Preservation
Working Group

July 10, 2017

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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 Jim,

The undersigned members of the national Preservation Working Group (PWG) appreciate 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.

PWG is a national coalition of housing owners, developers, tenant associations, and state and local housing agencies dedicated to the preservation of multifamily housing for low-income families. In 2016, PWG provided detailed comments on FHFA's Duty to Serve proposed rule. We were pleased that the final rule included several modifications designed to enhance investments in affordable housing preservation and energy efficiency improvements within existing multifamily rental properties. The following comments focus on the multifamily affordable housing preservation sections of the Enterprises' Underserved Markets Plans and are informed by the many years of related experience of the signatories.

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 and ambitious impact as they finalize their proposed plans. As both draft plans note, the country is facing an affordability crisis with half of all renters "rent burdened" (paying more than 30 percent of income for rent) and one in four renter households "severely rent burdened" (paying more than 50 percent 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 percent. The justification for this steep downward adjustment assumes that in the coming year, Congress will reduce the corporate tax rate to 20 percent 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 percent. 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 already have taken part 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 an Enterprise's potential impact.

C. 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 years 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 8 guidelines, we also encourage it to engage lender and borrower stakeholders to discuss new approaches 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 require significant time to create a new offering. 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 Markets Plans, we recommend that the Enterprises provide a letter of credit to a lender to guarantee up to 95 percent 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 also should 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.

PWG members are greatly experienced with the challenges of financing a LIHTC property and are encouraged by Freddie Mac's objective to create a new offering with a streamlined path for financing properties moving toward 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 it creates.

ii. Equity Investments

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 rental housing in rural communities. To the extent that an Enterprise resumes LIHTC investments, we encourage a range of investments in developments that 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 projects are likely to have less investor demand than others. Further, we recommend that the Enterprises invest through multi-investor funds, whose flexible funding is not tied to Community Reinvestment Act (CRA) credit and is more often used for preservation deals which utilize tax-exempt bond financed 4 percent LIHTC deals.

In some cases, Enterprise investments in LIHTC properties have led to complicated negotiations over disposition at the end of the tax credit compliance period. As part of their Duty to Serve, we urge the Enterprises to recognize that their obligation to promote the long-term affordability of properties built or rehabilitated with the use of the LIHTC requires that, whenever practicable, they transfer their partnership interests in LIHTC properties to nonprofit owners with the mission and experience to maintain these properties in good condition and available for long-term affordability.

c. Rental Assistance Demonstration (RAD) Program

We are encouraged by the proposed objectives of both Enterprises to support preservation through the RAD program. Given that Congress increased the cap on the number of units that may be converted under RAD in the Fiscal Year 2017 Appropriations Act, thereby growing the potential for lending, the Enterprises should set more ambitious targets for RAD loan purchases.

D. Financing improvements on multifamily properties that reduce energy and water consumption

a. Loans to support energy or water improvements on multifamily properties

We are pleased that the Duty to Serve final rule recognizes that energy costs are the largest controllable variable operating costs for multifamily housing. To help address this issue for affordable housing owners, CDFI lenders are creating financing products that allow property owners to implement energy and water efficiency measures by providing loans that take the projected energy savings into account. Presently, there are several obstacles to providing this product behind a current Enterprise loan.

We encourage the Enterprises to take steps to eliminate these hurdles within their Underserved Market Plans. First, we urge Fannie Mae and Freddie Mac to allow a second lien behind their mortgages. Second, we recommend that the Enterprises standardize an inter-creditor agreement for subordinate energy efficiency loans behind their mortgages. Finally, we advise Fannie Mae and Freddie Mac to ensure that the debt payments on the CDFI Efficiency Loan are excluded from hard debt service coverage covenants. The factsheet created by the National Housing Trust provides greater detail of this proposal.

b. Implement research in parallel with testing new pilots and products

Both Enterprises in their Draft Plans, Objective 1 and 2 for Fannie Mae and Objective A for Freddie Mac, appear to contemplate a significant period of research before they expect to specify and implement new products or product features. We urge the Enterprises to expand their plans to describe a robust set of product concepts that could be tested in the market, even if some of the concepts may not come to fruition. Many specific, well-grounded concepts are available to be implemented now with a reasonable basis to expect good outcomes. Small-scale pilot programs could allow for market-based results while also limiting the GSEs risk exposure.

We recommend the Enterprises' Underserved Markets Plans prioritize and specify immediate market interventions for Duty to Serve borrowers with tests and pilots of new products (or product terms or feature) that support financing of energy and water efficiency improvements.

c. Enhance consumer research

Consumer research listed in Fannie Mae's Objective 2 should focus not only on deriving consumer insights, but also on consumers' financing needs, future trends, business models, and opportunities. Should either Enterprise incorporate consumer research into its Underserved Markets Plan, this broader focus should be adopted.

d. Improve the GSEs' ability to track loans with energy efficiency elements

We support the high value of the research objectives identified in the Objectives A, B and D in the Freddie Mac Plan and Objectives 2 and 4 in the Fannie Mae Plan. Research is vital, so support and Duty to Serve credit for research activities is appropriate. In particular, it is important for the Enterprises to improve their ability to track and substantiate how different energy- and water-usage attributes of a home factor into valuation and to understand how these factors change over time. Analysis of energy and water efficiency in the homes covered by the Enterprises' loan purchases should create an ongoing ability to track, not just a one-time investigation.

e. Utilize and analyze data on all Enterprise activity related to energy efficiency, not just Duty to Serve eligible loans

The Enterprises should conduct research about energy and water use continually and across their portfolios generally, not limited to Duty to Serve eligible transactions. The Enterprises have a strong interest in improving energy and water efficiency in the properties securing their portfolio of loans. We recommend Fannie Mae and Freddie Mac engage in this process beyond simply Duty to Serve. Research should inform product management, product development, and risk management across their portfolios.

The Enterprises' research plans should expressly contemplate gathering information outside the conventional loan documents. We encourage the Enterprises to seek information from other sources for purposes of analysis, reporting, and other uses such as Home Energy Rating System (HERS), rating, U.S. Department of Energy's Home Energy Score, LEED, and other criteria approved by the FHFA final rule.

FHFA or an external third party could coordinate research work with the Enterprises when the findings would be improved by a larger pool of loans and loan–related data. This would strengthen the Enterprises' plans for research and reporting on energy and water features of properties securing Enterprise loans. We encourage FHFA to explore options for such studies to harness the information residing with both Fannie Mae and Freddie Mac and potentially additional willing data partners such as the Federal Housing Administration (FHA) or even private mortgage lenders, insurers, service providers, or large investors.

f. Leverage multifamily energy and water efficiency programs from utilities and others

As discussed in the final rule, utilities, state energy offices, and other related parties operate robust programs to support residential energy and water efficiency projects. The programs offer support to multifamily building owners for a wide range of energy and water efficiency projects.

We encourage the Enterprises to provide greater specificity in their Underserved Markets Plans about how they would seek to work with such existing programs. Specifically, the Enterprises should clarify the flexibility provided in the final rule to rely upon project eligibility for utility incentives to satisfy Duty to Serve energy savings and cost neutrality requirements.

FHFA's final rule commentary indicates that the Enterprises have additional flexibility to support financing of projects that are eligible for utility program incentives. For example, if a utility program provides incentives for the installation of a heat-pump water heater, Fannie Mae or Freddie Mac may support financing of the cost to install the heat-pump water heater as an eligible measure without independently substantiating that the measure is cost-effective based on expected energy savings.

Relying on a utility program's eligible measures list also may help the Enterprises avoid certain difficult fact patterns. For example, in the case of a customer replacing essential equipment (like an air conditioner or heater) with a high efficiency model, the local program may require a calculation using the cost premium for the high efficiency model (not the total cost of installation), and comparing it to a baseline model. These are calculations at a level of detail that the Enterprises and lenders should not be expected to delve into. Another option to simplify this process is to make Energy Star rated equipment eligible.

g. Underserved Markets Plans should connect to products and tests beyond Duty to Serve loans

For multifamily loans, even though Duty to Serve credit will occur only for supporting financing to Duty to Serve eligible loans, the Enterprises' Underserved Markets Plans should describe products and tests that reach a broader set of borrowers and prospective borrowers. Determining which loans are eligible for Duty to Serve credit should occur separately from eligibility for a loan or pilot.

Fannie Mae and Freddie Mac's multifamily green initiatives have spurred product improvements implemented separately from the Duty to Serve rule, based on findings that more efficient properties produce better outcomes for the Enterprises and all stakeholders. It would not make sense to limit eligibility for the Multifamily Green Rewards and Green Advantage products to Duty to Serve eligible customers, because these programs already serve more broadly. Instead, the Enterprises should identify the subset of transactions that meet the Duty to Serve criteria.

Prior to the Duty to Serve rulemaking, Fannie Mae and Freddie Mac's multifamily businesses began to examine how energy and water efficiency could be better addressed in their loan products. They found the concept at the heart of the Duty to Serve rule, that making energy efficiency and water repairs and improvements will deliver reduced energy expenses, superior properties, and better loans, values that accrue to the benefit of the Enterprises, owners, and residents. The Enterprises have implemented loan products that address the problem and provide solutions. Now they can work incrementally toward improved products as the markets change.

The commitment to correct loan products to account for the values of energy and water pre-dates and is separate from Duty to Serve. Duty to Serve, then, for the multifamily business becomes about finding ways to measure performance and setting benchmarks and goals.

In the context of this rulemaking, the plans must focus on the narrow terms FHFA has identified for Duty to Serve credit. But the Enterprises should acknowledge the value of supporting energy and water related improvements is substantial and offers potential benefits across all Fannie Mae and Freddie Mac activities.

h. Set more ambitious multifamily goals

Fannie Mae's draft plan in Objective 6 states that it will purchase at least 25 loans that reduce usage by 15 percent in year one, with 25 percent increase annually. While we wish to recognize and acknowledge the excellent leadership of both Enterprises in implementing market-leading products, the goals for the planning period should be more ambitious. The Enterprises should implement a portfolio based approach, based on a proportion of the loan volume and increase that share of the portfolio every year. Underserved Markets Plans also should track energy and water savings in properties.

Freddie Mac should set similar specific goals for its multifamily program. Freddie Mac's draft plan does not include specific measures that would indicate progress on Duty to Serve objectives. Freddie Mac's plan should be revised to include such goals, drawing on the detail set forth below.

i. Achieve greater consistency in multifamily reports and assessments

For multifamily housing, Fannie Mae and Freddie Mac should consider including in their Underserved Markets Plans an objective to achieve greater market consistency in the energy and water attributes of the property condition reports or assessments required of property owners in connection with purchase and refinancing loans.

The property condition report or assessment identifies the repairs and improvements an owner and lender should expect during the term of a loan. Both Fannie Mae and Freddie Mac use the property condition report to identify needed repairs and improvements in purchase and refinancing. Both Enterprises use a property condition report, along with an energy audit, to identify repairs and improvements eligible for financing with their Green Advantage and Green Rewards financing products.

Greater standardization in the requirements associated with the property condition report would benefit a range of market participants. We encourage both Enterprises to use their strong leadership capabilities to confer with a wide range of affordable housing finance participants, including CDFIs, state housing finance agencies, energy assessors and auditors, developers, and equipment manufacturers. One question to examine is whether common requirements across the industry for the energy and water elements of the property condition report would be beneficial. While we support the use of a reliable energy audit, a question to explore is whether a less intensive and less costly assessment for certain types of properties could produce reliable recommendations for less intensive repairs and improvements projects that still fulfill requirements.

j. Align incentives for market-rate and subsidized multifamily housing

Stakeholders, both housing practitioners and energy focused groups working to create more energy and water efficient multifamily housing observe a tension between two related goals:

1) Increase the overall volume of lending for energy and water efficiency in multifamily, regardless of the tenancy served. This requires economies of scale and some amount of standardization. Advocates for this goal fear that an emphasis on particular subcategories will trade off with overall volume.
2) Ensure that low-income residents in subsidized affordable housing benefit from energy and water efficiency improvements. Preservation of affordable housing is often complicated, requiring customized transactions that add an additional layer of difficulty that can resist standardization crafted for market-rate properties. Advocates for this second goal fear that a focus on total volume will leave affordable housing behind.

We therefore propose a combined objective to address this tension. Each Enterprise should identify an achievable percentage (by units) of its total volume of energy and water efficiency loans that would be targeted to subsidized affordable housing. Overall points would be based on total volume achieved if the Enterprise meets the targeted affordable percentage. Total points would be reduced (or potentially increased) by the extent to which the enterprise missed (or surpassed) the percentage of targeted affordable units.

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 Ellen Lurie Hoffman, Federal Policy Director for the National Housing Trust.

Sincerely,

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