MEMORANDUM

TO: File Number SR-FINRA-2015-036

FROM: Jessica Mark
Law Clerk
Office of Financial Responsibility, Division of Trading and Markets
U.S. Securities and Exchange Commission

DATE: November 6, 2015

RE: Meeting with Mortgage Bankers Association

On November 6, 2015, Commission staff met with representatives of Mortgage Bankers Association ("MBA") to discuss Financial Industry Regulatory Authority, Inc. ("FINRA") proposed rule change to amend FINRA Rule 4210 (Margin Requirements) to establish margin requirements for the TBA Market (release number 34-76148).

The Commission staff at the meeting were Michael Macchiaroli, Thomas McGowan, Randall Roy, Timothy Fox, and Jessica Mark from the Division of Trading and Markets.

The FINRA attendees at the meeting were Adam Arkel, Kris Dailey, Peter Tennyson, and Robert Mendelson.

The MBA attendees at the meeting were Thomas Kim, Eileen Grey, and Daniel McPheeters (MBA); David Borsos (National Multifamily Housing Council); Jay Donaldson (NorthMarq Capital); Michael May (Cantor Commercial Real Estate); Stephen Theobald (Walker & Dunlop); and Steven Wendel (CBRE).

MBa

MORTGAGE BANKERS ASSOCIATION

September 9, 2014

Mr. Thomas Wipf
Chair, Treasury Market Practices Group
C/O Federal Reserve Bank of New York
33 Liberty Street
New York City, NY 10045

Re: Margining and the Multifamily Agency Securitization Market

Dear Mr. Wipf:

Thank you for meeting with the Mortgage Bankers Association to discuss the multifamily agency securitization market and the implications of potential margining requirements on this industry. As the national association of the real estate finance industry, MBA appreciates the thoughtful discussion, and we look forward to the ongoing dialogue on this important matter. MBA shares the goals of maintaining integrity and efficiency in the agency mortgage-backed securities market,[1] and recognizes the importance of managing counterparty and systemic risk — goals identified by the Treasury Market Practices Group (TMPG) in recommending margin requirements for agency securities.[2]

Since the meeting with the TMPG, MBA has engaged in ongoing discussions with our multifamily lender members, and the concerns we previously expressed very much remain. For the multifamily and residential healthcare agency markets,[3] we do not believe that margining should be required during the origination and securitization process for multifamily agency lending.[4]

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[1] *Best Practices for Treasury, Agency Debt, and Agency Mortgage-Backed Securities Markets*, TMPG, Revised April 2014.

[2] *Margining in Agency MBS Trading*, TMPG, November 2012.

[3] Multifamily housing generally refers to rental housing properties with five or more dwelling units. Residential healthcare properties include a range of property types, including assisted living, skilled nursing and other facilities, which are eligible to be financed through the agencies. Where not specified, the use of "multifamily" throughout the letter is intended to subsume residential healthcare property types eligible for an agency execution.

[4] Our comments are focused on new issue multifamily agency securitizations, rather than trades of such securities following settlement in the secondary market.

Overview

As previously noted, market participants in the multifamily agency securitization market were surprised by the TMPG's June 2014 FAQ,[5] which scoped multifamily agency securities into the TMPG's margining best practices. The proposal that mark-to-market margining would be imposed in the multifamily agency securities market remains problematic at a number of levels. Before allowing margining requirements to move forward on a broad basis, we believe that the TMPG should re-examine and carefully consider the size and nature of the multifamily agency securitization market and its existing robust safeguards — in order to avoid costly, repetitious and disruptive impacts to the market.

The forward-settling multifamily agency securities market[6] is much smaller than and fundamentally different from the single-family TBA market. With about $40 billion in lending annually in a strong year,[7] the forward-settling multifamily market does not present the potential "contagion effect" and systemic risk concerns that appear to be core reasons behind the TMPG's best practices. Moreover, the amount of outstanding forward commitments at a given point in time would be only a *fraction* of the total annual lending volume (for example, the weekly average amount of outstanding forward commitments in the Fannie Mae DUS program was about *$3.32 billion* in 2013). The average daily transaction volume in the single-family mortgage market is in the range of $100 billion.[8] The multifamily forward-settling market, while vital to the financing of rental housing, is not large enough to present systemic risk concerns.

Delivery fails in the multifamily agency securitization market also have been extremely rare, an indication that existing safeguards and agreements have overall worked well. These safeguards in this market already address counterparty risk. Current practices — including the posting of Good Faith Deposits, trading agreements, and compliance with agency guidelines — impose safeguards that significantly mitigate market and counterparty risk for participants, while increasing certainty of execution. With strong market-specific safeguards and oversight by the

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[5] *Frequently Asked Questions: Margining Agency MBS Transactions*, TMPG, June 13, 2014.

[6] The Fannie Mae Delegated Underwriting and Servicing (DUS) program and the Ginnie Mae multifamily and residential healthcare program are the primary multifamily agency programs that utilize a forward-settling securitization model.

[7] MBA's Annual Origination Summation tracked $43 billion of multifamily and healthcare originations for Fannie Mae and FHA/Ginnie Mae in 2013, their second strongest year on record.

[8] *Margining in Agency MBS Trading*, TMPG, November 2012 ("Because the majority of transactions settle just once a month and trading is conducted using forward settlement, gross unsettled and unmargined bilateral agency MBS transactions could be in the range of $750 billion to $1.5 trillion at any point in time.")

agencies (Fannie Mae, HUD/FHA, Ginnie Mae[9]), the market has operated successfully for decades throughout different market cycles, including the recent major recession. Robust risk management standards, ongoing monitoring, and existing remedies provide strong safeguards that manage counterparty and systemic risk in this market. As a result, the number of failed deliveries is miniscule relative to the total volume of deals completed in this market — strong indicia that existing safeguards supported lenders and broker-dealers, as counterparties, to continue their operations and fulfill their obligations.

Should lenders be required to post margin (beyond the Good Faith Deposit) for multifamily agency securities, significant burdens would be imposed on market participants, particularly small lenders who finance affordable rental properties. This could be highly disruptive, produce unintended consequences without a commensurate benefit, and potentially impact capital availability in the rental housing market that serves low- and moderate-income households.

Fundamentally, margining is one tool used to mitigate certain market risks. *As a means to an end*, margining need not and should not be imposed where other safeguards exist and effective risk management tools are utilized, as in the case of the multifamily agency market. Rather than superimposing a generic Wall Street-based solution that could lead to detrimental and unintended consequences, we recommend that the TMPG consider existing, time-tested tools and safeguards, including the Good Faith Deposit, extension fees, the specific mechanics of the trade, and oversight by the agencies and regulators, that have been tailored to the multifamily finance market and its participants.

Accordingly, we recommend that the TMPG clarify that margining as currently envisioned by the TMPG's best practices would not be required for the new issue multifamily agency securities market.

Alternatively, the TMPG should treat the Good Faith Deposit (and any applicable extension fees) as a sufficient form of margin — including considering it as a cap for any potential variation margin. The Good Faith Deposit is *a form of margin* and an industry-developed best practice. In this regard, we recommend that the TMPG update its FAQ in a manner that clarifies that *Good Faith Deposits posted in multifamily agency securitizations are to be considered by dealers as fulfilling any applicable margining requirement*.

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[9] Both the Federal Housing Administration (FHA) and Ginnie Mae are part of the U.S. Department of Housing and Urban Development (HUD). Ginnie Mae largely operates as an independent agency within HUD.

This would be consistent with the TMPG's recommendation "that margining be applied based on the type of agency MBS transaction and the *existing market trading and settlement conventions for each transaction type*."[10]

The discussion below expands upon the foregoing points.

- First, we review certain key aspects of forward-settling multifamily agency transactions.
- Second, we discuss the concerns that appear to be the drivers of the TMPG's margining best practices — systemic risk and counterparty risk.
- Third, we address why the multifamily forward-settling agency securitization market does not pose systemic risk.
- Fourth, we identify existing safeguards in this market that effectively manage counterparty risk.
- Finally, we discuss why imposing margining would be highly disruptive and produce unintended consequences without a commensurate benefit in the forward-settling multifamily agency finance market.

I. KEY ASPECTS OF FORWARD-SETTLING MULTIFAMILY AGENCY SECURITIZATION

As previously discussed, the multifamily agency securitization process differs considerably from that of the single-family TBA market, which has been the TMPG's focus in developing best practices on margining in the agency securities market. For the forward-settling portion of the multifamily agency market, a security is backed by a particular loan collateralized by an identified, unique and extensively underwritten multifamily housing property — rather than a pool of yet-to-be identified single-family mortgages. In substance, the asset purchased by the investor is much more akin to a whole loan; its form as a security simply provides greater liquidity and the agency guarantee to the investor. The average loan balance originated for multifamily and healthcare mortgages in 2013 was $9.2 million for FHA and $10.3 million for Fannie Mae.[11] The borrowers/owners of the properties tend to be institutional entities, although there can be family-owned properties in the smaller multifamily housing market.

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[10] *TMPG Releases Updates to Agency MBS Margining Recommendation*, TMPG, March 27, 2013 (emphasis added).

[11] The TMPG's recommendations are focused on forward-settling agency securities. Therefore, agency models that do not utilize a forward trade would not be directly impacted by the rule. As discussed below, margining requirements could reduce competition among the agencies and other capital sources, which would not be beneficial to the market.

The lender and broker-dealer in the multifamily agency market are intermediaries that ultimately connect the borrower/owner to the investor of the security. The lender underwrites the multifamily property subject to agency guidelines and oversight (Fannie Mae, Ginnie Mae, HUD/FHA) that govern the origination of the loan and the lender itself.

Underwriting and Due Diligence

The underwriting and due diligence processes are extensive. The lender engages in a detailed examination of the multifamily property, an income-producing asset, including a property inspection, appraisal, engineering, environmental and structural assessments, a careful review of the financial details of the property, and a review of the geographic market in which the property is located.

The lender also carefully evaluates the borrower entity, its key principals, financial capabilities, and historical performance in owning and operating income-producing real estate. The process, typically taking months, is comprehensive, and both the borrower and lender are fully engaged.

Rate Lock and Good Faith Deposit

If all underwriting requirements, contractual terms and agency-provided guidelines are met, a rate lock agreement is executed between the borrower and the lender on an identified, underwritten multifamily property. The borrower has a strong incentive to lock the interest rate as soon as possible to solidify loan terms. The rate lock is a legally binding commitment, which, among other things, requires a Good Faith Deposit to be provided to the lender. The Good Faith Deposit is paid to or held for the benefit of the investor of the security to ensure borrower performance. The borrower may also be liable to the lender for all damages, obligations and liabilities relating to a failed closing of the loan in an amount equal to the lender's liability to its counterparty on the trade, the investor. The borrower accepts this performance risk to eliminate its interest-rate risk (market risk) during the time of the rate lock until the time the loan is closed and funded.

Forward Settlement, Trade Confirmation and Risk Management

At the time the lender locks the rate on the loan with the borrower, the lender is, in effect, selling the loan (at the terms and rate identified with the borrower) on a forward-settling basis to a broker-dealer or institutional buyer, who is a sophisticated party able to hedge its exposure to market risk. The trade is documented in a Trade Confirmation Letter that is signed by both parties upon execution of the trade. The Trade Confirmation Letter specifies the terms of the specific underlying loan and identifies the security. This documentation includes terms for the purchase price, amount of the Good Faith Deposit, delivery, extensions, settlement, and other representations and warranties.

Through the trade, the lender mitigates its interest-rate risk/market risk during the time of the rate lock until the time the loan is securitized and delivered to the dealer or investor. The lender also manages its counterparty risk by performing due diligence on the borrower, the income-producing multifamily rental property, and the broker-dealer, including but not limited to the review of financial statements, credit ratings, and establishing counterparty exposure limits. Notably, lenders typically only deal with approved broker-dealers, often dictated by the banks providing warehouse lines to the lender.

Broker-dealers also manage their counterparty risk by performing due diligence on the lender, including but not limited to the review of financial statements, compliance with agency (FHA, Ginnie Mae, or Fannie Mae) requirements, and establishing counterparty limits. The investor assumes interest rate risk in a manner consistent with its investment objectives in exchange for certainty of execution. It is worth noting that due to the length of time and level of due diligence that is required, certain affordable multifamily projects may not be economically viable if the borrower had to assume interest rate risk until the security is delivered to an investor.

The above project-specific origination and securitization process for multifamily loans differs significantly from the single-family TBA market where lenders enter into forward TBA contracts while originating single-family loans for delivery. In the single-family mortgage market, lenders seek to fill a pipeline and inventory with mortgages prior to settlement (when pools must be delivered). Single-family originators assume the risk that they will be able to deliver the agreed-upon quantity of loans with similar generic terms by a certain date.

This differs greatly from the multifamily agency securitization market, where the underlying loan has been identified and underwritten, and is already committed to by both the borrower and the lender. Meaningful penalties exist for the borrower if the borrower were to fail to close the loan.

Analogue

Multifamily agency lenders present a vastly different counterparty profile than secondary market trading firms. An appropriate analogue is the "end user" exemption that is utilized in other securities regulatory contexts. For example, the CFTC's final swap rules exempt from the clearing requirement swaps entered into for the hedging or mitigation of risk.

The policy purpose is to allow firms that are not actively "taking a position" in the market to hedge risks that arise as an incidental part of conducting business, without incurring prohibitive regulatory burdens. The forward-settling nature of new issue multifamily MBS exists to allow borrowers to rate lock their loans. The forward commitments entered into help facilitate that process and mitigate risks that arise incident to that activity. Margining, therefore, should not be required in this context.

II. Systemic and Counter-party Risk Management as Underlying Objectives

It appears that the main reasons for expanding the margining best practices to the multifamily agency market were concerns stemming from counterparty and systemic risk. As the TMPG is aware, these were discussed during the prior meeting, identified in the TMPG's June 2014 FAQ,[12] and described in the TMPG November 2012 white paper, "Margining in Agency MBS Trading," which presented the framework for requiring margining for agency MBS trading. In the section of the white paper on "What Risks Margining Meant to Address?," concerns were raised that the lack of margin for agency MBS raised potential "contagion effect."[13]

The TMPG's release that accompanied the white paper summarized the purposes for which margining is recommended: "A sizeable portion of the non-centrally cleared agency MBS market currently remains unmargined, posing both counterparty and systemic risks to overall market functioning if one or more market participants were to default."[14]

While the concerns raised in the white paper may be applicable to certain securities markets, the new issue multifamily agency market contains safeguards and speed brakes that make the potential for contagion and a systemic event highly remote.

III. The Multifamily Forward-settling Agency Market Does Not Pose Systemic Risk

Systemic risk concerns appear to be a central reason for imposing margining on the multifamily forward-settling market. Given both the size of this market and the structural characteristics of multifamily asset-based lending, we do not believe that this market presents systemic risk.

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[12] *Frequently Asked Questions: Margining Agency MBS Transactions*, TMPG, June 13, 2014 ("The forward-settling nature of most agency MBS transactions exposes trading parties to counterparty credit risk between trade and settlement. Given the *size* of the forward-settling agency MBS market, unmargined trades also pose systemic risks to overall market functioning if one or more market participants were to default. . . .") (emphasis added).

[13] *Margining in Agency MBS Trading*, TMPG, November 2012.

[14] *TMPG Recommends Margining of Agency MBS Transactions to Reduce Counterparty and Systemic Risks*, TMPG, November 14, 2012.

Size of Forward-Settling Multifamily Agency Securitization Market

While the multifamily agency market is a critically important source of financing for rental housing in the U.S., the volumes are not large enough to pose systemic risk concerns. In 2013, the second strongest year on record for the multifamily agency market, forward-settling multifamily executions originated $43 billion in multifamily lending, which is dwarfed by the approximately $1.6 trillion in agency MBS issuance in 2013 in the single-family market.

Moreover, it is important to recognize that only of a *fraction* of the annual origination volume is outstanding during a forward commitment period at a given point in time. For example, while the total originations under Fannie Mae DUS program for 2013 was $28.8 billion, the weekly average amount of outstanding forward commitments in the Fannie Mae DUS program is estimated to be only *$3.32 billion* in 2013.

Asset-Specific Lending as Risk Mitigant

The asset-specific lending character of this market largely confines the risk to the identified asset and isolates it from "contagion risk." Since multifamily properties are heterogeneous, each agency multifamily security is property-specific with the terms of the mortgage loan and security known at the time of forward trade. Unlike in the single-family mortgage market, multifamily agency lenders do not enter into forward TBA contracts and seek to fill a pipeline and inventory with mortgages prior to settlement (when pools must be delivered). Single-family originators assume the risk that they will be able to deliver the agreed upon quantity of loans with similar generic terms by a certain date. This differs greatly from the multifamily agency securitization market, where the underlying loan is already committed to by both the borrower and the lender, with meaningful penalties to the borrower for failing to close the loan.

The multifamily execution risk is collateralized by the Good Faith Deposit and managed by the terms in the rate lock agreement with the borrower. In the event of a delivery failure, financial relief for losses comes from remedies provided in the transaction documents — there is not a market mechanism to replace the security with another similar security, given that the trade is for a specific security backed by an identified multifamily loan. In other words, the trades and securities are *not fungible*, as the multifamily transaction stipulates a specific asset — a loan on an identified, unique multifamily property.

Because the entire securitization transaction is driven by the identified, income-producing multifamily property that is under lender due diligence for months, risks are largely isolated to the particular transaction. The borrower cannot simply and easily switch lenders or capital sources based on market fluctuations. Breakage fees are substantial, and costly third-party reviews have been performed that cannot be readily transferred to another lending source. In addition, the months required to switch capital sources would prevent borrowers from capitalizing on short-term interest rate movements, as the lengthy underwriting process for the borrower would have to begin again upon switching lenders. Consequently, the TMPG's concern that "market functioning could deteriorate amid one-sided trading and price volatility as its counterparties sought to replace their trades at the same time"[15] clearly is not applicable to the multifamily agency MBS market.

De Minimis Number of Delivery Fails as Reflection of Existing Safeguards

There have been very few settlement fails in the history of the forward-settling multifamily agency market. Based on information provided by market participants, there have been a very small number of delivery fails during the past decades. Many lenders have reported that they have experienced no delivery fails or one or a few fails *during their entire history as agency lenders*.[16]

The de minimis number of delivery fails is strong *indicia* that the safeguards and counterparty risk protections in the market have been effective, even during periods of severe market disruption. In other words, the extremely small number of delivery fails demonstrates that lenders, as counterparties, continued to operate as going concerns and fulfilled their obligation as loan sellers and/or issuers. We understand the same to be true for broker-dealers as counterparties in the multifamily agency market.

IV. EXISTING SAFEGUARDS MANAGE COUNTERPARTY RISK IN THE MULTIFAMILY FORWARD-SETTLING AGENCY MARKET

Strong safeguards already exist to provide counterparty risk protections in the multifamily agency MBS market that obviate the need for the recommended margining requirements.

Good Faith Deposit

Upon rate lock, multifamily MBS trades are backed by a legally binding commitment from the borrower. As part of this commitment, the lender requires the borrower, among other things, to place a Good Faith Deposit with the lender or broker-dealer for the benefit of the investor. The borrower may also be liable for all damages, obligations and liabilities relating to a failed origination of the loan in an amount equal to the lender's liability to the counterparty on the trade (investor) under the rate lock.

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[15] *Margining in Agency MBS Trading*, Treasury Practices Working Group, November 2012.

[16] Among the small number of delivery fails that have occurred, a common cause was a property-level event (rather than a counterparty risk-driven cause), such as property damage caused by a natural disaster.

The Good Faith Deposit collected from the borrower is typically 2 percent for Fannie Mae DUS loans and 0.5 to 1 percent for loans securitized through Ginnie Mae. *The Good Faith Deposit is a form of margin and an industry-developed best practice.* Given that Ginnie Mae and Fannie Mae somewhat appeal to different market segments, the difference in the amount of Good Faith Deposit reflects each agency's evaluation of market dynamics and execution risk. Extension fees are also required where there is an inability to meet the original timeframe under the rate lock agreement.

<u>Agency/Regulatory Oversight and Counterparty Risk Measures</u>

The agencies (Fannie Mae, Ginnie Mae and HUD/FHA) exercise extensive oversight and monitoring of lenders that originate multifamily loans and securitize through forward-settling platforms. Fannie Mae, for example, performs regular monitoring of transactions and oversight of all (currently 24) of the DUS lenders' operations and performance. This includes periodic on-site lender assessments, on-going transaction reviews, and a review of financial and business eligibility. Lenders submit quarterly financial information and attest to compliance with required capital levels, including restricted liquidity, operational liquidity and net worth requirements. Restricted liquidity must be held at a U.S. bank and is monitored on a monthly basis. If the monitoring reveals negative trends, Fannie Mae may increase the frequency of reporting and communication with the lender's senior management; require submission of an action plan to address risk and liquidity issues; and require posting of additional restricted liquidity and maintenance of additional operational liquidity. These safeguards place stringent requirements on the financial condition of DUS lenders.

For FHA lenders who securitize through Ginnie Mae, HUD requires lenders to submit evidence that they have complied with HUD approved Quality Control Plans at least twice annually. If there is a level of nonperforming loans, HUD will meet with senior executives to discuss workout approaches. FHA also requires lenders to submit audited financial statements annually, and requires lenders to meet net worth and liquidity requirements. Ginnie Mae also has additional, higher net worth and liquidity requirements which must also be maintained throughout the year and is subject to audit annually.[17] GNMA independently sends outside auditors to lenders/issuers (currently, there are 55 lender/issuers) for an audit at least every three years and more frequently if any material deficiencies are identified.

Beyond the above *direct* oversight/regulation of individual lender/issuers, the lender manages its counterparty risk by performing due diligence on the borrower, the income-producing multifamily rental property, and the broker-dealer, including but not limited to the review of financial statements, credit ratings, and establishing counterparty exposure limits. Likewise, broker-dealers manage their counterparty risk by performing due diligence on the lenders,

[17] *See* GNMA Handbook 5500.3, Rev-1 Paragraph 3-8.

including but not limited to the review of financial statements, compliance with agency (FHA, Ginnie Mae, and Fannie Mae) requirements, and establishing counterparty limits.

Safeguards that Govern *Prior* to Rate Lock

It is important to recall that even prior to the rate lock and posting of the Good Faith Deposit, numerous steps have occurred to align the interests of the parties to complete the transaction and avoid a delivery failure.

A rate lock is virtually always issued after the multifamily loan and property has been fully underwritten, including the performance of an appraisal, and engineering and environmental analyses. For loans to be purchased by Fannie Mae in the DUS program, the lender not only must meet underwriting guidelines, the lender shares in the risk of loss with Fannie Mae, either a first loss position or on a pari passu basis. For loans to be insured by HUD and securitized through Ginnie Mae, the lender must submit the loan application to HUD, and HUD must issue a firm commitment. After draft loan documents have been prepared and submitted to HUD for approval, the lender/issuer and HUD must both agree that the transaction can proceed forward and set a target date for closing. This is, again, in stark contrast to the "TBA" character of single-family mortgage pools where the underlying loans have not been identified at the time of the trade.

Completion of the underwriting and due diligence that takes place prior to rate lock provides strong alignment of objectives between the borrower and lender to consummate the transaction. Borrowers also pay a commitment fee for processing of the loan, another incentive for the borrower to close the transaction. These steps, in effect, significantly help manage counterparty and execution risk during the forward-commitment period.

Agency Remedies and Ability to Assign Loan to Another Lender

In the very unlikely situation that a lender files for bankruptcy or experiences severe financial hardship during the forward-settling period, HUD/Ginnie Mae could direct the loan to be assigned to another issuer to complete the delivery. Ginnie Mae requires assignment documents to be executed at closing and submitted to the agency for issuance of the security.[18] For Fannie Mae DUS transactions, Fannie Mae is the purchaser of the loan and issuer of the MBS (with the lender receiving either cash or more typically an MBS). Fannie Mae has substantial latitude and authority to address highly anomalous situations involving lender default. In addition, where lenders utilize a warehouse line made available by Fannie Mae,

[18] GNMA MBS Guide, Appendix V-1, Chapter 6(C).

additional remedies would exist to address a lender-collapse situation.[19] Thus, in extraordinary situations, where necessary, agency remedies exist that would limit counterparty risk to the broker-dealer/investor and systemic-level "contagion" risk.

V. Imposing Margin Requirements Would Be Highly Disruptive and Produce Unintended Consequences Without a Commensurate Benefit

Disruptive Impact

The forward-settling multifamily agency market enables the borrower to rate lock and the lender to mitigate interest-rate risk, thereby allowing the lender to finance additional multifamily projects and provide liquidity to the market. A margining requirement would effectively impose additional liquidity requirements creating a barrier to entry for smaller lenders and placing liquidity pressures on multifamily agency lenders broadly. Particularly given the safeguards and protections that already exist in the market (*e.g.*, the Good Faith Deposit, agency oversight and regulation, and counterparty risk management measures), we believe the negative consequences outweigh any incremental benefit.

Requiring lenders to post margin for multifamily agency securities would pose significant burdens on market participants, disrupt mechanisms that are currently in place, and result in unintended consequences. The liquidity and operational burden would be particularly detrimental to smaller lenders. Small, non-bank-owned lenders, who tend to finance more affordable rental properties with Ginnie Mae or Fannie Mae, will face difficulty in implementing margining mechanisms; the personnel, infrastructure and resources needed for these firms could be cost prohibitive.

Even for large lenders with diversified operations, changes to the current procedures and arrangements between dealers and lenders would require significant effort and lead time (in addition to dealing with the inherent difficulties of marking-to-market heterogeneous assets, as discussed below). And while one could argue that the lenders would benefit from margining requirements imposed upon broker/dealers they trade with, a requirement to do so would remove the ability of the lender to determine whether the cost of mitigating a remote risk is worth the benefit of reducing such risk.

[19] After funding a loan, lenders have the ability to assign the loan to Fannie Mae that will be placed on the warehouse line and delivered back to the lender prior to settlement through a simultaneous redelivery confirmation (back to the lender) and the warehouse line sale (to the dealer). If a lender were to become insolvent while loans were on the warehouse line, Fannie Mae would work with the dealer to deliver the bonds.

Inherent Difficulties of Marking-to-Market

For those parties who may be in a position to post margin, mark-to-market valuation will be difficult and, in some cases, nearly impossible to do in an accurate or consistent manner. Multifamily agency MBS, like the underlying collateral, is heterogeneous and different dealers will often provide differing bids on a bond. This would compound the difficulty of determining how much margin would need to be posted.

Price discovery will be challenging at best and likely cause disputes among lenders and dealers, exacerbating the time and resources expended to comply with the requirement. There are no widely used indexes, exchanges, or virtual marketplaces to trade agency multifamily MBS at this time. Each bond is sold via direct placement or auction to set a rate for a specific property with specific characteristics, *e.g.*, asset/product type, loan term, prepayment protection, amortization, interest only period, and lien position. An adjustment to one of the variables above may increase/decrease the rate by 15-20 basis points. Additionally, the same loan may have a bid range of up to 20-40 basis points from different dealers. A highly structured loan with a few special disclosures may never be offered again, making on-going mark-to-market valuation purely subjective.

Differences in perceived value will result in disputes, which will require time and effort to resolve. The mark-to-market issue is even more problematic for construction loans that back Ginnie Mae Construction Loan Certificates (CLCs), where the forward commitment period can last many months.[20]

Unintended Consequences

Imposing margining also would raise the cost of capital of forward-settling executions, shifting capital away from certain agency executions and toward others. Borrowers will be incentivized to approach other sources, thereby reducing the level of market competition, and putting forward-settling capital sources at a strong disadvantage. This would reduce the positive diversification of capital sources that currently exists in the multifamily finance market and

[20] The Ginnie Mae program is unique in that the new construction or substantial rehabilitation of a multifamily or residential healthcare property is financed through one long term loan with two securities – one for the construction loan phase (CLCs – a series of CLCs are issued and settled as draws occur during the construction period) and the other for the project's permanent loan (PLC – issued in exchange for the outstanding CLCs when the loan is converted to a permanent loan). Counterparty exposure is reduced incrementally over the construction term. Borrowers draw funds according to their construction schedule throughout the term and the individual construction draws are delivered to the investor (dealer) on a pro-rata basis, thus reducing the counterparty exposure.

reduce market liquidity that supports multifamily rental housing. An incentive would also be created to trade multifamily MBS away from broker-dealers who are required to impose margining.

The affordable rental housing market, in particular, could be disproportionately harmed. Capital sources, whether equity or debt, are often limited for "targeted affordable properties," such as those supported by the federal low-income housing tax credit, historic tax credits, or city or local government grants. The liquidity that would be necessary to provide margining may not be available from any of the market participants that are constructing, rehabilitating or refinancing an affordable rental property. Notwithstanding the limited availability of capital for these property types, the same safeguards and protections noted above exist, including the Good Faith Deposit and stringent oversight and monitoring by the agencies.

Likewise, many borrowers (who will ultimately bear the cost of margining) are not in a position to post significant margin beyond the Good Faith Deposit. A significant number of borrowers who own, operate and renovate affordable rental housing are smaller institutions or nonprofit organizations. Unable to post margin (beyond the Good Faith Deposit), such borrowers would be unable to lock-in a long term fixed rate during the underwriting and closing process, which would significantly increase their execution risk. The effect could be that modest multifamily rental properties, seniors housing properties, or affordable apartment buildings may not get constructed, renovated or rehabilitated.

In sum, the goals of transparency and efficiency outlined in the TMPG's best practices would be undermined by the proposal to require margining in the multifamily agency securitization market. Given the protections and oversight that currently exist, margining as proposed is neither necessary nor beneficial. Conversely, imposing margining will cause harm by creating disruption, placing at risk certain lenders and/or borrowers without the infrastructure or resources to implement margining. This, in turn, would impede capital flow to a market that largely serves low- to moderate-income families who rent their homes.

Conclusion

The size and limited exposure of the multifamily forward-settling agency market, the safeguards that already exist to address counterparty risk, and the agency oversight and monitoring of multifamily agency lenders strongly suggest that margining, as proposed, is not necessary in the multifamily agency market. In lieu of a generic, far-reaching approach that would impose harmful consequences, we recommend that the TMPG consider existing, time-tested tools and safeguards, including the Good Faith Deposit, Extension Fees and oversight by the agencies and regulators, that have been tailored to the multifamily finance market and have been proven to be effective over many market cycles.

Accordingly, we urge the TMPG to either exempt new issue multifamily agency securitizations from its margining recommendations or expressly treat the Good Faith Deposit as satisfying any margin requirement, in light of existing safeguards and best practices in the multifamily agency securitization market.

We would welcome the opportunity to continue the dialogue with the TMPG regarding the matters discussed above. If you have any questions, please contact Thomas Kim at 202-557-2745 or tkim@mba.org.

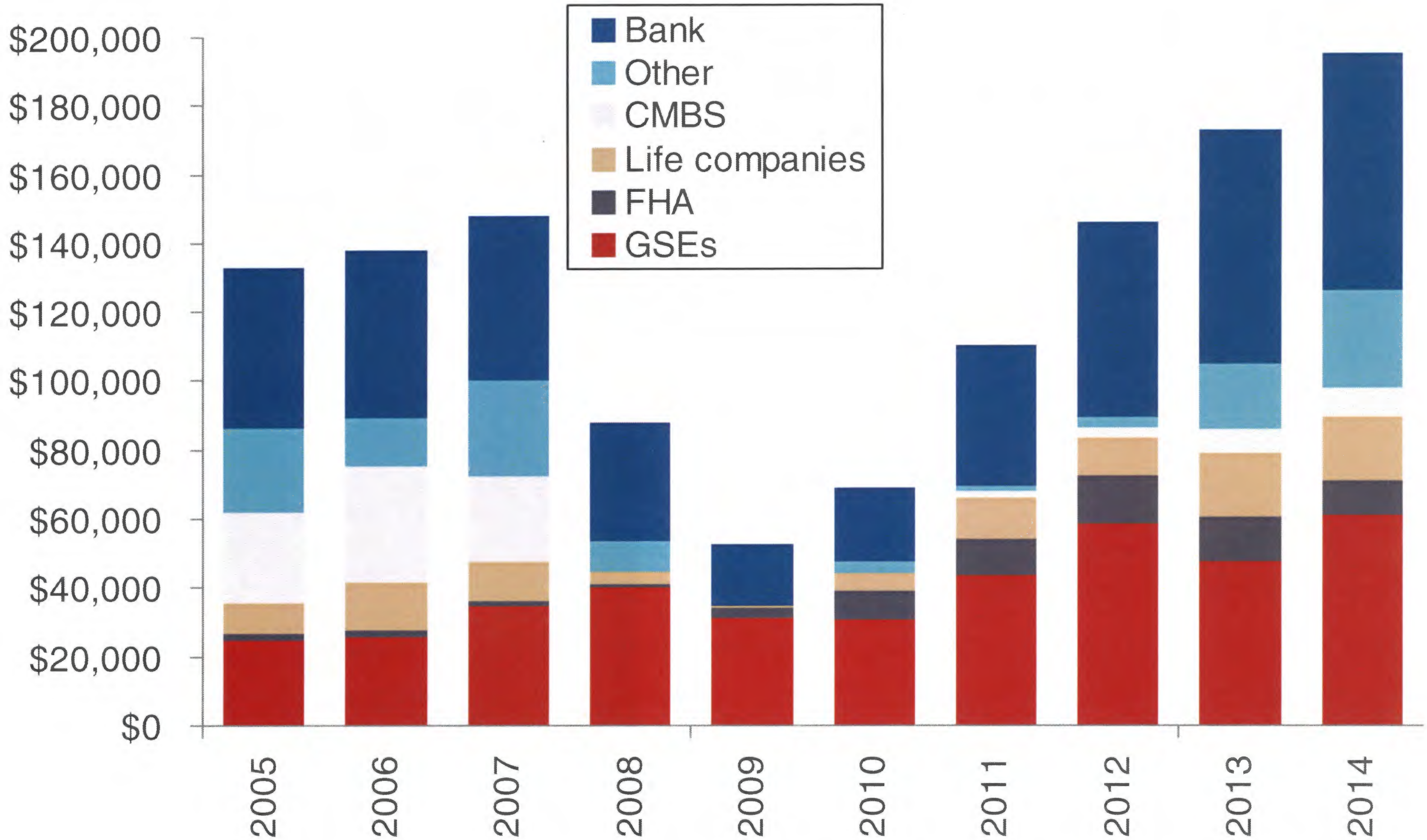
Sincerely,

David H. Stevens
President and Chief Executive Officer
Mortgage Bankers Association

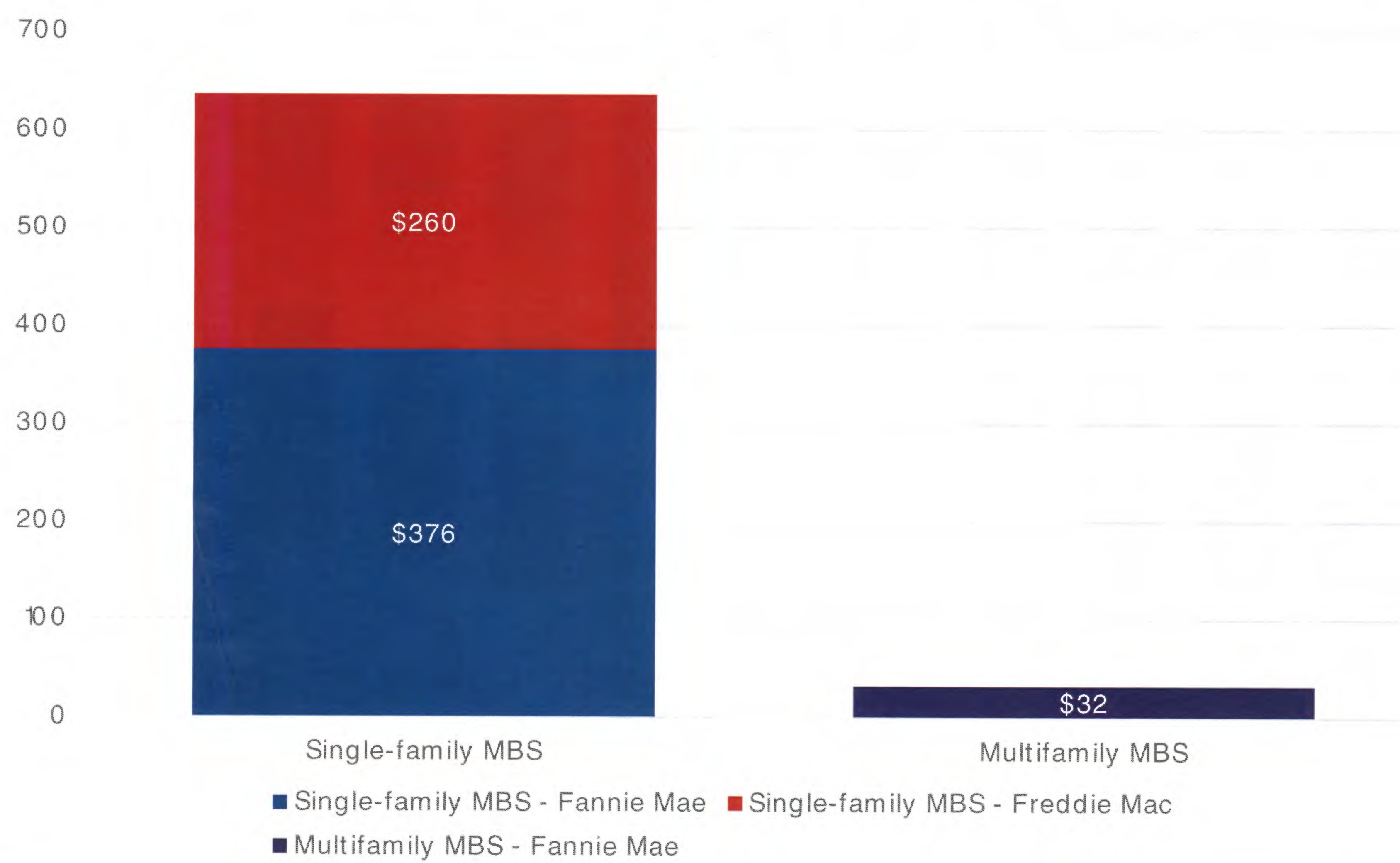
cc: Rodrigo López
Chairman, MBA Commercial Real Estate/Multifamily Finance Board of Governors

Thomas Kim
Senior Vice President, Commercial & Multifamily Policy, MBA

MBA Estimate of Total Multifamily Mortgage Originations by Investor Group ($millions)



2014 Fannie Mae And Freddie Mac Issuance of Single-family MBS and Fannie Mae Issuance of Multifamily MBS ($billions)



Source: Fannie Mae and Freddie Mac Annual Reports. "Fannie Mae: Single-family Fannie Mae MBS issuances." "Freddie Mac: Issuance — Single-family credit guarantees" (Includes conversions of previously issued other guarantee commitments into Freddie Mac mortgage-related securities.) "Multifamily Fannie Mae MBS issuances" (Reflects unpaid principal balance of multifamily Fannie Mae MBS issued during the period.)