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DEPARTMENT OF
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RAFAEL E. CESTERO
Commissioner

To: Alfred M. Pollard, General Counsel
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Re: Comments/RIN 2590-AA26
FHFA Proposed Rule 2010-2011 Enterprise Affordable Housing Goals; Enterprise Book-entry Procedures

Date: April 12, 2010

The following comments and suggestions are submitted by the Department of Housing Preservation and Development (HPD) of the City of New York in response to the public comment period for the FHFA Proposed Rule 2010-2011 Enterprise Affordable Housing Goals; Enterprise Book-entry Procedures. All comments relate to multifamily housing goals.

HPD is the largest local-government housing agency in the United States. HPD is the administrative grantee of HUD's HOME Investment Partnership grant, which in 2010 is over $124 million. Much of this funding is used in conjunction with Low-Income Housing Tax Credits (LIHTC) and/or Tax-Exempt Private Activity Bonds. HPD also operates a large-scale Section 8 Housing Choice Voucher Program, the second largest in the U.S.

Background

Similar to the nationwide mortgage foreclosure epidemic, we are already seeing signs of problems in the multifamily housing sector in New York City. It is now apparent that many multifamily buildings, like too many single family homes across the nation, are also "under water". A growing number of owners of residential apartment buildings hold commercial mortgages unsupportable by tenant rents. While some of these buildings are overleveraged as a result of overly speculative assumptions, others have been caught in the downturn in the housing market. In the cases of speculation, buyers purchased properties using faulty assumptions. These assumptions, shared by the lenders and borrowers, included that the real estate market would continue to rise and that there would be high levels of tenant turnover in buildings which would allow conversion of affordable rental units to market rate. We are now at a point where many of these developers/owners are at risk of defaulting on their mortgages. Multifamily housing loan failures threaten to affect tenants, communities and the broader US economy. Locally, failure to act could lead to decades of decline the likes New York City saw in the 1970's and 1980's.

As a public housing agency, HPD is especially concerned about tenants living in overleveraged multifamily buildings. In cases where debt is not supportable by building income, two scenarios are common. In the first scenario where rental markets are strong, landlords seeking higher rents try to force tenants out of affordable units, particularly units that are rent-regulated. In softer rental markets, building conditions and services begin to decline as landlords seek to cut operating costs. Declining building conditions can mean threats to the life and safety of tenants in worst cases. Deterioration of buildings can impact blocks and whole neighborhoods, leading to possible loss of affordable units as run down buildings are no longer habitable. In New York City we have already begun to see declining building conditions at some properties that are on the leading edge of this crisis.

GSE Preservation Model
On the leading edge of the crisis are 25 properties in the South Bronx owned by a real estate investment company, 10 of which were placed on the city's worst buildings list in 2007 and 2008, racking up 5,000 serious and immediately hazardous housing maintenance code violations. Fannie Mae bought the loans for these buildings totaling $29 million from 2006 to 2007. The buildings had fallen into severe disrepair, exposing residents to extremely poor living conditions. At one of the buildings, residents endured winter days without heat and hot water. At another building, the occupants of one apartment abandoned it after parts of the ceiling collapsed. In August of 2009, the City of New York worked with Fannie Mae to cancel the auction which was scheduled to sell the buildings online as part of the foreclosure process.

Instead, Fannie Mae and HPD collaborated to identify a new, responsible owner to maintain and rehabilitate the buildings as quickly as possible. HPD provided a list of preservation buyers to Fannie Mae for a restricted bid. Omni New York LLC – led by former New York Met Maurice "Mo" Vaughn – was chosen by Fannie Mae as the successful bidder. The collateral for this portfolio is made up of fourteen individual properties consisting of 416 units with mortgage debt totaling $23.8 million, which Omni has purchased from Fannie Mae and Deutsche Bank at a reduced price through the bidding process. Omni has committed to invest up to $1 million in emergency repairs and will work to obtain the deed to each of the properties in order to take title and become the long-term owner.

New Goals Based on Lessons Learned
FHFA can prevent government sponsored enterprises (GSEs) from contributing to another housing crisis by ensuring that GSE investment, especially those investments aimed at increasing the availability and preservation of affordable housing for low and very low-income families, is based on sound underwriting principles.

FHFA can further support communities across the nation by incentivizing refinancing and preservation of overleveraged multifamily properties by expanding criteria used to qualify investments for housing goals credits. This may include incentives for GSEs to transfer troubled multifamily buildings to responsible preservation buyers and recognition of responsible and proactive action taken by the GSEs in cases like the restricted bid offered by Fannie Mae for the South Bronx properties.

Setting goals based on sound underwriting principles

- FHFA should set housing goals which support healthy underwriting principles based on existing and documented building income and operating costs and reasonable assumptions about future changes in building tenancy.

- FHFA should prohibit government sponsored enterprises (GSEs) from receiving housing goal credits for investments in multifamily loans or portfolios in which total building debt exceeds a reasonable multiple of documented net operating income, thereby ensuring sustained affordability for existing tenancy.

- HPD supports FHFA's proposed exclusion of private label securities from counting for purposes of the affordable housing goals. Investment in private label securities fails to protect tenants from the risks of unsupportable debt and aggressive turnover schedules, which is paramount to sustainable affordable housing.

- FHFA should consider amending multifamily subgoal for very low-income families to include the following:
    - Targeted investment in at-risk neighborhoods and buildings identified by local government. In the current economic climate, targeted investment is essential to supporting neighborhoods at risk of decline. Local communities know best how valuable resources should be targeted. In many communities across the nation, targeted investment is needed in neighborhoods hardest hit by the foreclosure crisis. In high-cost and high-density cities, such as New York, investment is needed to protect vulnerable communities affected by the risks of failing multifamily buildings which can destabilize blocks and entire neighborhoods through neglect and possible abandonment.

- Additional requirements for small multifamily properties such as the following should be considered:

- Small multifamily subgoals should be established for future years in order to ensure market liquidity. Without market liquidity refinancing options will be limited for small building owners, creating financial stress on landlords and investors which in the past has led to poor building maintenance, cuts in building services and reductions in needed capital improvements. This is especially true for many buildings with little or no equity which FHFA notes is a problem of growing concern as owners and investors worry about properties that are overleveraged or generating negative cash flows. Improved liquidity in the small building market will also deter banks from holding REO stock for long periods.
- Small multifamily subgoals should be expanded to include mixed use residential properties. There are limited financing options for 1-4 family buildings with a ground floor commercial space. These buildings are essential to the vitality of many town centers and provide small business opportunities for their owners and tenants yet have not been a financing priority for GSEs. Improving lending options for small multifamily residential buildings with commercial space will not only ensure vitality in town centers but will also assist in job creation and formation of new businesses.

Setting preservation goals to benefit families and communities

- To ensure troubled multifamily buildings are transferred to responsible owners, FHFA should establish a housing goal to give GSEs credit for multifamily properties in the process of foreclosure for which the Enterprise transfers or sells property or debt to a preservation buyer approved by the local housing authority. GSEs should not be required to achieve maximum resale proceeds for such a transaction. FHFA may also consider piloting this solution in a series of controlled bids for certain community assets which are deemed by local agencies to be at-risk, modeled on the successful cooperation of Fannie Mae and HPD in the South Bronx.

Thank you for the opportunity to submit comments.

Sincerely,

Rafael E. Cestero