Fannie Mae®

June 7, 2017

Alfred M. Pollard, Esq.
General Counsel
Federal Housing Finance Agency
400 Seventh Street SW
Washington, DC 20024
Submitted at: www.fhfa.gov

Re: Comments on proposed Duty to Serve Evaluation Guidance 2018-2020 Plan Cycle Guidance 2017-1

Dear Mr. Pollard,

Fannie Mae welcomes the opportunity to provide its comments in response to the publication by the Federal Housing Finance Agency (FHFA) of its proposed *Duty to Serve Evaluation Guidance, 2018-2020 Plan Cycle* published January 13, 2017 (Proposed Guidance). Fannie Mae appreciates FHFA's efforts to create a thoughtful and well-written companion to the final Duty to serve regulations (Regulations).[1] However, we continue to recommend, as we did in connection with the Regulations when they were proposed, that FHFA simplify its assessment structure to provide greater understanding and transparency in its application. This also will allow the Enterprises to spend more time engaging in activities designed to serve the underserved markets.

In the Proposed Guidance, FHFA invited responses to a number of questions which Fannie Mae addresses below. Since the Proposed Guidance was published, Fannie Mae has also submitted its draft *Duty to Serve Underserved Markets Plans for the Manufactured Housing, Affordable Housing Preservation, and Rural Housing Markets* (May 8, 2017) (Draft Plan). As we crafted our Draft Plan in accordance with the Regulations and the Proposed Guidance, Fannie Mae identified several other matters which it raises here for FHFA's consideration.

I. Responses to Questions Posed by FHFA

Chapter 1: Developing Underserved Market Plans: Contents and Considerations

In the section on residential economic diversity, FHFA outlines proposed criteria for state or local Qualified Allocation Plan (QAP) definitions of high opportunity areas that would be eligible for purposes of setting objectives related to residential economic diversity.

1. ***Which state or local QAPs include definitions of high opportunity areas that meet these criteria?***

Based on Fannie Mae's initial research, there are resources available that provide state and local QAPs, but they do not aggregate the information sought (i.e., whether the definitions are clearly intended to describe areas that provide strong opportunities for the residents of housing funded through the QAP and whether the QAP includes mapping or describes these areas in such a way so as to enable mapping). Accordingly, the definition of high opportunity will need to be identified for each QAP, retrieved, and then measured against FHFA's criteria, a substantial undertaking. Fannie Mae has not begun this effort, but would be willing to work with FHFA and other stakeholders in the market to determine how it might best be undertaken and aggregated for all the markets to ensure consistency and transparency.

Chapter 2: Evaluation process for Scoring Enterprise Performance

Step One: Quantitative Evaluation

[1] *Enterprise Duty To Serve Underserved Markets*, 81 Fed. Reg. 96242 (Dec. 29, 2016).

1. ***Should FHFA make partial credit available for objectives that are not fully accomplished? If so, are the levels of partial credit appropriate (6 points for substantial and 3 for moderate accomplishment of the objective)? Is the partial credit approach for loan purchase and investment objectives, which relies on baseline measures set by the Enterprises, an effective method? If not, how should FHFA make partial credit available for objectives not fully completed?***

Fannie Mae concurs that partial credit should be available for objectives that are not fully accomplished. However, because this portion of the assessment is a quantitative analysis, we believe that the determination of how the Enterprise performs should contain a mathematical component which considers the extent to which the tasks identified to accomplish the objective have actually been achieved. To that end, we suggest that rather than assigning a number to a verbal description, which we believe implicitly incorporates a qualitative analysis, (e.g., 6 points for "substantial" performance), a simplified approach using a traditional linear grading system be applied. Under such a system, the score would be proportional to the percentage of the targeted tasks which have been performed. Thus, if 75 percent of the tasks underlying the objective were achieved, then on a 10 point scale, the score would be 7.5. If only 25 percent of the objective was achieved, then the score would be 2.5. This scoring system would work equally well for the loan purchase/investment evaluation areas as for the outreach/loan product evaluation areas. Using a traditional scoring system for all objectives will bring greater understanding and transparency to the scoring process.

2. ***FHFA proposes setting the score needed to receive a passing rating under Step One at 70 percent. Is the proposed threshold of 70 percent too low or too high?***

It is Fannie Mae's view that 70 percent represents an appropriate benchmark for "passing" performance, if FHFA chooses to adopt a simplified traditional linear grading system. As such, it is at the low end of an academic C-.

If FHFA maintains its existing proposal then we believe, given the associated word description of "substantial performance," a "6" should constitute a passing grade. Definitions for "substantial" include meanings such as "of considerable importance, size, or worth" or "real and tangible" or "considerable in quantity." In meeting their Duty to Serve, the Enterprises will take on some of the most challenging issues in our nation's underserved housing markets. In that context, identifying and successfully meeting objectives in a way that is "of considerable importance, size or worth," or similarly qualified should constitute a passing grade.

Step Two: Qualitative Evaluation

3. ***Has FHFA clearly articulated the implementation and impact criteria in a reasonable way in Appendix B? Should FHFA consider different or additional evaluation criteria?***

We understand that the assessment of an Enterprise's achievement of the objectives is a step in the quantitative evaluation process. However, we believe that the findings from that assessment are relevant to the qualitative evaluation and should be incorporated. For example, a proposed objective could hypothetically have a significant impact, but if the objective is not achieved then it has no impact. On the opposite end of the scale, if an objective is exceeded (e.g., 100 loans were projected for purchase, but acquisitions exceeded 500) then that "over-achievement" should be reflected in the impact score. One way it might be considered is to use the numerical scores for the objectives in a way that is more closely linked to implementation under the Qualitative Evaluation which is now stated in words (e.g., "minimal impact" or "meaningful impact") and numbers that are not linked to the scoring of the objectives. Assigning numbers linked to actual achievement of the objective clarifies the scoring process.

4. ***Should FHFA assign individual scores at the objective level as proposed under Step Two, or should FHFA instead assign a single score under Step Two for all actions undertaken by an Enterprise in each underserved market? How should FHFA balance providing clear guidelines to the Enterprises with minimizing complexity?***

Fannie Mae strongly prefers that each objective be scored for purposes of evaluating implementation and impact. This includes taking into consideration the tasks underlying the objective as well as the fact that some objectives are interrelated. Fannie Mae believes that such an approach offers clearer guidance – particularly where the concept score for the activity was confirmed to the Enterprise prior to the start of the year being evaluated – and minimizes the complexity of the scoring. Consistent with its other comments, Fannie Mae believes that the scoring for the qualitative analysis should be based on an academic-like linear scoring system which should parallel the other scoring steps.

5. ***FHFA proposes to create concept scores at the Plan development stage which would then serve as a guide for assessing the achievements toward objectives at the evaluation stage. Is this proposal an effective approach? When should FHFA share a preliminary concept score with an Enterprise?***

It is Fannie Mae's view, reflected in its Draft Plan, that a proposed concept score for each objective or set of objectives, as the case may be, should be included in each initial Draft Plan. FHFA should confirm or modify each score in its response to the initial draft. However, Fannie Mae believes it is important for FHFA to be flexible about how concept scores are applied. What initially may appear to be an activity of low impact, for example, may prove to have a high impact in its later execution. In such a circumstance, it would be appropriate to change the applicable concept score.

6. ***Once FHFA assigns a score for each objective, FHFA proposes to average the scores of all of the objectives within an evaluation area (outreach, loan products, loan purchases, investments and grants) and produce a single score for each evaluation area. FHFA would then calculate a weighted average for all of the Enterprise's objectives in a particular underserved market. Should FHFA weight objectives by evaluation areas? Has FHFA proposed to weight the evaluation areas appropriately?***

Fannie Mae agrees that a weighted average is the appropriate manner to quantify value, but questions whether weighting (up to) four averages of the scores in evaluation areas reflects the best methodology for encouraging the activity which FHFA clearly prefers, loan purchases. This is because by only applying weighting to the average scores of each set of activities under the same evaluation area, there is no benefit to an Enterprise for the number of, for example, distinct loan purchase objectives it pursues.

For instance, in the example on Page 35, there are three loan purchase objectives. Yet, the same scoring for Examples One and Two would apply for the overall Step Two score whether the number of distinct objectives was 1 or 40, so long as they averaged the same score (30 and 20, respectively). This appears not to incent the Enterprises to have more objectives weighted toward loan purchases and away from outreach, if the absolute number of overall objectives is not taken into account in the weighting. Fannie Mae encourages FHFA to re-evaluate the weighting process to take account of the overall number of objectives in the weighting process, not just the relative weight among the averaged scores.

In response to the inquiry: "Has FHFA proposed to weight the evaluation areas appropriately?" we believe it has not. The Proposed Guidance provides a weighted score for the Duty to Serve evaluation areas as follows:

Loan Purchase	Loan Product	Outreach	Investments & Grants
35%	30%	20%	15%

We believe this would not provide sufficient weight for the investments factor, particularly investments in affordable properties, such as Low Income Housing Tax Credit (LIHTC) projects. With properties such as these, the purchase of credits often provides more liquidity to the market than does financing of the debt (i.e., a loan purchase). This is illustrated by an example of the amounts, sources, and uses of funds for a hypothetical LIHTC project, as provided by the Office of the Comptroller of the Currency (OCC).[2]

Table 3: Sources and Uses of Funds

Sources of funds	Amount
Equity (sale of 9 percent LIHTCs)	$13,162,500
Permanent loan […]	1,056,200
Second mortgage (state housing program loan)	500,000
Third mortgage (state housing development corporation)	500,000
General partner equity	1,300
Total sources of funds	**$15,220,000**
Uses of funds	**Amount**
Land costs	$400,000
Construction costs	10,411,178
Soft costs	2,852,008
Developer's fee	1,556,814
Total development costs	**$15,220,000**

We offer this example from the OCC as an illustration. However, the substantial difference between the amount of liquidity contributed as equity, and the amount of liquidity contributed as debt, is consistent with our significant experience in these matters. The amount of liquidity provided through an equity investment (here, $13,162,500) often significantly exceeds the amount of liquidity that would be contributed to the market through the purchase of the associated loan (here, $1,056,200).

Moreover, new multifamily housing construction includes very little market rate Class B and Class C (i.e., workforce and affordable) housing. In 2016, only about 6,000 units were built so the opportunities to purchase loans for new workforce and affordable housing is limited. This is in comparison to the estimated 90,000 new construction and substantial rehabilitation LIHTC units that were built in the same year. Accordingly, investments in LIHTC properties are of extreme importance in creating and retaining affordable housing stock. That there are not enough LIHTC properties being built or substantially rehabilitated to serve the eligible population is evident from studies such as the one recently completed by Enterprise Community Partners and the Harvard Joint Center for Housing Studies. In that analysis it was estimated that the number of severely cost-burdened renter households – those spending over half of their income on housing – will grow by anywhere from 1.7 to 3 million in the coming decade, demonstrating a solid demand for housing for very low- and low-income families.

Under such circumstances, assigning a low weight to the investment evaluation area is inconsistent with the purpose of the Duty to Serve, because equity investments significantly increase liquidity to the underserved

[2] Office of the Comptroller of the Currency, Community Developments Insights, *Low Income Housing Tax Credits: Affordable Housing Investment Opportunities for Banks* 26 (Apr. 2014).

markets. Thus, investments that provide liquidity to the market should be treated on an equal par with loan purchases (i.e., with a weighted score of 35 percent) and we respectfully request that FHFA revise its approach to appropriately reflect their importance.[3] In making this recommendation, we recognize that Enterprise investments in LIHTC transactions are subject to FHFA approval.

Step Three: Extra Credit Evaluation

7. ***Has FHFA selected appropriate activities for which to award extra credit? Has FHFA appropriately calibrated the size of the extra credit adjustment?***

Fannie Mae has no objections to the activities selected by FHFA for extra credit. However, it is Fannie Mae's current understanding that a failure to identify an extra credit activity in its plan precludes it from getting credit for this activity if it subsequently has an opportunity to engage in a qualifying transaction. Given markets change, unexpected transactions develop, and product enhancements are identified and completed, we believe that FHFA should provide extra credit for such activities to encourage the Enterprises to engage in them even if they have not been pre-designated.

8. ***Has FHFA appropriately limited extra credit only to those objectives achieving a Step Two final score of at least 40? Should extra credit be available for objectives receiving a Step Two final score of 30 or less?***

Fannie Mae believes that extra credit should be awarded for loan purchase objectives having a final Step Two score equal to or greater than 30. The activities designated for extra credit are identified as such because they represent transactions that are particularly problematic to address. Under these circumstances, the problem may have to be "chipped away at" little by little. Such efforts should not be discouraged because they don't achieve something between "meaningful" and "comprehensive" impact (i.e., the definition of a score of 40). Rather, if they achieve something "meaningful" (i.e., a 30), then extra credit should be available.

Converting the Results of the Evaluations into a Final Rating

9. ***Are the cut-offs for determining whether an Enterprise qualifies for each of the four passing ratings appropriate?***

As suggested in our responses to other Questions, Fannie Mae would very much like to see linear scoring adopted for each step of the assessment process because of the greater understanding and transparency it would bring to the evaluation system. Additionally, for purposes of continuity and greater clarity, Fannie Mae would like to see each scoring scale parallel other scales in the process (e.g., if one is based on a 100 point system, then they all should be based on a 100 point system.) These comments apply to the cut-offs as well. In addition, to the extent the cut-offs do not recognize our recommendation that a "6" should represent a passing grade, we believe they should be revised accordingly.

10. ***How might the overall evaluation process (Steps One, Two, and Three) be revised to strike an appropriate balance between providing simplicity and specificity in evaluating the Enterprises' Duty to Serve activities?***

---

[3] If FHFA accepts this proposed change, we suggest that investments that provide liquidity to an underserved market also receive the same treatment as loan purchases do in assigning scores to each objective under step two (e.g., "…all loan purchases will be assumed to qualify for a score of 50 under the implementation criteria for purposes of this evaluation.") Proposed Guidance at 33.

We suggest that the scores assigned to the objectives for purposes of the Quantitative Evaluation be established as part of a linear scoring system. These scores should then be utilized to assess the degree of implementation considered as part of the Qualitative Evaluation. We believe the use of word descriptions to describe performance results in subjectivity and is difficult to understand.[4] Creating an additional scale to assign scores for assessment purposes complicates the analysis and does not clearly draw the nexus between objective achievement and scoring.

II. Additional Comments

A. Overview: Plan Structure[5]

The Proposed Guidance and the Regulations require that numerous components be addressed in the Duty to Serve plans.[6] As a result of these requirements, coupled with Fannie Mae's ambitious list of objectives, our Draft Plan approaches 240 pages. Its table of contents alone is seven pages, making it problematic to locate matters. Fannie Mae is concerned that such a large document is difficult for its readers to handle, review, and analyze. Moreover, reporting and any modifications will be challenging as well if it must all be linked to this one large document. Finally, it should be noted that the Regulations contemplate that each underserved market will be considered individually for purposes of securing FHFA's non-objection. Making changes to one big plan instead of one of three smaller plans creates significant logistical problems that easily could be avoided.

Accordingly, Fannie Mae respectfully requests that the Evaluation Guidance be revised to allow for the submission of three separate plans, one for each underserved market. We believe having this option provides more flexibility which will make the individual plans easier to handle, understand, implement, and track.

B. Plan Contents: SMART Criteria, Measurable[7]

For loan purchase and investment evaluation areas, the Proposed Guidance requires that the Enterprises provide:

> . . . both the measurable target for the objective and a measurable baseline representing recent performance by the Enterprise. This baseline will facilitate FHFA's evaluation of these objectives. The Enterprise must identify this measurable baseline in its Plan and justify the methodology used to select it. Among other potentially acceptable methodologies for setting baselines for loan purchase and investment objectives, the Enterprises may use an average of three years of data on recent performance. To supplement both the measurable target and the measurable baseline,

---

[4] For example, these word descriptions include: The Enterprise implemented "nominally" or "effectively" or "in a way that also enhanced the actions accomplished under the objective."

[5] Proposed Guidance at 3.

[6] For example, the Proposed Guidance provides that "Each Enterprise's Plan should be divided into three sections, and each of these sections should cover the three-year Plan period." It also requires that there should be three subsections for each underserved market, including: (1) a Strategic Priorities Statement; (2) Statutory and Regulatory Activities Considered but Not Included; and (3) Activities and Objectives. In addition, the Regulations and the Proposed Guidance provide that the objectives in a three-year Plan must address numerous elements. Among other things, these include the five "SMART" Criteria, the four possible evaluation factors applying to the activities for each year, the income levels of the families being served by the objective for each year, and the proposed concept score for each year. Other elements, such as the baseline for loan purchases, were added as part of the required mix under the Proposed Guidance.

[7] Proposed Guidance at 6.

the Enterprises should provide information on their performance for actions similar to those required by the objectives over the three preceding years.

Fannie Mae seeks clarification on whether such baselines in year two or three of a Plan should be expressed with reference to the actual performance in the calendar year preceding it (i.e., year one), rather than the baseline used for the first year of the Plan. For example, if the original baseline is the average of three years of performance (e.g., 2014, 2015, and 2016), resulting in the baseline for the first year being 50 loans, but the actual acquisitions for the first year are 55 loans, should the baseline in the second year be recalculated using a three year period which now includes the 55 loan acquisitions in the first year of the plan (i.e., 2015, 2016, and 2017)? Alternatively, may the "measurable target" for years two or three expressly be left as "to be determined" (TBD) in the final Plan and then updated during the life of the Plan? If the baseline for years two and three is recalculated or if it was left to be determined, would it have to be treated as a modification to the plan pursuant to 12 CFR §1282.32(h)?

Fannie Mae recommends that the baselines for years two and three should be TBD and recalculated at the end of year one (for year two) and at the end of year two (for year three), to take into consideration performance in the most recent full year. Fannie Mae further recommends that this recalculation should not be the subject of a formal modification to its Plan, but that such changes, subject to FHFA's informal approval, should be made on its Plan and posted on FHFA and Fannie Mae's website.

C. Additional Guidance for Plans[8]

Geographical diversity. The Proposed Guidance states that: "An Enterprise should consider how to serve a diversity of geographic areas for each Duty to Serve activity in its Plans." Fannie Mae would appreciate clarification as to whether geographic diversity will be a qualitative factor in considering and evaluating performance under Step Two. Further, clarification would be helpful as to what FHFA means regarding "geographical diversity." Is this "geographical diversity" within the context of a Regulatory Activity (e.g., diversity as between Middle Appalachia, the Lower Mississippi Delta, and the colonias) or does this geographical diversity generally refer to the United States as a whole (e.g., diversity as between Montana and North Carolina)?

Research. The Proposed Guidance states that ". . . [R]esearch activities are not a substitute for loan purchases and other actions that can increase liquidity in the underserved markets." In view of the weighting system that assigns higher comparative scores to loan purchases than to the other evaluation areas in calculating an overall Step Two score, Fannie Mae would welcome confirmation from FHFA that "research" under whatever evaluation area (i.e., investment, outreach, loan product)) would not be assigned a lower concept score than that of other activities.

D. Averaging of Scores[9]

Fannie Mae seeks clarification from FHFA on how objectives that have multiple targets within them are to be quantitatively evaluated in Step One. It is Fannie Mae's view that each of the individual tasks/steps within an objective should be rated individually in accordance with applicable targets and baselines, then mathematically averaged to produce the quantitative score for that objective.

---

[8] Proposed Guidance at 11 & 12.

[9] Proposed Guidance at 19.

E. Purchase or Rehabilitation of Certain Distressed Properties

Section 1282.34 (d)(7) of the Regulations, affordable housing preservation market, provides for the following Regulatory Activity:

> (7) *Purchase or rehabilitation of certain distressed properties.* Lending programs for the purchase or rehabilitation by very low-, low-, or moderate-income families, or by nonprofit organizations or local or tribal governments serving such families, of homes eligible for short sale, homes eligible for foreclosure sale, or properties that a lender acquires as a result of foreclosure.

In the preamble to the Regulations, FHFA found that:

> . . . [F]inancing to address blighted properties is critical to preserve the affordability of those properties as well as naturally occurring affordability in their surrounding neighborhoods. Accordingly, FHFA's interpretation of 'preservation' includes the Regulatory Activity established in § 1282.34(d)(7). FHFA will provide additional guidance on such purchase and rehabilitation in the Evaluation Guidance [10]

However, the Proposed Guidance does not appear to contain any additional guidance on 12 CFR §1282.34(d)(7). In the absence of clarification, we are unsure how to implement this Regulatory Activity. Accordingly, Fannie Mae would appreciate further explanation on the following in the final Evaluation Guidance.

The lending programs described in this Regulatory Activity, summarily stated, appear to have two components: (1) purchase or rehabilitation (by a qualifying family or entity) of, (2) a distressed property (i.e., a home eligible for a short or foreclosure sale, or an REO). We understand how this Regulatory Activity could include: (1) a lending program to finance the purchase of a distressed property, or (2) a lending program to finance the purchase and rehabilitation of a distressed property. However, we do not understand how this Regulatory Activity could include a lending program for just the rehabilitation of a distressed property as is implicit from the language "purchase or rehabilitation."

Accordingly, we seek a clarification of whether the pertinent language of Section 1282.34(d)(7) should read: (1) the "purchase, or purchase and rehabilitation…;" or just (2) the "purchase and rehabilitation…." We believe the former is correct because it best serves the dual purpose of assisting potential homebuyers to obtain financing to purchase distressed properties and assisting purchasing homeowners to address the property's rehabilitation needs, as provided in the discussion of this provision in the Regulations.

> Distressed properties threaten the values of surrounding properties and ultimately the stability of neighborhoods. Many of these properties require extensive repairs, but homeowners in the Duty to Serve income-qualifying range often face difficulties obtaining financing to make those repairs. Potential homebuyers in this income-qualifying range also often face difficulties obtaining financing to purchase distressed properties. Establishing a Regulatory Activity in the final rule for Enterprise support for such financing could help address the credit gap for these homeowners, potential homebuyers, and nonprofit organizations. [11]

[10] Regulations at 96272.
[11] Regulations at 96271-96273.

F. <u>Advancing Multiple Activities in a Single Underserved Market</u>

It is our understanding that a loan purchase will receive Duty to Serve credit in more than one underserved market if it qualifies for Duty to Serve credit in each one. For example, a loan on a manufactured home titled as real property located in a high-needs rural region will receive Duty to Serve credit for both the manufactured housing market and the rural market. This makes sense because the loan serves two distinct purposes --- as a Regulatory Activity, to provide liquidity for manufactured housing and, as a second Regulatory Activity, to provide liquidity for rural housing.

The Proposed Guidance and the Regulations do not address whether a loan purchase may receive credit for meeting a combination of Statutory and/or Regulatory Activities within a single underserved market. We believe that credit for each activity should be provided within a single market and that the Evaluation Guide should address this point consistent with providing credit in each market for loan purchase which span markets.

For example, if a multifamily loan is acquired that finances a resident-owned manufactured housing community (a Regulatory Activity) which also happens to meet FHFA's pad lease protections (another Regulatory Activity), then the loan should qualify as a purchase under both of those Regulatory Activities because it provides liquidity for dual purposes. Similarly, if a loan is acquired on a project-based Section 8 property (Statutory Activity) which simultaneously finances qualifying energy or water improvements on the same property (Regulatory Activity) then the liquidity provided here has also satisfied two purposes and should qualify for credit for both. By providing distinct credit for both activities, FHFA is consistent in its approach to recognizing the same activity can serve multiple purposes (as it does across markets). It also serves to incent the Enterprises to focus on the identified Regulatory and Statutory Activities, regardless of their grouping in one underserved market or in two.

We appreciate the opportunity to provide these comments, and look forward to working with FHFA and the various stakeholders and market participants to address the finalization and implementation of our Plan.

Regards,

Michael T. Hernandez
Vice President Housing Access, Affordable Housing Initiatives