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Federal Housing Finance Agency
fhfa.gov/PolicyProgramsResearch/Programs/Pages/DTSDraftUnderservedMarketsPlansForm.aspx

Re: DTS Draft Underserved Market Plans Input

To Whom It Concerns:

The following comments relate to the sections of the Underserved Market Plans ("Plans") in which the Enterprises describe how they will accomplish the Regulatory Activity of supporting the financing of small multifamily rental housing, where the financing is provided by small financial institutions.

The purpose of the Regulatory Activity is to increase the volume of small multifamily lending, and to increase the number of smaller lenders that the Enterprises work with on small multifamily lending.

The Regulatory Activity aligns with today's need for banks and other small financial institutions to reduce their multifamily loan portfolio and risk concentrations. In December 2015, banking regulators expressed concern about growing commercial real estate exposures.[1] Nevertheless, in the five following quarters, the multifamily loan portfolios of commercial banks and thrifts grew from $344 billion to $390 billion (13.4%), and banks' multifamily sector concentration as a percentage of capital increased from 23.1% to 24.8%.[2,3] Absent ways for banks to liquidate their multifamily loans, regulatory pressure and the prudence of bank managers will inhibit additional financing of small multifamily rental housing.

The Plans recognize that the Enterprises can enhance marketplace liquidity by purchasing or credit enhancing portfolios of multifamily loans from small financial institutions ("Liquidity Transactions"). Freddie Mac's and Fannie Mae's recent transactions with medium and large banks demonstrate demand for Liquidity Transactions exists now.

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[1] "Statement on Prudent Risk Management for Commercial Real Estate Lending", December 18, 2015, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency.
[2] "Commercial / Multifamily Quarterly Databooks", Q4 2015 and Q1 2017, Mortgage Bankers Association
[3] "QBP Time Series Spreadsheets/Balance Sheets", 2017 Q1, FDIC.

Volumes proposed by the Enterprises are minuscule compared to the multifamily portfolios of small financial institutions. In December 2016, FHFA reported that the banks among the small financial institutions had $108 billion in multifamily assets.[4] Assuming Fannie Mae's 2020 target of 45 loans is equivalent to $100 million, then Fannie Mae is proposing liquidating less than 0.1% of small financial institutions' multifamily loan portfolios. Freddie Mac's goals are larger but still very small compared to the need. The proposed undertakings will fail to materially increase the volume of small multifamily lending and, since the volumes do not exceed the Enterprises' recent business with small financial institutions, an Enterprise may achieve its targets without doing business with any new small lenders. The Enterprises should target much greater volumes in their Plans, sooner.

FHFA is required to evaluate the Enterprises' compliance with DTS by evaluating the volume of loans purchased in each underserved market relative to the market opportunities. Accordingly, the Enterprises should present volume targets as a percentage of small financial institutions' aggregate multifamily loan portfolios, all banks' multifamily loan portfolios, and their own portfolios.

The three-year plans should propose targets in the context of long term goals. A reasonable ten-year goal for each Enterprise is to have outstanding Liquidity Transactions that are 15% of the outstanding loans originated by small financial institutions. Each Enterprise can achieve that percentage if its volumes are 1% of outstanding loans originated by small financial institutions in 2018, 2% in 2019, and 3.1% in 2020 and subsequent years.[5]

Freddie Mac SBL is the most significant advancement in the Enterprises' multifamily lending in the past twenty years. In 2017, the third year of SBL, originations will be $7 - $8 billion. The quick growth of SBL demonstrates what an Enterprise can achieve when it is committed to a program. The Enterprises can realistically achieve the volume targets I suggest. Achieving those volumes will materially enhance market liquidity for small multifamily lenders.

The Plans do not provide specifics of safety and soundness. Each Enterprise's plan should specify that:

- All Liquidity Transactions will be structured to protect the Enterprise from first-loss risk; and

- All Liquidity Transactions will be structured to lower overall taxpayer risk, that is, a material part of credit risk must be transferred to private capital that is neither Federally-sponsored nor supported by Federal deposit insurance. Structures in which first-loss risk is retained by the small financial institution may be safe and sound for the Enterprise, but unless risk is shifted to private capital there will be no net reduction of taxpayer risk. If first-loss risk is to be transferred to private capital, as in SBL, then it will be much easier for each Enterprise to expeditiously develop and implement safe and sound Liquidity Transaction programs.

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[4] FHFA notes that they were working from call report data, so this figure presumably doesn't include the multifamily loans of community development financial institutions and credit unions. Still, the figure is a reasonable proxy for market size and I used it in my calculations.

[5] Underlying these figures are the assumptions that the loans in Liquidity Transactions pay off at an annual rate of 15%, and that the outstanding balances of loans originated by small financial institutions grow 2% annually.

Thank you for the opportunity to comment. If you have any questions, you may contact me at the email address or phone number below.

Most Sincerely,

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