NCSHA
National Council of
State Housing Agencies

October 22, 2012

Mr. Ben Bernanke, Chairman
C/O Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Connecticut Avenue, NW
Washington, DC 20551
Re: FR 2012-17010

The Honorable Martin J. Gruenberg, Acting Chairman
C/O Robert Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
FDIC RIN 3064-AD96; Attention: Comments, Federal Deposit Insurance Corporation

Mr. Thomas J. Curry, Comptroller of the Currency
Office of the Comptroller of the Currency
250 E Street, SW., Mail Stop 2-3
Washington, DC 20219
Docket ID OCC-2012-0009

Dear Chairman Bernanke, Chairman Gruenberg, and Comptroller Curry:

On behalf of the state Housing Finance Agencies (HFAs) it represents, the National Council of State Housing Agencies (NCSHA) welcomes the opportunity to comment on the agencies' June 7 proposed rule implementing the regulatory capital standards outlined by the Basel Committee on Banking Supervision (BCBS). NCSHA supports efforts to ensure that banks maintain strong capital buffers that will allow them to withstand a financial downturn and continue extending credit during tough economic times. However, we have strong concerns that the proposed risk weights for some residential mortgages are too stringent and will restrict low- and moderate-income Americans' ability to secure affordable home loans.

We propose that the risk weights for Category 1 home loans be adjusted downward, and that HFA-financed loans that are not federally guaranteed or GSE-financed be assigned a risk weight of less than 50 percent. Further, we recommend you amend the rule so that private mortgage insurance may still be factored in when calculating a mortgage's loan-to-value ratio (LTV).

In addition, we also urge you to rescind the provision that would assign a 50 percent risk weight to all municipal revenue obligation securities, and instead assign a 20 percent risk weight on all investment-grade municipal securities. Finally, we suggest that the final rule respect the precedent of and continue the long-standing federal policy under which municipal bonds receive the same regulatory treatment as U.S. Treasuries.

HFAs are state-chartered housing agencies that operate in every state, the District of Columbia, New York City, Puerto Rico, and the U.S. Virgin Islands. Though they vary widely in their characteristics, including their relationship to state government, HFAs share a common mission of supporting affordable housing lending help to those who need it. HFAs also administer a wide range of affordable housing and community development programs, including HOME, down payment assistance, homebuyer education, loan servicing, the Low Income Housing Tax Credit, Section 8, homeless assistance programs, and state housing trust funds.

HFAs have proven over many decades that affordable housing lending done right is good lending. HFAs do it right in the case of first-time homebuyer lending through a time-tested combination of low-cost financing; traditional fixed-rate, long-term products; flexible, but prudent, underwriting with careful credit evaluation; diligent loan documentation and income verification; down payment and closing cost assistance; homeownership counseling; and proactive servicing.

Reduce Risk Weights for Residential Mortgages

Current regulations assign prudently underwritten mortgage loans a risk weight of 50 percent. The proposed rule would divide mortgages into two specific categories (Category 1 and Category 2) and then subdivide them by LTV ratio. Under this new system, prudently underwritten loans (classified as Category 1) with an LTV above 80, which would currently have a risk weight of 50 percent, would require higher capital buffers. This would make it more expensive for banks to originate loans where the borrower has made a down payment of less than 20 percent. This impact is compounded by the provision that proposes that banks no longer be allowed to include private mortgage insurance (PMI) when calculating a loan's LTV.

If banks are required to hold more capital for every loan with an LTV above 80, no matter how carefully underwritten, they will be inclined to require 20 percent down payments on most home loans. Many first-time and low-income homebuyers will be unable to meet this requirement, which will reduce their access to affordable home lending. This capital requirement will also reduce banks' interest in purchasing mortgage-backed securities (MBS) that contain loans with LTVs above 80. This would further reduce liquidity at a critical time when policymakers are trying to increase homebuyer access to credit.

These new capital standards could be particularly troublesome for HFAs, which often partner with private lenders. HFAs' primary mission is to help underserved and lower income consumers obtain affordable homes, including first-time homebuyers. To accomplish this, HFAs offer a wide variety of loan products that require a low down payment or sometimes no down payment. While HFAs currently enjoy productive business relationships with private lenders, lenders would be disinclined to offer HFA high-LTV loan products if capital rules were to require lenders to hold additional capital for them. This would significantly hinder HFAs' ability to provide affordable housing help to those that need it.

In addition to having a chilling effect on affordable home lending, requiring higher risk weights for loans with higher LTV ratios may not even achieve the rule's stated goal of increasing lender risk-sensitivity. Generally, the size of a loan's down payment is of minimal predictive value regarding the loan's future performance. Overall, the best predictor of a loan's future performance is whether it is carefully underwritten, taking into account multiple factors. HFA loans, which often require lower down payments, have maintained a default rate better than traditional mortgage lenders through homebuyer education and prudent underwriting. Consequently, we recommend that HFA loan products that are not federally guaranteed or GSE-financed, due to their superior performance record and stringent underwriting standards, be assigned a risk weight of less than 50 percent.

We also recommend that you eliminate the blanket prohibition on using PMI to determine a loan's LTV. PMI is a valuable tool that has allowed responsible borrowers who cannot afford a large down payment to acquire an affordable home loan. It also protects lenders against losses. While PMI is used on only a small percentage of HFA loans now, it has traditionally played a major role in encouraging lenders to make HFA loans and protected mortgage holders from losses.

We understand the agencies' concern about the reliability of some PMI policies due to the relative financial strength of PMI providers, but an across-the-board prohibition is an overreaction that ignores those providers who are, or may become, financially healthy. A better approach to addressing the agencies' concerns would be to develop a tiered system that would allow PMI from fiscally sound providers to be included in the LTV calculation.

Lower the Risk Weight Standard for Investment-Grade Municipal Revenue Obligation Bonds

To finance affordable housing for homebuyers and renters, HFAs issue mostly tax-exempt municipal revenue obligation bonds, such as single-family Mortgage Revenue Bonds (MRB) or multifamily housing bonds. In 2010, HFAs combined issued $8.86 billion in municipal bonds. The proceeds from these sales are crucial toward helping HFAs fulfill their obligations to serve low- and moderate-income consumers.

The proposed rule would require that municipal general obligation bonds be assigned a 20 percent risk weight and municipal revenue obligation bonds be assigned a 50 percent risk weight. The agencies' contend that the reason for this disparity is that revenue obligation bonds, because their repayment depends on the performance of a specific project, pose more relative risk than general obligation bonds.

Federal Reserve Bank-conducted research shows that investment-grade municipal bonds, including state HFA bonds, have a default rate of only 0.25 percent. There appears to be no compelling reason to differentiate between municipal bonds and assign them different risk weights solely on the basis of whether they are investment-grade general revenue or investment-grade obligation bonds. Therefore, we urge you to rescind the provision that would assign a 50 percent risk weight to all municipal revenue obligation securities, and instead adopt a system that would assign a 20 percent risk weight on all investment-grade municipal securities.

Assigning tax-exempt housing bonds a higher risk weight could substantially increase borrowing costs for HFAs and make it infeasible, or at least harder, for them to deliver housing help to those who need it. The new capital standards for revenue obligation bonds could decrease demand for MRBs and multifamily housing bonds, forcing HFAs to pay higher interest rates and resulting in fewer proceeds for them to help people.

Preserve Federal Policy Treating Municipal and Federal Debt Equally

The proposed rule also considers treating bank-owned municipal bonds and bank-owned U.S. Treasuries differently under regulatory capital rules related to debt securities held by banks under the Available-for-Sale election. This proposal is a departure from nearly 80 years of federal policy, promulgated by both Congress and federal agencies, that treats municipal securities the same as U.S. Treasury debt for regulatory purposes.

The proposed rule would set a dangerous precedent that could impact impending rules on eligible liquidity capital. These rules could make it significantly more expensive for states, cities, and instrumentalities of government to issue the debt they need to support their infrastructure needs. We ask that you respect the longstanding preferences of federal policymakers and eliminate any provisions that would alter municipal securities' equal standing with U.S. Treasuries.

Thank you for your consideration. We would be happy to discuss these issues with you at your convenience.

Sincerely,

Garth Rieman
Director of Housing Advocacy and Strategic Initiatives