Testimony of David H. Stevens

President & Chief Executive Officer
Mortgage Bankers Association

Before

The U.S. Senate Committee on
Banking, Housing and Urban Affairs

"Housing Finance Reform: Essential Elements of a Government Guarantee for Mortgage-Backed Securities"

October 31, 2013

1919 M STREET NW, 5th FLOOR · WASHINGTON, DC 20036 · MBA.ORG · (202) 557-2700

Chairman Johnson, Ranking Member Crapo, and members of the Senate Banking Committee, thank you for the opportunity to testify on behalf of the Mortgage Bankers Association. My name is David H. Stevens and I am the President and CEO of MBA. From 2009 to 2011, I served as Assistant Secretary for Housing and FHA Commissioner at the U.S. Department of Housing and Urban Development (HUD). I have over 30 years experience in real estate finance.

I appreciate the opportunity to share with this committee MBA's views on how to ensure that the multiple objectives of secondary market reform can be best balanced: ensuring liquidity in the secondary market, providing mortgage products that borrowers want at a price that is competitive, and protecting taxpayers from risk. My testimony today describes how these objectives can be achieved, focusing on the interplay between private capital and a necessary government backstop.

MBA recognizes that a successful secondary market needs to be more stable and competitive for all lenders with greater protections for borrowers and taxpayers. This system would utilize familiar and operationally reliable business systems, processes, and personnel from the current GSE model. It is also essential that any new system be accessible by lenders of all sizes and business models – as a robust and competitive marketplace benefits everyone, including borrowers, taxpayers, and our industry

We are encouraged by recent legislative activity that has revived the policy debate on the future of Fannie Mae and Freddie Mac, including S. 1217 offered by Senator Mark Warner and Senator Bob Corker. We commend the efforts of the Chairman and Ranking Member for working in a thoughtful and transparent manner as you seek to reach consensus on legislation to reform the secondary mortgage market and create a potential new end state for the housing GSEs.

Objectives of Secondary Market Reform

Five years after being placed in conservatorship, Fannie Mae and Freddie Mac continue to play a central role in the U.S. mortgage market. MBA believes a successful secondary market needs to produce a more stable and competitive system for all lenders. Any transition to an improved system must retain and redeploy key aspects of the GSEs' existing infrastructures, including certain operational functions, systems, people, and business processes.

In order to prevent disruptions to day-to-day business activities of lenders and to ensure a fair, competitive and efficient mortgage market, any new proposal must be carefully phased-in to protect the housing finance system from unnecessary disruptions.

MBA believes that the secondary market should:

- Ensure equitable, transparent and direct access to secondary market programs for lenders of all sizes and business models;
- Preserve key GSE assets – technology, systems, data and people – by transferring them to any new entities created by GSE reform, or placing them into a public utility.
- Promote liquidity and stability by connecting global capital to the U.S. mortgage market;
- Provide an efficient means of hedging interest rate risk through a robust TBA market;
- Provide for a consistent offering of core products including the 30-year, fixed-rate, prepayable mortgage;
- Provide certainty in mortgage transactions for qualified borrowers;
- Rely on a single, highly-liquid, government-guaranteed security that is delivered through a common securitization platform;

Achieving these objectives will require:

- An explicit government guarantee for mortgage securities backed by a well-defined class of high quality home mortgages;
- Protection for taxpayers through deep credit enhancement that puts private capital in a first loss position, with no institution too big to fail; and
- Fair and transparent guarantee fees to create an FDIC-like federal insurance fund in the event of catastrophic losses.

The government's role is to provide quality regulation of guarantors and systems and to provide a clearly defined, but limited, catastrophic credit backstop to the system. Without this government backstop, the mortgage market would be smaller and mortgage credit would be more expensive, meaning that qualified lower and middle class households would have less access to affordable mortgage credit and be less able to qualify to achieve sustainable homeownership and the multifamily rental market, which predominantly serves those of modest incomes, would be adversely impacted.

The Need for a Government Backstop

The American mortgage market has long been dominated by 30-year, fixed-rate, fully amortizing loans, with no penalty for refinancing the loan. The advantage for borrowers is that it protects them against increases in interest rates while providing a long period over which to amortize the loan principal, thus providing more affordable monthly payments than would be available under a shorter amortization schedule.

The advantages for borrowers, however, are offset by the risks posed to depository institutions trying to hold 30-year fixed-rate mortgages in portfolio, given the short duration of most bank deposits and other liabilities. When interest rates rise, banks may end up earning negative spreads on the mortgages they hold. This funding mismatch can be dangerous for financial institutions.

For example, the thrift industry debacle of the 1980s largely grew out of the removal of interest rate ceilings on bank and thrift deposits for many years. The resulting spike in the interest rates on the deposits funding long-term, fixed- rate mortgages essentially wiped out the capital at

many thrifts. Similarly, funding mortgages with long-dated fixed-rate deposits can be a problem if rates fall and borrowers exercise their options to refinance their mortgages at lower rates. The bank then faces low or negative interest rate spreads when it reinvests the funds from the paid-off mortgages at lower rates. Thus, relying on bank portfolios to fund 30-year fixed-rate mortgages places tremendous risk on the existing government support of the mortgage market through the FDIC.

Securitization developed as a means of removing this interest rate risk from depository balance sheets, while providing a long-term, fixed-rate asset for investors that had a better capacity to manage such cash flows. However, securitization relies on a steady presence of private investors willing to take on the risks of mortgage-backed securities. We have seen repeatedly over the last twenty years that while investors are generally willing to buy guaranteed MBS, even during a market disruption, they are unwilling to take on uncertain credit risk during these times.

When depositors or security holders become concerned over the health of the assets supporting their investments, they want to liquidate their positions and hold on to their cash until the situation settles. In the case of banks, this is a run on deposits. For securitization, it is a panic sale of the securities with a large drop in price. It is as if bank depositors were forced to sell their deposits to another investor at a deep discount rather than attempting to redeem them at par at the bank. Because those who sell first suffer the smallest losses, there is an advantage to sell quickly before a panic, thus helping fuel a panic. Even if they do not sell, mark-to-market accounting rules do not distinguish between normal price drops and those caused by panic selling, causing large losses for investors

The question is not whether a government guarantee will limit the potential damage of periodic panics in the securities. The benefit is clear. The real question is how to go about limiting the risk to the taxpayers that comes with any sort of government support. Adequate private capital in a first loss position, the establishment of an insurance fund, and a limited, clearly defined credit box (such as has been accomplished with the QM rule) all would be strong steps in this direction.

In summary, the U.S. mortgage market is unique in the degree to which 30-year fixed-rate mortgages play such a large role in financing home purchases. To date, however, that market has been supported by securitization and the implicit and explicit support the taxpayers have given to that market. MBA believes that such a guarantee can be put in place in order to reduce the volatility that would exist in a purely private market, but that would be implemented in such a way as to limit the exposure of the taxpayers.

Investors should be able to rely solely on the full faith and credit guaranty behind the security

Investors should be ensured that they will receive timely payment of principal and interest, and that this backstop reflects the full faith and credit of the U.S. government. As noted above, the purpose of the backstop on the security is to ensure liquidity even during financial market disruptions. Limiting the coverage to less than 100% would cause investors to question whether the securities would remain liquid in a downturn.

The government guaranty should be paid for through premiums that build up a Mortgage Insurance Fund (MIF) over time. The MIF only pays in the event that a private credit enhancer goes out of business.

Attachment Points, Capital requirements, and Risk

A central question in reordering the secondary market is to define where private risk-taking ends and where government support begins. In most proposals, private entities (or capital market structures) are assumed to take losses up until the point that the entities fail (or the structures are tapped out). The key question then becomes how much capital the entities need to set aside to absorb losses, or alternatively, how thick subordinate tranches within capital market structures need to be.

There are several challenges in answering these questions. First, there is uncertainty regarding precisely how much risk resides within a pool, vintage, or population of mortgages. Mortgage losses are a function of borrower, loan, and property characteristics that are measurable at origination. Lenders, investors, rating agencies, and regulators have developed considerable information and analytics which can accurately gauge the *relative* risk of default and loss from mortgages with different characteristics. For example, Standard & Poors in their 2009 ratings criteria estimate that holding all other factors equal, loans with a 50 LTV are at less than half the risk of default of loans with a 75 LTV, while loans with a 90 LTV are 2.5 times more likely to default. Loans to borrowers with a credit score of 680 are at twice the risk of default of a borrower with a 725. ARM loans have a baseline default rate that is 1.2 times higher. No doc loans are at six times the risk of full documentation loans.

However, despite these accurate and precise estimates of relative default risk, it is more difficult to get a handle on the level of absolute risk. In a recession, when unemployment increases sharply, default rates across all types of loans increase. A sudden, sharp increase in interest rates can lead borrowers with adjustable-rate mortgages to fall behind on their payments. And as we have clearly witnessed in the Great Recession, borrowers who cannot sell their homes because they are underwater, i.e., their property value is less than the balance on their mortgage, are more likely to default and go to foreclosure. Home price movements are thus a critical factor. Faster rates of home price appreciation such as we saw during the boom can dampen default and loss rates across all types of loans, while steep declines in home prices may lead to higher loss rates across the board.

Lenders, investors, and others attempt to address these economic risks by estimating loan performance across a range of different economic environments, testing the impact of alternative home price, interest rate, and economic scenarios. These experiments result in estimates of performance across a range of outcomes, and can provide a credible picture of the potential distribution of losses one might expect from a given set of loans.

It is worth noting that the range of scenarios imagined may necessarily be limited by historical experience. In more than 70 years, the US had not experienced an economic and housing market downturn that severe since the Great Depression. It is extremely difficult to accurately gauge the likelihood of such a tail event recurring. Are the odds 1 in 70? 1 in 200? 1 in 30? The data do not reveal enough information to accurately make that judgment. It is

fundamentally an assumption, and similar to an engineer constructing a bridge, it is reasonable to err on the side of conservatism, but there are costs to being too conservative.

Typical practice in industry would be to target a rating (e.g., "AAA") which is associated with surviving a certain level of losses while remaining solvent. An alternative approach is to define a stressful economic path, and then show that the entity would survive such a stress. The OFHEO risk-based capital test utilized a stress path (roughly a 15% decline in national home prices) from the oil-patch recession in the mid-1980s, and then applied that level of losses on a national basis. The Corker-Warner bill requires that entities be able to survive a 35% decline in national home prices. (Note that different home price measures and other factors can lead to very different levels of stress, so a larger number may not necessarily be consistent with a more severe stress if a more volatile home price index is used.)

What level of protection is enough? Private credit enhancers should have sufficient capital so that it is extremely rare that the insurance fund is called upon. And the insurance fund and associated premiums should be large enough such that government outlays would almost never be required.

However, as noted, there is a cost to being too conservative. Requiring capital beyond the actual economic risk drives up costs and would limit access to credit. A balance must be achieved.

Private capital should stand in front of the government backstop in order to protect taxpayers, but should be at a level to keep credit affordable and accessible to middle class homeowners

At the loan or at the pool level, substantial private capital should stand in front of the government backstop in order to limit taxpayer exposure. Most discussions suggest that private capital should take on the "predominant" credit risk.

Congress should set broad parameters for the regulator to establish capital requirements/credit enhancement levels that are in line with regulatory capital standards for mortgages held by other institutions. In effect, Congress should establish a system where there is no opportunity for regulatory capital arbitrage.

Regardless of who holds mortgage credit risk, regardless of charter type, the capital requirement should be the same. For example, legislation should reference the most recent version of the Basel standards when instructing the regulator with respect to proper levels of capital.

In the old regime, the GSEs were only required to hold 45 bps of capital against "off balance sheet" exposure to mortgage credit risk. Banks and other depositories holding whole mortgage loans had to hold 4% capital (50% risk weight against 8% total capital requirement).

Moreover, the banks had a 20% risk weight on GSE MBS, so they could hold 1.6% capital on MBS. Taken together, the system went from 4% capital for whole loans on bank books to 2.05% capital for loans guaranteed by the GSEs but held by banks as MBS. Tragically this was too little to buffer against the losses experienced through the downturn.

Not surprisingly, the GSEs rapidly gained market share under this artificial competitive advantage with respect to required capital.

Under S. 1217, the securitization channel for conforming loans would have a 10% capital requirement. Banks under Basel III are still at 4% (5-6% for the very largest banks under the new leverage requirement). With this requirement, mortgages would be expected to flow to the banking system. Another worse possibility is that only the highest risk mortgages, which warrant higher capital standards, would be securitized and receive the government backstop, leading the government-backed segment of the market to be small, high-risk, and high cost.

Lenders originate to best execution. Operationally this means that when they are taking an application and pricing a loan, their systems determine which possible investors/programs might be eligible, sort by best all-in price, then assume that the loan will be sold through the highest price channel ("execution').

For example, suppose a customer would like a 30-year loan. The bank he is working with could sell the loan to the GSEs, securitize through a private-label issuer, or hold the loan on their balance sheet. At the time of application, the lender knows the prices associated with each, and assumes that the loan will be sold to the best opportunity, and typically would use that quote to provide a rate to the consumer. Between application and origination and sale, circumstances may change, and the loan may wind up being sold to an alternate execution.

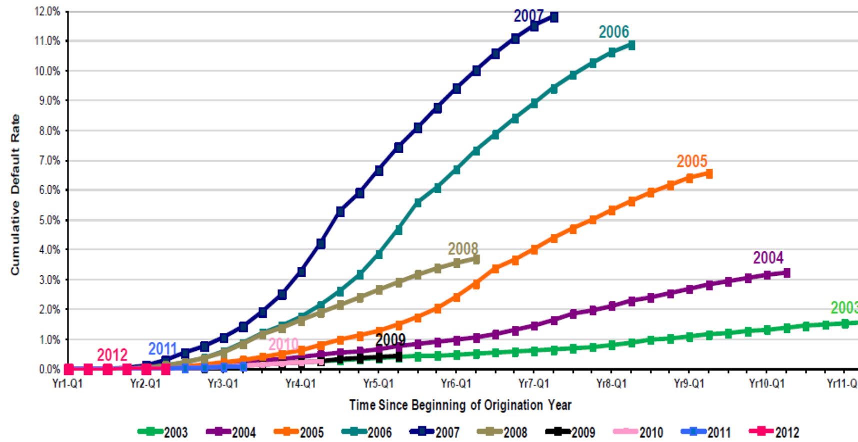
The relevance here is that relatively small changes in the price of one channel can quickly lead to large changes in best execution. A most recent example concerns the jumbo market. Before the run up in rates, private-label jumbo securitizations were beginning to pick up. After that run up, securitization cannot compete with a portfolio execution, so you are seeing jumbo securitizations being cancelled or postponed.

A longer-term trend with respect to jumbos is this: typically, the jumbo-conforming spread on 30-year fixed-rate loans had been roughly 25-50 bps. Though not seemingly dramatic, this spread was enough to drive consumer and lender behavior. The ARM share of conforming loans was roughly 20%. For jumbo loans it was roughly 60%. The relatively small difference in rates on jumbo vs. conforming loans was sufficient to cause jumbo borrowers to choose ARMs.

If the FMIC channel is relatively expensive compared to other executions, one of two outcomes will occur. Either no loans will go through this channel, or only the higher risk loans will go through. This adverse selection would increase risk to the taxpayer, as the insurance fund and the government would be left reinsuring a much riskier pool of loans.

How do we know that a capital level similar to what the banks are held to would be sufficient to protect taxpayers? There are multiple, sophisticated approaches one could take to answering this question, but the simplest, most direct approach is to simply require that credit enhancers hold sufficient capital so that they could have survived the downturn we just experienced.

Cumulative Default Rates of Single-Family Conventional Guaranty Book of Business by Origination Year



Note: Defaults consist of loan liquidations other than through voluntary pay-off or repurchase by lenders and include loan foreclosures, short sales, sales to third parties and deeds-in-lieu of foreclosure. Cumulative Default Rate is the total number of single-family conventional loans in the guaranty book of business originated in the identified year that have defaulted, divided by the total number of single-family conventional loans in the guaranty book of business originated in the identified year.

Data as of June 30, 2013 is not necessarily indicative of the ultimate performance of the loans and performance is likely to change, perhaps materially, in future periods.

As shown in the chart above, the default rate on the 2007 book of business from Fannie Mae is approaching 12%. This book contained substantial amounts of Alt-A and other high-risk business that would be explicitly excluded by a QM requirement. Loss severity, i.e., losses as a proportion of the unpaid principal balance, are running at about one-third. This means that a 12% default rate translates to a loss rate of roughly 4% on this 2007 book. To the extent that tighter underwriting results in lower default rates, loss rates even in future extremely adverse scenarios should remain below this recent experience.

Charging a modest reinsurance premium (on the order of 10-15 bps) should be more than sufficient to cover any residual risk over time, particularly if the mortgage credit risk is limited by mandating that only QM loans may be securitized.

Beyond this simple analysis, researchers (e.g., Moody's Analytics, Urban Institute, et al) have conducted substantial econometric analysis that shows that capital in the range of 4-5% would cover losses in all but the most extreme scenarios.

Proper regulation and oversight to minimize systemic risk

While setting proper capital requirement levels is critical, other aspects of regulation and supervision must receive attention as well.

MBA strongly recommends that the system be set up so that there is robust competition for business in the secondary market, and so there is a credible threat of additional competitors entering the market if existing companies are making outsized profits. Congress and the regulator should work to eliminate barriers to entry. Fannie Mae and Freddie Mac had a legislatively granted duopoly.

In addition to promulgating regulations around capital requirements, the regulator should also have rigorous criteria for approving lenders, servicers, credit enhancers, and other participants in the market. The regulator should also be an active supervisor, with sufficient timely information to be able to make judgments about potential required actions to limit risk to the MIF and to the taxpayer.

The regulator should monitor concentration risks within the system. If the new regime relies upon a small number of entities with highly correlated business models, there is a risk that they could all fail at the same time. Plans for the new system should carefully calibrate capital requirements to mitigate this potential, and contemplate how the new regulator could continue lending until new entities could be formed following a crisis. The ability for the regulator to temporarily lower capital requirements for reinsurance eligibility during a systemic event is a wise and necessary provision.

If the new regime relies heavily upon capital markets to lay off credit risk, the systemic risk potential is that concentrations of risk exposures and leverage could build up in hidden ways throughout the system. Unlike with entities that have clear and transparent capital requirements, capital market leverage can be hidden and can result in multiple, opaque layers of leverage even if transactions appear to be in “cash”.

The new system should promote direct access to the secondary market for lenders of all sizes and support a broad variety of business models

MBA believes that any improved secondary mortgage system should utilize familiar and operationally reliable business systems and processes from the current GSE model. It should also include components to ensure access for lenders of all sizes. Some examples of what the new model should deliver include the following functions:

- Cash Window/Whole Loan Execution
- Multi-Lender Security Execution
- Single Loan Securitization
- Servicing Retained Sales
- Servicing Released Sales

Single-family lenders should be able to utilize familiar credit enhancement options, such as mortgage insurance, to facilitate secondary market transactions in a timely and orderly way. Key functions present in today's secondary market system should be preserved, while allowing new forms of private credit enhancement to develop over time.

It may well take a combination of approaches to ensure that the system works for both smaller and larger lenders. It is imperative that the new system provide access on a competitive basis to qualified institutions, as this vibrant competition will ultimately benefit borrowers.

Under the current GSE model, Fannie Mae and Freddie Mac are the issuers. They purchase loans from lenders and provide a guarantee (backed by an implicit government guarantee).

Under the Ginnie Mae model, lenders are the issuers. Lenders obtain loan-level insurance from a government program (FHA, VA, USDA) and then issue the securities, obtaining a security-level guarantee from Ginnie Mae.

The GSE model provides for many, typically smaller, lenders to sell whole loans to Fannie Mae and Freddie Mac for cash. This provides quick funding, which is a valuable benefit for many smaller lenders.

The Ginnie Mae approach puts greater responsibility and control with the lender. However, the operational complexities may prevent some smaller lenders from becoming issuers. As a reference, there are roughly 400 Ginnie Mae issuers, and over 1000 direct sellers to Fannie and Freddie.

The Corker-Warner bill provides both paths, with an ability for lenders to obtain private credit enhancement and be the issuer, and a Mutual Securitization Company which can fill the aggregation role for those lenders who do not have the operational capability or desire to be an issuer. Additionally, the bill would allow the Federal Home Loan Banks to act as aggregators for smaller lenders.

MBA believes serious consideration should be given to expanding Federal Home Loan Bank membership eligibility to include access for non-depository mortgage lenders. In fact, historical evidence shows that such a move is consistent with the original intent of the system (see Snowden, 2013). These lenders are often smaller, community-based independent mortgage bankers focused on providing mainstream mortgage products to consumers. In exchange for membership in the FHLB system, these institutions could be required to hold a limited class of stock with appropriate restrictions. Expanding FHLB access to these institutions would enhance market liquidity and ensure a broader range of mortgage options for consumers.

Getting more private capital back into the market today while the legislative process continues to refine the proper end state

Fannie Mae and Freddie Mac have recently reported substantial profits, leading some to ask whether the business models of Fannie Mae and Freddie Mac have regained credibility that was lost during the financial crisis. Record GSE profits do not tell the whole story. In their current form, GSE profits are dependent in large part on three factors:

- Guarantee fees, which have more than doubled in recent years.
- Remarkably low- risk business, a sign of tight credit.
- Their ability to shift legacy costs back to lenders

This current status is not sustainable over the longer term, and MBA believes that we should begin moving toward a more sustainable environment. While the legislative process will continue to refine the desired end state, MBA has proposed a set of transition steps designed to move in the direction of the developing consensus regarding the shape of the future secondary market. The steps we propose, none of which require legislation, create an even greater competitive landscape for all originators beyond where we are today, and provide better value to borrowers. Further, they are consistent with the vast majority of end-state proposals.

- FHFA and the GSEs should move to a common, fungible MBS to improve liquidity in the market. The discount on Freddie Mac's security represents a loss to the taxpayer, as it is being implicitly subsidized by lower guarantee fees resulting in lower dividends to the Treasury. We should act now to remove this distortion by moving to a common, fungible security.
- FHFA should mandate that the GSEs accept deeper credit enhancement on pools from lenders in exchange for reduced guarantee fees in order to lower costs and increase access to credit for consumers. The PATH Act includes language to this effect, which we would support as a means of bringing additional private capital into the market. Importantly, we believe that lenders should have "front-end" credit enhancement options in addition to the "back-end" options, as we believe the former have the potential to produce greater cost savings for consumers.
- Regardless of which end state Congress decides upon, we need to ensure that lenders of all sizes have securitization options to directly access the secondary market in order to level the playing field.
- FHFA should impose a well-regulated and fully transparent credit framework with clear representation and warranty protections to increase transparency in the system and enable lenders to responsibly expand access to credit.
- FHFA should continue to seek stakeholder input regarding the Common Securitization Platform to lay the groundwork for a more efficient market in the future. The PATH Act also contains plans for a new market Utility that would perform many of the roles and functions envisioned for the platform, with the exception that the bill would not permit the Utility to securitize government-backed loans. While we appreciate the agreement that such a central, operationally focused utility is needed, we do believe that some level of government backstop is needed for the conventional conforming market.

Below is an illustrative example of how MBA's proposal for upfront credit enhancement would work. In today's market, private capital can be competitive with the GSEs in certain segments. If guarantee fees were to increase further, borrowers could realize real savings through this approach at the same time that taxpayer exposure to the mortgage market is reduced.

Upfront Risk Share Proposal – Illustrative Example

	Credit Enhancement Costs - Current			
90 LTV	**MI Premium**	**Base Gfee**	**Upfront Gfee**	**Total**
760+	0.44%	0.55%	0.13%	1.12%
720-739	0.49%	0.55%	0.13%	1.17%

- Upfront Gfee reflects loan-level price adjustments (LLPAs).
- MI premium is standard 25% coverage. Pricing is by credit tier.

	Credit Enhancement Costs - Potential			
90 LTV	**MI Premium**	**Total Gfee**	**Total**	**Potential Borrower Savings**
760+	0.75%	0.20%	0.95%	0.17%
720-739	0.80%	0.20%	1.00%	0.17%

- Proposed deeper coverage (45% on 90 LTV) accounts for vast majority of the risk.
- 10 bps covers catastrophic risk assuming MI is sufficiently capitalized.
- 10 bps for payroll tax.
- Specific Gfee is most sensitive to level of MI capitalization and required returns for GSEs.
- Savings to borrowers are significant. Would extend to borrowers at lower credit tiers as well.

Process

- Each approved MI would file a standard pool policy with FHFA/Fannie and Freddie and the insurance regulators so that everyone was clear on the structure--the simpler, the better.
- Any approved lender could deliver deep CE pools to the GSEs for a Gfee discount.
- Menu approach – lenders would have the option to deliver loans and pay the full Gfee, or arrange for deeper CE through an MI or by retaining recourse, and pay a much reduced Gfee.
- MIs would compete for the business on total price, but also on mix of business, e.g., LTV and credit score. Allows for differences in views on credit.

Multifamily Finance Key Principles for Multifamily Housing Finance Reform

Our views on the multifamily housing finance market run parallel and are consistent with our views on the single-family residential market.

More than one in three American households rent their home, and more than 16 million[1] of those households live in multifamily rental housing, a development with five or more units. Renters include workers who want to live near their jobs, young professionals, empty-nesters, retirees on a fixed income, families with children, students, and households who value the convenience and mobility that renting offers. Notably, the vast majority of multifamily rental housing provides homes for households earning modest incomes, with 93 percent of multifamily rental apartments having rents affordable to households earning at or below the area median income.[2]

Recognizing the unique attributes of the multifamily market as a key component of the broader housing finance system, we believe that policy makers should pursue the following principles in shaping the government's role in the multifamily housing finance system.

First, our nation's housing policies should reflect the importance of multifamily rental housing, the range of capital sources that support this market, and the need for liquidity and stability in all market cycles. The number of renter households in multifamily housing is expected to grow from the current estimate that exceeds 16 million. A broad range of capital sources support the multifamily finance market, including private capital sources. The roles of the GSEs and FHA in financing multifamily mortgages have been substantial, but other market participants – including life insurance companies, banks and other lenders – have maintained a strong presence as well. With respect to the GSEs' multifamily activities, credit performance has been strong during the recent market downturn and, with government support, the GSEs have served a countercyclical role that provided liquidity when private capital sources largely exited the market.

Second, private capital should be the primary source of financing for multifamily housing with a limited, government-backed insurance program ensuring that the market has access to liquidity in all cycles. The risk insurance program would provide support at the mortgage-backed security, rather than at the entity, level. The role of private capital is vital in several respects: (1) the deployment of private capital through market participants that have historically supported multifamily finance, such as portfolio lenders and CMBS investors; (2) the private capital that is already embedded within existing market executions (e.g., DUS, K-Deals) through risk-sharing structures; and (3) the investment of private capital in entities that would be permitted to issue government-backed securities. We believe that a focused role for the federal government through a government-backed risk insurance fund, with a federal catastrophic backstop, would ensure continuous liquidity and stability in all market cycles. Eligible mortgage-backed securities would have a government wrap. The insurance fund, paid for through risk-based premiums, could be modeled after FDIC programs and would support such mortgage-backed securities, not at the level of the issuer, as is the case today.

Third, entities eligible to issue government-backed securities should be funded by private capital, be focused on securitization, serve the workforce rental market, and be regulated in a

---

[1] 2011 American Housing Survey
[2] Joint Center for Housing Studies tabulations of 2009 American Housing Survey, US Census Bureau.

manner that protects taxpayers and ensures robust competition among capital sources. A strong government regulator with market expertise would provide oversight regarding the issuing entities, including their safety and soundness, risk-based capital requirements, and products offered. The entities, which would not be limited to potential successor entities to the GSEs, also would assume a significant risk position by providing an entity-level buffer, placing private capital at risk ahead of any government backstop. Risk-based premiums would be deposited into a federal insurance fund, to be drawn upon only if and when the entity becomes insolvent. The pricing of the premiums would be structured in a manner that allows robust competition. Importantly, the issuing entities would need to attract private capital and maintain financial viability. We believe, however, that they should be mono-line institutions limited to secondary mortgage market activities and the housing finance sector, with a focus on workforce and affordable rental housing.

Fourth, stewardship of existing GSE assets and resources on behalf of taxpayers should be a core consideration for any action – during the current period of conservatorship, any transition period, and in the future state of multifamily finance. The talent and expertise at the GSEs, their existing books of business, their market executions and any profits generated by their multifamily businesses are valuable to U.S. taxpayers and should be deployed in a manner that supports the future state of multifamily housing finance. Preserving and dedicating such resources would support an orderly transition to a new mortgage finance system and optimize potential returns to taxpayers. Fundamentally, the "do no harm" principle should govern, particularly in light of the stability and successes of the multifamily market overall.

We wish to underscore that as policy makers deliberate the future of the government's role in multifamily housing finance, it is vital they ensure that capital continues to be available to support this essential source of housing.

In conclusion, I appreciate this opportunity to again present testimony before this committee, and look forward to answering any questions you may have.