

June 19, 2009

The Honorable Timothy F. Geithner
United States Secretary of the Treasury
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

The Honorable James B. Lockhart III
Director
Federal Housing Finance Agency
1700 G Street, NW
Washington, DC 20552

Dear Secretary Geithner and Director Lockhart:

This letter is to follow up on recent conversations with your respective staffs about the proposal of the Warehouse Lending Project¹ (WLP) and the Mortgage Bankers Association² (MBA) to provide a framework for Fannie Mae and/or Freddie Mac (“the GSEs”) to facilitate increased warehouse lending capacity to support the origination by mortgage bankers of home loans eligible for a) direct sale to the GSEs, b) sale to another GSE-approved seller for ultimate sale to the GSEs, or c) sale into securities to be guaranteed by the GSEs. This proposal accomplishes several key objectives that are necessary for any solution to have a significant and timely impact on the market:

- ◆ It uses existing GSE legal authority to purchase participation interests in eligible mortgages.
- ◆ It brings new capital and liquidity into the warehouse lending market through GSE purchase of participation interests in mortgages owned by warehouse

¹ The Warehouse Lending Project is a coalition of more than 30 independent mortgage bankers that depend upon warehouse lines from commercial banks to fund their residential mortgage loan originations. More information regarding The Warehouse Lending Project is located at www.warehouselendingproject.com.

² 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.

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lenders, subject to repurchase agreements with originating mortgage banking companies.

- ◆ It allows existing warehouse lenders to increase their warehouse lending capacity by permitting them to free up existing capital devoted to warehouse lending and re-use that capital for expanded lending.

Under the proposal, the GSEs would provide support for warehouse lending by purchasing participation interests in warehouse lines of credit that are backed by single family loans “accepted” by Desktop Underwriter (DU) or Loan Prospector (LP) and awaiting delivery to the GSEs (either whole loan or into a GSE mortgage backed security), or to another Fannie Mae- or Freddie Mac-approved seller for subsequent delivery to the GSEs. The legal structure to be followed for such purchases, we believe, conforms to the charter provisions of both Fannie Mae and Freddie Mac as we explain below.

The details of our proposal are contained in the attached **Term Sheet** (Exhibit 1). What follows in this letter is a discussion of the current situation giving rise to the need for this proposal and a brief discussion of the authority we believe the Federal Housing Finance Authority (FHFA) possesses to put this proposal into effect.

I. Background and Exigent Circumstances

Warehouse lending is the mechanism by which virtually all non-depository mortgage bankers fund loans that are eventually sold into the secondary market to Fannie Mae, Freddie Mac and Ginnie Mae. Today, independent mortgage bankers using warehouse lines are responsible for about 40% of all residential mortgages originated in the U.S. Moreover, these independent mortgage bankers originate nearly 55% of all FHA loans. Together, GSE-eligible and FHA/VA loans have become the only viable mortgage option for most homebuyers and refinancers. In short, warehouse lending is a critical conduit that brings the funds from the secondary market to the closing table.

When financial markets are healthy, warehouse lending is a little noticed corner of the mortgage finance system. Unfortunately, one of the casualties of the financial crisis has been a sharp decline in the availability of warehouse credit facilities for mortgage bankers. In consultations with various experts in the warehouse lending industry, we believe that 85-90% of the warehouse lending capacity has exited the market over the past two years. And just since March 1, two more major warehouse lenders have announced plans to leave the market in the months ahead – Guaranty Bank and PNC/National City. Of the remaining major warehouse lenders, several are experiencing financial and capital constraints of their own that limit their ability to expand their lending. Although two lenders have announced plans to expand, these plans mean the market is trading water at best, and the capacity shortfall remains acute.

Based on current projections of \$2.6 trillion in home mortgage originations in 2009, the current limits in warehouse lending capacity could produce a \$630 billion shortfall in home

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mortgage originations by mortgage bankers.³ While this estimate assumes that banks and thrifts will pick up a share of the mortgage bankers' market, the shortfall is simply too large for depository institutions to pick up all the slack. Moreover, independent mortgage banks with local market knowledge are critical to maintaining liquidity and competition in our real estate finance markets. Failure to address the warehouse shortfall will only accelerate the trend toward consolidation of mortgage originations into a handful of large national originators that control the market, putting jobs at risk and undermining competitive local markets.

With new loan programs for refinancing, tax credits for first time buyers, and Federal Reserve efforts to reduce and sustain lower mortgage rates showing signs of working to support a housing recovery, the lack of sufficient warehouse lending capacity has become the "choke point" in the system that undermines these initiatives. Simply put, the lack of warehouse credit has created a major supply-demand imbalance in the primary mortgage market, and despite policies intended to lower mortgage yields, the Federal Reserve cannot control primary market pricing "on the street." Without adequate warehouse capacity, lenders are being forced to increase interest rates in order to reduce demand and manage their loan application pipelines, and constrained warehouse lending capacity is causing the mortgage market to experience extended loan processing times, rate lock expirations and other related problems for borrowers.

There are two basic legal structures for traditional warehouse lending: one is the commercial line of credit model, whereby the warehouse bank advances funds on a line of credit to a mortgage banking company for newly originated mortgages, with these newly originated mortgages serving as collateral for the funds advanced until the mortgages are sold or placed into mortgage-backed securities. The second is the "purchase and sale" method, whereby the warehouse lender advances funds for the purchase of newly originated mortgages from the originating mortgage banking company. Such mortgages become assets of the warehouse lender, subject to an agreement with the originating mortgage banking company to, within a specified time period, repurchase the mortgage loan for a sale to another lender, or for delivery into a mortgage pool that will back a to-be-issued mortgage backed security. **For charter reasons discussed below, this proposal only covers warehouse lines that employ the "purchase and sale" method.**

According to our analysis of the Fannie Mae and Freddie Mac charters, both corporations are authorized to purchase whole loans or participation interests therein.⁴ While both corporations are authorized to lend upon the security of mortgages that are eligible for purchase,⁵ both corporations are prohibited from advancing funds to a mortgage seller on an interim basis, using the mortgage loans as collateral, pending the sale of the mortgage

³ See Exhibit 2 for derivation of this estimate.

⁴ Fannie Mae Charter, Sections 301(b)(1) and (2); Freddie Mac Charter 305(a)(1).

⁵ Fannie Mae Charter, Sections 301(b)(1) and (2); Freddie Mac Charter 305(a)(1).

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loans in the secondary market.⁶ Therefore, in order for the corporations to operate as proposed, each must be purchasing participation interests in loans already sold by the originating lender to the warehouse lender, and not directly advancing funds to the originating lender.

As we enter this critical stage in our housing recovery, we urge the Treasury Department and FHFA to consider our proposal to use the GSEs' loan purchase authority, in partnership with existing warehouse lenders, to expand capacity and encourage new sources of capital to enter the market. We believe the structure of this program is charter compliant and within the authority of the FHFA to approve. Moreover, based on consultations with several warehouse lenders, we believe that it will, in fact, produce the needed increase in lending capacity to support the housing recovery.

II. Proposal

While the details of our proposal are set forth in Exhibit 1, we have provided a summary explanation in the next few paragraphs of this letter. In short, we propose that the GSEs be authorized by FHFA to purchase participation interests in any warehouse lines where the warehouse lender has purchased closed loans that were covered by a DU or LP "Accept," and that are subject to a repurchase obligation/commitment by a Fannie Mae/Freddie Mac-approved seller that will be selling the loan to another lender, or delivering the loan to a pool that will back a to-be-issued mortgage backed security. Alternatively, for those mortgage bankers that are not GSE-approved, we propose that the GSEs purchase the participation interest only if the warehouse bank agrees to repurchase any loan that is ineligible for GSE purchase that is not repurchased from the warehouse by the mortgage banker. The proposal is designed to rest upon the same framework as the existing mortgage purchase programs run by the GSEs. The risks faced by the GSEs in this program are manageable, are faced by the GSEs today in their purchase and securitizations operations and include interest rate risk, fraud risk, lender bankruptcy and borrower early-default.

The key to controlling these risks includes the following:

- ◆ Each eligible loan in the warehouse must be covered by a take out commitment either under a pending issuance of a proposed GSE security, GSE whole loan purchase, or a purchase from another investor approved by the GSEs.
- ◆ The GSEs would also issue standardized participation agreements that would govern the respective rights and obligations of the warehouse lender as the lead lender/participant and the GSEs as the participant in the warehouse lending arrangement. Risk of loss on GSE-participating warehouse lines to GSE-approved sellers would be shared on a pro rata basis between the warehouse banks and the GSEs. The warehouse banks would be required to pursue available remedies in the event of a default. In addition the warehouse banks would only be liable to the GSEs for

⁶ Fannie Mae Charter, Section 301(b)(2)(A); Freddie Mac Charter 305(a)(4)(A).

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their own negligent acts as lead participant and not for negligent acts on the part of the GSE-approved seller in originating the mortgages. For GSE-participating warehouse lines to non-GSE-approved sellers, the warehouse banks would be liable for repurchase of ineligible mortgages that are not repurchased by the mortgage banker.

- ◆ The GSEs and the FHFA would promulgate standards and exercise oversight of the warehouse lenders permitted to participate in this program (either directly or through third party contractors with expertise in warehouse lending).
- ◆ The GSEs would pay a par price for the participation interests and other terms would be negotiated between the GSEs and each warehouse lender.
- ◆ The maximum participation interest that could be purchased by the GSEs would be fifty percent and the purchase of the participation interest could not take place until two days after the funding of the loan. Both of these requirements are to ensure compliance with the GSEs' respective charters.

Based on discussions with warehouse lenders, mortgage bankers, and capital markets experts, the Warehouse Lending Project and MBA believe purchase of participation interests in warehouse lending arrangements structured under the "purchase and sale" method would allow warehouse lenders to expand their current warehouse lending activity.

III. Legal Authorities

We recognize that a review is required for any new GSE activity. Our preliminary assessment suggests that the FHFA and the GSEs can support the warehouse lending market, provided the assistance is properly structured for charter purposes, responsive to exigent market-wide circumstances, and temporary – sufficient to spark private sector solutions but not to supplant them.

Pursuant to Section 301 of both the Fannie Mae and the Freddie Mac Charters, the corporations are given clear and sweeping authority to purchase or issue commitments to purchase FHA-insured, VA-guaranteed and conventional mortgages that meet the requirements set forth in the charter.

In addition, the recent GSE reform legislation appears to confer broad authority to the FHFA Director in a market crisis to permit the GSEs to mitigate the impact of adverse market events, including:

- ◆ Fostering "liquid, efficient, competitive, and resilient national housing finance markets...." (Section 1102, Housing and Economic Recovery Act of 2008)
- ◆ The FHFA is also provided authority to manage or direct the portfolio activities of the GSEs, including directing the enterprises to "acquire any asset, if the Director determines that such action is consistent with the purposes of this Act or any of the authorizing statutes." (Section 1109, Housing and Economic Recovery Act of 2008).

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Taken together, these authorities appear to provide a foundation for the GSEs, under FHFA's oversight, to address the current warehouse lending capacity crunch. A detailed review of both charters we obtained from a well known law firm is attached (see Exhibit 3) which provides a strong case that a properly structured participation interest in a warehouse facility is within the scope of the GSEs' charters.

IV. Conclusion

We understand that there are a host of details to be resolved, but we believe that the major elements of the proposal provide sufficient background to move forward. Given the pressing need for additional warehouse lending capacity, we look forward to establishing a constructive dialogue with the FHFA and the GSEs on this proposal as soon as possible. Thank you in advance for your consideration.

Sincerely,

The Warehouse Lending Project

Mortgage Bankers Association

EXHIBIT 1

TERM SHEET

There is a demonstrated lack of warehouse financing within the residential mortgage market. The program described below is designed to utilize statutory authority under the existing Fannie Mae and Freddie Mac mortgage purchase programs. The proposed framework is designed to be generic so that either Fannie Mae or Freddie Mac could enter into the arrangement with GSE-approved warehouse lenders and mortgage bankers, hence the use of the term "the GSEs" as a reference to both Fannie Mae and/or Freddie Mac. Here are the steps:

Structure of Program

1. An existing warehouse provider ("WH Provider"), will enter into a certain Master Loan Purchase and Sale Agreement (a "Purchase Agreement") with GSE-approved mortgage bankers ("Seller") pursuant to which, from time to time, Seller may sell at a "haircut" or discount to WH Provider on the third business day after funding, closed, conventional mortgage loans that are eligible for purchase by the GSEs, and that such loans have an "Accept" from the Desktop Underwriter and/or Loan Prospector automated underwriting systems (collectively "Mortgage Loans"). Seller must agree with the GSEs that its standard representations and warranties to the GSEs remain in full force and effect throughout the time period that the Mortgage Loan remains the property of WH Provider.

A WH Provider may also enter into a Master Loan Purchase and Sale Agreement with a mortgage banker that is not approved by the GSEs (Non-Approved Seller") pursuant to which, from time to time, Non-Approved Seller may sell at a "haircut" or discount to WH Provider, closed, conventional mortgage loans that are eligible for purchase by the GSEs, and that such loans have an "Accept" from the Desktop Underwriter and/or Loan Prospector automated underwriting systems (collectively "Mortgage Loans"). WH Provider must agree with the GSEs to repurchase any loan in the warehouse that cannot be sold because it is ineligible for purchase by the GSEs and is not repurchased by the Non-Approved Seller.

2. The obligation of WH Provider to purchase a Mortgage Loan from a Seller or Non-Approved Seller is subject to the satisfaction of various conditions, including, without limitation, that such Mortgage Loan is covered by either (a) a Commitment to Guarantee Mortgage-Backed Securities ("The GSEs Commitment") and subject to a "Qualified Forward Contract" with a "Qualified Counterparty" to purchase the GSEs Mortgage Backed Securities when issued or (b) a commitment ("Other Takeout Commitment") by another investor approved by WH Provider and The GSEs ("Other Investor") (including commitments to purchase issued by The GSEs through its cash window purchase operations) to purchase such Mortgage Loan from Seller or Non-Approved Seller, which such The GSEs Commitment and Qualified Forward Contract

or Other Takeout Commitment, as applicable, are assigned by Seller or Non-Approved Seller to WH Provider simultaneously with the sale of the Mortgage Loan to WH Provider.

3. The GSEs shall agree to purchase a participation interest, up to a maximum of fifty percent in each Purchase Agreement at a price of par and on such terms as may be negotiated between The GSEs and WH Provider.

4. Each WH Provider that sells a participation interest in a Purchase Agreement to The GSEs would be able to expand its warehouse lending by an amount equal to the amount purchased by The GSEs, either through an expansion of the Purchase Agreement to the Seller, or through extension of a Purchase Agreement to another Seller or Non-Approved Seller, or a combination of the two.

5. The Seller or Non-Approved Seller, as a subservicer to WH Provider as master servicer (or a subservicer acting on behalf of the Seller or Non-Approved Seller), will service the Mortgage Loans while WH Provider owns the Mortgage Loans.

6. WH Provider is required to exercise accepted practices of warehouse lending diligence including credit review and approval of the independent mortgage lenders and their respective counterparties, warehouse advance rates, leverage ratios and other restrictive loan covenants and other standard diligence practices. For each Purchase Agreement with a Seller, WH Provider shall be liable for its actions as lead participant, but shall not be liable for the actions of the Seller, including but not limited to Seller's actions in originating the Mortgage Loans. For each Purchase Agreement with a Non-Approved Seller, WH Provider, in addition to liability for its actions as lead participant, shall agree to repurchase any Mortgage Loans that are ineligible for purchase by the GSEs and that are not repurchased by the Non-Approved Seller following determination of the ineligibility for GSE purchase.

Scope of program

The program should be large enough to alleviate the severe capacity shortfall in the warehouse market, but not so large as to supplant private capital or deter new entrants. WLP and MBA propose that each GSE be directed to purchase participation interests of \$10 billion. The \$20 billion aggregate assistance would relieve pressure on the market, while leaving sufficient demand-supply imbalance so as to attract new private sector capital to warehouse lending. The proposed scope of the program takes into account the proposed GNMA warehouse program, which would be \$15 billion in scope. Between the proposed GNMA program and the proposed GSE program, we believe the combined scope should appropriately address the warehouse lending shortage.

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Length of Program

The GSE participation program should be limited to 24 months. The term could be extended based on a finding that private capital remains in short supply. Efforts should be made to phase the program out as private capital returns in order to avoid sharp withdrawals of warehouse capacity that could stress the market.

EXHIBIT 2
Estimated Warehouse Lending Gap

1. Estimated 2009 Home Mortgage Originations	\$2.6 trillion
2. Mortgage Banker Market Share	41%
3. Total mortgage banker originations (line 1 * line 2)	\$1.07 trillion
4. Estimated <u>current</u> WH lines from major lenders	\$25 billion
5. Average sustainable long-term line usage @ 70% (.7 * line 4)	\$18 billion
6. Estimated maximum funding capacity from <u>existing</u> warehouse lines (line 5 * 20)	\$360 billion
7. Estimated funding gap due to reduced warehouse line capacity (line 3 - line 6)	\$710 billion
8. Adjusted home mortgage funding gap (.8* line 7)†	\$568 billion
9. Estimated shortfall in warehouse lending capacity (line 8/20)†	\$28 billion

† This is a baseline estimate of the additional warehouse line capacity (line 9) that would be needed to accommodate the projected funding gap in 2009 (line 8). Higher loan origination volume in 2009 and/or increased mortgage banker market share as a result of increased use of FHA loans would produce a larger gap/need.

Sources/Derivation of Estimates:

1. Most recent published estimate: MBA forecasts \$2.6T in home mortgage originations for 2009 (rev. 05-26-2009).
2. Based on 2007 HMDA data LARs submitted by non-federally supervised lenders. This estimate excludes from the mortgage banker market share ALL RETAIL originations reported on the Countrywide Home Loans (non-bank) LAR.
4. Unofficial estimate from Reynolds Consulting.
5. This is an estimate of the average sustainable line usage over a full year. Lenders cannot maintain a line in 100% drawdown. Line usage must accommodate peaks and troughs through monthly and seasonal funding cycles. Based on historical experience, a 70% average would represent heavy usage over a one-year period.
6. Assumes typical loan stays in warehouse facility for 18 days, and lines can be turned over 20 times in one year.
8. Assumes banks and thrifts will be able to absorb 20% of mortgage banker volume in 2009.