



REGULATORY & HOUSING POLICY

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March 4, 2008

Mr. Alfred M. Pollard
General Counsel
Attention: Comments/RIN 2550-AA38
Office of Federal Housing Enterprise Oversight
Fourth Floor
1700 G Street, NW
Washington, DC 20552

Re: Risk-Based Capital Regulation – Loss Severity Amendments (RIN 2550-AA38)

Dear Mr. Pollard:

On behalf of the 235,000 members of the National Association of Home Builders (NAHB), I would like to submit comments on the Office of Federal Housing Enterprise Oversight's (OFHEO) December 5, 2007 Notice of Proposed Rulemaking (NPR) relating to amendments to the Risk Based Capital (RBC) Regulation for Fannie Mae and Freddie Mac (the Enterprises). OFHEO proposes to amend the RBC Regulation to change certain loss severity equations that may understate losses on defaulted single-family conventional and government-backed mortgage loans and to conform the treatment of Federal Housing Administration (FHA)-insured loans to current law.

NAHB fully supports the proposed technical corrections that are exclusively related to mortgages carrying FHA insurance or a Department of Veterans Affairs (VA) guarantee. We have strong concerns, however, regarding OFHEO's proposal to amend the loss severity equation for both conventional and government-backed mortgages in a manner that would entirely exclude the possibility of gains on foreclosed mortgages in the calculation.

In the NPR, OFHEO maintains that, as currently specified, certain loss severity equations overstate recoveries on foreclosed mortgages during the calculation of the risk-based capital requirement. Specifically, the current calculations can produce negative losses (profits) for foreclosures involving low loan-to-value (LTV) and government-backed mortgages. OFHEO's principal criticism is that the formula for estimating the current LTV of a loan often overstates home price appreciation, a flaw that OFHEO finds magnified as result of the sharp increases in home prices in recent years. OFHEO states that foreclosure profits on low LTV mortgages occur only rarely because borrowers on such loans can usually sell their house and prepay the mortgage rather than default. OFHEO concludes that actual defaults in such circumstances generally would yield recovery proceeds below the rate specified in the current equations.

Furthermore, OFHEO believes that an assumption of profits on defaults is not consistent with the credit stress environment envisioned in the RBC.

OFHEO does not propose other configurations for the loss severity equations, finding that alternative specifications that avoid the problem of profits on default would add considerable complexity to the model and have other, undisclosed problems. OFHEO's proposed solution is to "correct" the loss severity equations by constraining the results to be non-negative. In other words, break-even would be the best outcome of any default, regardless of circumstances.

NAHB disagrees with the approach of over riding equations in the RBC Regulations. If OFHEO feels the formula for determining current house prices and LTVs is faulty, NAHB believes that the appropriate solution is to amend those equations in a comprehensive manner, based on an analysis of a representative sample of loss severity results for low LTV and government-backed mortgages. OFHEO's solution is a piecemeal patch that fails to appropriately calibrate capital requirements to risk. The major problem with the proposal is that it limits recognition of risk-management and loss-mitigation efforts of the Enterprises. There are situations where the Enterprises have arranged private mortgage insurance coverage that is deeper than required by statute, obtained defined benefit coverage that may exceed actual recovery losses, or instituted other credit enhancement protection. These provisions should be recognized in the calculation of loss severity, but would be ignored as a result of the proposal to constrain non-negative losses.

In conclusion, NAHB supports amendments to the RBC Regulation that would improve the alignment of capital with risk while appropriately balancing safety and soundness with mission achievement for the Enterprises. NAHB agrees that the proposed technical corrections specified exclusively for government-backed loans achieve these principles. However, we believe the proposed non-negative constraint on the loss severity equations does not meet these principles and, therefore, should be revisited or abandoned.

We appreciate the opportunity to comment on the proposed RBC Regulation amendments. Please contact John Dimitri in NAHB's Housing Finance Department (202-266-8529; jdimitri@nahb.com) with any questions on our submission.

Respectfully,



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Regulatory and Housing Policy