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ASSOCIATION OF FINANCIAL GUARANTY INSURERS

Unconditional, Irrevocable Guaranty

Via Electronic Submission

September 4, 2012

Mr. Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
400 7th Street, SW
Washington, DC 20024

RE: Use of Eminent Domain to Restructure Performing Loans

Dear Mr. Pollard:

The Association of Financial Guaranty Insurers ("AFGI"), a trade association representing the unique perspective of financial guaranty insurers and reinsurers, commends the Federal Housing Finance Agency ("FHFA") for its recent notice in the Federal Register[1] regarding the use of eminent domain to acquire residential mortgage loans, as proposed in San Bernardino County, California; Chicago, Illinois; Berkeley, California, and other municipalities.[2] Because we see significant and adverse consequences for AFGI members, taxpayers, the mortgage market, and homeowners alike, and because we consider the proposed use of eminent domain unlawful, AFGI fully supports the FHFA's decision to take action to prevent the use of eminent domain to acquire residential mortgage loans. Moreover, we believe any action by the FHFA to prevent the use of eminent domain to acquire residential mortgage loans is consistent with its mandate to support the housing market and protect taxpayers from unnecessary losses.

As an industry, AFGI members represent perhaps the second largest group of financial institutions, behind the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac"), with substantial exposures to the residential mortgage-backed securities ("RMBS") market. Through their insurance of RMBS, AFGI members bear the risk of loss on RMBS that would be impacted by the proposed use of eminent domain. Indeed, the proposal would selectively seize private loans at below fair market valuations from innocent RMBS investors under the pretense of helping homeowners. Further, under the proposal, the profit from such enterprise would be largely distributed to the scheme's originators and private sector investors, not a public purpose sufficient to justify the use of the eminent domain power.

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[1] Federal Housing Finance Agency, Notice; Input Accepted, *Use of Eminent Domain To Restructure Performing Loans*, 77 Fed. Reg. 47652 (Aug. 9, 2012).

[2] For simplicity, our comments refer to the Community Action to Restore Equity (CARES) proposal promulgated by San Francisco-based Mortgage Resolution Partners, which we understand is being considered by San Bernardino County, Chicago and Berkeley.

The losses to AFGI members from such a plan if pursued on a wide scale could be significant. The proposal, as FHFA notes, would unilaterally disrupt millions of complex contractual arrangements, involving homeowners, lenders, servicers, investors (including pension funds) and financial guarantors, with the expected result of reducing the cash flow on RMBS insured by AFGI members. Consequently, AFGI members will challenge any such eminent domain scheme through appropriate legal avenues.

More broadly, we are concerned about the inevitable effects that such a proposal would have on the already tenuous RMBS market and on the ability to secure financing for those who need it most. If an eminent domain proposal were applied, underwriters and investors in the RMBS market would demand to be compensated for this new risk of government seizure of private property. This would result in higher borrowing costs for those seeking a mortgage loan and would further decrease access to financing to those who need it most. . Liquidity and access to credit would be unfavorably impacted not only in those municipalities where the eminent domain proposal is applied, but potentially across the private mortgage market. We worry that reducing liquidity in this market will cause home prices to drop further, imperiling the already weak recovery within the housing market and within the economy as a whole, and further increasing the risk of loss on RMBS insured by AFGI members.

AFGI is also concerned with the scope of the proposed eminent domain scheme.. Specifically, the current proposal would apply eminent domain only to *performing* underwater mortgage loans. By only targeting performing loans and leaving the other, less attractive loans in the trusts, the ultimate impact would be a decrease in cash flow available to pay RMBS investors their scheduled principal and interest. In other words, performance of the RMBS would be impaired by eliminating the cash flow from performing loans paying interest at a rate higher than the interest rate on the RMBS (this difference in rates is commonly referred to as "excess spread"). Any such arrangement would put downward pressure on the private mortgage market and thereby exacerbate homeowners' inability to access financing. . Additionally, even if the scope of the eminent domain proposal is broadened to apply to non-performing or defaulted underwater mortgage loans, the sponsors proposing the scheme plan to cherry-pick the more attractive mortgage loans and pay for those loans at less than fair market value (as described below), which also adversely affects the related RMBS trusts, yet maximizing potential profits for the scheme's sponsors.

We believe that the definition of "fair market value" proposed for the seized loans is inadequate. The proposal states that it would seize current paying loans for underwater borrowers at "fair market value," but instead of assessing fair market value at 100 percent of the loan value, the proposal envisions applying a significant discount to the loans (~40-45% for loans with market-to-market loans-to-value between 120%-125%). To justify this discount, the proposal assumes that all eligible loans for the program would eventually default. However, given that these are *all* current paying loans, this is neither a realistic assumption nor justified by data. Indeed, using eminent domain as proposed is *only* attractive for the scheme's sponsors if the purported "fair market value" is sufficiently low to make the scheme profitable. Of note, the same deep haircut below "fair market value" would need to be applied to non-performing or defaulted mortgage loans in order for the scheme's sponsors to recover their costs and fees. Additionally, AFGI members believe that the proposal intends to target primarily first-lien mortgage loans and not second-lien loans. We worry

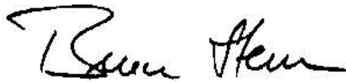
that this approach would represent an unfair disregard of lien priority and would minimize the alleged benefit to the borrower that the proposal purports to assist.

Even if there were a sufficient public purpose as required by the constitutional tests, the failure to pay fair value for the mortgage loans under the proposal is contrary to law. In order to define a legal taking under the principle of eminent domain, the U.S. Constitution requires the seizure of property with "just compensation." The approach to the valuation used under the proposal would be unjust, given the assumptions that would be used. Invariably, the valuation would be contested in court and ultimately decided by a judge and potentially a jury. Independent from the outcome, the inevitably protracted litigation would create unnecessary uncertainty and weigh heavily on the already stressed mortgage market.

AFGI members support a strong and healthy housing market as we know it is good for the economy. We concur with the FHFA's concerns about the adverse consequences that would result from the application of eminent domain to acquire residential mortgage loans. We believe that should this ill-conceived proposal be allowed to be realized, it would not only negatively impact RMBS insurers, but it would also affect RMBS investors, including retirees and pension plans, existing and prospective homeowners, and the broader economy.

We thank you for the opportunity to comment on this matter and appreciate your attention to the concerns highlighted by AFGI in this letter. If you have any questions, please do not hesitate to contact the undersigned at bstern@assuredguaranty.com or (212) 339-3482.

Sincerely,



Bruce E. Stern, Chairman
Association of Financial Guaranty Insurers