NATIONAL LOW INCOME HOUSING COALITION

July 10, 2017

Jim Gray
Duty to Serve Program Manager
Federal Housing Finance Agency
400 Seventh Street SW
Room 10276
Washington, DC 20219

Submitted via FHFA.gov

RE: Fannie Mae and Freddie Mac Underserved Markets Plans for the Duty to Serve

Dear Mr. Gray,

The National Low Income Housing Coalition (NLIHC) appreciates the opportunity to provide comments to the Federal Housing Finance Agency (FHFA), Fannie Mae, and Freddie Mac (the Enterprises) on the Underserved Market Plans required of the Enterprises to meet their Duty to Serve obligations to facilitate a secondary market for mortgages related to manufactured housing, affordable housing preservation, and housing in rural markets.

NLIHC is a nonprofit advocacy and research organization dedicated solely to achieving socially just public policy that assures people with the lowest incomes in the United States have affordable and decent homes. Our members include nonprofit housing providers, homeless service providers, fair housing organizations, state and local housing coalitions, public housing agencies, private developers, and property owners, housing researchers, local and state government agencies, faith-based organizations, residents of public and assisted housing and their organizations, and concerned citizens. While our members include the spectrum of housing interests, we do not represent any segment of the housing industry. Rather, we focus on what is in the best interest of people who are in need of affordable housing, especially extremely low income people and people who are homeless.

The Housing and Economic Recovery Act of 2008 (HERA) included provisions requiring the Enterprises to serve undeserved markets, as well

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as contribute to the National Housing Trust Fund (NHTF) and Capital Magnet Fund (CMF), and meet certain affordable housing goals. Together, these requirements have the potential to serve as an important tool in addressing America's growing rental crisis.

1. General Comments

We applaud the creativity and initiative of the Enterprises in developing their plans and appreciate their significant efforts to engage stakeholders. While the plans demonstrate the Enterprises' commitment to increase their impact in underserved markets, they also evidence a heavy focus on scoring and technical compliance. We encourage the Enterprises to strive for a significant impact as they finalize their proposed plans. As both draft plans note, the country is facing an affordability crisis with half of renters "rent burdened" (paying more than the recommended 30% of income for rent) and one in four renter households "severely rent burdened" (paying more than 50% of their monthly income for rent). In this context, we offer the following general comments on the plans.

a. Create more aggressive loan purchase targets

As required under the Final Rule and Evaluation Guidance, both Enterprises have set loan purchase goals using actual past loan purchases as a baseline. While it is appropriate to adjust the baseline in anticipation of regulatory and market changes, both plans include very conservative downward adjustments. For instance, the Freddie Mac target for Low-Income Housing Tax Credit (LIHTC) and Section 8 loan purchases has discounted the average purchases over the last three years by 35%. The justification for this steep downward adjustment assumes that in the coming year, Congress will reduce the corporate tax rate to 20% and eliminate or materially reduce funding for the HOME Investment Partnerships Program (HOME) and Community Development Block Grants (CDBG). While tax and appropriations changes are risks, the discount applied here is far more conservative than what the marketplace is using. By comparison, lenders and investors concerned with the impact of lower corporate tax rates under tax reform are generally underwriting transactions at a rate of 25%. Further, it is unclear if Congress will adopt drastic cuts to HOME and CDBG as proposed by the Trump Administration. Finally, even if these changes were to occur, their impact would not be fully realized in 2018.

Loan purchase targets that are roughly half of those from recent years are unlikely to represent a meaningful impact and certainly not an improvement in service to underserved markets. Given that the Enterprises have the opportunity to modify their plans annually, loan purchase goals should not be based on assumptions that are more conservative than other market participants. We encourage FHFA to require the Enterprises to adjust their affordable housing preservation loan purchase targets.

b. Expedite timelines for objectives

As noted above, we recognize that the Enterprises have already engaged in significant outreach, stakeholder engagement and research around new product offerings and term changes to existing programs. Given the urgent need to preserve housing and affordability in these underserved markets and the considerable knowledge and resources already invested, we urge the Enterprises to expedite the publication of reports and resources, as well as the roll out of new offerings. In the energy efficiency space, given its depth of experience with energy efficiency Freddie Mac should seek to publish its first report early in the first year. (Activity 6). Further, we encourage FHFA in its evaluation to consider the expedited release of well-researched resources and products as part of its potential impact.

2. Affordable Housing Preservation Activities

a. Section 8

Project-based Section 8, project-based vouchers, and Housing Choice Vouchers (HCVs) are critical to housing the most vulnerable low-income populations, however they are only effective preservation tools if they can be leveraged for long term financing. While the Enterprises have a strong history of purchasing mortgages on properties with project-based rental assistance, additional conditions on these loans and frequently required waivers can be costly and time consuming. Existing Enterprise underwriting guidance typically does not consider income from preservation vouchers.

We applaud Fannie Mae's objective of modifying underwriting guidelines and credit standards pertaining to above market Housing Assistance Payment (HAP) contracts, large re-stabilization reserves, appropriations risks, and Section 8 tenant vouchers (Activity A, Objective 1). Adjustments to these criteria could expedite processing and reduce costs for preservation loans. Fannie Mae's proposed plan contemplates an analysis in the first year with changes and tracking in year two and three. We encourage Fannie Mae to pursue published changes as soon as possible. Given its significant history of purchasing loans secured by properties with project-based Section 8, Fannie Mae should have sufficient experience to design appropriate updates, particularly around appropriations risk and re-stabilization reserve issues that exist in most Section 8 transactions. As Fannie Mae analyzes pre-review requests and contemplates updates to Section guidelines, we also encourage it to engage lender and borrower stakeholders to discuss new approaches that that would facilitate transactions, rather than relying only on the terms of past waivers.

Similarly, we are encouraged by Freddie Mac's proposed development of a new offering with a more efficient origination for Section 8 and LIHTC preservation loans (Activities 1 and 2, Objective B). We urge Freddie Mac to specific consider transition reserve requirements and guarantee requirements for nonprofits 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.

Freddie Mac's Section 8 Objective 3 recognizes the threat of diminishing resources to finance the preservation of Section 8 properties and the need for funding to close capital gaps. While the need for gap funding is clear, it is less clear that a new loan purchase product can provide an impactful solution. Affordable housing developers are challenged by operating revenue which is constrained by affordability restrictions and insufficient to support debt service on the total preservation cost. This objective seeks to replace equity or soft funding with a new debt product. Given that properties will not have increased revenue to service additional debt, the impact of a new product may be limited unless the terms are very favorable. Freddie Mac appropriately identifies the challenges of meeting investor yield expectations as well as consolidating investors with diverse geographic restrictions and appetites for risk and anticipates that it will required significant time to develop an infrastructure. Rather than developing another untested infrastructure for delivering gap financings, we encourage Freddie Mac to pursue this objective through partnership with high capacity community development financial institutions (CDFIs), which are skilled in working with mission-driven capital and structuring investments that facilitate complex transactions. While CDFIs regularly blend funds to create innovative products that bridge financing needs, many lack access to long-term capital, making them less able to provide long-term gap/secondary financing in preservation transactions.

As we have previously commented, new strategies for preservation should expand needed resources available to CDFIs, as well as mission-driven owners and developers, that will enable them to strengthen their preservation efforts. Specifically, the Enterprises could promote lending products for preservation activities that do not require uniform underwriting criteria. These loans could be made to CDFIs or developers with strong experience undertaking preservation transactions. Such lending products should include below-market interest rates, flexible amortization and loan terms, low transaction costs, and might include or leverage grants for credit enhancement and underwriting costs.

To support affordable housing preservation with the Underserved Market Plans, we recommend that the Enterprises provide a letter of credit to a lender to guarantee up to 95% of the Loan to Value (LTV) ratio of a loan for the acquisition and/or rehabilitation of an affordable housing property. The letter of credit could be tied directly to the mortgage on the property. Eligible lenders for this letter of credit could include CDFIs. The attached fact sheet developed by the National Housing Trust provides greater detail of this proposal.

In addition to CDFIs, select mission driven real estate investment trusts (REITs) provide flexible debt and equity to facilitate affordable housing investment. Freddie Mac and Fannie Mae should also explore this existing financing structure as a means for providing gap financing.

b. Low Income Housing Tax Credit (LIHTC) Program

i. Loan Purchases

The Enterprises' commitment to continuing to purchase loans financing LIHTC properties is appropriate and as discussed more generally above should include more ambitious targets for serving this asset class. While investment in LIHTC currently is presently tempered by uncertainty in the marketplace, LIHTC will continue to be the primary financing vehicle for construction and rehabilitation of affordable housing.

We are encouraged by Freddie Mac's objective to create a new offering with a streamlined path for financing properties moving towards or already in their extended compliance period. As noted in the discussion of this offering for Section 8 properties, we urge Freddie Mac to engage with stakeholders in designing this product and to identify standards for measuring the savings created by the new offering.

ii. Equity Investments

Both Fannie Mae and Freddie Mac propose returning to an active role purchasing Low Income Housing Tax Credit equity (Fannie Mae Regulatory Activity B for high-needs rural regions, Freddie Mac Rural Housing Activity 2).

The decision whether to allow LIHTC investment or not is based on conservatorship, not Duty to Serve. However, FHFA should be aware that it is very difficult for an Enterprise to make LIHTC investments just in underserved areas. Like any investment portfolio, an LIHTC portfolio should diversify risk and return. Setting an objective for LIHTC investment in underserved areas may naturally lead to requests to engage in LIHTC investment generally.

The Enterprise should only receive Duty to Serve credit for LIHTC purchases that expand opportunity in underserved areas. If they are simply displacing existing LIHTC investors without bringing significantly better (from the property perspective) investment or more demand for investment in underserved areas, FHFA should not award much if any Duty to Serve credit.

Investors buy the overall national allocation of LIHTC every year—credits are not going wanting. Rural LIHTC allocations are successful every year. More might be possible, although state allocating agencies may be wisely limiting their allocations to projects that are feasible. Adding additional investor demand from Fannie Mae and Freddie Mac could improve pricing, or it could simply push some smaller investors out of the market. FHFA should consult with state LIHTC allocators and other knowledgeable stakeholders when evaluating Duty to Serve performance to determine what impact, if any, the Enterprise's investment had on allocations or pricing in underserved areas.

3. Residential Economic Diversity

Neither Enterprise offers much detail on how they plan to track whether and how their activities contribute to residential economic diversity. However, during the rule development process, we heard many assertions that residential economic diversity is difficult to measure and to correlate with individual loans. Both plans should specify how they will track performance in this area relative to FHFA criteria and identify any barriers they need to overcome.

Freddie Mac's plan asserts in several places that preservation of affordable housing in high-opportunity areas will contribute, which is reasonable. It offers no specifics or targets for loan purchases, which would provide more confidence.
Fannie Mae's plan sets targets for loan purchases meeting residential economic diversity criteria within many of its activities. Specific targets help motivate fulfillment of objectives and maintain awareness of the extra credit objective throughout the work. We commend this approach generally and encourage both GSEs to become more specific as the plans progress.

4. Rural Markets

While dramatic improvements have been made in rural housing quality over the last few decades, problems persist. Many of rural America's 65 million residents experience acute housing problems that are often overlooked. Farm workers, especially those who move from place to place to find work, suffer some of the worst, yet least visible, housing conditions in the country.

Nearly 30% of rural households experience at least one major housing problem, such as high cost, physical deficiencies, or overcrowding. Forty-seven percent of rural renters are cost burdened, paying more than 30% of their income for their housing, and nearly half of them pay more than 50% of their income for housing. More than half of the rural households living with multiple problems—like affordability, physical inadequacies, or overcrowding—are renters.

Congress and FHFA have correctly identified the lack of capital required to finance affordable housing in rural areas, and the need to encourage the Enterprises to expand their rural activities under the DTS rule. NLIHC agrees with the comments submitted by our partner, the Housing Assistance Council, in regard to the Enterprises' duty to serve the rural housing market.

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Thank you for this opportunity to comment on the Enterprises' draft Underserved Markets' Plans. We look forward to working with FHFA and the Enterprises to facilitate the preservation of affordable housing. For more information, please contact Elayne Weiss, Senior Policy Analyst for the National Low Income Housing Coalition.

Sincerely,

Diane Yentel

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National Low Income Housing Coalition