September 18, 2009

Alfred M. Pollard
General Counsel
Attention: Comments/RIN 2590–AA27
Federal Housing Finance Agency
Fourth Floor
1700 G Street, NW
Washington, DC 20552

RE: RIN 2590–AA27, Advance Notice of Proposed Rulemaking on the Duty to Serve Underserved Markets for Enterprises

Dear Mr. Pollard:

The Local Initiatives Support Corporation is pleased to have the opportunity to respond to the Federal Housing Finance Agency's request for comments published in the *Federal Register* on August 4, 2009. The Advance Notice of Proposed Rulemaking seeks input on the types of activities that should be evaluated and method of evaluation for Fannie Mae and Freddie Mac's Duty to Serve Underserved Markets.

LISC is a national nonprofit intermediary that is dedicated to helping community residents transform distressed neighborhoods into healthy and sustainable communities of choice and opportunity. LISC mobilizes corporate, government and philanthropic support to provide local community development organizations in both urban and rural areas with: loans, grants and equity investments; local, statewide and national policy support; and technical and management assistance. Our Affordable Housing Preservation Initiative supports these efforts by facilitating the preservation of affordable rental apartments whose uses are in jeopardy because of expiring federal subsidies, or for other reasons. In this regard, LISC helps nonprofit community development corporations acquire and preserve housing developments, builds partnerships with housing authorities and other organizations, and advocates for government policies that can reduce the loss of affordable homes and apartments.

LISC strongly supports the efforts of Congress and FHFA to expand the mission regulation of the Government Sponsored Enterprises (GSEs) beyond the affordable housing goals that have been in place since 1992. While those goals were effective at increasing the GSEs' attention to affordable housing issues, they have not by themselves been able to ensure that the GSEs focus

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their attention on the Nation's most pressing housing needs. The Housing and Economic Recovery Act (HERA) refined the affordable housing goals while adding additional requirements, including the Duty to Serve Underserved Markets and the requirements to contribute to the Housing Trust Fund and the Capital Magnet Fund.

The Duty to Serve requirements are unique and should be treated differently than the housing goals. The housing goals are measures of volumes and shares of business meeting certain characteristics, and performance on the goals is often a reflection of the overall movements in the marketplace upon which the GSEs may or may not have had any influence. The Duty to Serve provisions should be focused more on the specific efforts that the GSEs make toward helping solve complex financing issues as well as the outcomes of those specific efforts. LISC believes that it will be important to focus on three types of efforts:

- Deal Level: individualized or "one-off" assistance for certain transactions
- Pilot/Variance Level: special pilots or variances that are applicable only to small portions of the market such as individual seller-servicers or geographies
- Product/Guide Level: more fundamental reforms that are broadly applicable to all geographies and all sellers and borrowers

While Product/Guide level reforms are an important end goal that may be reached for some of the activities covered under the Duty to Serve, the first two types remain necessary to help overcome some of the obstacles that difficult transactions face and often can provide stepping stones to more fundamental reforms. All three of these types of efforts should be measured and evaluated for the Duty to Serve Underserved Markets.

Because the Duty to Serve involves the *effort* of the GSEs, FHFA should not focus solely on measurement of the results in quantitative ways. Some quantification is necessary and desirable, but, as more specifically noted below, a qualitative assessment of the value to the market and the public purpose served by their actions should be the core of the evaluation.

It is important to note that these comments are in response to FHFA's efforts to implement the Duty to Serve elements of HERA as they apply to Fannie Mae and Freddie Mac. Given the likelihood of future changes relating to the GSEs, we believe these duties should apply to all entities that participate in the secondary mortgage market and/or that bundle, securitize, and sell mortgage backed securities.

Below we provide comments on the specific subject areas as requested in the Notice.

A. Overview

FHFA is seeking comment on whether there are certain categories of mortgages for which the GSEs should not receive credit under the Duty to Serve. One such category that FHFA should consider excluding is investments in private label securities. The mortgages funded through these investments in the past did not typically comply with GSE lending standards and the investments do not require substantial effort on the part of the GSEs to transform the market, in contrast to the expectations under the Duty to Serve. However, a GSE should be able to obtain credit for such investments if it can show that the investments are serving a particular acute need within the underserved markets, and if the mortgages purchased through the investments can be proven to comply with all of the otherwise applicable responsible lending standards.

LISC agrees with FHFA's intention to exclude HOEPA mortgages, mortgages with unacceptable terms and conditions, and mortgages resulting from unacceptable practices, as is currently done for the housing goals. In order to ensure that enough of a deterrent is in place, it may be necessary to actually give negative credit for any of these types of mortgages purchased in the areas covered by the Duty to Serve. FHFA should also make sure that the list of unacceptable terms, conditions, and practices is up to date with the most recent lessons from the mortgage crisis, and that sufficient guidance is provided to the GSEs on how to ensure that they are not purchasing mortgages with these characteristics.

B. Underserved Markets

Affordable Housing Preservation

LISC's preservation initiative focuses primarily on projects subsidized by HUD and USDA, however unsubsidized projects that have guarantees of long term affordability for residents are also included. We consider preservation to include not only a transaction in which a property is explicitly at-risk due to loss of a subsidy or use agreement, but also transfers and recapitalizations of existing affordable housing that is at-risk of loss due to deterioration, obsolescence, or mismanagement. For these projects, the injection of new funds can help ensure the long-term availability of the housing and/or improve its impact on the residents, the environment, and the surrounding community.

Affordable Housing Program Types

The GSE role in affordable housing preservation is multi-faceted, as are the programs that are involved in the preservation of affordable rental housing. The HERA legislative language and the Notice include a list of programs that have produced affordable housing over the past several decades. Below we provide a discussion of these programs and the ways in which the GSEs can

provide meaningful assistance. The details of many of these programs and the preservation challenges they face are discussed more fully in LISC's publications[1], including *Stemming the Tide: A Handbook on Preserving Multifamily Subsidized Housing; Recapitalizing Affordable Rental Housing: A Handbook for Nonprofit Owners*; and *Preservation of Affordable Rural Housing: A Practitioner's Guide to the Section 515 Program.*

- Section 8 Assistance: By far the most common subsidy program involved in preservation transactions today is project-based Section 8. The GSEs provide debt and equity for many affordable multifamily transactions, and flexible and sound standards are needed for underwriting the Section 8 rental income for these properties. Current underwriting practices penalize the properties for what is known as appropriations risk, or the theoretical possibility that Congress could fail to appropriate funds during the term of the Section 8 contract, even for contracts that extend as long as 20 years. Likewise, the assumptions used to underwrite tenant-based Enhanced Vouchers are critical to financial feasibility of preservation transactions. The GSEs could look to the standards established by the Federal Housing Administration (FHA) as a starting point for some of the flexibilities that would benefit the broader market for preservation transactions. For example, when FHA underwrites a project with a renewed Section 8 contract, it will recognize the renewed Section 8 rents for at least as long as the Section 8 Housing Assistance Payments (HAP) contract term, even though an appropriations failure would result in risk to the FHA mortgage insurance fund. Some specific suggestions for underwriting practices that would benefit Section 8 properties are included in the next section.

- Older Mortgage Subsidy Programs: The 221(d)(3) BMIR[2] program was a low-interest loan program that provided a mortgage subsidy for affordable housing properties. Section 236 projects were financed directly by private lenders or housing finance agencies, but receive a stream of income known as Interest Reduction Payments to reduce the effective interest rate on the mortgage to one percent. The Section 202 program for seniors housing began as a subsidized direct loan program before it transitioned to a market rate loan with Section 8 rental assistance in the 1970s, and then finally to a capital grant in the 1990s. These programs all had original mortgages with terms of 40 years, many of which were prepayable after year 20. The bulk of these properties (those which have not yet prepaid) are reaching the end of their 40 year mortgages between 2011 and 2015, at which point the owners will no longer be held to the affordability restrictions. Refinancing or transferring these properties in a manner that retains the affordability for current tenants

[1] All of these publications are available for download from LISC's Online Resource Library at www.lisc.org.
[2] Housing financed under Section 221(d)(4), which provided market rate loans to both for profits and nonprofit owners, is not an affordable housing mortgage subsidy program. However, nonprofits and limited dividend owners financing housing under the related Section 221(d)(3) program were eligible for a Below Market Interest Rate (BMIR) loan in return for providing affordable rents for the 40-year term of the loan. We believe it was the intent of Congress to focus on the preservation needs of this 221(d)(3) BMIR program.

is a major challenge facing the affordable housing community, and flexible debt and equity financing at the point of recapitalization is key to preserving these properties.

Many of these older assisted projects with subsidized mortgages also have project-based Section 8 assistance on all or a portion of the units as a result of the Loan Management Set Aside (LMSA) program. Once the original mortgage matures or is prepaid, the Section 8 contract can be renewed at the owner's discretion. Section 8 contracts on some of these properties are eligible to be "skewed" higher than market levels in order to help support some of the non-subsidized units. Lenders' and GSEs' underwriting needs to recognize this authority and not penalize a property for the skewed rent structure.

- Capital Grant Programs: As the notice points out, affordable housing subsidy programs do not all involve traditional debt-financed properties. Some of the more recent subsidy programs such as the newer Section 202 seniors and Section 811 for the disabled have involved capital grants that allow a property to operate debt-free. The GSEs can play a role in the preservation of this housing by facilitating the investment of equity either through grants, direct equity investments, or through guaranteed equity funds and other mechanisms to help ensure a smoothly functioning equity market. In contrast, the McKinney-Vento supportive housing programs are often financed through multiple sources of funds because the capital grant is limited to a total of $400,000 per project. As with other affordable housing, recapitalizing and preserving these projects is made more feasible through the provision of long-term low-cost debt with flexible terms and conditions. Preservation of supportive housing may also involve an increased level of GSE participation in Single Room Occupancy (SRO) housing developments, which has been limited in the past.

- Section 515: The Rural Housing Service's Section 515 program produced rental housing in rural areas through 30 to 40-year direct loans, primarily between the early 1970s and mid-1990s. This housing inventory is aging and in need of significant capital improvements that may exceed the value of the property. Refinancing a Section 515 mortgage can be a challenging process and can take a significant amount of time and effort on the part of the owner or purchaser of the property. In addition, these properties are often subsidized in part by HUD through the Section 8 program, adding even more complexity to their preservation. Lenders providing new financing for these projects need to be adaptable and flexible enough to take part in the long and complicated process of obtaining the various approvals needed. It can also be very difficult to find lenders that will serve the rural areas in which these projects are located, and the small size of the projects can be a disincentive to lender participation.

- Section 42 Low-Income Housing Tax Credits: The first properties subsidized under the LIHTC program began reaching the end of their initial 15-year affordability period in the

past 5-7 years, and the number of properties reaching year-15 will be escalating between 2010 and 2018. Although most of these properties are subject to an additional 15-year affordability period (for a total of 30 years), they will often undergo a change in ownership and a recapitalization at the 15th year. A common strategy is to have the new ownership entity assume the original project debt, however new owners often need to raise additional capital. For properties where refinancing will take place, underwriting will typically need to recognize and work flexibly with a continuing package of soft debt and associated use restrictions.

All affordable housing programs mentioned in the notice involve cooperation with subsidy providers, regulators, and other funders both at the loan product level and when working through the details of individual transactions. The GSEs should work cooperatively with these other entities to design loan products that are targeted to preservation of the properties and do not contain conflicting provisions such as duplicative reserve accounts. It is important to have access to flexible loan products that can work with the structure of the ongoing subsidy and regulatory framework in which the properties are operating.

Finally, preservation of affordable housing involves not only new transactions, but also the preservation of projects previously financed by the GSEs. A great deal of attention is needed to address distressed multifamily mortgages (with or without subsidy) already on their books to ensure the responsible disposition of the properties in a way the helps ensure their long-term affordability. At a minimum, GSEs should have the duty to monitor property conditions prudently and to take action appropriate for a mortgagee to prevent property conditions from threatening either the value of the collateral or the health and safety of the residents.

Inclusion of NSP Activity

FHFA is seeking comment on whether the GSEs' activity related to HUD's Neighborhood Stabilization Program (NSP) should be included in the Duty to Serve evaluations. Although the GSEs' work on NSP and foreclosure mitigation and response is extremely important, it was not the intent of the legislation to include those subjects as part of the affordable housing preservation duty, which otherwise focuses entirely on affordable multifamily housing programs. Combining the NSP-related activity, which does include some multifamily properties but is predominantly single-family, is likely to dilute the attention that the GSEs provide to the multifamily programs. However, we do believe that the foreclosure response activities are important enough in their own right to be covered under a separate Duty to Serve category, as allowed in the legislation (which will require consultation with Congress).

Inclusion of Additional Categories

The HERA legislation also allows for the inclusion of other affordable housing programs under the Duty to Serve Affordable Housing Preservation. Below is a list of programs that should be considered.

- Subsidized or non-subsidized affordable housing where there is and/or will be a local, state or federal long-term affordable use restriction in place for at least 20 percent of the units.
- State mortgage subsidy programs.
- State low-income housing tax credit programs.
- Tax-exempt bond-financed housing.
- Public housing and State public housing involving mixed-finance redevelopment.

Rural Markets

FHFA is seeking comment on the definition of "Rural Areas" for purposes of the Duty to Serve evaluation. LISC agrees with FHFA that county-based designations are not the best criteria on which to base a rural definition. Likewise, the Census Bureau's Metropolitan areas are not appropriate given that more than half of the Census-defined rural population now resides in Metropolitan areas.

For programmatic purposes, such as a rural definition for Duty to Serve, LISC recommends USDA's Rural Development (RD) definition of eligible areas for the affordable housing and community development programs that the agency administers. USDA's eligible areas definition, as set forth in 42 USC 1490, generally includes open country or rural towns with no more 20,000 in population.

The USDA RD definition of rural is not based on county or tract boundaries, and therefore often provides a more precise indicator of rural territory and population. Additionally, this definition is familiar to rural housing practitioners and policy makers as it has been the basis of USDA's affordable housing programs and efforts for decades. However, the USDA definition is not without its own drawbacks. Like the Census defined Urban-Rural definition, USDA's classification system does not conform to standard political or jurisdictional geographies. Likewise, the USDA eligible areas definition is expansive and incorporates larger territory and population than most definitions of rural.

While there is no perfect definition of rural, LISC believes that USDA's eligible areas classification is the best programmatic definition of rural and should be adopted as the rural definition for Duty to Serve. In addition, LISC recommends that all federally designated tribal

areas within USDA eligible areas be specifically included within the Duty to Serve rural areas definition.

C. Evaluation of Performance

Evaluation Criteria

As discussed in the introduction to this letter, LISC believes that the Duty to Serve should be evaluated primarily using qualitative techniques rather than focusing on purely quantitative measures. Below we provide additional input on the various tests and methodologies that may be needed to ensure a robust assessment of each Enterprise's performance under the Duty to Serve provisions.

Loan Product Test: FHFA is seeking input on specific underwriting standards and loan products that would benefit underserved markets. First mortgage loans supporting preservation transactions should meet the regulatory needs and requirements of the individual programs as described above, and should include appropriate underwriting flexibilities and terms such as those described below in more detail. In addition to increased flexibility in first mortgage financing, the preservation of affordable housing can be supported through innovative second mortgage or mezzanine products that facilitate the acquisition, refinancing, and rehabilitation of existing projects.

- Reasonably sized transition reserve accounts. Underwriting for a Section 8 project often requires transition reserve accounts sized to absorb the impact of a potential loss of the rental assistance contract, and the assumptions used in GSE underwriting are among the more conservative currently in use. The sizing of these reserves is highly sensitive to the assumptions that are made about the timing of a hypothetical loss of project-based subsidy and the rate at which the replacement Enhanced Vouchers[3] (EVs) will turn over. Underwriting often assumes that the contract is lost after only one to three years of operation and that the EVs turn over to fully unsubsidized units after three years. If a transition reserve is required, a more realistic scenario for sizing the reserve, still conservative based on experience to date, might be to assume a potential contract loss at year five or later, and then assuming a ten-year turnover of the EVs. GSEs can go even further by providing for forbearance in the case of a contract loss resulting from the failure to appropriate funds. Transition reserves would then be reduced by the amount of forbearance allowed, permitting more funds to go into stabilizing the real estate itself.

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[3] Enhanced Vouchers are provided to all tenants in a subsidized project that loses its Section 8 rental assistance contract. These vouchers allow the tenants to continue to afford the unsubsidized rent levels, but the tenants are allowed to leave the property and take the voucher with them.

- Loans supported by the full amount of the Section 8 rent. Properties with project-based Section 8 that have rents over the use-restricted rents (usually LIHTC rent levels) are often unable to obtain debt financing based on the full amount of the Section 8 rents. This leaves an unleveraged “overhang” of cash flow and often limits the amount of rehabilitation a preservation owner or purchaser is able to achieve for the property and can often make the preservation of affordability infeasible. GSE underwriting should allow debt service based on the full amount of the Section 8 rent levels as long as these rents are not above market levels. Alternatively, innovative financing can be designed such that the “overhang” supports mezzanine or second mortgage financing that is compatible and/or coordinated with the first mortgage financing, including reasonable requirements to collateralize junior debt.

- Underwrite the post-rehabilitation rental income and property value. Preservation transactions often involve rehabilitation of the property that takes place on a rolling basis after the closing of the permanent loan, leading, among other things, to higher post-rehabilitation value and rent potential and potentially lower operating costs. Recognition of the post-rehab rent levels in both the operating cost projections and the loan-to-value calculations is key to making these projects work well.

- Allowance for hard subordinate financing from CDFIs. Because of their complexity, preservation deals may also involve several layers of secondary financing from public and private sources. Community Development Financial Institutions, such as LISC, are often willing to provide mini-perm or permanent financing to help fill gaps in the development budget. Unlike soft debt from a public agency to a project, these loans must be paid back in full to the CDFI and the CDFI must be able to obtain appropriate collateral for their loans. However, current GSE requirements can make obtaining this type of hard second mortgage difficult. The GSEs should develop standard loan documents for use with hard subordinate debt provided by CDFIs and other lenders.

- Align debt coverage and loan to value with unsubsidized projects. Projects subsidized with Section 8 often do not qualify for the same basic debt service coverage ratios and loan to value ratios that non-subsidized or LIHTC-only projects can access. For example, a Section 8 project may be required to achieve a DSCR of 1.20-1.25 or greater, while a similar LIHTC-only or market-rate projects is permitted to have a 1.15 DSCR. These parameters should be more aligned to remove the disincentive to undertake projects with rental assistance.

- Long terms and low, fixed rates. Unlike other commercial lending, multifamily affordable housing is often financed with long-term loans and extended amortization periods. The GSEs should support the market for loan products that provide these long terms at low costs to the borrowers to help provide extended affordability and long-term

security for the project. In the past, this has been provided by products such as a bond credit enhancement with a swap that converts the variable interest rate to a fixed rate, however these are less available in the current market and when available may not be priced in a manner that works for many preservation deals. New products that provide similar features should be developed to support preservation in a variety of market environments.

- Flexible, holistic underwriting. Inflexible underwriting standards can double or triple penalize a property by requiring, for example, both a more conservative debt coverage and/or loan-to-value ratio in addition to a more conservatively sized transition or operating reserve account. The complexity of the deals often means that standard underwriting models are not appropriate. A more hands-on approach that considers the overall risk of a project may be necessary.

- Eliminate yield maintenance requirements. Because preservation typically involves refinancing or paying off existing debt, yield maintenance fees can increase the cost of a preservation transaction or even prevent an otherwise willing owner from selling or refinancing their property. The GSEs should eliminate these fees for purposes of a preservation transaction, as long as long-term affordability is being maintained.

- Support for green rehabilitation. The GSEs can also play an increased role in providing a secondary market for green rehabilitation loans for existing affordable housing projects. LISC believes that a green retrofit of an existing project can help extend the useful life and therefore long-term affordability of the project, in addition to benefiting residents through improved and healthier living environments. Therefore, it is important for underwriting standards to recognize the long-term effects on operating costs of comprehensive green rehabilitation plans that meet or exceed current industry recommendations. This would both support individual property requests and provide an industry-leading standard.

Outreach Test: The GSEs can expand their outreach to new categories of lenders that are currently active serving underserved markets, such as CDFIs and other nonprofit lenders, Community Development Credit Unions, and small community banks. They can also encourage their current network of lenders to improve their service to underserved markets. FHFA can objectively measure the performance of these various lender categories and the contribution that each makes to a GSE's qualifying business. Over time, a greater share of the traditional lenders' business should be contributing to the Duty to Serve (although fluctuations will occur), and the GSEs should be able to measurably increase both the number of approved non-traditional seller-servicers and the volume of qualifying business coming from non-traditional channels. FHFA should also evaluate the consistency with which various seller-servicers make available the underwriting flexibilities and loan products meeting the Duty to Serve provisions. Finally, FHFA

can evaluate the clarity and frequency with which each GSE makes available information on flexible underwriting and new products to its seller-servicer network. Events such as trainings and conferences for both borrowers and lenders may be needed to effectively disseminate information on relevant products and to ensure consistency in applying underwriting standards.

Purchase Test: Measuring purchase activity by either number of units or dollar volume will have a tendency to favor larger transactions over smaller ones. LISC strongly believes that GSEs should be encouraged to help support smaller transactions, such as multifamily loans below $3 million. These loans are often less profitable to originate and therefore are an underserved part of the market for preservation lending and particularly for rural areas. Using the number of mortgages for the purchase test would be more appropriate, as long as there are separate analyses for single-family and multifamily activities.

A measure based on the number of mortgages would also avoid the problems experienced in attempting to size the market for the affordable housing goals, which have been measured in units. Market data on the number of units supported by both single-family and multifamily mortgages is not generally available, and as a result any comparisons between a unit-based market estimate and GSE performance will be inaccurate. Data sources such as the Home Mortgage Disclosure Act (HMDA) data are made available at the mortgage level (and dollars) but do not contain information on the number of units in the property.

Grants Test: Although FHFA has labeled this the "grants" test, LISC believes it is equally as important to highlight the role of the GSEs in financial investments that serve underserved markets, in addition to their charitable grantmaking activities. These two different activities should be evaluated separately to ensure that each receives the appropriate level of attention in the Duty to Serve evaluation. Specific types of grants and investments are described below.

- LIHTC Investments and Guarantees. In the current market environment, LIHTC investments are hard to find in all but the strongest markets. A robust GSE role in improving the availability of investment capital would benefit the market in general and would be especially valuable for underserved markets. Rural areas, smaller cities, the Gulf Coast disaster area, and some states are having the greatest difficulty, as are complex projects that address acute housing needs such as those targeted by the Duty to Serve – for example, those serving the homeless, preserving HUD or USDA assisted properties, and in economically distressed regions and neighborhoods.

  While the GSEs are currently not active in new LIHTC investments, their role continues to be important to the overall equity market. As the largest investors in LIHTC equity until recent years, the GSEs have sizable portfolios of existing investments. Any actions taken by a GSE to dispose of investments in a manner that negatively impacts the credit

markets would be detrimental to the overall market and particularly harmful to underserved markets.

If direct equity investment continues to be infeasible, GSEs can also investigate other ways to participate in the equity markets through mechanisms such as guaranteed funds. Fannie Mae or Freddie Mac could provide a guaranty (for a fee) on a fund targeted to the underserved markets, which would in turn make certain deals more attractive to investors and improve the availability of capital.

- Bond purchases and guarantees. GSEs are often direct purchasers of tax exempt and taxable bond issuances. Preservation transactions, in particular, are often done with a combination of tax exempt bonds and 4% LIHTC, and so an active role for the GSEs in bond investments is critical to this market and should be encouraged.

- CDFI investments and grants. Community Development Financial Institutions (CDFIs) are public purpose lenders, many of them nonprofit organizations. Today, there are about 1,000 certified CDFIs nationwide with a collective $25 billion in assets at work to rebuild low-income communities through housing, economic development, and community services. CDFIs raise capital, often from banks, and provide financing that conventional lenders find too risky, complex or time consuming to offer alone. CDFIs such as LISC provide a valuable intermediary role in providing not just financing but also extensive technical assistance to enable the successful completion of complex preservation deals. CDFIs can play an intermediary role to help the GSEs reach the more difficult transactions through establishment of revolving predevelopment, acquisition, and bridge funds. Flexible and low-cost predevelopment funds are particularly important to preservation transactions because of the high costs involved in structuring such complex deals and obtaining all the necessary regulatory approvals.

Sizing the Market

Sizing the multifamily market is traditionally extremely difficult because of the lack of good sources of data, even on past market performance. Ideally, HUD or FHFA would re-establish the Survey of Mortgage Lending Activity (or something similar) to obtain an estimate of the size of various mortgage market segments. Cooperation with various industry groups that currently collect data could allow FHFA to obtain rough estimates. Sizing the market for preservation can also be done roughly through public databases such as HUD’s Section 8 contracts and insured mortgages databases. However, any market sizing methodologies developed by FHFA should be published for comment by the industry.

Evaluating Compliance

LISC believes that a rating system similar to the Community Reinvestment Act's system could be a valuable tool, particularly given the qualitative nature of the activities being assessed. However, certain weaknesses in the CRA rating system should be corrected before applying to the GSEs. For example, CRA currently undervalues high-impact but low-volume community development loans and investments through a mostly quantitative analysis. The great majority of banks receive a CRA rating of Satisfactory, a rating that does not differentiate among a wide range of performance. In addition, institutions have little incentive to achieve an Outstanding rating.

Accordingly, we recommend:

- More refined grading scale than that currently used for CRA. Currently, CRA ratings roughly correspond to school grades of A (Outstanding), B (Satisfactory), D (Needs Improvement) and F (Substantial Noncompliance). At minimum, there should be a "Low Satisfactory" rating similar to a school grade of C in addition to a "High Satisfactory" rating.

- Recognition of high-impact, low-volume activity. A point-based rating system should be designed in a manner that does not create a disincentive for low-volume activities, as long as those activities have a high level of market relevance and impact. It should also be designed to recognize the different scale of activities being pursued based on the three levels of activity discussed in the introduction (deal level, variance level, product/guide level).

- Remediation plans for low performance. Any GSE receiving a Low Satisfactory or lower rating should submit a remediation plan for approval by FHFA following public comment, and then follow the plan. This penalty should apply to any overall score and to any specific test or sub-element of the Duty to Serve evaluation.

It would be appropriate to customize the points system to each of the underserved markets covered in the Duty to Serve rather than attempting to develop a one-size fits all system. LISC believes that any point-based rating system developed by the FHFA should be published and open to comment by the industry prior to implementation.

D. Reporting Requirements

Reports provided by the GSEs should be made public and easily accessible, and should include a detailed description of the deal-level flexibilities, variances, pilots, and new products developed

as well as data on the results. A complete listing of transactions is valuable as long as confidentiality concerns are appropriately addressed.

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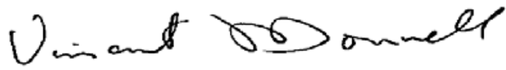
We hope these comments are helpful to you as you develop the regulations and guidelines for these important new GSE Duty to Serve requirements. We are more than happy to discuss any of our recommendations in more detail with FHFA and the GSEs.

Sincerely,



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