the CLL. An unknown number of borrowers also are facing reset of adjustable rate mortgages at the CLL. An unintended consequence of OFHEO’s approach may be to deny these borrowers such an opportunity.

V. In Today's Mortgage Market Environment, There Are Strong Policy Reasons Not to Reduce the CLL.

A. Detrimental Impact on Borrowers in Need of Financing

Borrowers depend on the ability of the housing industries for construction of new homes, facilitation with the transaction process and financing to make home ownership possible. As you are aware, the housing sector is undergoing a transition and there is widespread concern about the availability of funds for the refinancing of loans and for new loans. While MBA supports the non-agency side of the housing finance system, the ability of the GSEs to provide liquidity is vital to borrowers at this time.

The Refinancing Borrower: Borrowers with loans at the CLL will be unable to refinance those loans with GSE financing if the CLL subsequently goes down. Many loans are made at the CLL. Reasons for borrower refinancing could range from the need for additional funds to the desire to change to a mortgage product that is more appropriate for the borrower. The alternative to such borrowers is non-conforming loan financing and a non-conforming loan will cost the borrower more and, in some cases, the higher non-conforming mortgage loan rate could result in inability for a refinancing borrower to qualify for the loan. Some borrowers will be caught, and we note that concerns about current ARM borrowers who could be better served with a different ARM or FRM product, are not likely to be resolved by January 2009, at which time the Proposed Guidance would allow potentially for a decrease to the CLL.

The New Construction Borrower: Commitments on new construction loans can extend for periods in excess of one year. OFHEO has acknowledged the need for a period of adjustment in the Proposed Guidance by deferring any CLL decreases for one year. We appreciate that deferral, but we do not believe that the one-year period is sufficient to cover long term commitments for new construction. We reiterate that a certain percentage of buyers would fail to qualify for financing the home they plan to build if they have to pay the higher non-conforming rate.

The First-Time Home Buyer and Low-Income Borrower: The government loan programs of FHA and VA have long been good sources of funding for low- and moderate-income borrowers, minority borrowers and first time home buyers. The impact of a decrease in the CLL would fall hardest of all on the population most in need of support.

The mortgage limits for FHA-insured loans are set on an area-by-area basis and the limits are indexed to the lesser of two benchmarks: (1) the median home price for the area, or (2) the CLL. For a one-family property, the FHA mortgage limit for an area is the lesser of (1) 95 percent of the median home price for the area or (2) 87 percent of the CLL, but not less than 48 percent of the Freddie Mac limit. The upper limit for VA loans is also tied to the CLL.

With the current and expected contraction in the availability of funds for low-income and non-prime borrowers, the availability of the government loan programs is particularly high. We understand that some borrowers in unaffordable non-conforming loans are refinancing into the government loan programs. We think that those government programs are very much in need at this time and we do not think it is good public policy to curtail them.

B. Detrimental Impact on Home Owners

The impact of a decrease in the availability of financing options and increased costs of mortgage financing is potentially detrimental to the value of housing as measured in price. OFHEO staff are housing finance experts and we need not belabor the point that there is currently concern about housing price levels and about the economic impact of price declines. A decrease in the CLL in itself could have a depressing effect on consumer perception of the housing market. The overall impact on housing prices of a decrease in the CLL could not be positive and could be negative.

C. Detrimental Impact on the Housing Industries

The business of our members is housing and we rely on a system of housing finance in which the GSEs and the government loan programs play a significant role in the support of homeownership. While we have diversified the secondary market sources of liquidity to accommodate the jumbo and non-conforming loan sectors, preserving the GSE and government facilities is important to serving our customers. Any decrease to the CLL that would limit the role of the GSE and government loan programs would be a step in the wrong direction, particularly at this time.

As MBA members pointed out to OFHEO in its letter of May 18, 2007, increases and decreases to the CLL both are costly, but decreases can be very expensive. If a lender has to cancel a loan commitment or place a loan in the pipeline outside of conforming financing, it is an expensive proposition.

The mortgage market is in a difficult period as lending standards readjust and the pace of home price appreciation slows and, in some local markets, even decreases. As some borrowers attempt to move to new mortgages in order to avoid interest rate increases on their adjustable-rate mortgages, or otherwise create more certainty in their mortgage instruments, the resources of the GSEs are vital.

The GSE loan ceiling is a number that is closely watched in the mortgage industry. We do not think at this time that bringing that number down would be helpful in stabilizing the current mortgage market. In fact, we believe that bringing down the conforming loan ceiling could, in itself, confirm fears that housing values are down in all markets, which is not the case.

OFHEO staff have expressed to us some concern that failure to decrease the conforming loan ceiling could result in a disproportionately high GSE loan ceiling compared with the actual cost of housing. None of us expects that to be the case. An extended period of years of declining housing values would be unprecedented historically.

VI. MBA Supports the Approach of Not Lowering the CLL and Netting Increases Against Decreases.

As stated in our May letter to OFHEO, MBA does not believe that OFHEO should decrease the CLL, but instead should net decreases resulting from the FHFB Survey against increases in future years.

VII. Conclusion

While we disagree with OFHEO in significant ways, MBA would like to express our appreciation for the opportunity to comment on the Proposed Guidance. We simply cannot read the GSE charters in such a way that we see authority for OFHEO to reduce the CLL, and we do not see a compelling safety and soundness justification for it. On the contrary, we think OFHEO should wait for Congress to clarify its regulatory authority.

The liquidity facility of the GSEs is important for our industry and for consumers, particularly as we face a mortgage market adjustment of major proportions. MBA shares the goal of effective GSE regulation with OFHEO and we look forward to working with you on this issue and others of significance to the industry.

Any questions regarding this letter should be referred to Kathy Gibbons at (202) 557-2870 or kgibbons@mortgagebankers.org or to Ken Markison at (202) 557-2930 or kmarkison@mortgagebankers.org.

Most sincerely,

Jonathan L. Kempner

Jonathan L. Kempner
President and Chief Executive Officer