Public Comment on the Freddie Mac Underserved Market Plan
Notes from a meeting held on June 29, 2017, Nashville, TN

Introduction

A public meeting was held at the Metropolitan Development and Housing Authority headquarters in Nashville, Tennessee on June 29, 2017, co-convened by the Lincoln Institute of Land Policy, and the Grounded Solutions Network. Approximately 35 participants, including representatives from both Government-sponsored Enterprises (GSEs: Fannie Mae and Freddie Mac), reviewed the Underserved Market Plans (UMPs) of the GSEs to meet their Duty to Serve (DTS) obligations.

The main goal of the meeting was to review the plans with specific reference to three housing submarkets: manufactured housing; preservation of affordable rental housing; and preservation of affordable homeownership. Meeting participants discussed the challenges presented in each submarket, each of the GSEs' proposed plans to improve financing services in each submarket, and whether they considered the proposed plans satisfactory for serving the submarkets. The discussion was based on participants' assessments of the ability of the GSEs to serve the submarkets while meeting their obligations to maintain safety and soundness.

The discussion of the Freddie Mac UMP generated the commentary that follows. Participants at the meeting who agreed with the commentary and signed on to these comments are listed at the end of this report.

Overview

Participants were impressed with the breadth of Freddie Mac's plan across many statutory and regulatory activities in each of the three submarkets. In addition, meeting participants felt that the plans are achievable, but that the plans were achievable because they lacked ambition and specificity. Participants found Freddie Mac's analysis of the underserved markets acceptable, but disappointing, especially its failure to identify possible partners in each market and the slow pace of the proposed implementation of the UMP.

Importantly, participants felt that the UMP tends to ignore the depth and breadth of the affordable housing field. In their view, participants felt that the field is full of well-established counterparties who could partner with Freddie Mac to expand its service in these submarkets, while at the same time helping to manage and reduce risk. These counterparties include: national, state, and local networks of practitioners; state housing finance agencies; and, mission-driven lenders such as CDFIs and Credit Unions. In addition, many of these counterparties have innovated and tested lending products and processes that are ready for scaled investment from the GSEs. However, the UMP calls for years to study the markets and/or to design more effective lending products to serve the markets, as if deeper market knowledge or effective lending products do not already exist.

Many participants felt that Freddie Mac was “padding the calendar” to manage expectations for implementation of its plan. Participants felt that more aggressive implementation is warranted, particularly because of the urgent needs for financing services in the submarkets.

Finally, participants felt that the UMP fell short on one very important matter—the extent to which Freddie Mac could play the role of “market-maker,” a role it has played in the past. For example, Freddie Mac helped to standardize the mortgage underwriting process and helped to invent the “vanilla” mortgage when it began securitizing mortgages in the early 1970s. This introduced efficiencies in the markets that made it possible to offer mortgages at more attractive rates for borrowers, but also laid the groundwork for the innovation of desktop underwriting. Providers of lending capital can drive quality into underserved submarkets by establishing and enforcing new standards that require conformity of borrowers to access capital on desirable terms. If Freddie Mac worked with counterparties in the field to achieve a nuanced understanding of the three submarkets, it could drive the submarkets to overcome the specific dysfunctions that made them hard to serve in the first place.

If Freddie Mac were to play the role of market-maker, it is essential that it maintain an investment portfolio. There is scant reference to maintaining or expanding Freddie Mac’s existing portfolio in the UMP. Without a portfolio from which to pilot new products and approaches to serve these submarkets, Freddie Mac’s efforts will be narrowed to efforts that can attract secondary capital. Until a track record is established for new products and approaches the secondary market will likely over-price capital and constrain its flow, further limiting the information that might be gleaned through disciplined portfolio lending. Participants urge the FHFA to permit both GSEs to maintain a prudently managed portfolio to cultivate high-quality lending in these submarkets.

In the following pages, more specific comments about the Freddie Mac UMP are presented by submarket.

1. **Manufactured Housing (MH)**

Overall, it is notable that the proposed targets in the UMP, while important, would barely improve the market for manufactured housing financing during the three years of the plans. This is disappointing. Freddie Mac can do better and at the same time help the submarket to overcome its dysfunction. By entering the market with sufficient liquidity, Freddie Mac can drive the market to higher levels of quality—e.g. more efficient transactions offering less expensive mortgage debt. Standardized and streamlined underwriting processes would drive lower quality lending out of the market—idiosyncratic processes that harm the image of the market, for example, chattel loans on energy inefficient, poorly sited housing.

The basic dysfunction in the market is driven by market players’ and policymakers’ lack of product understanding—lending products, but also the quality of unit construction, siting standards, and other amenities. The resulting poor image of the housing stock constrains the

flow of capital into the sector, which leads to discrimination in zoning, lower unit values, and a higher severity of losses when loans go bad. By providing capital on the right terms, with the right standards imposed for manufacture, pricing, and siting of the homes, the GSEs can lead real change in the submarket that has the potential to correct the dysfunctions listed above and drive market convergence for manufactured housing and site-built housing without sacrificing the enhanced affordability of manufactured housing.

The UMP offers meaningful information its introduction. Freddie Mac's opening section provides a good discussion of the structural challenges currently imbedded in the manufactured housing finance market, including:

- Unit supply
- Lack of lenders
- Weak titling law
- Lack of mortgage insurance or other credit enhancements
- Appraisal challenges
- Lack of loan data, especially from existing, large single-family loan portfolios

Notably, the UMP recognizes the fundamental need for coordinated outreach and basic research, research that is taken for granted in other housing sectors. For example, public loan performance research is largely nonexistent, with the notable exemptions of CFED's 2013 study on manufactured home mortgages, and the lending record of the New Hampshire Community Loan Fund's mortgage program. It is important to note that even less is known about the performance of chattel lending products.

MH real estate (RE) loans as a share of Freddie Mac's portfolio trended down in the last four years. These loans accounted for just .32% of loans funded in 2016. Year 2 and 3 targets propose significant increases in loan purchases as a share of its overall portfolio, but it is important to note that Freddie Mac projects significant declines in its overall business. It is correct to note that any increase in actual loans is important in a small market. That said, *Freddie Mac should propose an actual increase in MH RE loan volume*.

Fundamental to improving loan volume is Freddie Mac's commitment to revise practices, guidance and other restrictions on MH. Fundamentally, any loan product, and especially those designed to serve the affordable market, such as Home Possible and Home Possible Advantage mortgages should be available to any single-family home loan borrower. These loans should have the same parameters, loan level pricing and underwriting for MH as for any other property type. For example, there should be equal treatment of gifts and grants for downpayments, subordinated financing such as the Affordable Second, lower mortgage insurance coverage, higher loan-to-value ratios, construction conversion with a single closing and no discrimination against single-section homes, including the restriction of single-section homes to certain developments.

The challenge of appropriate foundation systems also needs to be addressed. Too often, lenders or agencies prescribe needlessly complicated and expensive systems, which are over-engineered and too expensive. Special consideration needs to be given to existing homes and homes in communities—whether the same foundation systems that would be required for new placements should be mandated for them.

Participants appreciate that Freddie Mac has committed to design and study a chattel pilot regarding safety and soundness. It is hoped that Freddie Mac could drive higher quality into chattel lending by offering liquidity on the right terms. including good loan terms for borrowers and land lease protections for tenants. Given the huge share of MH lending done through chattel, no effort to serve the manufactured home loan market can succeed without a chattel program. Freddie Mac should commit to a chattel program; its proposal to consider buying existing portfolios is meaningful, but should be done as early as possible to inform its research. It is important to note that many state HFAs currently do not make or purchase chattel loans because they do not approve of loan terms or protections for borrowers. Perhaps Freddie Mac can establish the right guidelines to give these important counterparties comfort in participating in this lending, which would suggest driving the chattel market to converge with the real estate mortgage markets regarding loan terms and protections.

a. Manufactured Housing Communities (MHCs)

Freddie Mac proposes new research on community finance. This is vital to the market, but a lot is already known. Participants appreciate the 2014 Freddie product that funds loans for resident owned communities (ROCs). Its purchase of two ROC loans will help to inform its work, but it is not enough. It is noteworthy that DTS requires serving the LMI market, and Freddie Mac likely will have to adjust its products to meet this truly affordable segment of the housing market. Though a small market, CDFI partners have demonstrated safe and sound lending to hundreds of ROCS. A commitment by Freddie Mac to expand its lending to ROCs will accelerate these efforts and increase interest in resident ownership. It should, at a minimum, double its plan to purchase 2-4 ROC loans, or more, per year by 2020.

Freddie Mac needs to reconsider its decision not to fund MHCs owned by nonprofits or governmental instrumentalities. Often these entities purchase communities to preserve workforce housing that would otherwise be lost. These purchases also can provide transitions of communities to resident-ownership, a segment Freddie plans to pursue. Freddie Mac should address the need to support responsible investor-owners of MHCs who offer meaningful lease protections. These are too often absent in the real world.

Freddie Mac needs to invest in communities at this critical time. MHCs are under considerable pressure from other investors to close and convert to alternate land uses. The current inventory of manufactured housing in MHCs represents the largest share of unsubsidized affordable housing in the country. Without a serious commitment to preserve this housing stock, families living in these communities will be cast into competition for a grossly inadequate

affordable housing stock, or worse yet, adding their names to years-long waiting lists for housing subsidies.

2. Multifamily Preservation and Rural Markets

a. Partnering with Housing Finance Agencies in Preservation Activities

In Freddie Mac's UMP, small financial institutions are referenced as if they are separate from Housing Finance Agencies (HFAs). Partnering with state agencies can provide Freddie Mac important connections to local markets. For example, Minnesota Housing has a strategic priority to preserve federally assisted multifamily developments. In addition, the agency is the Performance-Based Contract Administrator for HUD's Section 8 portfolio for the state of Minnesota and utilizes this relationship to strategically allocate preservation resources. Minnesota Housing would be an important strategic partner for Freddie Mac in its efforts to preserve affordable housing in the state. Similarly, other state HFAs, like the Tennessee Housing Development Agency (THDA) stand ready to partner with Freddie Mac to preserve affordable housing in their states.

To facilitate preservation of affordable housing, Freddie Mac should consider developing a fully amortizing product to parallel FHA mortgage insurance products that is priced to reflect the stability of long term owners. The product should include low interest rates that are comparable to standard balloon deals, higher loan to value ratios (up to 100% in certain markets compared to standard 85%), better baseline pricing on fully amortized loans. If there were better baseline pricing on fully amortizing loans for affordable loans, state HFAs would be in a better position to follow with a second or other deferred financing.

Freddie Mac does not specifically address the statutory activity of "other comparable state or local affordable housing programs" in its UMP, and focuses on federally assisted programs, including LIHTC, Section 8 and USDA Section 515 loans. As such, even if Freddie Mac does not address state and local programs, partnering with state agencies such as Minnesota Housing or THDA in identifying local preservation needs of these federal programs is crucial to channel capital to communities that need it the most.

Developing a new offering to close capital gaps for Section 8 transactions and rental assistance demonstration (RAD) are important given tax credit pricing and federal appropriations uncertainties. These products need to have terms conducive to supporting deep subsidies, such as lower interest rates, higher loan to value ratios (up to 100%), and better baseline pricing for affordable products. Participants encourage Freddie Mac to consider solutions beyond a first amortizing mortgage, such as a soft second or even deferred activity to help to achieve deep affordability.

It would be extremely helpful if Freddie Mac could help to solve the conundrum of financing mixed-income development. Although this is a frequently articulated goal in public policy, financing solutions for mixed income are conspicuously absent from guidelines for developing

or preserving affordable housing. For example, Freddie Mac could explicitly include “residential economic diversity” in scoring applications for multifamily preservation financing, especially related to RAD. In addition, creating a mixed-income financing product that has terms, pricing, and execution that are superior to existing products would help to catalyze preservation of this important segment of the housing stock. An important component for this lending product would be providing forward commitments to give assurance to other partners that permanent financing will be accessible. As noted in other areas of this comment, it will be necessary for Freddie Mac to maintain or expand its portfolio lending to innovate in this space.

b. Financing of Small Multifamily Loans in Preservation and Rural Markets

Overall, Freddie Mac needs to develop a preservation funding model and to open securitization channels to purchase existing loans. Preservation products should include below market interest rates, low transaction costs, and could include or leverage grants for credit enhancement and underwriting costs. Purchasing small multifamily loans from HFAs that specifically serve rural or preservation markets would help to increase liquidity. To facilitate and streamline purchasing of small multifamily loans from entities such as HFAs, Freddie Mac needs to develop standardized lending templates into which to originate.

To address the preservation regulatory activity of financing small multifamily rental properties, Freddie Mac intends to develop a new suite of offerings for five to 50 unit properties. The Small Balance Loan (SBL) platform pooling 5-50 unit properties should increase liquidity to the market through the pool securitization and purchasing or guaranteeing of SBLs from small financial institutions (like HFAs). Participants encourage expanding this tool for the portfolios of small financial institutions, as it will provide a standardized securitization mechanism to work with small financial institutions. We encourage terms to be flexible, not all preservation transactions will match a cookie cutter approach, LTV limits need to be higher, and lengths of loan term and amortization should also be longer.

USDA Rural Development Section 515 plans are a key objective both from a preservation standpoint as well as a small property perspective. Participants support the objective of developing a new offering for USDA Section 515 preservation in year one, and encourage Freddie Mac to accelerate development of loan purchase activities to address the maturing mortgage crisis before 2020.

c. Low Income Housing Tax Credit Activities in Preservation and Rural Markets

If feasible, participants encourage balancing the LIHTC activities that meet the definition of “high needs” rural areas and populations with preservation deals that are in other rural areas (such as low CRA demand areas). Participants encourage the GSEs to partner with state equity funds, such as the Minnesota Equity Fund to develop relationships in these areas.

In the rural market, Freddie Mac has identified an objective to research, develop equity offerings, and engage in equity investments for high needs rural populations. This is an area

that needs some additional research to identify syndicators that are doing this development well. State HFAs and other partners can help to provide data on cost and price differentials in rural and metro markets.

In the preservation market, Freddie Mac proposes to develop a new offering to close capital caps for LIHTC transactions left by the reduction in available LIHTC equity, developing a pilot offering term sheet to Targeted Affordable Housing seller/servicers in year 1. Freddie Mac should consider expanding this offering to include small financial institutions, such as HFAs, as partners.

3. Shared Equity Homeownership

Freddie Mac intends to invest up to $2 million in 2018 in research and development on a shared appreciation loan fund; however, we believe that they must concurrently develop a loan product and commit to two years of investment in it. Nonetheless, Freddie Mac should be commended for making an investment in an innovative strategy to scale the field. Freddie Mac hopes to design a pilot to test product underwriting features and flexibilities. However, it will be vital that loan product development accommodates how the shared appreciation loans would be structured, and these loan products must be available to recruit investors and successfully deploy shared appreciation loans through the fund. Therefore, participants request an explicit commitment to establish loan product clarifications and terms within Freddie Mac's Selling Guide that support the shared appreciation loan fund. Additionally, because it is not possible to fully anticipate the timeline and the comprehensive needs for research and development, Freddie Mac should commit up to $1 million in 2019 in addition to its $2 million commitment in 2018. If the investment is not needed or the fund is rendered infeasible then participants would support changes in the UMP.

Freddie Mac needs even more intensive pursuit of efforts to explore innovative opportunities to scale housing with lasting affordability. Outside of the shared appreciation loan fund, there is a huge opportunity to advance permanent affordability in rental housing. Support is needed to conduct an applied research project that "works the problem" of building in permanent affordability requirements to publicly supported rental projects.

Freddie Mac plans to increase market awareness of shared equity programs; however, participants believe that some of its proposed activities could be more impactful. For example, a survey of lenders as a Year 1 activity is unnecessary in light of the fact that it is very clear that Freddie Mac lenders don't know about shared equity homeownership, given the limited offerings in place presently. Participants fully support intensive lender and shared equity practitioner education, recruitment, and incentives to originate loans to shared equity buyers, especially after loan product changes have occurred, but more strategic activities, however, than providing "at least two lender trainings."

Incentives should be considered to recruit lenders. Ultimately, these loans are unique, take extra work to ensure compliance, and are for small amounts. Education alone may not drastically increase volume. Additionally, participants recommend proactively recruiting a select group of Freddie Mac lenders working at financial institutions with large geographic footprints to educate, train, and incentivize them to partner with shared equity programs to originate mortgages to their homebuyer and owners.

Freddie Mac also references curriculum for lenders in Year 2 and then curriculum for shared equity programs in Year 3. Clear, easy-to-understand step-by-step guides for various shared equity models, explained in the Selling Guide could serve both audiences. Participants urge this to be developed in Year 2 (and modified over time if additional loan product changes occur). In addition, Freddie Mac should engage in strategic dissemination of curriculum and more aggressive partnership building, whereby it identifies lenders in markets with shared equity homeownership programs and builds partnerships between originators and the program. This would be much more impactful than webinars.

Lastly, Freddie Mac mentions offering technical assistance and customer support through current infrastructure. Participants feel that a "help desk" that is available for lenders and program providers would be very useful, especially if lenders in the middle of deals can get fast answers and certainty on compliance and program providers could request help to find local Freddie Mac lenders that can be trained and supported (and hopefully, incentivized) on shared equity homeownership origination.

Freddie Mac plans to develop comprehensive underwriting guidelines to facilitate originations of loans in Year 1 & 2; however, this needs to be catalyzed and loan purchase goals should be incorporated. The commitment to "develop comprehensive underwriting guidelines" and to account for the "right balance between standardization and flexibility" as Freddie Mac develops "uniform legal instruments" is commendable. However, Freddie Mac needs to make an explicit commitment to serve each type of shared equity homeownership model included under the DTS definition (i.e. community land trusts, deed-restricted housing with and without restrictions surviving foreclosure, and shared appreciation loans). Notably, participants would also like Freddie Mac to explore how they can support financing needs in limited equity housing cooperatives.

There is no need for a "pilot" to test potential variations; rather, we support rolling them out and evaluating loan performance over time. All research consistently indicates that shared equity first mortgages perform exceptionally well, and the volume would be too small, based upon the relative size of the field, to threaten safety and soundness. *It is vital that the ability to purchase shared appreciation loans is in place before the Shared Appreciation Loan Fund launches.* Therefore, all "Actions" listed in the table in the plan under "Specific Action" should be pursued in Year 1.

Last, but certainly not least, loan product changes should result in Freddie Mac becoming an active participant in the shared equity homeownership market, which means that by Year 3 (at the very least) a loan purchase objective should be in place. Participants recommend no less than 500 loans get purchased in the first year. However, this should not be done through a pilot that would privilege certain shared equity programs or certain models of shared equity access to the secondary market.

Appendix: Meeting Participants

Amy Barnard, Next Step
Kay Bowers, New Level CDC
Hiram Brown, Urban Housing Solutions
Kathy Buggs, Congressman Cooper's Office
Kim Cox, Walker & Dunlop
Marshall Crawford, The Housing Fund
Jessica Deegan, Minnesota Housing Finance Agency
David "Buck" Dellinger, Metropolitan Development and Housing Agency (MDHA), Nashville
Stacey Epperson, Next Step
Clint Gwin, Pathway Lending
Jim Harbison, Metropolitan Development and Housing Agency (MDHA), Nashville
Jennifer Hopkins, New Hampshire Community Loan Fund
David Johnson, Johnson Johnson Crabtree Architects
Eddie Latimer, Affordable Housing Resources, Inc.
Morgan Mansa, Mayor's Office of Nashville
George "Mac" McCarthy, Lincoln Institute of Land Policy
Laura Mullahy, Lincoln Institute of Land Policy
Barry Noffsinger, Credit Human Federal Credit Union
Ralph Perrey, Tennessee Housing Development Agency
Doug Ryan, Prosperity Now
Emily Thaden, Grounded Solutions Network
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Betty Whittaker, Kentucky MHI
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