Statement of

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Mortgage Bankers Association

For the

Committee on Banking, Housing and Urban Affairs

United States Senate

Hearing on

"The State of the Nation's Housing Market"

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Chairman Dodd, Ranking Member Shelby, and members of the committee, thank you for the opportunity to testify on the state of the nation's housing market. I am Emile J. Brinkmann, Chief Economist and Senior Vice President for Research and Economics for the Mortgage Bankers Association (MBA).[1]

Whenever I am asked about the state of the mortgage and housing market, I explain that the economy and the housing market are inextricably linked. The state of the overall economy and the number of people receiving paychecks will drive the demand for houses and apartments. The recovery of the housing market will be the result of a larger economic recovery, not a driver of that recovery, but there are a number of policy initiatives that can assist in improving the housing market which I will discuss in my testimony.

What is different about this recession, compared to others for which we have data, is the higher rates of delinquencies and foreclosures for the levels of unemployment we are experiencing, particularly in certain states.

Why is that? Perhaps the most important reason is that we entered this recession with an already weakened housing market. In past recessions, it was the loss of jobs and the paychecks needed to make mortgage or rental payments that weakened the housing market. In this recession, the housing market was already weak before the recession even started.

The use of loan products like pay option adjustable rate mortgages (ARMs) and stated income loans by borrowers for whom these loan products were not designed, together with rampant fraud by some borrowers buying multiple properties and speculating on continued price increases, led to very high levels of construction to meet demand that turned out to be unsustainable. When changes in the market caused demand for homes to suddenly shrink, a large number of houses were stranded without potential buyers. The resulting imbalance in supply and demand drove prices down, particularly in the most overbuilt markets like California, Florida, Arizona, and Nevada – markets that had previously seen some of the nation's largest price increases.

The problem is that when the recession hit and people began to lose their jobs, the equity in their properties may already have been wiped out. In past recessions, they may have been able to sell their home and recover some of their equity, but in markets where we have seen sizeable price drops, that is no longer an option.

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,400 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

Here are a few numbers to illustrate the point. A year ago, subprime ARM loans accounted for 36 percent of foreclosures started, the largest share of any loan type despite being only 6 percent of the loans outstanding. As of June 30, 2009, prime fixed-rate loans represented the largest share of foreclosures initiated. Perhaps more significantly, almost 40 percent of those prime fixed-rate foreclosures are in the states of California, Florida, Arizona and Nevada. Due to the imbalance between supply and demand in those states, prices have dropped so far that any life event that would normally lead simply to a delinquency – like the loss of a job or a divorce – is now also leading to a foreclosure.

The national quarterly foreclosure rate reported by the MBA for the second quarter of this year was 1.36 percent. However, in the four states I mentioned, it was 2.34 percent, roughly 10 times the rate we saw in those states during the boom years. Without those four states, the national foreclosure rate would be about 1.04 percent, roughly double the rate we saw for the rest of the country during the boom years.

Exacerbating the problem of the oversupply of homes is the potential shadow inventory from mortgages that are either in foreclosure or that may enter foreclosure and "pent up" supply, i.e., households the have been unable to sell due to the frozen housing markets. The current supply of previously-owned and new homes on the market is roughly 3.9 million. The number of loans 90 days or more past due nationwide is also about 3.9 million. Some of these mortgages will be successfully modified or otherwise become current, but some of these problem loans will result in additional homes being put on the market. Freddie Mac, for example, estimates that 36 percent of its mortgages that are at least 90 days past due or in foreclosure are already vacant. There is no borrower living in the house to whom a modification plan can be offered. In Florida, 56 percent of this category of properties is vacant. In Nevada it is 45 percent, in Ohio 46 percent, and in Texas 44 percent.

When you see numbers of this magnitude, it is clear that recovery in the housing market will occur when the number of jobs in the economy begins to expand, thus creating the economic demand needed to absorb some of this excess inventory. Only then will we see an expansion in the number of households sufficient to fill the many vacant homes and apartments now available. Unfortunately, MBA's projection, and the projections of many other economic forecasters, is that unemployment will continue to get worse throughout the middle of next year before it slowly begins to improve. The lags between the recovery of the economy and the recovery in employment have grown longer and longer over the past several recessions and we expect this recession to continue this trend.

One problem for the housing market, however, is that there is no guarantee that when the jobs come back, they will come back where the excess single-family and rental housing units are located. For example, employment in Michigan has still not recovered from the 2001 recession. There may well be some areas of the country that stay mired in a housing recession for several years after the rest of the nation recovers.

In addition, it is important to note that the mortgage lenders doing business today are the ones who did not make the riskiest loans and who had the greatest control over their underwriting standards. These surviving lenders are, by the mere fact that they are still here, the most conservative and the least likely to become very expansionist with their lending policies. These lenders largely did the right thing and were often criticized by shareholders and others for losing market share during the middle of this decade because they did not rush into the riskiest forms of lending. Now they are bearing the brunt of bad publicity and strict supervisory actions from federal agencies such as the Federal Reserve and the Department of Housing and Urban Development (HUD) and a patchwork of inconsistent state regulations that are the result of the behaviors of their now-defunct competitors. The effect of the regulations and the negative publicity will likely make these institutions even more conservative in their policies.

Another series of challenges facing the mortgage and housing industries in both the immediate and long term stem from the government's actions to provide stability to the financial markets. Perhaps the most immediate challenge is what will happen to interest rates when the Federal Reserve terminates, in March 2010, its program for purchasing Fannie Mae and Freddie Mac mortgage-backed securities (MBS). The Federal Reserve has purchased the vast majority of MBS issued by these two companies this year. The benefit has been that mortgage rates have been held lower than what they would have been without the purchase program, but there is growing concern over where rates may go once the Federal Reserve stops buying and what this will mean for consumers. While the most benign estimates are for increases in the range of 20 to 30 basis points, some estimates of the potential increase in rates are several times those amounts.

We believe the termination of the program was extended to March in order to provide the Obama administration some cushion for announcing its recommendations for the future of the government sponsored enterprises (GSEs), Fannie Mae and Freddie Mac, which are expected to be included in February's budget announcement. We hope the administration will address some of the ambiguity in the degree of federal support for the long-term securities issued by Fannie and Freddie – ambiguity that partially caused credit spreads to increase significantly earlier this year and led to the initiation of the Fed's MBS purchase program.

In addition to whatever additional interim measures are announced for Fannie Mae and Freddie Mac, the administration and Congress will need to address the long-term structure of the secondary market. The federal government has played a key role in providing stability to the secondary market since the creation of Fannie Mae in the 1930s. However, the current housing crisis has tested the government's role and led to calls for a fundamental rethinking of how the government plays its part.

In the fall of 2008, MBA established the Council on Ensuring Mortgage Liquidity to provide information and insights to this rethinking. The council's mission has been to look beyond the current crisis, to what a functioning secondary mortgage market should like for the long term. After nearly a year of discussions and deliberations that resulted in a set of key considerations and principles for ensuring mortgage liquidity, the council formulated a suggested new framework (attached) for the government's involvement in the secondary market, with a particular focus on the roles currently played by Fannie Mae and Freddie Mac.

MBA's plan envisions a system composed of private, non-government credit guarantor entities that would insure mortgage loans against default and securitize those mortgages for sale to investors. These entities would be well-capitalized and regulated, and would be restricted to insuring only a core set of the safest types of mortgages. The resulting securities would, in turn, have the benefit of a federal wrap that would allow them to trade similar to the way Ginnie Mae securities trade today. The federal wrap would not be free. The entities would pay a risk-based fee for the wrap, with the fees building up an insurance fund that would operate similar to the bank deposit insurance fund, and would be subject to tight regulation. The advantage to this system is that any credit losses would be borne first by private equity and any risk-sharing arrangements put in place with lenders and private mortgage insurance companies. In the event one of these entities failed, the insurance fund would cover the losses. Only if the insurance fund were exhausted, would the government need to intervene.

While not the only potential framework, the council's recommendations represent a clear, concise and workable approach to ensuring liquidity to the mortgage market. The proposed framework carefully balances the government's involvement with the need to protect taxpayers from credit and interest rate risks associated with mortgage finance. We believe this proposal represents an important improvement over the present structure in a number of areas and we are eager to discuss it further with the members of this committee.

MBA Policy Recommendations

As Congress continues to examine ways to stabilize the economy, MBA has endorsed a series of near term measures to enhance liquidity, assist homebuyers and improve the overall functioning of the housing market.

Market View on Loan Limits

When the housing finance system collapsed nearly two years ago, private investors fled the secondary market, leaving Fannie Mae, Freddie Mac and the Federal Housing Administration (FHA) as the only significant sources of liquidity. However, these entities are restricted from purchasing loans above a statutory limit. For the GSEs, this limit is known as the conforming loan limit. The temporary increase in the FHA and conforming loan limits under the Economic Stimulus Act of 2008 and the continued temporary extension for high-cost areas under the American Recovery and Reinvestment Act of 2009 clearly had a positive impact on the mortgage market by increasing liquidity for and lowering the interest rates of loans that were previously beyond the GSEs' and FHA's reach.

Due to the temporary nature of the higher loan limits, which are scheduled to expire on December 31, 2009, the investment community will not purchase bundles of loans if they include more than ten percent of loans over $417,000. Because many lenders report their volume of high loan balance transactions exceed this ten percent threshold, they are being forced to resort to costlier alternatives to the securitization market.

Due to the pending loan limit expiration, MBA members are already seeing the investment community pull away from certain transactions. MBA believes it is critical for the GSEs and FHA to provide support for the broadest possible spectrum of home prices in all areas during these challenging times. By permanently increasing the FHA and conforming loan limits to $625,500, and up to $729,500 in high-cost areas, the investment community will be provided the necessary certainty to remain in the market, and American consumers will continue to have access to affordable mortgage credit.

MBA would also like to highlight the importance of FHA's multifamily programs in today's housing market. During the current market downturn, affordable rental housing has become a more urgent need for families and elderly individuals who either cannot afford to buy or who chose to rent. While FHA's multifamily loan limits are sufficiently high in most markets, in some areas of the country they are severely restricting the ability to use FHA insurance programs to finance rental housing. MBA encourages Congress to consider increasing the loan limits for elevator buildings and provide the HUD Secretary with additional discretion in extremely high-cost areas (similar to that provided in Alaska and Hawaii today).

Homebuyer Tax Credit

The Internal Revenue Service (IRS) recently reported that more than 1.4 million taxpayers have benefited from the first-time homebuyer tax credit enacted by Congress as part of the Housing and Economic Recovery Act of 2008.[2] MBA has supported the homebuyer tax credit since it first passed Congress and recognizes that we have an excessive inventory of available homes in many parts of the country. As I noted earlier, demand is simply not keeping up with the current oversupply. MBA supports tax initiatives that would encourage home purchase activity.

Specifically, MBA recommends the following changes to the current tax credit:

- Extend eligibility to *all* primary residence homebuyers.

- Increase the tax credit to up to 10 percent of the home purchase price up to a maximum of $15,000.

- Require the tax credit to be repaid in certain instances – The borrower should repay the tax credit if the residence is sold within three years (with an exception for employment-related moves) or in the event of a taxpayer default on any other mortgage that existed at the date the tax credit is claimed. This would serve to

[2] http://www.irs.gov/newsroom/article/0,,id=213375,00.html

discourage “buy and bail” behavior, where a borrower uses the tax credit for his or her advantage and then walks away from an existing mortgage obligation.

- Allow taxpayers to claim and receive the tax credit immediately, and facilitate the IRS sending funds claimed by the taxpayer directly to the settlement agent for use in the purchase mortgage transaction.

- Any enhancements to the program should be effective on the date of enactment.

Warehouse Lending Capacity Issues

Warehouse lending is a critical conduit that brings the funds from the secondary market to the closing table. In past years, independent, non-depository mortgage bankers that rely on warehouse lines to fund loans sold to Fannie Mae, Freddie Mac and Ginnie Mae were responsible for upwards of 40 percent of all residential mortgages originated in the United States and originated nearly 55 percent of all FHA loans.

Over the last 18 months, warehouse lending has been reduced as some warehouse lenders were bought or went out of business and others terminated or added restrictions to their warehouse lines of credit. Recently, new entrants to the warehouse lending business and a new Freddie Mac warehouse lending pilot program have helped ease the credit crisis for a small number of the largest independent mortgage bankers. However, for the small to midsized mortgage banker, the unavailability of credit is still an issue.

These small businesses have been faithfully serving their communities for decades and provide unparalleled customer service. MBA urges you to continue to support all independent mortgage bankers, and the mortgage industry at-large, by encouraging the Department of the Treasury, Fannie Mae, Freddie Mac and Ginnie Mae to support initiatives that help restore the flow of mortgage credit through warehouse lines of credit.

Commercial Market Concerns

For much of the year, the commercial mortgage-backed securities (CMBS) market has been virtually frozen, and we expect to see continued challenges in the commercial area. In June 2009, the Federal Reserve expanded the term asset-backed securities loan facility (TALF) to include legacy and recently issued CMBS. The market reacted positively, as spreads for highly-rated CMBS began to narrow. Unfortunately, the challenges facing the commercial real estate finance market will extend past the current TALF expiration dates for legacy CMBS (March 31, 2010) and newly issues CMBS (June 20, 2010).

In order to provide certainty to all market participants, MBA recommends that Congress encourage the Treasury Department and the Federal Reserve to extend the program to December 31, 2011. This extension period will allow market participants to include consideration of the TALF CMBS program in their short-term and mid-term finance strategies. This two-year timeframe will end rampant speculation and market disruption when extensions are announced several weeks or months before a program is set to expire. With a typical CMBS taking four to six months from the start of the loan aggregation process until the CMBS is issued, providing a two-year window will allow for an orderly CMBS aggregation and execution process and a bridge for new private sector lending structures to emerge.

Conclusion

While our economy is showing signs of recovery, and a number of local housing markets appear to be reaching the bottom, our long term recovery will be dependent on the creation of jobs. As we begin to see new employment opportunities, consumer confidence and spending will also return, and a new wave of homebuyers will begin to absorb the oversupply of homes. MBA looks forward to continuing to work with the committee as it examines additional policy initiatives to help stabilize our economy and improve our nation's housing market.

Attachment

MBA's Recommendations for the Future Government Role in the Core Secondary Mortgage Market

MBA's RECOMMENDATIONS FOR THE FUTURE GOVERNMENT ROLE

IN THE CORE SECONDARY MORTGAGE MARKET

MORTGAGE BANKERS ASSOCIATION®
Investing in communities

INTRODUCTION

Since the creation of Fannie Mae in the 1930s, the federal government has played a key role in providing stability to the secondary mortgage market. The current housing crisis has tested the government's role and led to calls for a fundamental rethinking of how the government plays its part.

To provide information and insights to this rethinking, in October, 2008 the Mortgage Bankers Association (MBA) established the Council on Ensuring Mortgage Liquidity. The Council's mission has been to look beyond the current crisis, to what a functioning secondary mortgage market should like for the long term.

On November 19, 2008, the Council hosted a summit on the future of the secondary mortgage market and the GSEs that brought together leading thinkers from industry, academia and regulators to discuss what fundamental elements would be required for a functioning secondary market. The discussion led to the Council-issued report *Key Considerations for the Future of the Secondary Mortgage Market and the Government Sponsored Enterprises (GSEs),* which was released in January, 2009.

The Council's second task was to develop a set of guiding principles embodying the key considerations mentioned in the primer. The report *Principles for Ensuring Mortgage Liquidity* was released by the Council on March 19, 2009. The principles serve as a tool for evaluating proposals that arise for restructuring the secondary market.

As the policy spotlight has turned to the futures of Fannie Mae and Freddie Mac, the Council has taken on the questions of what an appropriate future government role in the core secondary mortgage market might look like. After thoughtful discussions and deliberations, we now present the Council's *Recommendations for the Future Government Role in the Core Secondary Mortgage Market.*

This report presents the Council's suggested framework for government involvement in the single-family and multifamily secondary mortgage markets, with a particular focus on the roles currently played by Fannie Mae and Freddie Mac. While clearly not the only potential framework for the future, the Council's recommendations represent a clear, concise and workable approach to ensuring liquidity to the mortgage market. The proposed framework carefully balances the government's ability to ensure liquidity with the need to protect taxpayers from credit and interest rate risks associated with mortgage finance. This and the other Council reports can be found at: www.mortgagebankers.org/CEML.

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In the coming months, MBA and the Council will continue to study the critical issues related to the future of the secondary mortgage market, and will continue to provide information and insights to regulators, legislators and others involved in the policymaking process. We want to thank the members of the Council for their valuable service, and for helping define a workable model for the future government role in the secondary mortgage market.

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1. OVERVIEW

The importance of housing in the economic and social fabric of the United States warrants a federal government role in promoting liquidity and stability in the market for mortgage debt. The size and scope of the U.S. housing market mean that, except in times of extreme duress, the federal government's role should be to promote liquidity for investor purchases of mortgage-backed securities, not to attempt to provide the capital for or absorb the risks itself.[1]

As a necessary component of this provision of liquidity and stability, a security-level credit guarantee backstop will be needed for the core mortgage market,[2] which should rely on security-level risk-based premiums paid into a federal insurance fund and loan-level guarantees provided by a small number of privately-owned, government-chartered and regulated mortgage credit-guarantor entities (MCGE). The government backstop should be explicit and should be focused on the credit risk and market liquidity of mortgage-related products, not any interest rate risk. The loan-level MCGE guarantee should be such that it absorbs all mortgage-related credit losses and that the federal insurance fund is called upon only in situations of extreme distress.

The centerpiece of federal support for the secondary mortgage market should be a new line of mortgage-backed securities. Each security would have two components: a) a security-level, federal government-guaranteed "wrap" (GG) like that on a GNMA security; which would in turn be backed by b) private, loan-level guarantees from privately owned, government-chartered and regulated mortgage credit-guarantor entities (MCGEs). The GG would be conceptually similar to the Ginnie Mae model and would guarantee timely interest and principal payments to bondholders, would explicitly carry the full faith and credit of the U.S. government and would be supported by a federal insurance fund, fueled by risk-based fees charged for the securities at issuance and on an ongoing basis. The MCGEs would in turn rely on their own capital base as well as risk-retention from originators, issuers and other secondary market entities such as mortgage insurers. Through these programs, the credit risk of the underlying mortgages would be removed from the securities issued, while the interest rate risk would remain with the security investor.

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2. MORTGAGE CREDIT-GUARANTOR ENTITIES (MCGE)

The MCGEs should be privately owned, mono-line institutions focused solely on the mortgage credit guarantee and securitization business. This business encompasses both single-family and multifamily residential mortgages. The loan-level MCGE guarantee would be backed by private capital held by the MCGEs which would be overseen by a strong regulator. The MCGEs would be required to manage their credit risk by using risk-based pricing, originator retention of risk (such as reps and warrants backed by sufficient capital to support them), private mortgage insurance (PMI) and risk transfer mechanisms including other risk-sharing arrangements, to ensure that there is a strong capital buffer before the GG and insurance fund would come into play. Loans would not be included in a GG security unless they were guaranteed by a MCGE.

In most cases the MCGEs would own the loans underlying the GG securities they issue, and in the event of foreclosure could own the real estate collateral.

The MCGEs would have standard corporate powers to raise debt and equity. Other than access to the related GG security they could issue, none of the corporate debt or equity the MCGEs issue would be guaranteed, either explicitly or implicitly, by the federal government. The corporate capital levels of the MCGEs must be actuarially sound and the entities should report regularly to the satisfaction of the GG, Treasury and the MCGEs' regulator.

The number of MCGEs should be based on the goals of a) competition, b) strong and effective regulatory oversight, c) efficiency and scale, d) standardization, e) security volume and liquidity, f) ensuring no one MCGE becomes "too big to fail" and g) the transition from the current government sponsored entity (GSE) framework. Initially, the number of MCGEs should be either two or three. The regulator would have the ability to increase that number over time, through the granting of charters, as the market develops. The ownership of at least one of the MCGEs could be in a co-op form with mortgage lenders as shareholders. The governance structure of the MCGEs should adequately represent both the multifamily and single-family mortgage markets.

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Allowable Mortgage Products of the MCGEs

The federally related securitization guarantee should support only "core" mortgage products with well-understood, well-documented risk characteristics. The federally related securitization guarantee should generally support: a) "conventional" single-family mortgage products traditionally supported by the GSEs, including those currently eligible for TBA funding; and b) multifamily mortgage products that fit the GSEs' published underwriting guidelines, including affordable multifamily rental housing mortgage products. If CRA-related loans are included in the definition of core products, the MCGEs and GG should provide a transparent and liquid market into which lenders can deliver them on a pricing and risk-adjusted basis.

In defining the products covered by the new guarantees, industry participants, the MCGEs, the GG and federal regulators should carefully review current product definitions and classifications to ensure maximum market transparency, efficiency and liquidity. New products would be proposed by the MCGEs, recommended by the GG and would require approval from the regulator. Thus new product development would be measured, prudently regulated and conservatively responsive to market demands.

Portfolio Authority

The key mission of the MCGEs should be to guarantee and securitize mortgages through the program described. The MCGEs should therefore hold only a *de minimus* portfolio of mortgage assets.[3] The portfolios' purposes would be to support securitization by allowing the MCGEs to a) aggregate allowable mortgages for securitization, b) manage loss mitigation through foreclosure, modifications and other activities, c) incubate mortgages that may need seasoning prior to securitization, d) develop new mortgage products through a strictly limited level of research and development prior to the development of a full-fledged securitization market and e) fund highly structured multifamily mortgages that are not conducive to securitization.

Regulator

The MCGEs' regulator should be strong, empowered and adequately funded through the GG insurance premiums.[4] The regulation regime contemplated would be similar to that of a public utility, with the MCGEs earning a conservative return on equity. The regulator should have the power to adequately oversee the MCGEs, specifically with regard to products, pricing and capital adequacy.

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3. FEDERAL GOVERNMENT GUARANTEED "WRAP" (GG) SECURITIES

GG securities would carry a guarantee of timely interest and principal payment, would explicitly carry the full faith and credit of the U.S. government and would be supported by a federal insurance fund, fueled by risk-based fees charged for the securities at issuance and on an ongoing basis. Ginnie Mae could potentially take on the responsibilities of the GG.

The GG would be responsible for standardization of mortgage products, indentures and mortgage documentation for the core mortgage market. Minimum regulated fees would be established for ongoing servicing, surveillance and reporting. This would ensure standardization and liquidity throughout the core market. Each MCGE would individually issue GG securities under this standardized regime. These new GG securities could also be issued by private institutions approved by the MCGEs. These securities would also carry the GG security-level guarantee backed by the MCGE loan-level guarantee; accordingly, the MCGEs will have approved and insured the underlying collateral.

The GG is not intended to support the entire mortgage market, but rather only those products needed to keep the secondary market for core mortgage products liquid and functioning through all environments. There would continue to be key roles for FHA, VA, RHS and Ginnie Mae as well as for the fully private market, particularly as such roles evolve in support of public or social housing policy goals and objectives. FHA, VA, RHS and Ginnie Mae would continue to play critical roles in providing government credit support for affordable housing, while the fully private market would provide finance vehicles for mortgages that fall outside of core product profiles. Mortgages made outside of a federally guaranteed framework would rely entirely on private capital and management of risks, in as much as such mortgages may exhibit risk characteristics that would not be well documented or well understood (and therefore would not be allowable products eligible for inclusion in GG securities).

The mission of any federally related mortgage securitization and guarantee program should be explicitly limited to ensuring liquidity in the core mortgage market through the issuance and guarantee of mortgage-backed securities.[5] This important mission should not be distorted by additional public or social housing policy goals. To the degree additional objectives are desired, they should be pursued through FHA, VA, RHS, Ginnie Mae and direct federal tax and spending programs, which should be adequately funded and supported to meet these important objectives. The self-supporting GG federal insurance fund, which is likely to run surpluses in all but the most extreme circumstances, could be a potential source of funds for Congress when considering affordable housing expenditures.

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While the full faith and credit of the U.S. government should mean there will not be a need for a liquidity backstop, in times of extreme market distress, liquidity could be provided to the GG securities market through Treasury and/or Federal Reserve purchases of GG mortgage securities.[6] As a result, there would not be a need for the MCGEs portfolios to be sized and structured to take on the role of "liquidity providers of last resort."

4. TRANSITION

The infrastructure of the existing GSEs should be used as a foundation for new MCGEs, with the technology, human capital, standard documents and existing relationships that the GSEs have developed available to one or more MCGEs. Every effort should be made to transfer existing origination, servicing and other industry relationships from the GSEs to the new MCGEs so as not to strand originators and servicers with ties to the existing GSEs. Historical performance data and other information should be made available to originators, the MCGEs, regulators, rating agencies, investors and providers of credit support to enhance the efficiency of the market.

Decisions regarding the futures of the GSEs should be made expeditiously so as to reduce continued losses of talent at Fannie Mae and Freddie Mac. This will be important both to maintain the ongoing management of the GSEs' existing books of business as well as to fully leverage their infrastructures for use by the new MCGEs.

In order to facilitate a more rapid transition, to maximize the usefulness of the existing infrastructure of the GSEs and to allow the federal government to continue to use that infrastructure to address the current housing market challenges, a good bank/bad bank resolution of the GSEs, their assets and liabilities should be considered.

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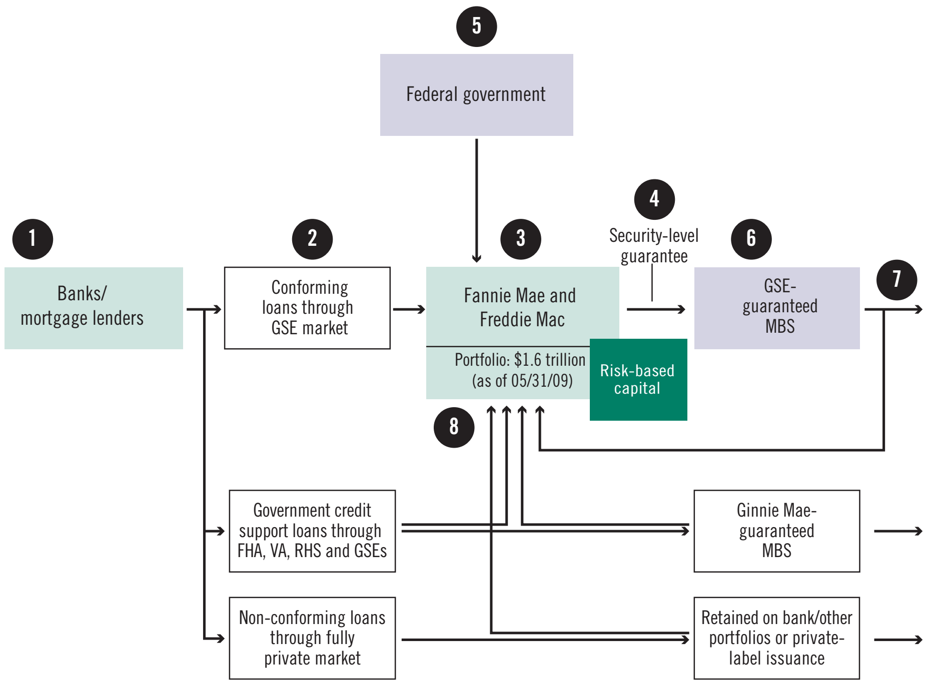
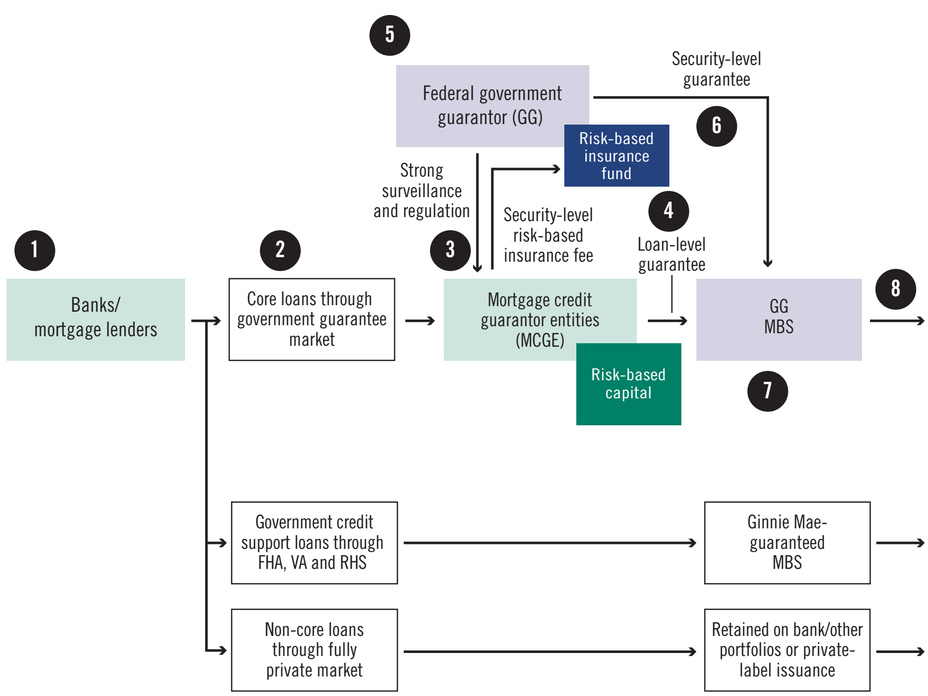
HIGH-LEVEL VIEW
CURRENT STATE: FANNIE MAE, FREDDIE MAC AND THE SECONDARY MORTGAGE MARKET



1. Mortgages are originated.
2. Mortgages are sold to Fannie Mae or Freddie Mac (FM).
3. FM prices and holds capital for the credit risk of the loans. FM either holds the loan in portfolio or includes it in MBS.
4. FM guarantees timely payment of principal and interest on MBS.
5. Federal agency provides oversight and regulation.
6. FM or mortgage lender issues FM-guaranteed security to the market.
7. Based on special status of the GSEs, security trades at a premium to other MBS.
8. FM may also purchase their own or other GSE-issued, Ginnie Mae or private label MBS as well as non-conventional government credit support loans to hold in portfolio, taking both the credit and interest rate risks.

HIGH-LEVEL VIEW
TARGET STATE: POTENTIAL ROLE OF THE FEDERAL GOVERNMENT IN THE CORE SECONDARY MORTGAGE MARKET



1. Mortgages are originated.
2. Mortgages are submitted to MCGE for credit underwriting and pooling.
3. MCGE prices and holds capital for the credit risk of the loans.
4. MCGE guarantees timely payment of principal and interest of the loans.
5. Federal agencies provide oversight, regulation and security-level guarantee in exchange for risk-based fee.
6. GG guarantees timely payment of principal and interest of the security.
7. MCGE or mortgage lender issues GG security to the market.
8. Based on the GG guarantee, security trades in equivalence to full faith and credit of the U.S. government; security buyer takes all the interest rate risk.

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NOTES

1. The Mortgage Bankers Association's Council on Ensuring Mortgage Liquidity. *Principles for Ensuring Mortgage Liquidity*. March 2009. "1.a. Except for times of extreme market stress, and except for the availability of a credit guarantee program as described in section 7 below, secondary market transactions should be funded by investors seeking market returns and who take on the credit, interest rate and / or other associated market risks for market-derived yields."

2. Ibid. "7. There is a role for a government credit-guarantee program to help attract investment to the residential secondary mortgage market."

3. Ibid. "7.c. Any government sponsored entity or program should preclude the creation of a GSE-like investment portfolio assembled for the purpose of arbitrage profits. A GSE or GSE-like entity may require a portfolio to support its securitization activities (i.e. aggregation, incubation, innovation), to accommodate limited amounts for highly structured products not conducive to securitization and /or to maintain an infrastructure for serving as a liquidity backstop for the market."

4. Ibid. "5.c. The regulator of any government sponsored / owned entity and other secondary mortgage market regulators should be strong, empowered and adequately funded."

5. Ibid. "8.a. The government should balance and coordinate any pursuit of social policy goals through the secondary mortgage market operations of government sponsored / owned entities with their implications for safety and soundness, the efficient operation of the secondary mortgage market and their consistency with primary mortgage market and / or other requirements. Such policy goals should be limited to residential housing in a way that does not contain market distortions."

6. Ibid. "10.a. In times of extreme market stress, the government should provide a mechanism to step into the secondary mortgage market as a liquidity provider of last resort by providing a liquidity backstop." MBA is currently developing a working brief discussing the merits of this approach.

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