Federal Housing Finance Agency

Duty to Serve

FHFA presents Snapshots from Freddie Mac's & Fannie Mae's Duty to Serve Underserved Markets Plans for Multifamily Rental Production

Effective December 14, 2018

Excerpts from Freddie Mac's and Fannie Mae's Duty to Serve Underserved Markets Plans: Multifamily Rental Production

Compiled by the Federal Housing Finance Agency

FHFA has compiled excerpts from Fannie Mae's and Freddie Mac's Duty to Serve Underserved Markets Plans addressing activities that support multifamily rental production. To access the Duty to Serve Underserved Markets Plans in their entirety, please visit FHFA's Duty to Serve website.

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DISCLAIMER

Implementation of the activities and objectives in Fannie Mae's and Freddie Mac's Duty to Serve Underserved Markets Plans may be subject to change based on factors including FHFA review for compliance with the Charter Acts, specific FHFA approval requirements and safety and soundness standards, and market or economic conditions, as applicable.

FHFA's Compilation of Snapshots from Freddie Mac's Duty to Serve Plan: Multifamily Rental Production

Activity 2 – Section 8: Statutory Activity

Project-based Section 8 is an important federal program connected to a substantial number of affordable housing units nationwide. In our analysis of the NHPD, we identified about 18,000 properties with an active project-based Section 8 subsidy supporting almost 1.27 million units. Figures on the total number of properties from other sources, most of which come from HUD's website, range from 14,700 to 17,000; total assisted unit figures typically range from 1.1 million to 1.28 million.

	Active Properties	Assisted Units
NHPD Estimate of Section 8	**18,031**[92]	**1,268,879**
Low estimate of outside sources	14,746	1,125,377
High estimate of outside sources	16,697	1,275,000

Section 8 HAP contracts are frequently combined with LIHTC equity to maximize the benefit of both programs. Per analysis from NCSHA in the 2015 State HFA factbook and provided to Freddie Mac, 15.8 percent of units financed with LIHTCs also have Project Based Section 8. As such, the market for Section 8 properties in a given year is tied to the market for tax credits. Where there is fluctuation in the LIHTC market, there will be fluctuation in the Section 8 market, particularly with respect to properties receiving new tax credits. As with LIHTC debt, it is vital that we continue to purchase loans in order to support this key federal program.

Given our history of growing our purchase volume, we are starting our Duty to Serve Plan from a position as clear market leader. Analysis of both Enterprise's draft Duty to Serve Plans reveals Freddie Mac held a 55 percent GSE market share from 2014-2016. As such, incrementally growing purchase volume is not our sole or primary objective. In fact, we caution that there is not much room for further growth in real terms (apart from that described by our new product offering in Objective B below) without growing market share and taking transactions from other market participants. Should other market participants seek to increase their loan purchases, they would likely need to take market share from Freddie Mac. Given the breadth and depth of our investment and experience and the consistency we provide, the only way for other participants to do this would be to loosen credit standards and/or reduce price significantly. Either or both of these measures have the potential to run contrary to safety and soundness and distort the mid- and long-term health of the market in favor of short term gains.

Therefore, the question becomes: How can we continue our strong support as the market experiences challenges from rising rates and decreasing tax credit pricing while at the same time find opportunities to expand the capability of borrowers to preserve more of the existing stock of affordable housing?

To meet these goals for Section 8 properties, we have the following objectives:[93]

A. Provide liquidity and stability through Section 8 loan purchases.

B. Develop a new offering with a more efficient origination path for Section 8 housing preservation.

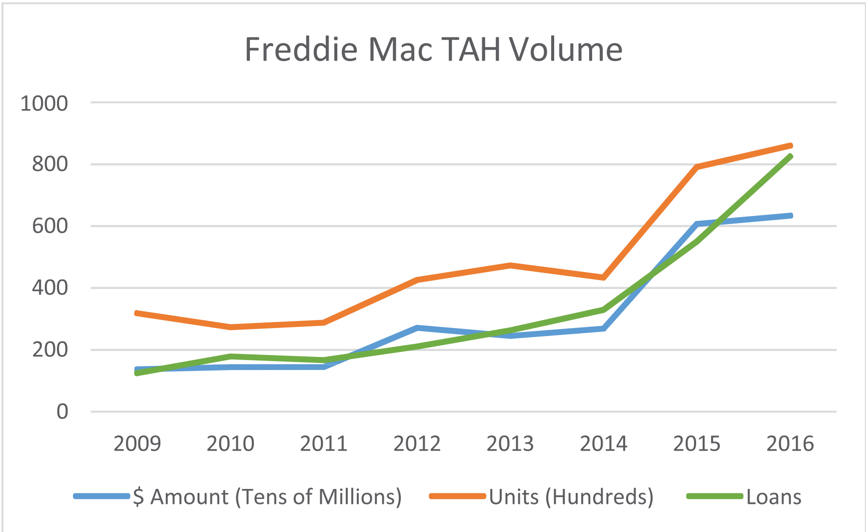
OBJECTIVE A: PROVIDE LIQUIDITY AND STABILITY THROUGH SECTION 8 LOAN PURCHASES

Evaluation Area	Year	Incomes Targeted	Extra Credit
Loan Purchase	**1, 2 and 3**	**VLI, LI, MI**	**Not applicable**

Throughout the entire Plan term, we intend to play a key role in providing liquidity, stability and affordability in the Section 8 market through a focus on loan purchases. Over the past three years, we have more than doubled our support for project based Section 8 and are a clear market leader with approximately 55 percent of the GSE market share during that period, consistent with our leadership in the Affordable Housing Preservation market generally.

Across our total TAH business, including Section 8 debt support, from 2009 to 2016, we have increased

1. the number of units we supported by 170 percent,
2. The number of loans by 560 percent, and
3. The annual loan amounts by 362 percent.



We have deliberately grown the TAH business considerably over the past 10 years since Duty to Serve was first described in HERA with a dramatic increase in the past few years as a result of a mature suite of product offerings and favorable market factors. And since 2014, we have doubled our dedicated core TAH production and underwriting staff and introduced five new loan offerings, including our Tax-Exempt Loan, Bridge to Resyndication, Special Needs Single-Family Rental, and Preservation Rehab, all of which play an important role in supporting the underserved and preserving affordable housing.

In our underwriting of Section 8 properties, we offer much flexibility as well as the ability to distribute risk away from the taxpayer though our industry leading K series and ML series securitizations. [94]

Baseline

In setting our baseline, we counted distinct units and properties on which we purchased loans during the year in question through our TAH retail seller/servicer network or via TAH negotiated transactions on individual mortgages. Between 2014 and 2016, we were very active in purchasing loans on properties with project-based Section 8, with 2015 and 2016 being atypically record years in purchase volume. That was in part because LIHTC equity pricing was at an all-time high and interest rates were at historical lows, the combination of which stretched LIHTC equity further and allowed properties to support more debt. It was also the direct result of investments we have made in our TAH platform, doubling staff and enhancing our suite of products.

The table below shows Freddie Mac's support for Section 8 over the last three years, inclusive of loans that support properties with project based Section 8 and other subsidies, such as LIHTC and RAD.

Year	2014	2015	2016	Three-Year Avg.
Total Loan Amount	$774MM	$1.4B	$1.4B	$1.2B
Section 8 Units	11,421	20,862	17,881	16,721
Properties	64	135	119	106

The three-year average baseline is $1.2 billion supporting 16,721 units across 106 properties.

Target

Due to market headwinds and challenges described below, we anticipate that the market for debt on Section 8 properties will be smaller than in 2015 and 2016. While the overall multifamily market may grow, at least in terms of debt origination dollars, the Section 8 market, which is dependent on federal and local subsidies, as well as tax credits, is constrained by their availability and use, so will likely shrink relative to recent years, and remain smaller for some time. For example, our 2017 Section 8 loan purchases in terms of units are down 36 percent through 3Q as compared to the first three quarters of 2016.

As a result of these factors, updated analysis of the Section 8 market, and public input we have set our purchase targets in excess of our baseline, but below our peak purchase volume, and we intend to increase purchases from there. In setting our targets, we will count distinct units and properties on which we purchase loans during the year in question through our TAH retail seller/servicer network or via TAH negotiated transactions on individual mortgages. We did this to account for the reduced LIHTC equity market and rising interest rates, and the likely concentration of public subsidies on fewer projects. We are also taking into account our position as market leader, with our support being in excess of other financing providers. We intend to continue in our role as market leader, and our purchase targets reflect that goal, relative to the availability of properties and units to finance.

Year	2018	2019	2020
Target	The Lesser of 16,750 Section 8 Units or 110 Properties	The Lesser of 17,250 Section 8 Units or 120 Properties	The Lesser of 18,000 Section 8 Units or 135 Properties

These targets may be adjusted upward or downward annually based on market conditions, such as market reactions to tax changes. We anticipate reaching these goals by leveraging our seller/servicer network and core products as well as innovating to reduce financing costs, increase efficiency and bring in new investors and/or partners. These innovations are described in Objective B below and in Objective B of the LIHTC Debt activity above, and account for the non-linear growth curve through 2020 despite the many challenges facing this market.

Challenges

The LIHTC market has experienced two simultaneous challenges in late 2016 and 2017 that have shrunk the market in the near term over recent record high market size and will likely have a sustained impact over time:

1. Reduced LIHTC equity pricing has led to a smaller market.
2. Rising interest rates have increased the need for LIHTC equity and soft subordinate debt.

In 2017, tax-credit pricing has reduced from historic highs of about $1.03 per credit in mid-2016 to $0.95 in mid-2017 per Affordable Housing Finance's survey of syndicators.[95] In a hypothetical transaction with $10 million of debt and a need for $6 million of equity, this reduction in tax credit pricing equates to a $480,000 funding gap, which would require additional tax credits or soft debt to close.

Increased interest rates have a direct effect on how much debt a property can support, and therefore how much LIHTC equity or soft debt is required. In 2016, interest rates were at historic lows. For example, over the course of 2016, the 10-year Treasury index had an average high for the year of 187 bps and an average low of 180 bps. In 2017 through July, the 10-year Treasury index had an average high for the year of 237 bps and an average low of 232 bps. Using a 50 bps difference in rate we can see the effect on a hypothetical property: if a property qualified for a loan amount of $10 million, a 50 bps increase in the 10-year Treasury index would mean that property would only qualify for about $9.44 million at the higher interest rate. This means that property would require an additional $560,000 of equity or soft debt in order to receive financing. This gap would be in addition to the gap caused by reduced LIHTC pricing. The combined effect of higher interest rates and lower equity pricing would be over a $1 million gap in funds to fill.

Where the gap in funds is growing, states have been required to focus their support on fewer transactions in order to help them succeed, which reduces the resources available for other properties. Indeed, as 2017 has progressed, we saw more and more examples of large scale LIHTC market disruption, two of which particularly highlight the impact:

1. On March 15, 2017, the California Tax Credit Allocation Committee (TCAC) passed a resolution allowing developers to exchange their 2016 9 percent LIHTC allocation for 2017 LIHTCs. Given delays in finding equity investors, developers found it impossible to close in time to complete construction by the end of 2018 (LIHTC deals must be "placed in service"- meaning 100 percent construction completion and receipt of the certificate of occupancy- by the end of the second year after receiving a LIHTC allocation).
2. In the Midwest, the Ohio Housing Finance Agency (OHFA) had to increase the allocation of LIHTC to deals awarded in 2016 because developers were not getting sufficient equity pricing to allow the deals to be economically feasible. Unfortunately, the additional credits had to come from the 2017 allocation, thus reducing the 2017 pool by approximately 12 percent.

As a result of this disruption, in the first half of 2017, there were 16 percent fewer new acquisitions compared to

the first half of 2016 per *Affordable Housing Finance*'s survey of syndicators.[96] We expect the market to remain smaller for some time unless interest rates experience a sustained reduction and either tax code changes or revisions to the LIHTC program are made, either of which could further affect the market.

Market Impacts

The combination of the above market challenges suggests that there will be downward pressure on project based Section 8 properties, as resources are concentrated more into properties with multiple subsidies as a result of LIHTC equity pricing and higher interest rates. This will make it more challenging to support Section 8 properties, as they require more funding than what we can typically provide. Still, we intend to continue in our role as market leader and provide material support to this market. We will do this by expanding our product set (as described below) and competitive stance. The result will be to further improve liquidity and mitigate the market declines for viable transactions.

Our continued market leadership will have a profound impact on the market as we will support more families than other lenders in the market and enable the continued improvement of properties while preserving affordable rents, leading to better quality affordable housing for residents over time.

Recognizing the critical role the GSEs may play in providing a source of stability during this period of market turmoil, we will be mindful of our status in conservatorship and ensure that our purchase volume and credit standard are consistent with safety and soundness. In furtherance of this goal, we are also able to distribute risk away from taxpayers with our market leading ML securitization execution, K series executions, and our PC execution, all of which can be used for LIHTC debt. These are the most comprehensive risk distribution methods in the market, and allow us to provide attractive financing and flexible terms to borrowers, channel private capital to support public good, all while protecting the taxpayer and maintaining safety and soundness.

OBJECTIVE B: DEVELOP A NEW OFFERING WITH A MORE EFFICIENT ORIGINATION PATH FOR SECTION 8 PRESERVATION

Evaluation Area	Year	Incomes Targeted	Extra Credit
Loan Product	**1**	**VLI, LI, MI**	**Not applicable**

Project-based Section 8 continues to be a vital federal program that enables long term affordable housing nationwide. After LIHTC, it is the second most prevalent form of federally assisted housing, with 1.27 million units in the program Section 8 properties often include other sources of federal or local subsidy, such as LIHTC and subordinate debt that add further analysis to the transactions.

Freddie Mac has extensive experience supporting project based Section 8 and is the market leader in this segment of affordable housing preservation, with approximately 55 percent of the GSE market share. We will leverage this experience to provide even stronger support, particularly for smaller, simpler Section 8 preservation transactions, where we have learned that the due diligence requirements, product parameters, and legal infrastructure can be tailored towards greater efficiency and flexibility for borrowers in this segment of the market to enable them to more cost effectively finance and preserve Section 8 properties and devote more resources to the property rather than to financing costs. Overall, we anticipate reducing financing costs by up to approximately 30 percent from a standard transaction. Major improvements and the savings associated are outlined below:

Due Diligence Streamlining	Product Parameters	Legal Infrastructure
• Single Physical Risk Report • Zoning Report Removed • New Survey Removed	• Stepdown Prepayment • Subordinate Debt Permitted • Loan terms up to 15 years	• Streamlined Commitment • Joint Counsel • No Opinion Letter
Savings • Monetary savings of up to approximately 10% from the current affordable Freddie Mac cash transaction. • Time reduction of 1 week from the complete transaction timeline.	**Savings** • Monetary and time savings will vary on a deal by deal basis, however is the cost is intended to be lower than the current affordable Freddie Mac cash transaction.	**Savings** • Monetary savings of up to approximately 30% from the current affordable cash transaction. • Time reduction of 2 weeks from the complete transaction timeline.

During Year 1 of the Plan, we intend to provide the market with a competitive, streamlined offering for transactions under $10 million on properties with Long-Term Section 8 HAP Contracts or existing LIHTC in Year 11 or later, and will leverage our market-leading risk transfer methods—our K series executions, our SB series executions, and/or our PC executions—to attract private capital to support public good and dramatically reduce risk to Freddie Mac and the taxpayer. We intend to do this in such a way that does not affect our safety and soundness and is consistent with our current industry accepted credit standards.

As a result of this offering, we anticipate purchasing more loans on Section 8 properties than we would otherwise. This increase is factored into our Section 8 purchase targets in Objective A above.

Baseline

Freddie Mac is the current market leader in supporting Section 8, though we recognize that there are opportunities to better serve smaller properties in this market. We do not currently have a product that deliberately targets smaller Section 8 transactions that have their own unique needs.

Challenges, Actions and Market Impacts

Market Challenge	Freddie Mac Action
High transaction costs (monetary and time) ▪ Typical debt offerings tend to be costly and time consuming for these simpler, smaller transactions, because such offerings require the same level of due diligence as highly complex affordable housing transactions. The time and cost often make it harder to preserve these properties as affordable. **Acceptance by capital markets** ▪ Investors are accustomed to seeing the same due diligence for each transaction during	**Year 1 – 2018** 1) Develop specific offering parameters, such as third-party reports, legal processing, and loan terms to create a streamlined, market-relevant competitive offering while ensuring that impacts to investors are minimal, and include in term sheet (described below). 2) Generate cost savings and impacts for borrowers, seller/servicers, and Freddie Mac, and include in term sheet (described below) or associated marketing materials.

securitization. **Product parameters** ▪ Borrowers for smaller transactions prefer offering parameters that are typically specific to the small property market. **Lender acceptance** ▪ The level of effort to finance a small property is just as much as to finance a large property, but typical lender compensation structures do not reward them equally for their efforts. This compensation structure creates a disincentive to pursue financing for small properties. **Borrower and property features** ▪ The borrower set for this offering may be different than the traditional Freddie Mac affordable borrower. ▪ The properties originated through this offering will most likely be smaller and pose different challenges as it relates to economies of scale than larger properties.	3) Develop and/or update legal document infrastructure to allow for efficiency to the borrower and security for the investor. Legal documents will include at least the following: a. Commitment Letter b. Loan and Security Agreement c. Note d. Guaranty 4) Publish an official product term sheet on our website that identifies the product and the acceptable terms. Term sheet will contain at least the following elements: a. Product overview and loan purpose b. Sponsor and/or property eligibility requirements c. Loan-to-Value limits d. Debt coverage limits e. Allowable lengths of loan term f. Allowable lengths of amortization g. Areas of streamlined processing 5) Engage all TAH seller/servicers to offer this product with appropriate compensation structure to incentivize them to finance small Section 8 properties 6) Provide one to three training sessions via webinar or in person as appropriate to provide seller/servicers with clear guidance to originate transactions under the new offering.
Resource Challenge	**Freddie Mac Action**
▪ Multiple resources from various teams within Freddie Mac will be essential to ensure success of the actions outlined above. ▪ Legal document infrastructure needs to be created, requiring multiple resources including, but not limited to internal counsel, underwriting, production, and servicing teams	**Year 1 – 2018** 1) Implement an internal working group to ensure that all resources are allocated appropriately and alignment is maintained throughout the creation of the new loan product.

Market Impact

Creating a new offering that provides an innovative solution to originate small, simple, Section 8 transactions will enable borrowers to more cost-effectively preserve long term affordability. The relative time and cost involved in smaller transactions often make it harder to preserve these properties as affordable. We anticipate the reduction in financing costs could reduce the rents required to operate the property and, therefore, reduce the amount of subsidy required per property or enable borrowers to make more property improvements that enhance the living conditions of the tenants. This will thereby stretch federal funding further and preserve the long-term affordability of the property well into its extended use period. This offering, particularly in a rising rate environment where a reduction in financing costs can offset an increase in rates, will be significant to the market.

This offering will provide borrowers a new standard in financing for these properties. The current available financing options from local and community banks provide shorter term loans (usually no more than five years, as opposed to our 10- or 15-year loans), which makes it difficult to preserve long term affordability. Repeated short-term loans also increase overall financing costs on the property—in order to get the same length of debt available with Freddie Mac, a borrower would have to seek financing with local banks two or three times—and give borrowers more opportunities to reexamine their financing and sell the property or convert it to market rate. Our offering will counter that.

Although this offering will introduce unique efficiencies, we believe that this offering will still maintain the high credit quality and underwriting standards and preserve the safety and soundness of the market. Indeed, maintaining strong credit standards will better enable us to attract private capital investors to support this part of the market and allow us to leverage our industry leading risk distribution methods that protect taxpayers from undue risk and promote safety and soundness.

Activity 3 – HUD Rental Assistance Demonstration Program: Regulatory Activity

HUD's Rental Assistance Demonstration (RAD) was established in 2011 to help convert at-risk public housing properties into project-based vouchers or rental assistance contracts under the Section 8 program. The net effect is to convert public housing projects into privately financed, government-subsidized properties using the Section 8 program. The goal is to preserve long-term affordability and renovate and improve obsolete affordable rental housing stock. This voluntary conversion gives public housing authorities more flexibility to access private and public funding sources. The majority of RAD transactions require LIHTC equity and/or soft subordinate debt in order to support the property rehabilitation.

RAD has two components. Component 1 focuses on converting and rehabilitating public housing properties, as described above. Component 2 addresses a different set of properties through the conversion of Section 8 Moderate Rehabilitation, Rent Supplement and Rental Assistance Payment properties. Freddie Mac is active in both components of the RAD program, and is the leading provider of financing for RAD generally.

We support the RAD program with many of our loan products, the most relevant of which are these:

- Tax-Exempt Loan, particularly with our forward commitment feature
- Preservation Rehab Loan
- Bond Credit Enhancement
- 9 percent new LIHTC Loan

In addition to these particular debt products, we are able to leverage our industry leading risk distribution measures for tax exempt financing—the M and ML series securitizations—to attract private investment to support affordable housing and distribute risk away from the taxpayers.

RAD has a cap on the total number of units eligible for conversion. Congress initially authorized HUD to convert 60,000 units under RAD after a pilot of 12,000 units. In 2015, this cap was raised to 185,000 units for Component 1, which focuses on public housing properties. However, this cap has been fully subscribed and additional properties have been placed on a waitlist. Importantly, additional units cannot be converted under Component 1 without congressional authorization.

In 2017, this cap was raised by 40,000 units from 185,000 to 225,000.[97] While this increase may lead to a near-term increase in RAD conversions started, we do not expect to see a near term increase in permanent debt on RAD conversions. This is because, even for shovel-ready projects, there is a multi-year construction period where construction financing is required, not permanent debt.

Freddie Mac has the capacity to forward commit to provide permanent takeout financing on RAD conversions once the construction period ends and the property stabilizes. Construction and rehab periods tend to last up to three years, especially when substantial work is involved across many large buildings. Therefore, it is unlikely we will see a material change in the number of RAD properties ready for permanent debt during this first Duty to Serve Plan term.

Although Component 2 does not have a cap, conversions are constrained by the availability of Section 8 Tenant Protection Vouchers, which are partially tied to congressional authorization.[98] The vast majority of Rent Supplement and Rental Assistance properties have already been converted. Per HUD's RAD Winter 2017 Newsletter, since 2011, 80 percent of the Rent Supplement and Rental Assistance Program units have converted under RAD. This results in only 62 remaining properties.[99] Consequently, we do not foresee a sizeable market for future purchases.

Many of the major cities with interest in RAD have already taken advantage of Component 1 rehabs that can be done in a manner that is cost neutral to HUD. Generally, forthcoming conversions will need to rely on other subsidies, which are not consistently available. Therefore, future RAD transactions will be increasingly hard to put together and execute. Additionally, at least in the near term, reduced LIHTC equity pricing and increased interest rates have a dampening effect on RAD transactions.

Freddie Mac has been committed to supporting RAD since its inception and has become the top RAD lender in the market overall. Among the total of 28 GSE-supported RAD properties through 2016, we have purchased loans on 24 for a GSE market share of 96 percent. We welcome the increase of the cap on RAD conversions and look to continue our support through loan purchases over time, even as transactions become more challenging.[100]

OBJECTIVE A: PROVIDE LIQUIDITY AND STABILITY THROUGH RAD LOAN PURCHASES

Evaluation Area	Year	Incomes Targeted	Extra Credit
Loan Purchase	**1, 2 and 3**	**VLI, LI, MI**	**Not applicable**

Freddie Mac has been an important source of debt financing for RAD transactions. Given our substantial GSE market share and the overall potential for market growth, we caution that there is not much room for further growth in real terms without growing market share and taking transactions from other market participants. In RAD, there is not a materially greater market share we can capture. Should other market participants seek to increase their loan purchases, they would likely need to take market share from Freddie Mac. Given the breadth and depth of our investment and experience and the consistency we provide, the only way for other participants to do this would be to loosen credit standards and/or reduce price significantly. Either or both of these measures have the potential to run contrary to safety and soundness and distort the mid- and long-term health of the market in favor of short-term gains.

Our support has included involvement in the largest, most innovative RAD portfolios, namely those in El Paso, Texas, and San Francisco, California. From 2014 through 2016, we purchased a total of nearly $270 million of RAD loans supporting nearly 3,200 units across 24 properties.

These major RAD portfolios have taken full advantage of the certainty of execution and liquidity our forward Tax-Exempt Loan offering provides. Without this forward commitment from Freddie Mac, there would likely be less construction financing and LIHTC equity available for RAD conversions because there would be fewer viable options for permanent debt, especially at the substantial scale of transactions such as those in San Francisco and El Paso.

Based on our outreach through conferences, discussions with developers, public housing authorities, state and local housing finance agencies, as well as our experience, we expect to see significantly fewer new RAD units converted going forward, especially over the next several years, as the pace for conversions slows for several reasons:

1. Major cities such as El Paso and San Francisco with cost-neutral rehabilitations have received their awards and Freddie Mac financing has been applied.
2. Property portfolios pursuing RAD will be smaller, with fewer units and a greater need for soft debt.
3. The majority of RAD transactions require tax credits and/or soft debt. Given reduced LIHTC pricing and higher interest rates, we anticipate RAD transactions will be harder to close because less debt will be supportable by the property at higher interest rates.

4. A significant portion of Component 2 properties has already been converted.
5. The cap for Component 1 was just raised by 40,000 units from 185,000 to 225,000 in mid-2017, so new construction is not likely to start until 2018 at the earliest as new projects are approved or moved from the waiting list. Consequently, permanent debt loan purchases would not occur on these properties until up to three years after construction is started.

Given the importance of RAD in improving the living conditions of so many people in public housing, combined with the challenges it will face in the coming years, it is important that Freddie Mac continue to provide liquidity and stability.

Consistent with safety and soundness concerns, our support will be relative to the likely size of the market.

Baseline

In setting our baseline, we counted distinct units and properties on which we purchased loans during the year in question through our TAH retail seller/servicer network or via TAH negotiated transactions on individual mortgages. In the prior three years, our market leading support for RAD through permanent debt has been as follows.

	2014	2015	2016	Three-Year Avg.
Total Loan Amount	$0	$119.3MM	$149.4MM	$89.5MM
Units	0	1,590	1,648	1,079
Properties	0	14	10	8

This leads to a three-year average baseline of support for RAD of $89.5 million of loans supporting 1,079 units across eight properties.

Target

The nature of RAD conversions is such that permanent debt committed today would not be funded until the construction or major rehab is completed and the property has stabilized. This means that even though the cap has been raised, over the next three years, we would not expect to see many new permanent debt loans being made or purchased by us or any other lender. Rather, the industry is completing projects committed in prior years while the cap was in place. We do not expect to see much new permanent debt in place until 2020 at the earliest, though more is likely in 2021.

Based on construction starts in the preceding three years that are expected to convert to permanent debt in the coming years, as well as the market constraints described above and below, we can expect to see fewer units supported in 2018, then an increase in 2019 as previously approved projects receive permanent financing, followed by a decrease again in 2020, and then an increase again in 2021 and beyond. The cap having just been raised, there is potential for new RAD conversions to take place, with permanent debt as early as 2020, but we do not expect to see requests for forward commitments until 2018, at the earliest, leading to construction completion in late 2020 and 2021, or even later. Indeed, based on our own experience, it can take six months or more for a property and developer to get RAD approval and financing lined up, and construction can even take up to 42 months, which means that four years could elapse from approval date to construction completion before any permanent debt is placed on the property. Additionally, we expect these properties to be smaller and more heavily reliant on various forms of public subsidy, and therefore harder to finance.

Therefore, we believe providing financing for the lesser of 750 units or 10 properties in 2018, and the lesser of 2,000 units or 15 properties in 2019 followed by a decrease to the lesser of 500 units or five properties in 2020, constitutes an aggressive and meaningful target. In setting our targets, we will count distinct units and properties on which we purchase loans during the year in question through our TAH retail seller/servicer network or via TAH negotiated transactions on individual mortgages.

	2018	2019	2020
Target	The Lesser of 750 Units or 10 Properties	The Lesser of 2,000 Units or 15 Properties	The Lesser of 500 Units or 5 Properties

It is our intention to continue to play a leadership role in RAD, and our purchase targets reflect that goal, relative to the availability of properties and units to finance. Indeed, it is not our desire to do less RAD business in 2020. Rather, this reduced target is simply a reflection of the smaller available market size at that time. Our targets may be adjusted upward or downward annually based on market conditions, such as market reactions to tax changes or faster than anticipated project starts and forward commitments.

We anticipate reaching these goals by leveraging our seller/servicer network and core products, which have already proven to be successful in the RAD market.

Challenges

RAD properties are some of the hardest to rehabilitate and finance effectively. This is due to several factors:

1. The RAD use agreement restricts lender remedies in the event of foreclosure.
2. Historically, HUD's budget for public housing has shrunk, leading to underinvestment in and deterioration of public housing properties.
3. Many properties in the RAD program have troubled history, including high vacancy rates, a history of public safety issues, and a tenant population that often needs various social services in addition to housing.
4. RAD transactions take a great deal of time to put together due to the approval process, layered financing, and individual program requirements.
5. Housing authorities often seek assistance from experienced developers and consultants, but there is a limited number of developers who have a demonstrated history of success.

In addition to these, many of the approved and economically viable RAD projects have already had financing applied or committed, often by Freddie Mac. As such, there is not likely to be significant growth in the RAD permanent debt market until new projects are approved and construction is completed.

Additionally, LIHTC equity pricing and interest rates are having an impact on the viability of new projects getting underway. In 2017 tax-credit pricing has reduced from historic highs of about $1.03 per credit in mid-2016 to $0.95 in mid-2017 per *Affordable Housing Finance*'s survey of syndicators.[101] In a hypothetical transaction with $10 million of debt and a need for $6 million of equity, this reduction in tax credit pricing equates to a $480,000 funding gap, which would require additional tax credits or soft debt to close.

Increased interest rates have a direct effect on how much debt a property can support, and therefore how much LIHTC equity or soft debt is required. In 2016, interest rates were at historic lows. For example, over the course of 2016, the 10-year Treasury index had an average high for the year of 187 bps and an average low of 180 bps. In 2017 through July, the 10-year Treasury index had an average high for the year of 237 bps and an average low of 232 bps. Using roughly a 50 bps difference in rate we can see the effect on a hypothetical property: if a property qualified for a loan amount of $10 million, a 50 bps increase in the 10-year Treasury index would mean that property would only qualify for about $9.44 million at the higher interest rate. This means that property would

require an additional $560,000 of equity or soft debt in order to receive financing. This gap would be in addition to the gap caused by reduced LIHTC pricing. The combined effect of higher interest rates and lower equity pricing would be over a $1 million gap in funds to fill. As a result of gaps like this, states are channeling their own funds into these transactions as subordinate debt. Given the limited funds available to states, by providing more money for individual transactions, they are not able to support as many properties.

Indeed, as 2017 has progressed, we saw more and more examples of large scale LIHTC market disruption, two of which particularly highlight the impact:

1. On March 15, 2017, the California Tax Credit Allocation Committee (TCAC) passed a resolution allowing developers to exchange their 2016 9 percent LIHTC allocation for 2017 LIHTCs. Given delays in finding equity investors, developers found it impossible to close in time to complete construction by the end of 2018 (LIHTC deals must be "placed in service", meaning 100 percent construction completion and receipt of the certificate of occupancy, by the end of the second year after receiving a LIHTC allocation).

2. In the Midwest, the Ohio Housing Finance Agency (OHFA) had to increase the allocation of LIHTC to deals awarded in 2016 because developers were not getting sufficient equity pricing to allow the deals to be economically feasible. Unfortunately, the additional credits had to come from the 2017 allocation, thus reducing the 2017 pool by approximately 12 percent.

As a result of this disruption, in the first half of 2017, there were 16 percent fewer new acquisitions compared to the first half of 2016 per *Affordable Housing Finance*'s survey of syndicators.[102]. We expect the market to remain smaller for some time unless interest rates experienced a sustained reduction and either tax code changes or revisions to the LIHTC program are made, either of which could further affect the market.

Market Impact

The combination of the challenges described above creates a highly difficult market to support, and underscores the deep commitment and substantial impact Freddie Mac has already had in providing liquidity, stability, and certainty of execution to Public Housing Authorities around the country. In fact, when the RAD program was created, we recognized its importance and the role we could play in making this market work effectively. Our continued presence as permanent debt provider through our forward Tax-Exempt Loan (TEL) product emphasizes to construction lenders and housing authorities that there is a stable source of permanent takeout financing, ready to commit in advance. This gives certainty to the construction lender and provides liquidity to the market for construction and major rehab projects. In turn, the construction lenders are more willing to lend, and can lend at lower rates. While the market has been constrained by the federally mandated cap on units eligible for conversion, over time, the permanent debt market will grow again as more cap space is allotted and new projects reach stabilization. Without our continued support and market leadership, this market would likely not function nearly as efficiently as it does today, or as it will.

Additionally, TEL is the most efficient, cost effective, and predictable tax exempt execution in the market, and that combination of virtues is especially important for RAD. While there are many associated challenges and uncertainties with RAD, as described above, the availability of cost effective permanent debt, at least, need not be one of them. Through our TEL, we are also able to distribute risk away from taxpayers with our market leading ML securitization execution. This is the most comprehensive risk distribution method in the tax-exempt market. It enables us to provide attractive financing and flexible terms to borrowers, attract private capital to support public good, all while protecting the taxpayer and maintaining safety and soundness.

The result of this is a clear benefit to tenants—improved living conditions as units are rehabilitated, services provided, and more safe, decent and affordable housing is preserved for those most in need.

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FHFA's Compilation of Snapshots from Fannie Mae's Duty to Serve Plan: Multifamily Rental Production

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A. Statutory Activity: Section 8. The project-based and tenant-based rental assistance housing programs under Section 8 of the U.S. Housing Act of 1937, 42 U.S.C. § 1437f.

1. *Objective #1: Purchase loans secured by properties served by the Section 8 program (Do What We Do Best).*

Meeting the Challenges
Section 8 properties have several key challenges, including: • Approximately 487,000[1] low-income units with Section 8 subsidies that will expire during the Plan and are at risk of being permanently lost from the affordable housing market. • The number of units with expiring Section 8 subsidies annually during the Plan will be decreasing from 169,000 to 151,000. To address these challenges, Fannie Mae will: • Provide liquidity to the market by increasing its purchase of loans that support Section 8 units during the Plan. • Serve as a stable liquidity provider for the preservation of Section 8 housing.

SMART Factors
Fannie Mae will undertake the following measurable Actions in the years indicated.

Year	Actions
2018	• Purchase loans secured by Section 8 properties that support 25,350 units, representing approximately 15 percent of the estimated 169,000 units with Section 8 subsidies expiring in 2018, a market share increase of five percent over Fannie Mae's Baseline of 10 percent of the total of number of units with expiring Section 8 subsidies. ○ **Baseline**: Between 2014 and 2017, Fannie Mae's purchase of loans secured by Section 8 properties supported an average of 15,748 units per year (2014: 13,400 units; 2015: 11,517 units; 2016: 18,272 units; 2017: 19,804 units). During the same time frame, an average of 152,250 Section 8 units expired annually (2014: 172,000; 2015: 119,000; 2016: 181,000; 2017: 137,000). Thus, Fannie Mae purchased loans that supported an average of 10 percent of the annual expiring Section 8 units between 2014 and 2017. Accordingly, Fannie Mae is using this average "market share" of expiring Section 8 units that it financed since 2014 as the Baseline. • Confirm loan purchase goals for 2019.
2019	• Purchase 158 loans secured by Section 8 properties[2] an increase of approximately 25 percent over Fannie Mae's Baseline of 126 loans. ○ **Baseline**: Between 2014 and 2017, Fannie Mae's acquired an average of 126 loans per year (2014: 120 loans; 2015: 85 loans; 2016: 144 loans; 2017: 153 loans). While the average loan purchases for this time period is less than the number of loans we acquired in 2016 and 2017, we believe these

1 This figure includes approximately 110,000 units each year that have either annual Section 8 subsidy renewals or existing subsidies from the prior year.
2 Consistent with the methodology used for FHFA Scorecard reporting, if at least 50% of the units are affordable at 100% AMI we will count the whole loan if fewer than 50% of the units are affordable at 100% AMI we will count ½ the loan.

Year	Actions
	acquisitions represent atypical record years in purchase volume. Due to the market headwinds and challenges described above, we anticipate the market for debt on Section 8 properties will be smaller than it was in these years. • Confirm loan purchase goals for 2020.
2020	• Purchase 151 loans secured by Section 8 properties, representing an increase of approximately 20 percent over Fannie Mae's Baseline of 126 loans. • Plan for the 2021 – 2023 Duty to Serve Plan.

Fannie Mae has regularly reviewed the preservation databases of HUD and others for market information and will continue to do so in order to confirm annual volume. According to recently updated data from the National Housing Preservation Database, approximately 487,000 low-income units with Section 8 subsidies are expiring during the three-year term of the Plan. Fannie Mae has a long history of purchasing loans secured by Section 8 properties and may rely on our traditional lender partners to continue to originate these transactions. Based on this experience and the currently available resources, Fannie Mae has determined that this Objective is realistic and may be achieved within the time periods described. Any changes to guidelines for Section 8 loan purchases and the purchases of the loans themselves will be subject to internal processes and review incorporating notions of safety and soundness.

Criteria	2018	2019	2020
Evaluation Factor:	Loan Purchase	Loan Purchase	Loan Purchase
Income Levels:	Very Low-Income Levels for all Years		

B. Statutory Activity: The supportive housing program for the elderly under Section 202 of the Housing Act of 1959, 12 U.S.C. § 1701q.

1. *Objective #1: Consider loan product changes, prepare work-plan, and purchase Section 202 loans (Analyze, Do What We Do Best).*

Meeting the Challenges
Financing Section 202 properties has several key challenges, including: • Between 2017 and 2021, the total maturing direct loans on Section 202 properties amount to nearly $210,000,000 on approximately 27,600 units. • Section 8 rents on older Section 202 properties are above market, but under Fannie Mae's current Section 8 underwriting guidelines the portion of the rent above market is not allowed to be underwritten. • Given the age of most Section 202 properties, the amount of rehabilitation required can be extensive, however not underwriting the above market portion of the rent results in inadequate proceeds for the rehabilitation. • Section 202 properties developed since 1991 using a capital grant program are also in need of rehabilitation and preservation. To address these challenges, Fannie Mae will:

Meeting the Challenges
• Identify and review two potential product enhancements to our existing affordable housing preservation products to increase Section 202 loan purchases. • Examine the capital needs for Section 202 properties that were not financed by a direct loan. • Proactively purchase loans secured by Section 202 properties.

SMART Factors
Fannie Mae will undertake the following measurable Actions in the years indicated.

Year	Actions
2018	• Create one Section 202 market analysis that addresses a wide variety of issues (e.g., expiring/maturing loans, loans eligible for prepayment, post 1991 construction property issues, identification of key owner operators, market conditions, Delegated Underwriting and Servicing (DUS)® lender appetite for financing and experience and geographic exposure). Fannie Mae will use this analysis to determine our most effective role and approach to preserve Section 202 properties. Fannie Mae will focus initially on Section 202 direct loan properties, but will include other types of Section 202 financing as part of our market analysis. • Review Fannie Mae's underwriting guidelines regarding above market Section 8 rents and other relevant Section 202 factors identified in the market analysis. • Based on the market analysis and the review of the underwriting guidelines, identify and approve one product enhancement which will increase Fannie Mae's ability to purchase Section 202 loans. • Implement product enhancement(s) by training three lenders who finance Section 202 loans to offer the product enhancement(s) and market the enhanced product to preservation stakeholders. • Implement operational changes in Fannie Mae's systems that will provide for the tracking of Section 202 loans. • Identify one potential portfolio refinance opportunity and determine whether it can be utilized. • Based on the work completed during 2018, confirm 2019 Baseline and loan purchase goals.
2019	• Finance 1,300 Section 202 units, representing 4.1 percent of Fannie Mae's Section 8 unit goal in 2019. o **Baseline**: Fannie Mae does not operationally track Section 202 unit financings so it is unable to identify our previous Section 202 unit financings over the last three years to establish a Baseline. Section 202 financing requests that lenders bring to Fannie Mae are delivered as "Section 8 preservation" loans that meet Fannie Mae's Section 8 underwriting guidelines; in other words, these loans are not identified as Section 202 properties which is why Fannie Mae does not have information regarding the historic number of Section 202 properties in our book. In order to estimate a proxy Baseline for Section 202 loans, Fannie Mae reviewed the Preservation Database (2017 update) to determine the proportion of Section 8 loans that are Section 202 properties and apply that ratio to Fannie Mae's targeted Section 8 loan purchase goals. While not perfect, as it infers that the expiring 202 units are a uniform percentage of expiring Section 8 units each year, it gives Fannie Mae a reasonable order of magnitude for estimating initial loan purchase goals. The 2017 Preservation Database indicates that Section 202 loans are approximately 4.1 percent of all Section 8 loans. Accordingly, Fannie Mae is establishing our Section 202 unit financing goal as 4.1 percent of our 2019 Section 8 unit financing goal (31,730 units), or 1,300 Section 202 units. As noted above, Fannie Mae will confirm the estimated Baseline and loan purchase goals as part of our product development work in 2018.

Year	Actions
	• Continue to conduct outreach to key stakeholders in Section 202 to update and adjust strategy as needed. • Confirm 2020 loan purchase goals.
2020	• Finance 1,238 Section 202 units, representing 4.1 percent of Fannie Mae's Section 8 unit goal in 2020.

The market opportunity for financing Section 202 units needs to be defined more precisely. However, several of Fannie Mae's traditional lender partners have significant experience in Section 202 refinance and there is current information available from HUD regarding the existing properties that have expiring subsidies in the next three years. Based on this information, the experience of our lenders and the available resources, Fannie Mae has determined that this Objective is realistic and may be achieved within the time periods described. Any changes in underwriting guidelines or credit risk standards and all loan purchases will be supported by thorough economic, risk, and operational analyses and will be subject to Fannie Mae's governance and approval processes, and will only be made consistent with safety and soundness concerns.

Criteria	2018	2019	2020
Evaluation Factor:	Loan Product	Loan Purchase	Loan Purchase
Income Levels:	Very Low-, Low-, and Moderate-Income Levels for all Years		

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J. Regulatory Activity: HUD Rental Assistance Demonstration (RAD) program (12 C.F.R. § 1282.34 (d) (6)).

1. *Objective #1: Conduct outreach, review potential loan product enhancements, and purchase loans secured by RAD properties (Analyze, Test and Learn, Do What We Do Best).*

Meeting the Challenges
Financing RAD properties has several key challenges, including: • Properties converting into a RAD structure are located in low-income communities that have significant challenges not directly tied to the property. • Because HUD is on both sides of the transaction (i.e., managing both the subsidy and the debt through FHA), developers often opt for FHA financing in the belief that it is more advantageous. • There is a wide range in size and capacity of Public Housing Authorities (PHA) and other parties to the transaction which lenders need to understand to assess counterparty risk. • While combining properties into a single loan could be cost beneficial, transactions must reflect unique property ownership characteristics. To address these challenges, Fannie Mae will: • Meet with key stakeholders including PHA, State HFA, and non-profit and for-profit developers to determine what, if any, product enhancements or other changes are needed to Fannie Mae's current RAD product to increase loan purchases. • Establish a PHA Advisory Council to provide insight and guidance to Fannie Mae as we address long term solutions for RAD and other PHA issues. • Increase loan purchases of mortgages secured by RAD properties.

SMART Factors
Fannie Mae will undertake the following measurable Actions in the years indicated.

Year	Actions

2018	• Conduct outreach to five key RAD stakeholders including PHA, State HFA, and non-profit and for-profit developers to determine challenges and possible solutions to increase RAD business.
	  ○ Establish a PHA Advisory Council to provide insight and guidance to Fannie Mae on RAD and other public housing issues.
	  ○ Ensure that the PHA Advisory Council includes PHA representation from diverse geographies and of different sizes so that Fannie Mae can better understand the varying needs across the country.
	• Conduct outreach and marketing to five Fannie Mae affordable lenders to (1) understand any issues with Fannie Mae's current RAD product and (2) enhance the lenders' knowledge of Fannie Mae's RAD program.
	• Utilize outreach responses to consider two changes to and/or incentives for the RAD financing product.

Year	Actions
	• Purchase loans secured by six RAD properties[1], representing a 100 percent increase over the Baseline. ○ **Baseline**: Fannie Mae did not have a product that provided for the purchase of these loans until 2016 and then did not start tracking these purchases until 2017. Accordingly, Fannie Mae is using our 2017 purchases of three loans, each secured by one RAD property, as the Baseline for this activity. • Review and adjust 2019 loan purchase goals as needed based on work completed in 2018.
2019	• Continue to conduct outreach to determine challenges and possible solutions to increase RAD business through quarterly PHA Advisory Council meetings. • Purchase loans secured by 10 RAD properties, representing a 233 percent increase over the Baseline. • Review and adjust 2020 loan purchase goals as needed based on work completed in 2019.
2020	• Purchase loans secured by 20 RAD properties, representing a 567 percent increase over the Baseline. • Review experiences with RAD program financing to inform the 2021 – 2023 Duty to Serve Plan.

The information gathered through outreach, analysis, and market research will help Fannie Mae determine potential product enhancements and/or marketing approaches necessary to increase our RAD business, which in turn will increase liquidity for very low-income housing. Fannie Mae actively established our guidelines for RAD financing over the last two years and has continued to track the RAD program and seek ways to increase our loan purchases secured by RAD properties.

As of January 1, 2017, there were roughly 127,500 units under the RAD program for which financing was likely to be sought. Additionally, the cap was increased to 225,000 (from 185,000 initially) units in May 2017. To date, Fannie Mae has engaged in several RAD transactions. In the past, volume has been limited largely due to the fact that many RAD deals were in process with FHA. However, the pace of conversion has increased significantly since FY 2015, when roughly 13,000 units converted. As of the end of April 2017, RAD units were converting at an annualized rate of roughly 35,000 (280 projects assuming 125 units/project) per year, with roughly 129,000 units remaining to be converted. HUD's data indicates that approximately 37 percent of RAD units will not require debt, but that nonetheless leaves roughly 80,000 units (640 projects assuming HUD's average of 125 units/project) that will need some kind of debt financing as they go through the RAD program. This would suggest that the bulk of the RAD units currently authorized and awarded will likely seek financing over the three year term of the Plan.

Based on our experience with RAD financing and similar products, Fannie Mae has determined that this Objective is realistic and may be achieved within the time periods described. Financing of RAD loans will be conducted subject to applicable underwriting guidelines and credit standards that incorporate notions of safety and soundness. Any changes to these guidelines or standards will be processed through Fannie Mae's standard internal approval procedures which also incorporate notions of safety and soundness.

Criteria	2018	2019	2020
Evaluation Factor:	Loan Purchase	Loan Purchase	Loan Purchase
Income Levels:	Very Low-, Low-, and Moderate-Income Levels for all Years		

1 One loan may be secured by multiple properties.

DISCLAIMER

Implementation of the activities and objectives in Fannie Mae's and Freddie Mac's Duty to Serve Underserved Markets Plans may be subject to change based on factors including FHFA review for compliance with the Charter Acts, specific FHFA approval requirements and safety and soundness standards, and market or economic conditions, as applicable.

Updated January 2019