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**Via Electronic Submission**

April 12, 2010

Mr. Alfred M. Pollard, Esq.  
General Counsel  
Federal Housing Finance Agency  
1700 G Street, N.W., Fourth Floor  
Washington, D.C. 20552

Attention: Comments – RIN 2590-AA26 (Enterprise Affordable Housing Goals)

Dear Mr. Pollard:

Freddie Mac is pleased to submit our enclosed comments on the Federal Housing Finance Agency's proposed rule regarding the 2010-2011 Enterprise Affordable Housing Goals.

Freddie Mac is committed to our statutory mission to provide liquidity, stability and affordability to the U.S. housing market. We commend FHFA for its thoughtful development of the proposed rule and look forward to working toward our shared objective of supporting affordable and sustainable homeownership and rental opportunities across the country.

Please do not hesitate to contact us if you have any questions.

Sincerely,

A handwritten signature in black ink, appearing to read "R. Bostrom", written over a white background.

Robert E. Bostrom

cc: Robert Tsien  
Wendell Chambliss  
Thomas Kim

Enclosure



**COMMENTS OF THE FEDERAL HOME LOAN MORTGAGE CORPORATION**

**ON**

**THE FEDERAL HOUSING FINANCE AGENCY'S PROPOSED RULE ON  
THE 2010-2011 ENTERPRISE AFFORDABLE HOUSING GOALS**

**RIN 2590-AA26**

**APRIL 12, 2010**

## OVERVIEW

The Federal Home Loan Mortgage Corporation (Freddie Mac) respectfully submits these comments to the Federal Housing Finance Agency (FHFA) with regard to its proposed rule on the 2010-2011 Enterprise Affordable Housing Goals.<sup>1</sup> FHFA's proposed rule reflects the new affordable housing goals established by the Housing and Economic Recovery Act of 2008 (HERA).<sup>2</sup>

Freddie Mac strongly supports a regulatory framework that views the affordable housing goals in the context of the Enterprises' overall public mission and safety and soundness principles. We commend FHFA for proposing a rule that reflects this holistic approach. Freddie Mac agrees that "[w]hile in conservatorship, . . . the Enterprises [are expected] to continue to fulfill their core statutory purposes, including their support for affordable housing,"<sup>3</sup> and that "[t]he affordable housing goals are one set of measures of that support."<sup>4</sup> At the same time, "FHFA does not intend for the Enterprises to undertake uneconomic or high-risk activities in support of the goals"<sup>5</sup> and believes that "[m]aintaining sound underwriting discipline going forward is important for conserving the Enterprises' assets and for supporting their mission in a manner in which the achievement of housing goals directly relates to actual market conditions."<sup>6</sup> The continuing uncertainty in the residential mortgage market supports the balanced approach FHFA has articulated.

Our comments on the proposed rule are organized as follows:

**Section I** discusses Freddie Mac's broad public purposes, its affordable housing mission, and the importance of safety and soundness. These foundational principles, we submit, should guide FHFA's rulemaking and any assessments thereunder.

**Section II** discusses the proposed single-family goals. Freddie Mac supports FHFA's new, dual approach to goals-setting, integrating prospective benchmark targets with a retrospective assessment of the mortgage market. We urge its careful implementation to ensure achievement of intended objectives while avoiding unintended consequences. Freddie Mac also commends FHFA for recognizing the critical connection between the public policy objectives of affordability and sustainability. In addition, we recommend that the proposed target for one of the four single-family benchmark targets be lowered

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<sup>1</sup> 75 Fed. Reg. 9034 (Feb. 26, 2010).

<sup>2</sup> The Federal Housing Finance Regulatory Reform Act of 2008, enacted as part of HERA, Public Law 110-289, signed into law on July 30, 2008, amended the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (FHEFSSA).

<sup>3</sup> 75 Fed. Reg. at 9035.

<sup>4</sup> *Id.*

<sup>5</sup> *Id.*

<sup>6</sup> 75 Fed. Reg. at 9036. *See also* 75 Fed. Reg. at 9056.

in light of recently available data. Finally, we express support for FHFA and other efforts to collect both single-family and multifamily mortgage market data on a more comprehensive and timely basis.

**Section III** discusses the proposed multifamily goals. Freddie Mac has and will continue to play a vital role in the multifamily mortgage market, which is integral to our affordable housing mission. We believe, however, that the multifamily targets in the proposed rule are not reflective of current market conditions and should be lowered. We also counsel against the establishment of an additional subgoal.

Finally, **Section IV** recommends a number of revisions and clarifications to FHFA's proposed goal counting rules. Our suggested changes, we believe, would strengthen and support Freddie Mac's efforts to "facilitate the financing" of affordable housing as envisioned by Congress.<sup>7</sup>

## I. FREDDIE MAC'S AFFORDABLE HOUSING MISSION

Freddie Mac was created to fulfill broad public objectives to serve the U.S. residential mortgage markets. Freddie Mac's Charter sets forth the public purposes of the Enterprise to:

- Provide stability in the secondary market for residential mortgages;
- Respond appropriately to the private capital market;
- Provide ongoing assistance to the secondary market for residential mortgages (including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing; and
- Promote access to mortgage credit throughout the Nation (including central cities, rural areas, and underserved areas) by increasing the liquidity of mortgage investment and improving the distribution of investment capital available for residential mortgage financing.<sup>8</sup>

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<sup>7</sup> FHEFSSA § 1302(7), 12 U.S.C. § 4501(7).

<sup>8</sup> Freddie Mac Act § 301(b), 12 U.S.C. § 1451(b)(Note) (as amended by section 1382(a)(3) of FHEFSSA, 12 U.S.C. § 4501 et seq.).

Our mission to provide liquidity, stability and affordability emerges from these public purposes. Freddie Mac's efforts to facilitate the financing of affordable housing as part of this broad public mission require careful and ongoing calibration, particularly as we "respond appropriately to the private capital market"<sup>9</sup> in the current housing market and the period of FHFA conservatorship.

Congress reinforced the multi-faceted character of our affordable housing mission when it established the affordable housing goals in 1992. Congress found that the Enterprises "have an affirmative obligation to facilitate the financing of affordable housing for low- and moderate-income families in a manner consistent with their overall public purposes, while maintaining a strong financial condition and a reasonable economic return."<sup>10</sup> Our affordable housing mission — including the affordable housing goals — cannot be viewed in isolation.

As the Treasury Department stated in December 2009: "Recent announcements on the tightening of underwriting standards by Fannie Mae, Freddie Mac, and the Federal Housing Administration, demonstrate a commitment to prudent housing finance policy that enables a transition to an environment where the private market is able to provide a larger source of mortgage finance."<sup>11</sup> Moreover, FHFA discusses its broad objective with regard to the 2009 housing goals, as well as those for 2010 and 2011: "In 2009, FHFA attempted to align the Enterprises' affordable housing goals with safe and sound practices and market reality, and the housing goals requirements for 2010 and 2011 must be similarly aligned."<sup>12</sup>

In light of FHFA's emphasis on balancing the affordable housing goals with safety and soundness, we note that our focus and that of FHFA on prudent risk management could result in the purchase of fewer loans, including fewer loans that qualify toward one or more of the housing goals. We recommend, therefore, that FHFA set the final 2010-2011 targets and subsequently review our goals-performance taking into account the impact of this approach.

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<sup>9</sup> Freddie Mac Act § 301(b)(2), 12 U.S.C. § 1451(b)(2)(Note), as amended.

<sup>10</sup> FHEFSSA § 1302(7), 12 U.S.C. § 4501(7).

<sup>11</sup> Press Release, U.S. Department of the Treasury, *Treasury Issues Update on Status of Support for Housing Programs* (Dec. 24, 2009).

<sup>12</sup> 75 Fed. Reg. at 9051. *See also* 75 Fed. Reg. at 9056.

## II. SINGLE-FAMILY MARKET BENCHMARKS AND MARKET ASSESSMENTS

### A. FHFA's Proposed Single-Family Goals-Setting Methodology

The pre-2010 goals-setting process sought to forecast economic conditions and mortgage market activity for multiple years in advance. FHFA has clearly recognized the difficulties inherent in such an exercise — difficulties compounded when largely unanticipated events create substantial deviations from prior, baseline mortgage market forecasts.<sup>13</sup> Projecting market size and composition — a challenging task even in a relatively stable economic environment — can become extremely difficult under the turbulent market conditions characterizing the last several years.<sup>14</sup> In particular, the interest rate environment, house prices, consumer confidence levels, household income and the unemployment rate can change rapidly as we have recently witnessed and, in turn, have a profound effect on the volume and goal-qualifying composition of the Enterprises' mortgage purchases.

By contrast, FHFA in its proposed 2010-2011 rule seeks to “measure the Enterprises' single-family goal performance relative to benchmark levels for the goals-qualifying shares of the Enterprises' mortgage purchases, as well as relative to the actual goals-qualifying shares of the primary mortgage market.”<sup>15</sup> FHFA's proposed dual approach to goals-setting eliminates exclusive reliance on uncertain market forecasts, retains incentives for the Enterprises' to strive to meet the proposed benchmarks, and enables the Enterprises to plan their mortgage purchase operations and related activities.

Freddie Mac believes that the statutory framework of HERA strongly supports housing goals based upon the integration of prospective goal targets with retrospective regulatory assessments of actual market purchase opportunities. FHFA appropriately points to numerous provisions in HERA requiring FHFA to establish annual targets and authorizing FHFA to adjust the annual goals within a given year based on market developments, market and economic conditions, and subsequent available data.<sup>16</sup>

In implementing the dual approach, we urge FHFA to incorporate several fundamental concepts to ensure achievement of FHFA's intended objectives while avoiding unintended consequences.

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<sup>13</sup> 75 Fed. Reg. at 9036 (referencing “the difficulties in anticipating market deviations from the normal home purchase environment in the traditional approach to goal setting”).

<sup>14</sup> Thus, FHFA determined to alter the goal-setting approach “in light of the difficulties of predicting the market, especially in light of recent market turmoil, but also in view of the difficulty in making those projections accurately even in more stable economic environments.” 75 Fed. Reg. at 9036.

<sup>15</sup> 75 Fed. Reg. at 9036.

<sup>16</sup> See 75 Fed. Reg. at 9036 nn. 19-22.

## **B. The Proposed Benchmarks and Retrospective Market Assessment**

The Enterprises are only able to purchase mortgages eligible under their respective Charters. In addition, fulfilling the Enterprises' overall mission, the emphasis on safety and soundness, and limitations set by FHFA or others can all limit the mortgages available for the Enterprises to purchase. We urge FHFA to consider all of these factors when setting benchmarks for Enterprise affordable goal performance, as well as in making its retrospective market assessment.

### **1. Defining the Single-Family Market: Appropriate Rate Spread Exclusion**

Proposed section 1282.12(b) limits the size of the market for each single-family goal to mortgages with characteristics that are within the scope of the goal (*e.g.*, mortgages on owner-occupied properties) and eligible for purchase. Proposed section 1282.12(b)(5), however, would exclude from the sizing of the market "[a]ll mortgages with rate spreads of 300 basis points or more above the applicable average prime offer rate [APOR] as reported in the Home Mortgage Disclosure Act data." We believe a more appropriate exclusion should be all mortgages with rate spreads of 150 basis points above the APOR.

In the proposed rule regarding higher-priced mortgage loans (HPMLs), the Federal Reserve Board defined HPMLs as "a consumer credit transaction that is secured by the consumer's principal dwelling in which the annual percent rate at consummation will exceed the yield on comparable Treasury securities by three or more percentage points for loans secured by a first lien on a dwelling, or by five or more percentage points for loans secured by a subordinate lien on a dwelling."<sup>17</sup> In the final rule, however, the Federal Reserve Board adopted a functionally similar definition, but one with a different benchmark and threshold — "[i]nstead of yields on Treasury securities, the definition uses average offer rates for the lowest-risk prime mortgages, termed 'average prime offer rates.'"<sup>18</sup> The threshold is set at 150 basis points above APOR for first lien loans and 350 basis points for subordinate lien loans.

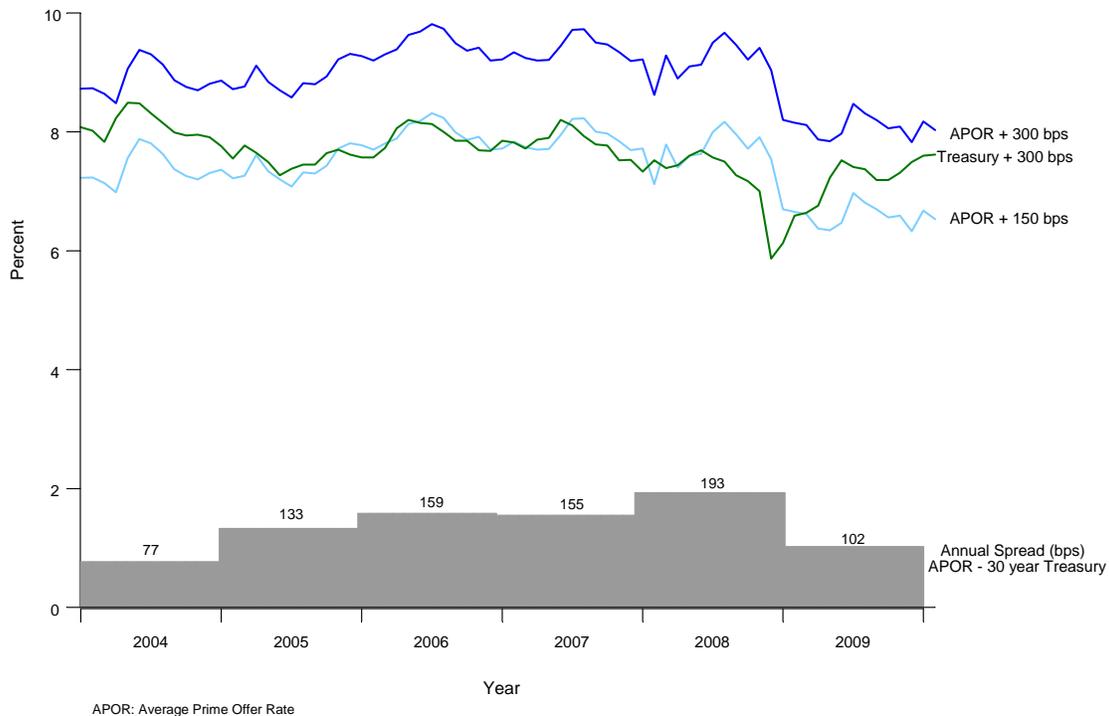
The figure below illustrates the substantial similarity between the Federal Reserve's proposed and final rules. It also shows that the proposed section 1282.12(b)(5) threshold of 300 basis point above APOR would cause the market (as sized for goals purposes) to include HPMLs as currently defined. The increased consumer protections required for HPMLs indicate the Federal Reserve's concerns about the increased risks of HPMLs. In the same spirit, we believe it would be appropriate to limit the market for goals-eligible loans in a manner consistent with the Federal Reserve's final HPML definition.

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<sup>17</sup> 73 Fed. Reg. at 1725 (Jan. 9, 2008).

<sup>18</sup> 73 Fed. Reg. 44522, 44531 (July 30, 2008).

## APOR Plus 150 Basis Points Correlates to Treasury Plus 300 Basis Points



Because subordinate lien loans are already excluded under section 1282.12(b)(3) (“all mortgages flagged as . . . subordinate lien loans shall be excluded”), we recommend amending subsection (b)(5) to read as follows:

“(b) *Size of market . . .*

(5) All first lien mortgages secured by a consumer’s principal dwelling with an annual percentage rate that exceeds the average prime offer rate for a comparable transaction as of the date the interest rate is set by 150 or more basis points shall be excluded;”

Finally, with the addition of a retrospective assessment based on HMDA data, alignment between FHFA and the Enterprises on the interpretation and processing of HMDA data becomes critically important. Given this, we would appreciate FHFA’s cooperation in matching results for the 2008 HMDA data as a trial run for the process that will be used in September 2011 for the 2010 HMDA data.

## 2. Sustainability and the Affordable Housing Goals

Freddie Mac commends FHFA for recognizing the integral connection between the public policy objectives of affordability and sustainability. In particular, we support FHFA's proposal to explore expected cumulative default rates (CDRs) as a market sizing alternative: "Under this approach, the housing goals would be defined in such a way that only mortgages that support sustainable homeownership would count toward the goals."<sup>19</sup>

In addition to being a more direct measure of expected sustainability for borrowers than the definition of HPMLs, the expected CDR metric has several other useful attributes. First, a default risk limit recognizes that the market may include mortgages with unacceptably high risks and thus appropriately narrows the proposed use of actual goals-qualifying shares of the primary mortgage market as a compliance standard. Second, it provides an intuitive summary statistic that allows analysis across many different combinations of product types and risk attributes. This unified measure is more comprehensive and ultimately simpler to implement than regulating explicitly based upon many possible combinations of product features and risk factors. Third, it can be a dynamic measure that can be judiciously adjusted as market conditions or product mixes change. Fourth, by defining the acceptable degree of risk for prime mortgages, the expected CDR measure should also help FHFA and the Enterprises align and maintain appropriate balance between affordability, sustainability, and safety and soundness.

To implement an expected CDR test, we agree that "FHFA would also have to develop estimates of the share of single-family mortgages originated each year that had estimated CDRs above and below that threshold."<sup>20</sup> Furthermore, such a methodology should be reasonably aligned with the proprietary models that the Enterprises use to assess the default risks of their purchases. Absent such alignment, there will be inconsistency between FHFA's and the Enterprises' views of market opportunities. Developing such a market model will, however, require material effort. We commend FHFA's efforts to develop new data and urge FHFA to collaborate with the Enterprises to develop the CDR concept in the context of the affordable housing goals.

### C. Three Single-Family Benchmarks Appear to be Within the Range of Market Forecasts, but the Low-Income Refinance Benchmark Appears Too High

Assuming that FHFA adopts our comments on appropriately sizing the market with respect to HPMLs, Freddie Mac views the benchmarks for the low-income goal, very low-income goal, and low-income areas goal as substantially consistent with our internal

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<sup>19</sup> 75 Fed. Reg. at 9051.

<sup>20</sup> *Id.*

market forecasts at this time. We believe, however, that the low-income refinance benchmark is set too high for 2010.

FHFA has proposed that the target for low-income refinances be set to 25 percent for 2010 and 2011. While this is a reasonable average of past years' performance based on HMDA data through 2008,<sup>21</sup> more recent data suggest that the 2010 market for low-income refinances will be substantially lower. Our latest estimate is 22.6 percent.

In general, the share of low-income refinance-qualifying mortgages decreases when the share of rate- or term-reducing refinances increases (as opposed to cash-out, Home Affordable Refinance Program (HARP) or other types of refinances). Because of this basic dynamic and the favorable interest rate environment over the past year, the mortgage market experienced a very substantial drop in the share of refinance mortgages taken out by low-income borrowers in 2009. This downward trend is, of course, not reflected in the 2008 HMDA data, and suggests that the market will enter 2010 at a low-income refinance-qualifying share substantially below 2008 levels.

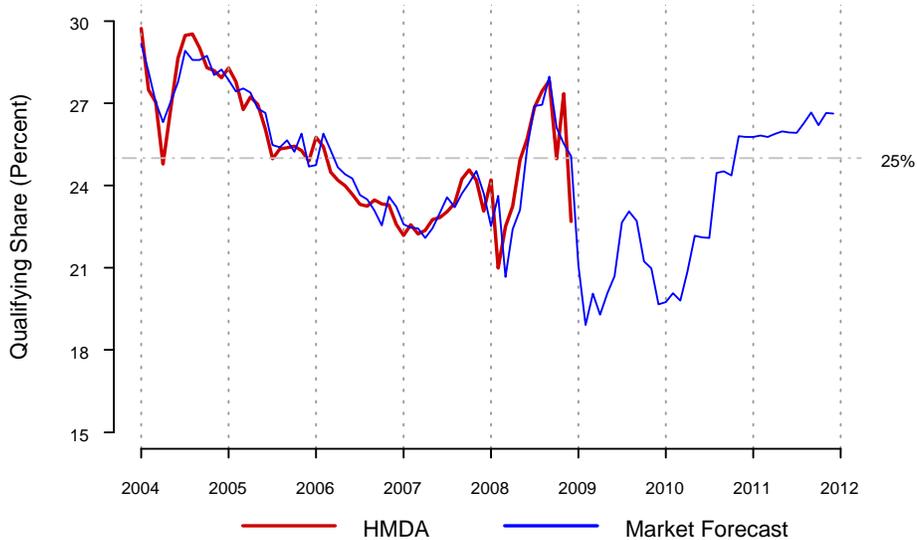
Notwithstanding the expectation that low-income refinance-qualifying shares will improve throughout 2010 (due to recovering house prices and increasing or stable interest rates), our current market forecast for the 2010 low-income refinance market is 22.6 percent, substantially below the proposed target of 25 percent.<sup>22</sup> The figure below shows our HMDA measure of the low-income market through 2008 and the Freddie Mac forecast through 2011. Freddie Mac therefore believes that a reduction in the low-income refinance target would be prudent and consistent with updated market data. We recommend setting the benchmark target for the low-income refinance goal at 22 to 23 percent for 2010. For 2011, we believe that the proposed target of 25 percent is within the range of our current market forecast.

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<sup>21</sup> Historically, the monthly share of qualifying low-income mortgage purchases has ranged widely from 20 to 30 percent, depending on mortgage interest rates and refinance shares.

<sup>22</sup> We expect an increasing trend through the year, but the timing of that increase will depend on long-term interest rates. As long-term interest rates increase, there will be a drop in the volume of rate-and-term refinances, which tend to be less goal-qualifying. While it is generally expected that long-term rates will likely rise, it is difficult to forecast how quickly or how soon long-term rates will do so.

Low Income Refinance Goal  
HMDA Market and Forecast



**D. FHFA's Proposed Monthly Survey**

FHFA has indicated that it will begin to conduct a monthly mortgage market survey in 2010 and “will use the survey data in its monitoring of Enterprise affordable housing goals performance in 2010 and subsequent years.”<sup>23</sup> Freddie Mac supports FHFA’s development of a monthly survey that focuses on a timely and broad assessment of current mortgage market activity. In collecting this data, we ask that FHFA appropriately address concerns around privacy and the use of proprietary information. Freddie Mac would be pleased to assist in this effort.

We also encourage FHFA to actively explore and promote parallel data collection efforts that may complement the proposed monthly mortgage market survey. These initiatives present a unique opportunity to compile current market information on prevailing loan terms, borrower characteristics and market pricing, and serve as a real-time gauge of key lending activities and financing costs.

As important as it is to improve single-family data, the need for better multifamily market data is even greater. Currently, there is no representative market survey of multifamily properties or mortgages. With our encouragement, the Department of Housing and Urban Development has taken a leadership role in developing the Rental

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<sup>23</sup> 75 Fed. Reg. at 9036.

Housing Finance Survey (RHFS). The current plan, as we understand, is for the data to be collected in 2011 and released in 2012. The survey will cover small and large multifamily rental properties and has the potential to serve as the basis for much more accurate market sizing and goal setting. We encourage FHFA to take advantage of these new data sources, particularly if FHFA might consider establishing an additional multifamily subgoal.

### **III. MULTIFAMILY TARGET LEVELS**

Freddie Mac has long been a reliable source of liquidity in the multifamily mortgage market, and throughout the current crisis, has continued to provide steadfast support for the financing of affordable multifamily housing. As FHFA observed, since the credit crisis began, “Freddie Mac and Fannie Mae [have served] as the principal sources of financing for most multifamily mortgages.”<sup>24</sup> At the same time, we have prudently managed our credit risk in this market. Indeed, our multifamily delinquency rate is among the lowest in the industry.

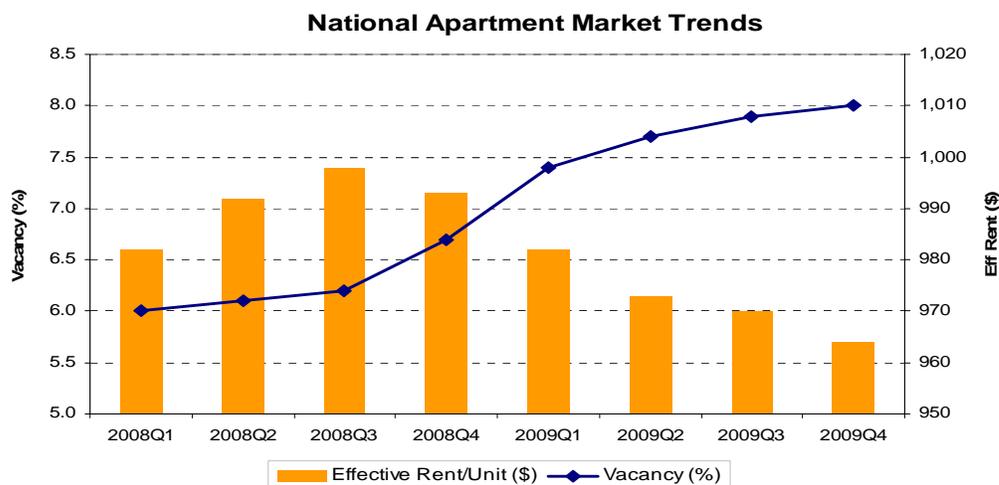
Given current conditions in the multifamily mortgage market, however, we believe that both of the multifamily targets are set too high. The following discussion explains the basis for this view.

#### **A. State of the Multifamily Market and the Proposed Targets**

The fundamentals of the multifamily housing market remain weak. In particular, high unemployment rates have depressed market rents and encouraged rent concessions. As shown in the figure below, the national vacancy rate reached a 30-year high of 8 percent in the fourth quarter of 2009. This figure represents a two percentage point rise in less than two years. At the same time, effective rents (*i.e.*, rents net of concessions provided to tenants) declined nearly three percent from the fourth quarter 2008 to the fourth quarter 2009, and the trend is expected to have continued at least through the first part of 2010.

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<sup>24</sup> 75 Fed. Reg. at 9051.



Data Source: REIS, Inc.

As FHFA discussed in the preamble to the proposed rules, property values and property starts have declined.<sup>25</sup> Reduced equity and tighter underwriting standards are limiting opportunities for cash-out “supplemental” subordinate loans or outright refinancing for borrowers with high loan-to-value ratios. Substantially lower property resale activity, combined with declines in construction and rehabilitation activity, has also reduced demand for financing. As a result, the demand for apartment financing in 2010 is expected to further shrink in the range of 10 to 15 percent lower than 2009. In fact, despite having relatively stable market share, Freddie Mac’s multifamily purchase volume for the first quarter of 2010 represents the lowest quarterly volume since the second quarter of 2005. At the same time, we expect competition for this smaller market to increase as multifamily lenders that were on the sidelines during 2009 have begun to re-enter the market this year.

Consequently, achieving the proposed targets, or even matching 2009, likely will not be feasible in a manner consistent with our safety and soundness. We request that FHFA adjust our 2010 multifamily targets to lower levels, taking into consideration our recently reported data for 2009 as well as the continuing market contraction and increased competition described above.

Given market uncertainty and the limited sources of market data available, we also recommend that FHFA set the 2011 goals at a later time using updated information about 2010 market conditions and Enterprise purchase trends.

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<sup>25</sup> 75 Fed. Reg. at 9052.

## **B. Small Multifamily Property Market**

FHFA seeks comment on “whether small multifamily low-income housing subgoals should be established for future years.”<sup>26</sup> As FHFA notes, “[m]ortgages on small multifamily properties . . . are often more at risk of delinquency and default than other multifamily mortgage property types.”<sup>27</sup>

Due to the very high inherent credit risk associated with this segment of the multifamily market, Freddie Mac has historically served this segment through the purchase of multifamily commercial mortgage-backed securities (CMBS) and other structured or credit-enhanced pool transactions. Through these executions, Freddie Mac has been able to provide liquidity to this affordable segment of the rental housing market, while managing the greater credit risk. Although, as FHFA notes, such executions are not currently widely available, we believe that avenues, including CMBS, for providing liquidity to this market should remain eligible for housing goal credit.

Importantly, we discourage FHFA from establishing another subgoal at this time. Given the uncertain multifamily market, the poor relative performance of this asset class, the dearth of authoritative market data with which to set a new subgoal that must appropriately correlate with other proposed targets, as well as the financial condition of both Enterprises, the relatively blunt instrument of a new subgoal would potentially expand lending without a full understanding of the safety and soundness considerations that are essential, particularly during this period of conservatorship. As FHFA continues to collect data on this segment of the market, we urge ongoing dialogue between Freddie Mac and FHFA on the most effective approaches to supporting the small multifamily property market.

## **IV. RECOMMENDATIONS ON PROPOSED GOAL COUNTING RULES**

The discussion above focused on the proposed targets for the single-family and multifamily housing goals. In this section, we recommend modifications and clarifications to the goal-counting rules that govern the transaction types, mortgage attributes or property characteristics that determine eligibility to count toward the affordable housing goals.

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<sup>26</sup> 75 Fed. Reg. at 9054.

<sup>27</sup> 75 Fed. Reg. at 9056.

## Homeownership Preservation and Neighborhood Stabilization

Supporting the Administration's efforts to prevent defaults and foreclosures remains a top Freddie Mac priority. We commend FHFA for retaining the rule that loan modifications in accordance with the Making Home Affordable (MHA) program will remain eligible under the proposed affordable housing goals. FHFA's favorable goals treatment of MHA modifications is supported by FHFA's finding in the 2009 rulemaking that the greatest current threat to home ownership is the risk of default and foreclosure.<sup>28</sup>

In addition to our commitment to MHA modifications, Freddie Mac continues to seek ways to reduce foreclosures, preserve homeownership and strengthen local communities that have been severely impacted by financial distress. We believe that loan modifications outside of MHA that preserve homeownership should be eligible to count toward the affordable housing goals too.

Freddie Mac also recommends that modifications of multifamily mortgages be goals-eligible. Interventions in the multifamily sector are designed to mitigate the risk and adverse impacts of foreclosure. Such modifications benefit tenants — the vast majority of whom are low- and moderate-income households — by preventing disinvestment and maintaining building services. This promotes decent, safe housing and helps avoid destabilizing the surrounding community.

Other neighborhood and community stabilization efforts beyond modifications and workouts, such as real estate owned (REO) management and disposition initiatives that preserve the safe, clean and affordable condition of single-family homes, as well as individual rental units and apartment buildings, help strengthen neighborhoods and stabilize communities that may be suffering from adverse economic impact.

Accordingly, we recommend the following amendments to the proposed regulatory language:

- “(10) *Loan modifications and related initiatives.* An Enterprise's modification of a loan shall be treated as a mortgage purchase for purposes of the housing goals only if:
- (A) The modification of the loan is in accordance with the Making Home Affordable program announced on March 4, 2009, and the loan is held in the Enterprise's portfolio or in a pool backing a security guaranteed by the Enterprise; or

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<sup>28</sup> 74 Fed. Reg. at 20251.

(B) The modification of the loan

- (i) is made in accordance with guidance by the Enterprise to its servicer, vendor or other agent,
- (ii) is made pursuant to a written agreement between the borrower and servicer, vendor or other agent of the Enterprise,
- (iii) results in one or more terms of the loan being materially changed so that payment is more affordable, and
- (iv) the loan is held in the Enterprise's portfolio or in a pool backing a security guaranteed by the Enterprise

*Other related initiatives.* Initiatives designed to support neighborhood and community stabilization shall be treated as a mortgage purchase for purposes of the housing goals, if approved by FHFA.”

FHFA would retain discretionary authority regarding the goals-eligibility of neighborhood stabilization-focused initiatives, such as those relating to REO-management and disposition, based on the specifics of any such initiative. We look forward to ongoing discussions with FHFA about such efforts, which we view as important to our affordable housing mission.

### **Private Label Securities, Securitization and Facilitating the Financing of Affordable Housing**

FHFA proposes to exclude the purchase of private label securities (PLS) from counting toward the affordable housing goals.<sup>29</sup> The proposed rule defines a PLS as “any mortgage-backed security that is neither issued nor guaranteed by Fannie Mae, Freddie Mac, Ginnie Mae or any other government agency.” In addition, FHFA seeks comment on alternatives to not counting PLS mortgages under the affordable housing goals.<sup>30</sup>

Consistent with FHFA's suggested alternative approach, we recommend that PLS may be eligible to count toward the affordable housing goals as long as an Enterprise conducts substantial due diligence on the underlying mortgage collateral in accordance with its credit and underwriting policies and such collateral meets goals eligibility requirements regarding “good mortgage practices, and [complies] with the interagency guidance on subprime lending and non-traditional loans.”<sup>31</sup> Where an Enterprise does

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<sup>29</sup> Prop. § 1282.16(b)(13). As a result of the proposed exclusion, “[p]roposed § 1282.16(c) would no longer include real estate mortgage investment conduits (REMICs) as mortgage purchases for purposes of the housing goals, consistent with the general exclusion of PLS under proposed § 1282.16(b)(13).” 75 Fed. Reg. at 9059

<sup>30</sup> 75 Fed. Reg. at 9059-60.

<sup>31</sup> *Id.*

not conduct such due diligence, cannot conduct such due diligence due to the unavailability of sufficient loan level credit information, or the Enterprise determines that the underlying collateral does not meet its credit and underwriting guidelines, the PLS would not be eligible to count toward the affordable housing goals.

In this regard, we note that the U.S. Securities and Exchange Commission (SEC) recently proposed rules to enhance investor protection and promote more efficient securitization markets. The SEC observed, “[u]nder the current ABS rules, information about the loans in the ABS pool is required only at the pool level.”<sup>32</sup> The SEC further stated that, “[t]he recent financial crisis highlighted that investors and other participants in the securitization market did not have the necessary tools to be able to fully understand the risk underlying those securities and did not value those securities properly or accurately.”<sup>33</sup>

The more nuanced distinction between “goals ineligible” and “goals eligible” PLS segments meets the policy objectives discussed in FHFA’s preamble, while allowing securitization to be used by an Enterprise to manage credit or operational risks and thereby to provide liquidity, stability and affordability to the mortgage markets in a manner consistent with safety and soundness.<sup>34</sup> Accordingly, we propose the following amendment in support of the suggested clarifications above:

“§1282.16(b)(13) — Purchases of private label securities, except as provided in paragraph (c)(11) of this section;” and

\* \* \*

“(c)(11) *Private label securities*. The purchase or guarantee by an Enterprise of a private label security shall be treated as a mortgage purchase for purposes of the housing goals if:

- (i) The Enterprise has performed its own due diligence on the mortgages underlying the private label security purchased by the Enterprise and determined that the mortgages comply with the Enterprise’s credit and underwriting guidelines; and

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<sup>32</sup> SEC Press Release 2010-54, *SEC Proposes Rules to Increase Investor Protections in Asset-Backed Securities* (April 7, 2010).

<sup>33</sup> SEC Proposed Rule, RIN 3235-AK37, at 9 (<http://www.sec.gov/rules/proposed/2010/33-9117.pdf>).

<sup>34</sup> For example, Freddie Mac has made tremendous progress in advancing its multifamily securitization capabilities, particularly with its “K-deal” securitization execution and its mortgage product, the Capital Markets Execution (CME). Freddie Mac is able to access more potential capital sources in order to finance multifamily properties at competitive rates, while providing greater liquidity and stability to a sector of the apartment market that would not otherwise be served under current market conditions. In our single family business, the “T-deal” execution represents a similar use of securitization and PLS that enhances credit risk management and operational efficiencies, while providing liquidity and stability to the conventional, conforming market.

- (ii) The Enterprise either:
  - (A) guarantees and issues an Enterprise security backed by the private label security; or
  - (B) purchases the private label security for its portfolio.”

## **Housing Finance Agency Bonds**

Freddie Mac supports FHFA’s proposed rule on the goals eligibility of mortgage revenue bonds (MRBs).<sup>35</sup> The proposed rule would treat the purchase or guarantee of MRBs as goals-eligible if the Enterprise has sufficient information available to determine whether underlying mortgages or mortgage-backed securities qualify under one or more goals.

Allowing goals credit in this manner will encourage the Enterprises to continue to support state and local housing finance agencies (HFAs) through the purchase or guarantee of single-family and multifamily mortgage revenue bonds, which finance below-market interest rate mortgages to low- and moderate-income first-time homebuyers and affordable rental housing. We also believe that the tremendous collaborative efforts of Freddie Mac, Fannie Mae, FHFA, the U.S. Treasury Department, and the U.S. Department of Housing and Urban Development to support state and local HFAs — begun in 2009 and executed in 2010 — would fall within the scope of this provision.<sup>36</sup>

While FHFA’s proposed rule — by addressing an Enterprise’s purchase or guarantee of mortgage revenue bonds — implements the HERA statutory mandate regarding HFA bonds,<sup>37</sup> we believe that a conforming change in another section of the proposed rule is required. Specifically, given that HERA requires FHFA to give full credit under the multifamily special affordable goal (and, we believe, the subgoal) for the guarantee of multifamily HFA bonds (*i.e.*, credit enhancement), we recommend that FHFA modify proposed section 1282.16(c)(1), which addresses credit enhancement transactions

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<sup>35</sup> Prop. § 1282.16(c)(8). 75 Fed. Reg. at 9069.

<sup>36</sup> See Press Release, U.S. Department of the Treasury, Administration Completes Implementation of Initiative to Support State and Local Housing Finance Agencies, Jan. 13, 2010. (<http://www.ustreas.gov/press/releases/20101131429486865.htm>).

<sup>37</sup> “The Director shall give full credit toward the achievement of the multifamily special affordable housing goal under this section (for purposes of section 1336) to dwelling units in multifamily housing that otherwise qualifies under such goal and that is financed by tax-exempt or taxable bonds issued by a State or local housing finance agency, if such bonds, in whole or in part — (1) are secured by the guarantee of the enterprise; or (2) are purchased by the enterprise, except that the Director may give less than full credit for purchases of investment grade bonds, to the extent that such purchases do not provide a new market or add liquidity to an existing market.” FHEFSSA § 1333(b).

involving HFA bonds. The elimination of the conditions in subsections (A) and (B) of proposed section 1282.16(c)(1) would be consistent with HERA's mandate.

### **Multifamily Subordinate Mortgages**

The proposed rule would exclude the purchase of "subordinate lien mortgages" from counting toward the housing goals.<sup>38</sup> This limitation reflects the "fact that, under section 1331 of [FHEFSSA], as amended, the single-family housing goals are limited to purchase money or refinancing mortgages." FHFA states that single-family "piggy-back" liens and home equity loans would be subject to this exclusion.<sup>39</sup>

Given FHFA's rationale for excluding second lien mortgages from goals calculations, it appears that FHFA did not intend to exclude multifamily subordinate mortgages from goals-eligibility. As FHFA is aware, multifamily subordinate mortgages fundamentally differ from single-family second or subordinate mortgages. The business rationale for subordinate mortgages in the multifamily sector and the benefits that such financing provides are critical to the multifamily market. Unlike most single-family loans, multifamily loans have call protection and early prepayment may require prepayment premiums. Depending upon interest rates, these prepayment premiums can be substantial and can make refinancing into potentially lower interest rate loans cost-prohibitive. Thus, multifamily apartment owners typically will seek subordinate mortgages, in lieu of refinancing, to take advantage of lower interest rates and/or to take advantage of rising property values when loan-to-values are low, often to make improvements that result in the property maintaining or increasing its value.

From a safety and soundness perspective, Freddie Mac underwrites and reviews subordinate multifamily mortgage loans to the same extent as the first mortgage loans. All loans outstanding are considered when Freddie Mac makes its underwriting and credit decisions.

In sum, the provision of multifamily subordinate financing is an efficient and standard industry practice that yields significant benefits to both owners and residents of multifamily rental housing. Excluding subordinate multifamily loans from housing goal-eligibility would reduce the availability of capital for multifamily properties, including for property repairs, improvements and upgrades. We recommend that FHFA's final rule clarify that multifamily subordinate mortgages are not excluded from goals eligibility.

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<sup>38</sup> Prop. § 1282.16(b)(10). 75 Fed. Reg. at 9069.

<sup>39</sup> 75 Fed. Reg. at 9060.

## Use of Effective Multifamily Rents

To determine the affordability of units in multifamily properties, the proposed rule uses “contract rent” defined as “the total rent that is, or is anticipated to be, specified in the rental contract as payable by the tenant to the owner for rental of a dwelling unit . . . .”<sup>40</sup> in the property backing the mortgage purchased by the Enterprise. Importantly, the proposed definition of “contract rent,” as in the pre-2010 regulatory definition, excludes consideration of concessions. We believe that the rent levels that Freddie Mac takes into account for underwriting purposes — the effective, economic value of the rent — should be used for goal qualification purposes, rather than amounts that disregard concessions provided to tenants.

Concessions have been a part of the rental landscape in most rental markets for over 20 years. Concessions can take the form of free or discounted rent and are usually not published. The current practice in apartment leasing is similar to practices long used in selling automobiles, where discounts are so widely used that the general consumer knows that the “list price” is only a starting point, and not what they will have to pay. Since 2003, concessions have averaged 5.5 percent of the value of contract rents nationally and ranged from 2.4 percent to 12.9 percent in major metropolitan areas. Market conditions also indicate that concessions will likely continue; in 2009, concessions reduced effective rents to be 6 percent less than contract rents.<sup>41</sup>

Given the impact concessions have on the financials of multifamily properties, Freddie Mac, like other industry participants, considers projected rents *net* of concessions (*i.e.*, effective rents) when underwriting multifamily loans and determining property income.

Accordingly, we recommend that FHFA delete the following sentence in the regulatory definition of “contract rent”: “In determining contract rent, rent concessions shall not be considered, *i.e.*, contract rent is not decreased by any rent concessions.”<sup>42</sup> Indeed, FHFA already appears to have recognized the value of aligning goals qualification rules with market standards. Proposed section 1282.1(b) provides: “Anticipated rent for unoccupied units may be the market rent for similar units in the neighborhood as determined by the lender or appraiser for underwriting purposes.” Amending the “contract rent” definition also would align the multifamily goals qualification methodology with that used for the single-family goals, where the borrower’s income “relied on in making the credit decision” determines goals qualification status.<sup>43</sup>

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<sup>40</sup> Prop. § 1282.1. 75 Fed. Reg. at 9064.

<sup>41</sup> Data provided by REIS, Inc.

<sup>42</sup> Prop. § 1282.1 (Definition of “Contract rent”). 75 Fed. Reg. at 9064.

<sup>43</sup> Prop. § 1282.1 (Definition of “Borrower income”). *Id.*

## **Manufactured Housing Communities**

Freddie Mac recommends that the final 2010-2011 rule allow goals-credit for the purchase of mortgages (and private label securities backed by such mortgages) on communities that offer home sites for manufactured homes. These transactions provide direct support to a highly affordable segment of the housing market and fully advance the Enterprises' housing mission. We note that our efforts in this market would fall squarely within the duty to serve underserved markets as well.

Home sites and supporting infrastructure in manufactured housing communities are necessary for the home to function as a residence, if the owner of the manufactured home chooses not to own, or cannot afford to own, land. Freddie Mac's purchase of these mortgages supports affordable housing by increasing the financing available for these communities. In support of this proposal, we recommend expanding the proposed definition of "dwelling unit" to include "a home site in a manufactured housing community."

## **Housing for Military Personnel and Their Families**

Freddie Mac believes that mortgages on properties that house military personnel and their families should be eligible for affordable housing goal credit. These military housing bonds are issued in connection with the Military Housing Privatization Initiative, which was established by Congress in 1996 as a tool to improve the condition of housing by attracting private sector financing, expertise and innovation.<sup>44</sup>

Freddie Mac has purchased privately-issued bonds backed by multifamily mortgages on housing serving military bases throughout the U.S. In the past, we purchased over \$3.5 billion of these bonds, providing capital for the provision of affordable, primarily on-base housing for approximately 40 military bases. Most of these purchases have been of credit-enhanced bonds; we have also purchased bonds with no third-party enhancement and in the future we might provide liquidity by serving as a guarantor of such securities.

In our PLS discussion above, we have described the circumstances under which we believe the Enterprises should receive goals credit for PLS transactions. Under our current credit policy, before we purchase a military housing bond, we perform a credit review of the underlying collateral using standards similar to those used for underwriting multifamily whole loans. Under the proposed rule, however, we could not receive goals credit.

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<sup>44</sup> The Department of Defense (DOD) was granted the authority to award projects to private sector companies to develop, construct, renovate and manage military housing. Financial institutions help provide financing to these DOD-authorized companies through the issuance of pass-through bonds backed by mortgages on these properties.

By investing in bonds that finance housing for military personnel and their families, Freddie Mac is providing liquidity to an important segment of the residential housing market. We believe that such transactions should be eligible under the affordable housing goals — whether as an exception to the proposed exclusion of private label securities and/or through another provision.

### **Definition of Mortgages with Unacceptable Terms or Conditions**

As FHFA is aware, Freddie Mac has long been a leader in combating predatory or abusive lending practices. In fact, many of the provisions included in the “Mortgages with Unacceptable Terms or Conditions” are based upon voluntary positions taken by the Enterprises. We remain supportive of the approach the regulation takes with respect to this category of loans. We would like to propose, however, a technical modification to the “points and fees” definition.

While the current points and fees definition is similar to the points and fees definition in the Home Ownership and Equity Protection Act’s (HOEPA) (15 U.S.C. § 1602(aa)) implementing regulations (12 C.F.R. § 226.32(b)), we believe a closer alignment to HOEPA can provide additional clarity and certainty to the Enterprises and the primary market. In particular, we believe that generally aligning the points and fees calculation for goals eligibility considerations with the points and fees calculation under HOEPA will provide helpful consistency between the two regulations. Because there exists a common and established understanding regarding how to perform a HOEPA points and fees calculation, the proposed regulatory alignment should provide improved guidance to mortgage lenders that originate loans with the intent to sell them to the Enterprises. In addition, many state anti-predatory lending laws similarly reference the HOEPA points and fees definition.

In addition to the proposed revision to the “points and fees” definition and, in part, as a result of the proposed revision, we would further recommend deleting that portion of the “Mortgage with unacceptable terms or conditions” provision that applies HOEPA’s annual percentage rate (APR) test to loans that are not subject to HOEPA, such as purchase money loans. The “points and fees” test, as we propose, would be more effective since it is not likely that many purchase money loans intended for sale to the Enterprises are being, or would be, originated with an APR at HOEPA’s APR threshold. We also believe that the “points and fees” revision will be slightly broader in terms of the coverage of loans because we propose reducing the number of fees that are excluded from the points and fees definition in the current regulation.

Our proposed revision to the definition of “mortgages with unacceptable terms or conditions” is as follows:

*“Mortgages with unacceptable terms or conditions means a single-family mortgage, including a reverse mortgage, or a group or category of such mortgages, with one or more of the following terms or conditions:*

- (l) The total points and fees charged to the borrower will exceed the greater of 5 percent of the loan amount or a maximum dollar amount of \$1000, or an alternative amount requested by an Enterprise and determined by the Director as appropriate for small mortgages.
  - (i) For purposes of this section, points and fees have the same meanings as provided in Regulation Z, 12 C.F.R. 226.32(b) and its commentary.
  - (ii) For purposes of this definition, points and fees do not include:
    - (A) Bona fide discount points; and
    - (B) The cost of credit-risk price adjustments.”

Finally, to allow lenders and third-party due diligence firms to update their systems in light of the revised definition, we request an effective date of January 1, 2011 (*i.e.*, loans originated on or after January 1, 2011).

#### **Prohibition on Counting Mortgages Previously Purchased by Either Enterprise**

Proposed section 1282.16(b)(11) would prohibit counting mortgages toward housing goal performance if the mortgage has previously been counted by either Enterprise during the preceding five-year period.

Freddie Mac currently has controls that compare current year mortgage purchases with active status loans (*e.g.*, loans that have not matured, prepaid, been repurchased) that were funded during the previous five years. To implement FHFA's proposed provision with regard to loans that Freddie Mac previously purchased, we would utilize our existing methodology, which relies on, among other things, seller-provided data and procedures reasonably designed to cross-check loan level data among the millions of loans that Freddie Mac has purchased and/or securitized.

The aspect of the proposed rule that prohibits the counting of a mortgage or mortgage-backed security that *either* Enterprise purchased within a five year period presents substantial operational and business challenges. While we do not have policy objections to this proposal, execution will require significant resources and development, deployment and on-going maintenance costs — all for very few, if any, mortgages at issue. This also would impose operational burdens on mortgage seller-servicers, who would have track and report the relevant data. Furthermore, building a process where the Enterprises share and have access to this level of data could undermine elements of

the Enterprises' competitive structure. Accordingly, we urge FHFA to eliminate the inter-Enterprise aspect of the proposed rule.

### **Timing of Reports**

Freddie Mac recommends that FHFA maintain the current timing of the reports specified in section 1282.62(c). Although Freddie Mac's reporting process has gained efficiencies from continued improvements and automation, the reporting process still requires manual reviews and controls that benefit from the current duration allowed for the production of the reports.

### **CONCLUSION**

Freddie Mac appreciates the opportunity to comment on this important rulemaking. We look forward to engaging in an ongoing dialogue with FHFA, as well as continuing our role to ensure the liquidity, stability and affordability of the U.S. mortgage markets.