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September 18, 2009

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

Dear Mr. Pollard:

Thank you for the opportunity to comment on RIN 2590–AA27, Advance Notice of Proposed Rulemaking on the Duty to Serve Underserved Markets for Enterprises.

Enterprise is a leading provider of capital and expertise to develop affordable housing. To date, Enterprise has helped build or preserve more than 257,000 affordable rental and for-sale homes and invested more than $10 billion to create vital communities across the country. Our success reflects a unique structure that blends social mission with financial innovation.

We provide much of this financing through subsidiaries such as Enterprise Community Investment, one of the leading national providers of Low Income Housing Tax Credit equity. Its asset management division oversees over 100,000 units of affordable rental housing.
Another Enterprise affiliate is the Enterprise Community Loan Fund, a certified Community Development Financial Institution (CDFI) that provides predevelopment loans, acquisition loans, working capital and other forms of short term financing. The Enterprise Community Loan Fund is one of the nation's largest CDFIs (CDFIs) and has invested more than $1 billion in low-income communities to help build or renovate over 95,000 affordable homes.

These comments are in response to FHFA's efforts to implement the Duty to Serve provisions of the Housing and Economic Recovery Act of 2008 (HERA) as they apply to Fannie Mae and Freddie Mac. Given the likelihood of future changes relating to the Government Sponsored Enterprises (GSEs), we believe these duties should apply to any successor or entities that participate in the secondary mortgage market and/or that bundle, securitize, and sell mortgage backed securities.

Enterprise strongly supports the efforts of Congress and FHFA to expand the mission regulation of 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 their attention on the nation's most pressing affordable housing needs, especially for affordable rental housing.

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Overview

In general, Enterprise believes that previous efforts to encourage the GSEs to serve affordable housing and underserved markets have often focused on numerical targets rather than on qualitative impacts, and that often these efforts have had limited effectiveness in promoting affordability. As part of its responsibility to oversee the duty to serve underserved markets, we urge the FHFA to focus on the overall quality and effectiveness of the GSEs efforts and products to serve these markets, rather than on fixed numerical targets.

In encouraging and evaluating the GSEs duty to serve underserved markets, we urge the FHFA to consider three categories of effort that, taken together, will help to promote both innovation and broad application of effective practices to preserve and expand the supply of affordable housing.

These three categories for evaluation of the GSE effort are:

1. *Project-specific efforts*, where new products or processes limited to individual properties or efforts can be attempted and evaluated;

2. *Prototype efforts*, where new products or processes are applied to transactions with specific characteristics, such as properties owned by large mission-oriented owners, properties with expiring HUD-subsidized mortgages, or properties in a limited geographic area; and

3. *Market-wide efforts*, which would include products or processes that are available to the broadest range of customers, geographic areas and properties. While the project-specific areas are intended to encourage innovation and evaluation on a limited basis, the market-wide efforts will ultimately have the greatest impact on the GSEs service to affordable housing.

Because the Duty to Serve involves the *effort* of the GSEs, FHFA should not become overly focused on measurement of the results in quantitative ways. Some quantification is necessary and desirable, but a *qualitative* assessment of the real demonstrable value to the market and the public purpose served by their actions should be the core of the evaluation.

We also understand that 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, as the mortgages funded through these investments do 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 response to specific questions asked by FHFA in the Advanced Notice of Proposed Rulemaking on how the GSEs should serve the various underserved markets as delineated in HERA, we have the following specific comments.

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Underserved Markets

While Enterprise believes that it is very important that the GSEs develop financial products and program initiatives to support the financing of manufactured and rural housing, the comments in this letter focus on the need for GSE products and programs to address the pressing affordable housing preservation needs in underserved markets. On manufactured and rural housing, we encourage the GSEs to create specialized products to serve their unique market needs.

Affordable Housing Preservation

The GSE role in affordable housing preservation is multi-faceted, as are the programs that are involved in the preservation of affordable rental housing. HERA 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.

- **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. 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 development 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.

- **Older Mortgage Subsidy Programs:** HUD's 221(d)(3) Below Market Interest Rate program was a low-interest direct 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. Both of these programs had original mortgages with terms of 40 years, many of which were prepayable after the 20th year. The bulk of these properties (those which have not yet prepaid) are reaching the end of their 40 year mortgage terms between 2011 and 2015, at which point the owners will no longer be held to the affordability restrictions. Refinancing these properties in a manner that retains the affordability for current tenants 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 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 procedures need 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 those for the elderly (Section 202) and supportive housing for people with disabilities (Section 811) have involved capital grants. 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 U.S. Department of Agriculture's (USDA) Rural Housing Service administers the Section 515 program, which produced rental housing in rural areas through 30-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.

- **Low-Income Housing Tax Credit (LIHTC):** The first properties subsidized under the LIHTC program began meeting the end of their initial 15-year affordability period in the past 5-7 years, and the number of LIHTC properties reaching such a milestone will be escalating between 2010 and 2018. Although most of these properties are subject to a minimum of 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 or 16th 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.

All affordable housing programs mentioned in the notice involve cooperation with subsidy providers, regulators, philanthropy 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, etc. 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 in the GSE's portfolios to ensure the responsible disposition of the properties in a way that helps ensure their long-term affordability.

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 stabilizing communities hard hit by foreclosures is extremely important, it was not the intent of the legislation to include those subjects as part of the Affordable Housing Preservation duty, which 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 and community stabilization activities are important enough in their own right to be covered under a separate Duty to Serve category, as allowed in the legislation.

Inclusion of Additional Categories

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

a) Subsidized or non-subsidized affordable housing where there is and/or will be a long-term affordable use restriction in place for at least 20 percent of the units
b) State mortgage subsidy programs
c) State rental assistance programs
d) State low-income housing tax credit programs
e) Tax-exempt bond-financed housing
f) Public housing and State public housing involving mixed-finance redevelopment
g) Affordable residential energy-efficiency and retrofit related programs
h) Affordable, sustainable communities and healthy housing programs

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Evaluation of GSE Performance on Preservation Activities

As discussed in the overview, Enterprise 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 GSE's performance under the Duty to Serve provisions.

<u>Loan Product Test</u>: *What types of loan products, more flexible underwriting, and other innovative approaches should the Enterprises develop?*

First mortgage loans supporting preservation transactions should meet the needs of the individual programs as described above, and should include appropriate underwriting flexibilities such as those described below in more detail.

- **<u>Reasonably sized transition reserve accounts</u>**. 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. These reserves are often sized using unrealistic assumptions about the rate at which the replacement Enhanced Vouchers (EVs) will turnover. Underwriting often assumes that the contract is lost after only a single year of operation and that the EVs turnover to fully unsubsidized units after three years. A more realistic scenario for sizing the transition reserve might be to assume a potential contract loss at year five 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.

- **<u>Loans supported by the full amount of the Section 8 rent</u>**. 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.

- **<u>Underwrite the post-rehabilitation rental income and property value</u>**. Preservation transactions often involve rehabilitation of the property that takes place on a rolling basis after the closing of the permanent loan. 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.

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➢ **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 Enterprise Community Loan Fund, are often willing to provide mini-perm or permanent financing to help fill gaps in the development budget. Unlike a public agency that provides soft debt 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 legal 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 require a DSCR (Debt Service Coverage Ratio) of 1.20-1.25 or greater, while a similar LIHTC-only or market-rate project can obtain 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.

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 allow for acquisition, refinancing and rehabilitation of existing projects.

The GSEs can also play an increased role in providing a secondary market for green rehabilitation loans and loan guarantees for existing affordable housing projects. Enterprise 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.

Grants Test: What types of investments and grants should be considered? How should performance be evaluated?

Although FHFA has labeled this the "grants" test, Enterprise 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 grant making activities.

- **LIHTC Investments and Guarantees.** Investment is still occurring in some communities where strong and sophisticated banks seek CRA recognition. But due to the recession and the financial market difficulties over the past 18 months, LIHTC investments are hard to find in many communities and so a GSE role in improving the availability of investment capital would be valuable for underserved markets. These communities outside those in CRA assessment areas of most banks are having the greatest difficulty attracting investment capital, especially rural areas, smaller cities, the Gulf Coast disaster area and even some states. Moreover, investors are rejecting well structured but 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.

  Until recently, Fannie Mae and Freddie Mac provided about 40 percent of LIHTC investments annually. Unfortunately, since late 2007, the GSEs have not been, nor currently are active in new LIHTC investments and their future structure is uncertain. However, their role continues to be important to the overall LIHTC equity market. The GSEs have sizable portfolios of existing LIHTC investments. Any actions taken by a GSE to dispose of investments in a manner that negatively impacts the primary LIHTC investment market would be detrimental to the overall market and particularly harmful to underserved markets.

  We encourage you to use your regulatory powers and new GSE product oversight to encourage Fannie Mae and Freddie Mac to provide greater liquidity in the market for LIHTC investments. In recent years, the LIHTC has increasingly been used to finance affordable rental housing preservation, and having greater liquidity in the LIHTC investment market would help support the preservation of affordable housing as their considerable expertise could help restore the investment market if they were to guarantee and/or securitize LIHTC investments made by others, including both banks and other less experienced corporate investors, and we believe that such a role clearly lies within their affordable housing mission. Guaranteeing/securitizing LIHTC investments, thereby creating a secondary market, would provide greater liquidity for the market, a source of revenue to the GSEs, and responsible credit risk protection for investors.

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For bank investors, the GSE guarantee could potentially reduce the amount of capital required to make an investment by 80 percent, subject to re-affirmation of existing policy by the Federal Reserve Board. The GSEs might also attract new, non-traditional investors by dividing what is normally a 15-17 year investment into shorter-duration investment segments.

We look forward to working with you to increase the flow of private capital to the affordable multifamily rental market and underserved communities, as well as help reactivate private investment in the Low Income Housing Tax Credit.

- **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 percent 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 Enterprise 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 and acquisition funds. 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.

Thank you for the opportunity to share our recommendations on how best to implement Duty to Serve responsibilities.

Sincerely,

Alazne (Ali) Solis
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Public Policy and Corporate Affairs Executive