July 10, 2017

Alfred M. Pollard, Esq.
General Counsel
Federal Housing Finance Agency
400 Seventh Street SW, 8th floor
Washington, DC 20024

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

Dear Mr. Pollard:

The LIHTC Working Group was established by Novogradac & Company LLP to provide low-income housing tax credit (LIHTC) industry participants a platform to work together to resolve technical and administrative LIHTC program issues. On behalf of the members of the LIHTC Working Group, we respectfully submit our comments on the Federal Housing Finance Agency (FHFA) Comments on Guidance 2017-1 — Duty to Serve Evaluation Guidance 2018-2020 Plan Cycle (Evaluation Guidance Plan). The proposed Evaluation Guidance Plan describes procedures for the Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac), hereafter collectively referred to as the Enterprise, to serve the following underserved markets—affordable housing preservation, rural housing, and manufactured housing (Duty to Serve)—as established by the Housing and Economic Recovery Act of 2008 (HERA, Public Law 110-289).

The members of the LIHTC Working Group strive to make the LIHTC program even more efficient in delivering benefits to help build affordable rental housing throughout the nation in a wide variety of different housing markets. Our group includes nonprofit and for-profit developers, property managers, lenders, syndicators, investors, accountants, lawyers and other LIHTC professionals.

We commend you for the approach taken in implementing the Duty to Serve provisions of HERA, in particular with regards to affordable housing preservation and rural housing. Combined with the Enterprises' affordable housing goals, the Housing Trust Fund, and Capital Magnet Fund, the Evaluation Guidance Plan would help direct the Enterprise's activities toward affordable housing investments to address the nation's most challenging and underserved markets.

Given that nearly 13 percent of the nation's affordable housing stock has been lost due to demolition, obsolescence, or conversion to market rate housing,[1] it is important that the

[1] "America's Rental Housing: Evolving Markets and Needs," Joint Center on Housing Studies, Harvard University, December 2013

Enterprise provides low-cost financing and innovative financial products to assist in the preservation of the existing U.S. affordable housing inventory.

For rural housing, the Evaluation Guidance Plan would direct Enterprise financing to historically underserved communities where housing costs may be relatively low compared to the rest of the nation, but where housing affordability is still a considerable problem and where Enterprise investment can be particularly impactful.

Both of these objectives—advancing rural housing and affordable housing preservation are important policy goals, and the most important source for capital for affordable rental housing preservation and rural rental housing development is the LIHTC. We will focus our comments on questions 1 through 6, 9, and 10 in the Evaluation Guidance Plan.

We will respond in further detail to the specific questions FHFA asked below, but we would like to reiterate our comment from the letter we submitted in response to the Duty to Serve proposed regulations to recommend the Enterprises should be allowed to reenter the LIHTC market with limitations, and they should be allowed to guarantee LIHTC investments. With regard to LIHTC equity investments as limited partner owners, we believe that FHFA should develop qualitative policies that encourage the Enterprises to focus in specific areas or development types where there is less LIHTC investment demand or during market dislocation events where Enterprise LIHTC investment could provide a helpful counter-cyclical role. Lastly, we believe that FHFA should award Duty to Serve credit for any LIHTC-related investment in rural or affordable rental housing preservation developments on similar terms to any credit awarded for mortgage finance-related investments. We understand that FHFA decided not to allow Duty to Serve credit for LIHTC equity investments in affordable rental housing developments in the final rule, but we continue to believe providing Duty to Serve credit for LIHTC equity investments preserving affordable rental housing developments under limited circumstances where market conditions warrant it would be beneficial.

Background

The LIHTC is the most important capital resource for affordable rental housing development, financing nearly 3 million affordable rental homes since its inception in 1987 and about 90,000-100,000 built, rehabilitated, or preserved annually in recent years.[2] Virtually all new rental housing affordable to households earning at or below 60 percent of the area median income constructed or rehabilitated since 1987 nationwide have depended on the LIHTC as its principal financing source.

In particular, it is a critical resource for preserving affordable rental housing. In 2007 before the recession, the LIHTC was responsible for the preservation and rehabilitation of about 65,000 affordable apartments with long-term affordability use restrictions, according to the National Housing Trust. In 2014, as the nation was slowly continuing to recover from recession, preservation represented over a third of LIHTC annual production[3].

[2] "State Housing Finance Agency Factbook: 2014 NCSHA Annual Survey Results," National Council of State Housing Agencies (NCSHA)
[3] Ibid.

LIHTC is also very important for the construction and preservation of rural housing. According to the National Rural Housing Coalition, more than 270,000 affordable rental homes in rural America developed during 1987-2010 were financed by the LIHTC, and in 2012, more than $250 million in LIHTC equity comprised nearly half (48 percent) of all available financing for the development of rural rental housing.[4] Additionally, although LIHTC was the largest source of financing in building affordable rural housing during 2016, rural communities have struggled to attract LIHTC investments due to funding cuts to the United States Department of Agriculture's Section 515 program.[5] The decline in Section 515 funding, resulting in increased difficulty in attracting LIHTC investments (the largest source of financing in building affordable rural housing), reinforces the need for Enterprise LIHTC equity investments in rural areas.[6]

The Enterprises were significant equity investors in the LIHTC marketplace prior to 2008, comprising 35 to 40 percent of the total LIHTC annual investment market,[7] but slowed investment when Fannie Mae[8] and Freddie Mac[9] became subject to the corporate alternative minimum tax (AMT) in 2007 and then halted investment as a result of being placed into government conservatorship a year later. Unlike most LIHTC investors, Fannie Mae and Freddie Mac were not motivated by the Community Reinvestment Act (CRA), and as a result they were more able to invest in rural areas, which tend to be outside CRA assessment areas.

General Comments

In addition to our responses to the questions posed by FHFA, we are encouraged by Freddie Mac's proposed development of a new offering with a more efficient origination for LIHTC preservation loans (Activities 1 and 2, Objective B). We urge Freddie Mac to specific consider transition reserve requirements and guarantee requirements as areas in which updates could help expedite processing. Further, we note that the status report contemplated includes a number of transactions, participants, and observations, but does not commit to measuring transactional costs or processing time or to providing any analysis of the impact of this product on overall Section 8 loan purchases across offerings. Without an indication of savings, either in real dollars or as a percentage of total transaction costs, the impact of a new offering in offsetting rising interest rates or otherwise facilitating transactions will be unknown. Freddie Mac should seek such measures.

Under the Duty to Serve final rule, Enterprise LIHTC equity investments will be eligible for Duty to Serve credit in rural areas only. Both Enterprises' proposed plans contemplate investments in rural communities. Spurring LIHTC investment in rural communities could have a meaningful impact on the creation and preservation of affordable rental housing in rural communities. If FHFA approves the Enterprises' reentry to the LIHTC equity market and to the

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[4] "The Low-Income Housing Tax Credit: Overcoming Barriers to Affordable Housing in Rural America," Rapoza Associates, August 2013.
[5] "2017 Impact Report: Measuring the Economic and Human Impact of Nonprofit Organizations in Rural America," National Rural Housing Coalition, 2017.
[6] Ibid.
[7] "Innovative Ideas for Revitalizing the LIHTC Market," The Federal Reserve Bank of St. Louis, November 2009.
[8] See Fannie Mae's 2007 10-K filing at http://www.fanniemae.com/resources/file/ir/pdf/proxy-statements/form10k_022708.pdf
[9] See Freddie Mac's 2007 Annual Report at http://www.freddiemac.com/investors/ar/pdf/2007annualrpt.pdf

extent that an Enterprise resumes LIHTC investments, we encourage a range of investments in developments that develop new and preserve federally-assisted housing across a broad geography including rural areas, small cities and urban centers, especially properties with expiring subsidies or those in need of refinancing. Based on past periods with less liquidity in the market, these developments are likely to have less investor demand than others.

Response to FHFA Questions

FHFA has asked for feedback on the Duty to Serve Evaluation Guidance 2018-2020 Plan Cycle as outlined in Guidance 2017-1. In response, The LIHTC Working Group has provided responses to the specific questions outlined in Chapter 3. Our comments and responses were derived utilizing benchmarks from state housing finance agency LIHTC programs, as well as our experience and research into how various state housing finance agencies evaluate LIHTC applications.

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 points 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?

Partial credit for objectives not fully accomplished is a worthwhile incentive/option to assure progress and eventual completion. A partial credit approach provides an effective method for incentives for furthering progress with various levels of achievement with the Enterprises. It can be advantageous to discuss further what qualifies objectives met as "moderate" versus "substantial." State housing finance agencies have established similar scoring criteria where a project has a maximum point value for evaluation in certain areas that have point thresholds based on various items: project location, housing needs characteristics, project characteristics, et cetera.

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?

A threshold of 60 percent, as opposed to 70 percent, can be more closely correlated to the previously mentioned thresholds in the partial credits points of 0, 3, 6, and 10. Another evaluation process used by State housing finance agencies would be to implement a ranking system of projects based on the scoring criteria above as opposed to a pass/fail system.

3. Has FHFA clearly articulated the implementation and impact criteria in a reasonable way in Appendix B (of the 2018-2020 Plan Cycle)? Should FHFA consider different or additional evaluation criteria?

The scores of 20 and 40 will potentially use more of an explanation as opposed to noting that the objectives are simply in between 10 and 30, as well as 30 and 50, which leads to ambiguity in the evaluation 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?

The individual scores at the objective level will make clear to the Enterprise as to the achievement of the criteria, rather than one single score. The use of more individualized objective levels can give a more balanced guide to the Enterprises, so that each step/criteria can be better understood. This will also minimize complexity.

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 will be advantageous for an Enterprise to have an understanding of its progress at the Plan development stage rather than at the completion of the evaluation stage. A preliminary concept score would benefit an Enterprise at the earliest possible stage. Once the Plan has been introduced into the development stage and a "draft" has been completed, an Enterprise can then utilize an assessment from FHFA for further development. It is typical in the application cycle for low-income housing tax credits for State Housing Finance Agencies to preliminarily approve an application and give feedback prior to going into the final round for an award.

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?

Evaluation areas should be weighted in order to better serve FHFA objectives. Currently, the FHFA has weighted "Loan Purchase," "Loan Product," "Outreach," and "Investments and Grants" at 35 percent, 30 percent, 20 percent, and 15 percent respectively. The objectives of FHFA are to increase the liquidity of mortgage investments and improve the distribution of investment capital available. Based on the FHFA objective to increase the liquidity of mortgage investments, "Investments and Grants" should be given a greater weight over "Outreach." We would propose weighting "Investments and Grants" and "Outreach" 20 percent and 15 percent, respectively.

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

The proposed cut-offs should be revised so that the ratings are more evenly distributed. Currently, the FHFA has distributed the final performance score ratings in such a manner so that a rating of "Minimally Passing" is 34 percent of the total cut-offs, "Low Satisfactory" is 16

percent, “High Satisfactory” is 20 percent and “Exceeds” is 30 percent. If the final performance score ratings were to be distributed evenly, then each rating would represent 25 percent of the total cut-offs, which provides an equal representation for each rating.

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?

To improve the overall simplicity of the evaluation process, the FHFA should consider the use of an evenly distributed scoring metric for the final performance ratings as discussed in our response to Question 9. Additionally, the “Extra Credit” phase should be incorporated as part of the “Qualitative Assessment” phase of the duty to serve evaluation process.

To improve the overall specificity of the evaluation process, as discussed in our response to Question 2, the FHFA should implement the use of a 60 percent threshold that will be more closely correlated to the thresholds in the partial credits points of 0, 3, 6, and 10. Furthermore, as discussed in our response to Question 3, the use of explanations for scores of 20 and 40 will reduce ambiguity in the evaluation process. FHFA objectives will also be better served by keeping a weighting system in place for the FHFA objectives as described in our response to Question 6.

Conclusion

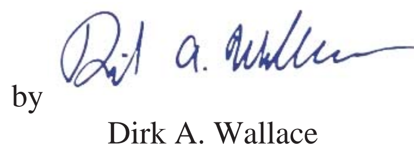
Again, we emphasize the importance of FHFA’s approval of the Enterprises’ reentry to the LIHTC equity market. Furthermore, we encourage the Enterprises to resume LIHTC investments in a range of investments in developments that develop new and preserve federally-assisted housing across a broad geography including rural areas, small cities and urban centers, especially properties with expiring subsidies or those in need of refinancing.

We appreciate efforts to improve the LIHTC program and the opportunity to comment on the Evaluation Guidance Plan. We look forward to working with the FHFA as it finalizes the plan.

Please do not hesitate to contact me at Dirk.Wallace@novoco.com or (330) 365-5400 if you have any questions regarding our comments or if we can be of further assistance.

THE LIHTC WORKING GROUP

Very truly yours,
NOVOGRADAC & COMPANY LLP



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