October 25, 2021

Clinton Jones, General Counsel
Attention: Comments / RIN 2590-AB12
Federal Housing Finance Agency
400 Seventh Street, SW.
Washington, DC 20219

Subject: Enterprise Housing Goals

Dear Mr. Jones:

On behalf of the DUS Peer Group[1], the DUS Advisory Council[2] welcomes the opportunity to comment on the 2022-2024 Enterprise Housing Goals Proposed Rule. We support the FHFA's focus on the Enterprises' affordability mission, and its efforts to support housing for Low-Income ("LI") and Very Low-Income ("VLI") renters.

The three pillars of the Enterprises' mission – affordability, liquidity, and stability – are often addressed via distinct regulation but are closely linked, where an overemphasis on any one pillar creates an unstable foundation for long-term success. The affordability component is related to, and cannot be considered without, the other two.

As a result, this comment letter first directly addresses the FHFA's proposed housing goals. Specifically, the DUS Advisory Council supports raising the targets for LI and VLI units but suggests a structural modification intended to increase predictability for the Enterprises and smooth their appetites to finance these units. However, we also consider the liquidity and stability missions, particularly as it relates to the capital rule. Since the FHFA has also solicited comments on RIN 2590-AB17, Amendments to the Enterprise Regulatory Capital Framework Rule, we will preview our positions on capital-related matters herein, and provide a more comprehensive discussion in a separate response letter.

We appreciate the FHFA's ongoing efforts to ensure a viable and vibrant housing finance system. Should you have any questions or need additional information, please feel free to contact Pattie Farrell, Chair, DUS Advisory Council, at pattie.farrell@wellsfargo.com.

Sincerely,

The DUS Advisory Council

[1] The Delegated Underwriting and Servicing (DUS) Peer Group is a coalition of lenders who originate the preponderance of multifamily mortgages that are sold to or securitized by Fannie Mae. Most of our members also utilize the Freddie Mac and Ginnie Mae programs for financing rental housing. Our members are key participants in the multifamily rental housing market as originators, securitizers and servicers of mortgages on rental housing for millions of U.S. households. For a complete list of DUS lenders who form the DUS Peer Group, see https://multifamily.fanniemae.com/about-multifamily/our-partners/dus-lenders.

[2] The DUS Advisory Council is elected by the DUS Peer Group to represent the DUS network. The members of the DUS Advisory Council include Berkadia Commercial Mortgage, LLC; Capital One, National Association; CBRE Multifamily Capital, Inc.; JLL Real Estate Capital, LLC; KeyBank National Association; Newmark; NorthMarq; PGIM Real Estate; Walker & Dunlop, LLC; and Wells Fargo Multifamily Capital

Multifamily Housing Goals

The DUS Advisory council broadly supports the FHFA's intention to increase the amount of lending targets on units affordable to Low-Income and Very-Low-Income families. We believe that this is consistent with all three pillars of the Enterprises' mission. It ensures financing to properties renting to those who need it most, it provides liquidity in secondary and tertiary markets where there may be less interest, particularly in times of distress, and as a result increases stability to a market segment that exists outside "gateway" markets.

Rather than a simple increase to the level, we believe the target should be changed structurally. The FHFA's proposed structure designates fixed targets, which leads to three problems. First, the current structure requires periodic adjustment as the FHFA must attempt to estimate items which cannot be known in advance. As the FHFA noted, "The use of total number of eligible units rather than percentages requires that FHFA take into account the expected size of the overall Multifamily mortgage market and the affordable share of the market, as well as the expected volume of the Enterprises' overall Multifamily purchases (in dollar terms) and the affordable share of those purchases."

Second, goals being expressed in absolute terms can incentivize erratic behavior from the GSEs – specifically aggressively competing for affordable or small loans until the unit targets are reached, and then reducing the emphasis placed on affordable units thereafter. This concept was recently shown in small loans. in 2021 the gap between Fannie Mae's small loan and conventional pricing increased through 3rd quarter deliveries. in October 2021 Fannie Mae began quoting business for 2022 deliveries, and contemporaneously announced pricing reductions on small loans, just as the FHFA proposed increasing the target. We expect this to substantially revert once the Enterprises become confident that they can meet their revised targets.

The third reason this structure is problematic is that the estimates-based goals in place can become disjointed from actual market conditions. To date this has taken the form of FHFA goals being materially below what's required by market conditions; however this could flip if interest rates increase materially and transaction volumes decline.

We propose that the FHFA circumvent this situation by expressing goals dynamically – either as a strict percentage or with breakpoints. This would align with the FHFA's restructuring of mission-driven affordability as a percentage, which effectively requires that for every dollar of non-mission-driven affordable business originated, it must have originated at least a dollar of mission-driven business. Breakpoints could act as a hybrid solution to incent an *overemphasis* on LI/VLI business until certain levels are met, while still requiring additional units thereafter as a lower percentage.

We do not believe it would be helpful for the DUS Advisory Council to suggest specific percentages and/or breakpoints as this is the FHFA's purview. We only suggest that this be informed by, and reasonably align with, the historical record and the FHFA's proposed EHG targets relative to 2022 caps.

Other DUS Advisory Council Recommendations

The DUS Advisory Council expects to submit a detailed response letter to RIN 2590-AB17, Amendments to the Enterprise Regulatory Capital Framework Rule. This letter will include items directly relating to the FHFA's proposal, namely the PLBA and Credit Risk Transfer modifications, as well as other items germane to the FHFA's regulation of the Enterprises to foster affordability, liquidity, and stability. Our primary points are expected to include:

1. **Subsidized Housing Multiplier**: We recommend the FHFA restore the 2018 Proposed Rule's 0.6x multiplier for subsidized housing. We believe that the data strongly supports favorable treatment, as the FHFA acknowledged the "relatively infrequent instances of loss across Multifamily loan programs that include a government subsidy." Curiously, it was removed in its *entirety* on the grounds that defaults were so rare that it was difficult to fine-tune assumptions around the precise *levels* of subsidy. We also believe this to be most consistent with the FHFA's mission of affordability as these programs more tangibly and directly help renters than market-rate LI/VLI units without rent restrictions.

2. **PLBA Changes**: We fully support the FHFA's desire to restore the leverage capital requirement and buffer to their intended roles as credible backstops, as their normally acting as binding constraints not only undermines the risk-based capital regime but encourages risk-taking by the Enterprises. We believe the prescribed leverage buffer amount (PLBA) should be reduced but not tied to the stability capital buffer, as doing so conflicts with the Enterprises' countercyclical mission. If the Enterprises fulfill their countercyclical missions, the stability capital buffer will increase and introduce procyclicality. More concretely, due to the stability capital buffer's construction each *marginal* dollar of lending in times of increased market share carries disproportionately high *marginal* capital to satisfy this requirement. This increases the de facto capital costs of stepping into the market and disincentivizes carrying out the countercyclical missions, reducing market stability.
3. **CRT Changes**: We fully support the proposed changes to Credit Risk Transfer modifications, in both the reduction in the minimum risk weight and the elimination of the Overall Effectiveness Adjustment. These are consistent with other FHFA objectives, as an appropriately-incentivized CRT structure facilitates the Enterprises' scorecard goals and promotes more stability, safety, and soundness for the Enterprises. We expect materially more benefit across Freddie Mac (K-Deal) and Fannie Mae (MCAS, MCIRT, and front-end risk sharing), which may restart some suspended programs.
4. **Procyclicality in Multifamily**: The DUS Advisory Council proposed a system to mitigate procyclicality in Multifamily, which was endorsed by Fannie Mae in its 2020 response to the Re-Proposal. The fundamental principle behind our proposal is that if capital is calibrated to absorb shocks of 15% to NOI and 35% to value, then no additional capital should be required until these declines are substantially realized[3]. This is accomplished without using a trendline, which we see as internally inconsistent and highly sensitive to the beginning and ending points used, which are best chosen with the benefit of hindsight and the flexibility of judgment. With respect to data, we've confirmed with NCREIF that the FHFA could use its free and publicly-accessible Apartment Price Change Index; a same-store NOI index could be readily constructed from Enterprise investor reporting. In any event, we believe that an index must be chosen given the potential repercussions of not doing so.
5. **Multifamily Capital and Risk-Insensitivity**: As detailed in prior response letters, the DUS Advisory Council has investigated many dimensions of the historical record and cannot find one that supports the level of Multifamily capital. Moreover, from both the empirical record and the FHFA's comments, it seems to be held to a far higher standard than Single-Family. Dr. Calabria indicated in Congressional testimony that the Credit Risk Capital grids reflect "historical experience and actual reality" and that the record would be shared, but to our knowledge it never was. Our analysis indicates that capital is slightly conservative but generally reasonable for high-leverage loans, but calls for progressively higher degrees of overcapitalization as leverage decreases. In other words, capital is relatively risk-insensitive when compared against the historical record, whether evaluated for the Enterprises themselves or with CMBS conduit loans included.
6. **Other Multipliers**: The FHFA has cited the performance of the Seniors Housing and Student Housing subtypes as a justification for high credit risk capital factors in the overall Multifamily space. The DUS Advisory Council completely agrees that the risk profiles of these businesses are drastically different than for conventional Multifamily. However, the capital rule does not differentiate between Seniors Housing and conventional Multifamily. We ask that the FHFA consider directly incorporating its concerns – shared by the DUS Advisory Council – into its capital rule by significantly increasing the capital multiplier affixed to Seniors loans. We also expect that this would simplify the discussion of conventional Multifamily capital levels relative to the associated risks. We also ask that the FHFA reevaluate its multiplier for Loan Term. Although capital increases

[3] This contains a mechanism to always capitalize to a minimum additional shock (e.g. values 10% below current levels), if desired by the FHFA.

with loan term in the Final Rule, we found that historical losses were *lower* as loan terms increased, presumably due to maturity risk declining in importance as terms push out on the back of amortization, inflation, and upward-trending real NOI growth. Correcting this would also enhance stability in the market – by having to access the capital markets less frequently, borrowers are less prone to fluctuations in the market.

The DUS Advisory Council would look forward to an open dialogue with the FHFA. The DUS Advisory Council's interests are substantially aligned as we both seek a safe, sustainable, and profitable multifamily housing market. As our businesses retain risk on Fannie Mae originations but are prohibited from transferring it via credit risk transfer as the Enterprises are required to do, we have at least as great an interest in encouraging sound lending practices as the FHFA and Enterprises themselves.