July 10, 2017

The Honorable Melvin L. Watt
Director, Federal Housing Finance Agency
ATTN: Office of Housing and Community Investment
Constitution Center
400 7th Street, SW
Washington, D.C. 20219

RE: Proposed Underserved Markets Plans

Dear Director Watt:

Fahe is pleased to submit comments to FHFA in response to Fannie Mae and Freddie Mac (the Enterprises) publishing inaugural Plans to meet their duty to serve underserved markets. Fahe is a network of 50+ nonprofits empowering the people and communities of Appalachia. We provide our members expertise in finance, collaboration, innovation, advocacy, and communication to achieve a more prosperous region. We strongly support your Agency's work to facilitate a secondary market for mortgages on housing in rural Appalachia, and across the nation's underserved markets.

Our overarching response to the Plans is an appreciation of the Enterprises' commitment to engage with the communities and financial interests in Appalachia. The Plans commit to research, analysis and an interest in establishing a community of practice for underserved parts of the housing market. These are extraordinarily important tasks and a welcome part of what the public should require of its GSE's.

Yet, our appreciation for the Enterprises' help in *thinking* about the challenges facing affordable, manufactured and rural housing markets is overshadowed by our concern that the Enterprises' Plans commit to *doing* less than the expected to expand activity in underserved mortgage markets. Duty to Serve is in statute to address decades of bias against the housing markets of rural America. The Enterprise's long-standing business practices have contributed to a tremendous transfer of wealth and vitality to suburban and urban places. Even if executed to their fullest extent, the Plans will not make a measurable impact on the quality or value of the rural housing stock.

The following comments are in addition to those included in the letter Fahe wrote in partnership with the group of regional Community Development Finance Institutions and National intermediaries that serve persistent and high poverty areas throughout the country. As a group, that letter focused on the Enterprise's single family goals within the Rural Housing Market proposal. This letter: raises three broad issues that the Plans could better address; introduces two new elements for consideration; and concludes with a sixth section of additional comments on elements of the Enterprises' plans. For context, objectives proposed by the Enterprises are listed with each of the issues raised, which are:

I. Add Capacity To Local Organizations
II. Address Market-Level Capacity Issues
III. Address Energy Efficiency Issues
IV. Work With Healthcare Organizations
V. Establish A Lending Cooperative For Rural Markets
VI. Additional Comments And Responses To Specific Elements Of The Plans

Thank you for this opportunity to comment on the Duty to Serve Underserved Markets Plans. Fahe looks forward to deepening our partnerships with FHFA and the Enterprises to build vibrant and sustainable housing markets across Appalachia. Refining the Plans drafted by the Enterprises is an important step in that direction. Should you need any additional information, please contact me at (859) 986-2321.

Sincerely,

Jim King

Cc: Jim Gray, Duty to Serve Program Manager

I. ADD CAPACITY TO LOCAL ORGANIZATIONS

CDFIs, small financial institutions and other organizations operating in high-need areas have little-to-no additional capacity for mastering and deploying a set of new investment products. No amount of training and technical assistance can overcome a lack of available staff and systems. Designing the right product, then monitoring the success of under-resourced organizations using that product, will undoubtedly result in the appearance of the product performing poorly. Building the capacity of the local organizations is an essential precursor to building a robust local market.

To test and/or deploy new products that have a chance to succeed, the Enterprises could:

- Provide pilot organizations with the resources to hire additional mortgage professionals to backfill for the core staff assigned to the pilot. This should be enough to cover staff time to ramp up at the beginning and debrief at the end. This acknowledges that learning the vagaries of rural markets takes significant time.
- Provide the pilot organization(s) with more debt and equity than can be reasonably deployed during the pilot period. If the pilot organization has a sense that newly-designed products from the Enterprises are a scarce resource, the organizations will not commit scarce staff time to a limited activity. It is particularly important to strengthen the organization(s) balance sheets (typically to 20 percent equity to debt) so that they have adequate liquidity to afford the holding time it takes from acquisition to sale of mortgages. This is also important as a hedge against the risk of mortgages being deemed non-conforming.
- Consider co-location with existing organizations
- Create a viable path for rural lenders to become seller-servicers by eliminating fees and reducing the staff and paperwork burden to apply and maintain access to this status and all of its accompanying systems.

Improving and adding to the following Activities could help address local organizations' capacity issues:

Freddie Mac
Activity 1, Objective D: Increase Industry Technical Expertise
Activity 1, O bjective J: Develop LIHTC equity investment offering
Activity 2, Objective B: Increase Technical Expertise in Indian Areas
Fannie Mae,
Activity 1, Objective #2 Establish dedicated staff located within high-needs rural regions
Activity 2, Objective #5: Establish a pilot program for potential entity level investments in non-profit organizations, CDFI, small financial institutions or other entities that have a major focus on high-needs populations.
Activity 3, Objective #1: Consider loan product and underwriting changes to purchase multifamily mortgage loans from small financial institutions in rural areas and purchase loans.

II. ADDRESS MARKET-LEVEL SKILLS GAPS

An array of skilled professionals must be present for a region to have a healthy mortgage market. The smooth transfer of ownership depends on more than capable lenders and readily available mortgages. It

takes realtors, construction workers and tradesmen, appraisers, assessors, title officers and processors, insurance agents, and several other professions to avoid market-level dysfunctions.

Unfortunately, rural regions rarely have all the players necessary for a functional housing market. For example, Meigs County, Ohio has no local lawyers providing bond counsel for LIHTC transactions. Absent this expertise, every LIHTC transaction in the county must cover the additional time and cost of retaining counsel from bigger and more expensive markets, such as Columbus. The county also has no registered architecture practices and only two active licensed appraisers. These absences distort the valuation and cost of every multifamily rehabilitation project.

Consistent provision of market-level skills and increased market activity will eventually attract and grow a local network of professionals. Fahe is doing this now. Our organizations addresses skill gaps by accessing Fahe's suite of products and services that we bring to transactions, including legal counsel and other professional resources.

It is not the Enterprise's role or responsibility to support the full complement of professionals a region needs to have a well-functioning housing market. Instead, the Enterprises' have the powerful but limited ability to design products that are sensitive to the impacts of market-level dysfunctions and scarcity. They can also support trainings and provide working capital to local professionals to build their business. Capacity follows money, and that money must feel predictable and accessible.

Improving and adding to the following Activities could help address local markets' skills gaps:

Freddie Mac
Activity 1, Objective D: Increase industry technical expertise

Fannie Mae
Activity 1, Objective #4: Increase access to Fannie Mae financing by making changes to single-family loan products that increase the population of loans eligible for sale to Fannie Mae, simplify product parameters and loan requirements, and maintain appropriate risk controls

III. ADDRESS ENERGY EFFICIENCY ISSUES

Rural residents consume more energy and have fewer options for energy service than the rest of the Nation. Residential per household energy consumption in rural areas is about 10 percent higher compared to urban areas, with electricity 50 percent higher (15,258kWh/year compared to 10,290 kWh/year)[1]. Improving the efficiency of rural residences is as important, if not more than, other places. Yet, the work of the Enterprises to promote energy efficiency products such as HomeStyle Energy have not generated much use in rural areas.

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[1] The U.S. Energy Information Administration administers periodically the Residential Energy Consumption Survey (RECS) to a nationally representative sample of housing units.

Meanwhile, several Appalachian utilities have developed Pay as You Save (PAYS®) and On-Bill financing programs that allow rural residents to repay loans with the savings generated from energy efficiency upgrades to their homes. Upfront improvements are financed with an agreement that debt service will be tied to meter readings and paid as a tariff on the utility bill. There is no outlay of upfront capital for the homeowner, and the stream of savings can be considered during underwriting as income when calculating the debt-to-income ratio.

It is recommended the Enterprises buy loans for energy efficiency improvements and accept repayment from energy savings. This could be done during a refinance or a purchase, on old houses and new construction. It may require accepting repayment from a third-party (utilities and energy cooperatives) instead of directly from the consumer.

IV. WORK WITH HEALTHCARE ORGANIZATIONS

Housing quality has a significant effect on health outcomes. Good physical and mental health depends on having homes that are safe and free from physical hazards. When adequate housing protects individuals and families from harmful exposures and provides them with a sense of privacy, security, stability, and control, it can make important contributions to health. In contrast, poor quality and inadequate housing contributes to health problems such as infectious and chronic diseases, injuries, and poor childhood development. For example, the most common chronic disease among children is asthma, and approximately forty percent of diagnosed asthma among children is believed to be attributable to residential exposures.

Housing affordability also has a significant effect on health outcomes. Housing generally represents an American's greatest single expenditure, and, for homeowners, their most significant source of wealth. The more affordable the home, the more wealth remains available to spend on other items, like medical care. Unfortunately, an increasing number of rural households find it difficult to pay their monthly housing expenses. Despite the fact that housing costs are lower in rural areas, over 7 million households pay more than 30 percent of their monthly incomes toward housing costs and are considered cost-burdened.

The Enterprises recognize the need to support health initiatives. For example, Fannie Mae recently launched the Healthy Housing Rewards Initiative to offer financial incentives to multifamily borrowers incorporating healthy design features in affordable housing. Many of us that sell mortgages to the Enterprises also take serious the leading role of housing quality as a social determinant of health. Fahe facilitates collaboration across sectors to increase health outcomes and reduce healthcare costs in Appalachia.

Improving health outcomes and rural lives is ample reason for creating healthier housing. Yet, there are emerging models to monetize the value of improved health outcomes, and use the cost savings to pay debt service on a mortgage. So-called "pay for success" (PFS) models offer strong incentives for entities to finance, spread, and scale interventions that address these upstream determinants of health. PFS can increase investment in upstream nonmedical determinants of health, providing attractive avenues for private investments in programs and services that both improve population health outcomes and achieve greater value and efficiency in the allocation of housing resources[2].

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[22] Health Affairs, November 2016

It is recommended the Enterprises establish relationships with health care and health insurance providers to finance the construction and rehabilitation of healthier housing. Savings generated by such efforts could be used to service the debt.

V. ESTABLISH A LENDING COOPERATIVE FOR RURAL MARKETS

The Enterprises maintain underwriting, eligibility, and risk management standards, and require lenders to report certain information, process transactions with certain advanced technology and establish certain contractual obligations. These standards and requirement are intended to protect the public interest and make for a profitable business model. The standards and requirements also have the effect of discouraging many small and rural lenders from using the Enterprises' products. With small loans and modest profit margins, local lenders cannot cover the additional process and reporting requirements.

In response, the Enterprises could form an independent loan consortium for rural markets. The consortium could function as an independent corporation, capitalized by Franchise holders, and functioning with a specialized credit profile and set of product requirements more closely aligned with rural market resources. This would allow the Enterprises to contain and better understand the risk associated with these loans. Franchise holders would avoid the complexity of mastering multiple small markets. Instead, there would be able to interact with a single specialized intermediary. Local lenders would gain a trusted intermediary that understands the credit and income profile of its borrowers and the rural lending environment. Cooperative lending structures such as this have previously been used to serve specialized segments of the subsidized affordable housing market, such as for lending for affordable housing preservation.

VI. ADDITIONAL COMMENTS AND RESPONSES TO SPECIFIC ELEMENTS OF THE PLANS

- Fannie Mae has set extraordinarily low targets for loan purchases in Appalachia (see Activity 1, Objectives 5 and 6.) Increasing single-family loan purchases by 1,000, and increasing multi-family purchases by 20 percent above a meager baseline fall fundamentally short of a good-faith effort. If Fannie were to reach these objectives, it would make almost no material impact on the underserved status of rural markets. A doubling of activity in both single- and multi-family rural markets would be a more reasonable objective.
- Both Enterprises seek to establish Advisory Boards. Consider having FHFA, or another neutral entity, establish and manage one Board that both Enterprises must support with research, reporting and responsiveness.
- Fannie Mae admirably suggests they establish staff within high-needs rural regions, presumably dedicated to serving that high-need region's lenders. It would be wise to co-locate that staff with one or more local lenders. Fahe is interested in hosting Enterprise staff. We would provide administrative support, and our lending staff would learn from regularly interacting with the Fannie Mae staff person. The Fannie Mae staff would gain a unique insight into the opportunities and challenges of Appalachian lending, and have an opportunity to interact with Fahe's network of over 50 of the region's community and economic development organizations.
- Rural advocates and stakeholders have called into question the effect the Community Reinvestment Act has on rural markets. While CRA was not designed to address the lack of affordable capital in

rural places, it was established to push large financial institutions to invest in areas where they otherwise avoid. Because the majority of affordable and subsidized capital investing is driven by CRA, affordable financing is concentrated in poor urban districts. Financial institutions have little impetus to deliver resources to the broader geography. Accordingly, CRA has inadvertently created an urban bias in the affordable lending landscape.