NATIONAL HOUSING CONFERENCE

March 15, 2016

Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
Eighth Floor
400 7th Street, SW
Washington, DC 20219

Re: Comments on Duty to Serve: RIN 2590-AA27

Dear Mr. Pollard,

The National Housing Conference (NHC) welcomes the opportunity to comment on the proposed Duty to Serve rule. The Federal Housing Finance Agency (FHFA) has proposed a rule that could powerfully and effectively direct Fannie Mae and Freddie Mac to better reach segments of the market that lack access to capital. We are pleased to see the rule moving forward, and we offer constructive comments here to help improve implementation.

The great need for affordable housing frames our recommendations. In places of high employment and economic growth, housing costs outstrip incomes for many, while in places of economic distress, lack of investment constrains revitalization. Research from NHC's Center for Housing Policy shows that more than 9.6 million working households struggle to afford housing that costs more than half of their income.[1] Extremely low-income households suffer the most, and the consequences of the mismatch between housing costs and incomes are most severe for those who have the least.

Declining housing affordability is not a sudden crisis, but a long-term problem that has been building for many years and promises to grow further.[2] The problem demands concerted, creative actions like those contemplated in the Duty to Serve rule that direct the energy of the private sector to serve the housing needs of all. Our comments, summarized below and explained further in the balance of this letter, aim to encourage the innovation and change needed to help change housing affordability for the better.

[1] Mindy Ault. Housing Landscape: An Annual Look at the Housing Affordability Challenges of America's Working Households. 2016. Washington, DC: National Housing Conference. http://www.nhc.org/#!2016-housing-landscape/s06lv

[2] Enterprise Community Partners and the Harvard Joint Center for Housing Studies. Projecting Trends in Severely Cost-Burdened Renters. 2015. http://www.enterprisecommunity.com/resources/ResourceDetails?ID=0100886#sthash.5KuAva6O.dpuf

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NATIONAL HOUSING CONFERENCE

I. About the National Housing Conference

The National Housing Conference represents a diverse membership of housing stakeholders including tenant advocates, mortgage bankers, non-profit and for-profit home builders, property managers, policy practitioners, real estate professional, equity investors, and more, all of whom share a commitment to safe, decent and affordable housing for all in America. We are the nation's oldest housing advocacy organization, dedicated to the affordable housing mission since our founding in 1931. As a nonpartisan, 501(c) 3 nonprofit, we are a research and education resource working to advance housing policy at all levels of government in order to improve housing outcomes for all in this country.

II. Duty to Serve process can create long-term affordable housing benefits

The process proposed for the Duty to Serve rule fits within the parameters of the Housing and Economic Recovery Act of 2008 to encourage a focus by the GSEs on specific portions of the market that lack access to capital for affordable housing. It is a natural complement to the quantitative affordable housing goals focused on immediate production and the scorecard process aimed at organizational change and achievement.

A. Iterative process leads to improvement

The Duty to Serve process described in the proposed rule should lead to improvement over time in access to capital if both the GSEs and FHFA maintain commitment to the mission and a collaborative spirit. The key elements of the process are:

1. Agree on activities to meet objectives

The GSEs have the expertise to identify ways to reach underserved markets, so the process relies upon the GSEs to propose specific means to meet the objective of the rule. FHFA has the perspective to look beyond immediate business imperatives and the limited competitive dynamic between the GSEs to focus on the mission objectives. If each GSE can agree with FHFA on a set of activities to pursue, the result should be achievable and meaningful.

2. Define evaluation criteria

For the GSEs to succeed in their Duty to Serve activities, they must know in advance how they will be evaluated and the evaluation criteria should remain stable over the three-year period of implementation. This is especially important because there will likely be many activities identified in a plan, and leadership of each GSE will rely on the evaluation criteria to prioritize which activities to pursue most vigorously. Adjustments may well be needed over time as market conditions change and the results of initial efforts reveal new information, but those adjustments should be done collaboratively to allow GSEs to make corresponding adjustments in their activities.

We therefore recommend that FHFA ask each GSE to propose evaluation criteria in the plan, review those criteria to ensure that they are measurable, achievable, and time-bound, and stick to the criteria over the three-year period. The annual review of the evaluation criteria may be necessary as a formal mechanism, but we recommend more frequent evaluation and collaboration, such as twice annually, to make sure that the GSEs are on track and that adjustments to the criteria do not come as disruptive surprises.

We further recommend that FHFA keep the numerical scoring simple and comprehensible. An overall total of 100 points is a logical framework, familiar from the K-12 grading process and beyond. We all know what a passing grade looks like in that scale. However, assigning ten points to each of ten activities without knowing the number, difficulty or scope of proposed activities seems counterproductive at this stage. Rather, we recommend assigning points to activities during the process of setting the evaluation criteria based on the activities proposed. No more than ten percent of the total should be awarded for research and development activities, so that the bulk of the points should be awarded for measurable results in households and communities. (questions 5 and 80)

FHFA should clarify that the prohibition in section 1282.38(b)(1) on National Housing Trust Fund or Capital Magnet fund contributions receiving credit under Duty to Serve does not prohibit other GSE activities on properties that happen to receive funds Housing Trust Fund or Capital Magnet Fund. For instance, a GSE purchase of a mortgage on a rental housing property receiving rental assistance through the National Housing Trust Fund could be eligible, but the rental assistance itself would not.

3. Allow time to implement activities

Reaching underserved markets necessarily involves trying approaches that will take significant effort and whose results are uncertain. Market capital has not served these areas well yet, and it will take time to adjust processes, create products, and build relationships that help capital to flow. We therefore believe the three-year term of the plan is an appropriate time frame for testing proposed efforts and evaluating their success. It is also further reason to keep the evaluation criteria stable over the three year period. (question 8)

4. Engage the public constructively

Public review of the plans and of the GSEs evaluations can be a constructive part of holding GSEs and FHFA accountable for results. Overall, we believe the proposed time-frames for public notice strike a good balance between allowing public review and making sure the regulatory and business processes involved can proceed.

We recommend that FHFA make data on the GSEs past activities in underserved markets and ongoing progress under the plan publicly available so the public can better evaluate the plans. This is valuable both for evaluating the proposed plan and mid-course corrections. Greater transparency about, for instance, numbers of loans made, geographic distribution, number of units in the properties financed,

and other features of lending activity are directly relevant to whether proposed activities are likely to succeed. We believe FHFA and the GSEs could make more data public without compromising the healthy competition between the GSEs. (question 9)

5. Iterate and improve

Perhaps the most important feature of the Duty to Serve process is that it allows the GSEs to improve their efforts over time as FHFA helps to raise the bar for success. We expect that after the first plans are evaluated, some of the activities will have proven successful and others will not. The process should encourage the GSEs to expand activities that show success and terminate activities that do not, with the latter just as important as the former. Reaching underserved markets necessarily involves experimentation, so an iterative process allows both the GSEs and their regulator to let experiments run their course.

B. Potential to lead the private market

Successes by the GSEs fulfilling their Duty to Serve can go beyond the immediate benefits of the capital they direct. If Fannie Mae or Freddie Mac can demonstrate profitable activities tied to financing affordable housing in currently underserved areas, private capital may follow. Getting private, non-GSE capital flowing into underserved markets in measurable amounts would be a major accomplishment of the Duty to Serve process, and one that will likely take years to materialize.

GSE demonstration and deliberate encouragement have brought in private capital to affordable housing before. As Fannie Mae documented in its comment letter on this rulemaking, guarantees of early Low Income Housing Tax Credit investment funds provided investors with enough confidence to test out a new and complex investment in affordable housing. Over many years, the investors became comfortable with the risks and returns involved, eventually making the GSE guarantees a minor part of the market.[3]

C. Connect to the Conservatorship Scorecard

To make the Duty to Serve process most effective, FHFA should incorporate the Duty to Serve evaluation into the Conservatorship Scorecard. The Scorecard has proven successful in focusing GSEs on the organizational development required by the regulator. Achieving a good Duty to Serve score should be compatible with that development, so incorporating the Duty to Serve should build on the success of the Scorecard process and avoid creating conflicting incentives for the GSEs. We are pleased that the 2015 Scorecard already includes preparations for Duty to Serve.

[3] Fannie Mae comment letter on Duty to Serve, February 22, 2016, https://www.fhfa.gov//SupervisionRegulation/Rules/Pages/Comment-Detail.aspx?CommentId=13783

III. Strengths of the secondary mortgage market for affordable housing

Fannie Mae and Freddie Mac have particular strengths as Government Sponsored Enterprises (GSEs) in the secondary mortgage market. Because they buy mortgage loans and package them into mortgage-backed securities, they have some ability to shape the origination market. Lenders will, in part, adjust their lending policies around what the GSEs will buy. But the GSEs can only buy what lenders bring them, so their market power only extends so far. Fannie Mae and Freddie Mac's strengths in the secondary market are particular, and that shapes how they can support affordable housing in underserved areas.

A. Operate at scale

Securitization, to work at all, requires a standard set of processes operated at large scale. The GSEs need standardization to achieve the efficiencies that keep the cost of capital to borrowers low. Originating lenders need standardization to make loans efficiently. Investors in single-family loans particularly need standardization, because they must efficiently evaluate, price, and manage securities that include large numbers of mortgages. Investors in multifamily loans benefit from standardization, too, although the properties are larger, there are fewer loans per security, and the underwriting is more detailed and customized.

Operating at scale allows the GSEs to set standards, something they have done successfully for many years. By setting standards for loan quality, servicing, loan terms, and more, the GSEs influence not only the loans they purchase but the overall market standard. Although federally-backed securities dominate the market now, past experience suggests that non-federally backed securities, when they arise again, will look to the federally-backed channels as a reference.

Standard-setting gives the GSEs the ability to encourage market activity, not just their own loan purchases, to better serve affordable housing. If one or both GSEs adjusts their standards to make an affordable housing lending product fit within their criteria, lenders originating for the GSEs can take it up, but so can lenders not specifically aiming for GSE purchase. The key is finding adjustments that still allow profitable, sustainable lending, so that GSEs can be market leaders in affordable housing in underserved areas.

B. Shallow subsidy

The efficiency benefits of securitization can reach widely, but by they are also shallow. Lowering the cost of capital by, say, 50 basis points can make an affordable rental development more feasible, but it cannot provide the ongoing subsidy needed to serve households who cannot afford enough rent to cover the operating and capital costs of a property. Generally speaking, a household at 30-40% of the area median income (AMI) paying 30% of income for rent generates only enough to cover operating costs for a rental apartment, much less the capital costs to develop and maintain. Similarly, lower cost

of capital can make the interest rate lower for a single-family mortgage, but it cannot create wealth for a downpayment or income to make monthly payments.

Therefore, the GSEs efforts under Duty to Serve should focus on what large-scale, efficient, secondary market activity can accomplish. Achieving affordability for extremely low income households necessitates making GSE products compatible with rental housing subsidies designed to reach those households, such as rental assistance and supportive services. Reaching low-income homeowners requires compatibility with downpayment assistance, shared equity models, and housing counseling. Duty to Serve activities should focus on how to expand existing products and innovate new products that reach underserved markets rather than relying solely on making loan rates and terms concessionary as a cost of doing business.

IV. Low Income Housing Tax Credits

Questions posed by FHFA about GSE participation in the Low Income Housing Tax Credit (LIHTC) market cut across several areas of Duty to Serve activity. Rather than address them repetitiously in each section, we offer one discussion here with reference to specific questions in parentheses.

A. GSEs should not buy LIHTC in current state of conservatorship

FHFA asks the first-order question of whether the GSEs should purchase LIHTC at all. (question 41) In the current state of conservatorship, all of the GSE's profits are being swept by the federal government. So, an investment that pays primarily a yield primarily in savings on federal taxes is pointless. FHFA is correct in its choice to keep the GSEs out of the LIHTC investment market in the current state of conservatorship. As conservatorship changes or ends, FHFA should reevaluate its decision.

B. Current LIHTC market does not need GSE participation

The current LIHTC investment market has widespread and strong investor demand. Properties regularly command more than $1.00 per dollar of LIHTC. That means investors are, in effect, paying more than $10 up front for the promise of $1 in reduced taxes per year over ten years. Such strong pricing means federal dollars go further to create affordable housing.

Such strong pricing also suggests no need for additional demand on the investor side. Indeed, investors motivated only by economic calculations have largely dropped out of the market for LIHTC, because other investors motivated by a combination of economic calculations and regulatory needs are willing to pay more.[4] Adding further demand from GSEs, which by definition would be motivated both by economic incentives and regulatory incentives, would only make the market more frothy and displace existing investors.

[4] Affordable Housing Finance, "Economic Investors Exit LIHTCs", Special Report, February 16, 2016, http://sms.hanleywood.com/specialreports/SMS_SpecialReport_Feb16-FullArticle-AHF.html

In the past, LIHTC demand driven by Community Reinvestment Act (CRA) requirements led to measurable pricing differences between areas where many financial institutions had overlapping footprints and areas with limited service by financial institutions.[5] Although some pricing difference persists, current LIHTC investor demand is so strong that even little CRA-driven interest can command pricing above $0.90 per dollar of LIHTC.

In the future, adding capital with a regulatory motivation could create less stability. Fannie and Freddie's exit from buying LIHTC in 2008 was part of a systemic event that also affected most major financial institutions and left a huge gap in investor demand for LIHTC. Fannie and Freddie alone were roughly half of the LIHTC investment market.[6] It is possible that future macroeconomic shocks will affect GSEs and other financial institutions differentially, but the country's most recent experience suggests that having a LIHTC dominated by a small number of regulatorily-motivated buyers makes the market fragile.

C. LIHTC is a proven tool to create affordable housing

More than 30 years of program history have shown the LIHTC to be an effective and efficient means to create and preserve affordable housing. By relying on sophisticated private investors for up-front capital and ongoing asset management, LIHTC properties have achieved long-term sustainability and very low default rates.[7] Annual allocation planning by state agencies has, on the whole, allowed flexible allocation to address each state's affordable housing needs and gradually improved the return on public investment. Since 1986, the LIHTC has financed more than 2.7 million affordable apartments nationwide.[8] As the primary capital subsidy for affordable rental housing, LIHTC will likely be an element of the transactions connected to Duty to Serve activities. GSE debt products will likely sit alongside LIHTC equity in the capital stack of many properties preserved or developed in rural or economically distressed areas, regardless of whether a GSE is the investor or guarantor.

D. A limited LIHTC role for GSEs offers little value

For any LIHTC investor, the ability to select investments and manage risk is essential. Indeed, the discipline of the investors is part of what has made the program so effective over time. Trying to direct

[5] Cohn Reznick. The Low-Income Housing Tax Credit Program: A Performance Update Analysis. December 2014. http://www.cohnreznick.com/ahfperfupdate

[6] Recap Real Estate Advisors, "Government-Sponsored Enterprises and Multifamily Housing Finance: Refocusing on Core Functions," October 2010, http://media.wix.com/ugd/19cfbe_d556fc7ea9b04fc3b45394918aa32956.pdf.

[7] CohnReznick. The Low-Income Housing Tax Credit Program: A Performance Update Analysis. December 2014. http://www.cohnreznick.com/ahfperfupdate

[8] Dietz, Robert. "How Many People Have Benefitted from the Affordable Housing Credit? National Association of HomeBuilders. November 16, 2015. http://eyeonhousing.org/2015/11/how-many-people-have-benefitted-from-the-affordable-housing-credit/

GSE LIHTC purchases only into underserved areas and capping their total investment cuts directly against the necessary portfolio management a sustainable LIHTC investor requires. (question 42)

Fannie Mae argued as much in its recent comment letter.[9] Both GSEs have a strong track record of large-scale, profitable LIHTC investing. They had skilled teams with deep knowledge of affordable housing and the risks involved. Part of what allowed them to be so successful was having a large, diversified portfolio with the freedom to select investments apart from CRA regulatory pressures. They would not likely be able to replicate their past success if constrained in portfolio size and directed only to the toughest markets.

E. No need for guarantor role in LIHTC

Allowing the GSEs into LIHTC as fund-level guarantors is backward looking, not forward looking. Guaranteed funds have passed their utility. Early in the program's history, guarantees allowed new investors to test the waters and become comfortable with the risks. Over time, many of those investors developed the expertise and the desire to make their own, non-guaranteed LIHTC investments. Now with more than 30 years of program experience, the investor community is sophisticated and well-informed, so the need for guarantees has largely passed.

Having guaranteed funds as a regular part of the market, rather than an introductory stage, offers little benefit. The LIHTC program works well because of investor oversight, which brings discipline to property development, financing, and operations. Having observed side-by-side results of guaranteed vs. non-guaranteed LIHTC investment funds created by the same syndicator, we can attest that guaranteed funds contained weaker properties with poorer performance. Having a guarantor allows investors to focus primarily on counterparty risk rather than real estate risk, and therefore leaves all oversight to the guarantor.

If the guarantor is a disciplined third party, it can still perform effective oversight. However, all that relationship accomplishes from a policy perspective is to encourage investors who cannot or will not perform oversight to still invest by relying on the guarantor. Since the LIHTC investor market has a surfeit of demand, there is little to be gained by reintroducing guaranteed funds.

V. Preservation of affordable housing

Congress correctly identified preservation of affordable housing as a goal of the Duty to Serve. The risks to existing properties come from both sides: market pressure to convert to higher rents and the erosion of the physical property over time. To address both risks, policy must help capital to flow in to sustain properties physically while regulating their use as affordable housing for the long term. Preservation maximizes the value of past federal investments in affordable housing in ways that are cost-effective,

[9] Fannie Mae comment letter on Duty to Serve

energy efficient, and compatible with both economically vibrant and revitalizing communities. It is also an area that plays to the GSEs strengths in offering low-cost permanent debt.

A. GSEs should provide capital not regulation

Preservation transactions generally involve multiple subsidy sources with overlapping regulatory requirements and use restrictions. As capital providers to lenders, the GSEs should not seek to layer additional use restrictions on top of those required by HUD, state agencies, localities, or other regulators. Rather, the GSEs should seek ways to make their lending more compatible with the customized, complex transactions often required to preserve properties developed under legacy affordable housing programs. Policies around required reserves, timelines for loan processing, and developer guarantees, among others, are ripe for adjustment. (question 28)

B. Property cohorts suitable for GSE involvement

The proposed rule asks by name about cohorts of federally-subsidized affordable housing properties identified in statute. The simplest way to categorize these cohorts of properties is by whether their income stream and regulatory configuration can support debt. If they can, GSE involvement can help to lower the cost of capital. If they cannot, there is little GSE involvement can accomplish.

Over time, recapitalization of no-debt property cohorts such late-stage Section 202 Housing for the Elderly or more recent permanent supportive housing properties may require changes in rental subsidy that would allow them to support debt. If, for instance, HUD provided rental assistance that covered both operating expenses and debt service, GSE action becomes feasible.

C. Preserve affordability in neighborhoods as well as properties

The proposed rule correctly identifies the challenge of maintaining affordability in places experiencing rapid expansion of demand for housing and displacement of long-time low-income residents. Preservation of existing properties is an essential part of the policy response, but adding density in such areas is also essential to reduce upward pressure on rents. If GSEs can provide permanent financing for properties that add affordable housing in neighborhoods under pressure to add supply, they should receive Duty to Serve credit. New construction of affordable housing can help to preserve affordability at a neighborhood level, which is entirely compatible with the Duty to Serve. (question 27)

Indeed, some existing preservation programs involve elements of new construction to reconfigure sites and add density. Choice Neighborhoods and the Rental Assistance Demonstration are current examples, and the earlier HOPE VI program is a past example. The proposed rule correctly identifies these examples of preservation including new construction that deserve Duty to Serve credit.

However, FHFA must be sure that providing debt for new construction in high-demand areas does not overshadow the core mission of preservation of existing, largely irreplaceable subsidized housing. The evaluation criteria should award the bulk of Duty to Serve credit for preservation to activity that

preserves existing subsidized housing while allowing additional credit for adding supply in areas of high housing demand. A GSE should not be able to score well without serving the core mission of preservation, but efforts in neighborhood-level preservation should allow the GSE to stand out.

D. Long-term affordable homeownership

Preservation is not exclusive to rental housing. Affordable homeownership is similarly essential, but too often homeownership assistance occurs in a one-household, one-time fashion that does not result in a long-term community asset. We welcome the inclusion of long-term affordable homeownership activities under the Duty to Serve. Lending supported by the GSEs can preserve affordability through either blanket or individual loans to low- or moderate-income buyers in shared equity housing cooperatives, community land trusts, and manufactured housing communities owned by mission-committed entities. Including it as a Regulatory Activity in the rule is appropriate. (questions 64 and 66)

Duty to Serve credit for preservation should focus on long-term affordable homeownership, not one-time assistance. Most shared equity mechanisms provide for preservation of affordability at resale, through a claw-back of equity, repayment of a soft loan, cooperatively held title to the land, or other mechanisms. Rather than identify a specific number of years in a use restriction, we recommend that the Duty to Serve activities focus on

Lack of financing is often a barrier to long-term affordable homeownership, for both cooperatives and individual aspiring homeowners. By creating more financing options and more mainstream financial understanding and inclusion of shared equity homeownership, the GSEs can aid the creation of more affordable homeownership that is more easily accessible to those who need it.

E. Preserve affordable housing through energy and water efficiency

Making homes more energy and water efficient has obvious benefits for residents and communities: lower utility costs, better health, greater comfort, and reduced environmental impact, among others. There are significant barriers to financing retrofits of owned and rented housing alike to achieve greater efficiency, particularly in giving capital providers sufficient assurance that predicted savings will occur to repay their investment. There are also incentives outside of Duty to Serve to do more lending in this arena, as evidenced especially by Fannie Mae's extensive work in both single family and multifamily. Indeed, NHC supports policy to encourage more energy efficient housing in a number of ways, primarily focused on affordable housing.

The Duty to Serve rule is an appropriate place to encourage preservation of affordable housing through energy and water savings. It should not, however, be the sole driver of the GSEs work in this space. FHFA should include energy and water efficiency as a Regulatory Activity, but it should ensure that the GSEs only receive Duty to Serve credit for the activities that serve households of moderate income and below. Put differently, Duty to Serve should encourage the GSEs to make sure their solutions for energy and water efficiency work for affordable housing as well as for higher-cost housing. (question 51)

Designing activities around energy and water efficiency will require flexibility to adapt to various mixes of tenant- and owner-paid utilities (for rental housing), state laws and incentive programs, energy usage patterns, subsidy arrangements, and other factors. We urge FHFA to avoid prescriptive requirements such as a minimum payback period, reduction in tenant utility costs, specific verification method, or others that may make innovation more difficult. Rather, we urge FHFA to evaluate proposed activities individually as proposed by each GSE against the basic principle of achieving verifiable utility savings that benefits residents, owners, public sector subsidy providers, and property viability. (questions 51 - 56)

VI. Rural housing

Congress and FHFA are correct to identify the lack of capital for affordable housing in rural areas and to encourage the GSEs to expand their rural activities under the Duty to Serve. NHC supports an expanded GSE presence in rural areas to create and preserve affordable rental and owned housing.

A. Definition of rural

Policy questions around rural housing far too often center on the definition of rural. Capital tends to flow to area of highest return and lowest cost, while many rural areas have for years now been places of level or declining population and weak economic activity. Too broad a definition of rural allows scarce government resources to flow first to places that have become suburban or exurban rather than to rural areas of greatest need. Too narrow a definition can inadvertently exclude places of need where investment could stimulate needed economic activity and meet housing need.

Further complicating the definitional question for FHFA is the need for a systematic and reliable definition. The lending activities the GSEs will pursue under Duty to Serve will be designed at least regionally if not nationally in scope. To work with multiple originating lenders in multiple places requires a definition compatible with geocoding and standardized solutions.

From an evaluation standpoint, stability of the definition is desirable but not an overriding concern. GSE activities will take many months to develop and implement, so there is a possibility that some areas will change status during implementation. There is also the possibility that methodological changes by the agency responsible for the definition may change the status of particular areas during the course of a three-year plan. Neither of these risks seem fatal. The semi-annual updates by GSEs to FHFA should allow for adjustments to the evaluation criteria if needed to accommodate definition changes. Concerns about fairness in evaluation could be addressed by declaring that any area designated as rural by the definition in force at the beginning of the three-year cycle counts as rural for evaluation purposes at the end of the cycle, even if the area's status change mid-cycle.

NHC supports the definition proposed by FHFA based on census tracts supplemented by USDA's Rural-Urban Commuting Area (RUCA) codes as supplemented by suggestions from the Housing Assistance

Council in its comments. The revised definition would define as rural a census tract either a) outside of a Metropolitan Statistical Area (MSA) as defined by OMB, or b) inside an MSA that is outside of RUCA code 1 and outside of RUCA code 2, if it has a housing density of over 64 housing units per square mile. (question 70)

NHC also supports designating high-needs rural populations and regions to better direct the GSE's activities. Appropriate regions to designate include Central Appalachia, the border colonias, the lower Mississippi Delta, the rural Southeast, and tribal areas. (question 72)

B. Mixed use development in rural areas

The GSEs can encourage both affordable housing and economic development by reducing financing barriers to mixed use development in rural areas. Mixed use generally combines ground floor commercial space with residential space on higher floors to make most effective use of real estate. Many rural downtowns feature some version of mixed use, often with residential apartments above storefronts.

Too-strict limits on commercial components by income or floor area can overly limit mixed use development.[10] For a simple example, consider that a 20% limit on commercial income in underwriting would require at least a 5-storey building for feasibility, larger than most rural downtowns typically support. More nuanced underwriting that allows higher proportions of commercial income and floor area, especially when residential units provide affordable housing, would be a useful activity for the GSEs to pursue under the Duty to Serve.

C. Rural housing preservation

Preservation challenges loom large for rural rental housing. The risk of conversion to higher-rent use is particularly strong for once-rural but now suburban properties, and the risk of physical deterioration is large as many properties are reaching or have passed 50 years of age. The Section 515 portfolio of USDA-financed properties has received less attention and financial help than other cohorts of older affordable housing, and there are generally fewer existing options for preservations transactions. The portfolio has also aged to the point of mortgage maturation, further limiting transaction opportunities to preserve many properties.

Our recommendations from the section above on preservation apply equally to rural areas. We encourage FHFA to take a similar approach to preservation in rural areas and to score rural preservation activities in the rural category to ensure they receive appropriate attention.

[10] Regional Plan Association, "The Unintended Consequences of Housing Finance." January 2016. http://library.rpa.org/pdf/RPA-The-Unintended-Consequences-of-Housing-Finance.pdf

VII. Manufactured housing

Manufactured housing is often the least-noticed form of affordable housing, but it is found nationwide and is one of the largest sources of unsubsidized affordable homes. Too often the financing arrangements and ownership structures limit wealth-building by residents or upkeep of properties. The GSEs can play a useful role through Duty to Serve activities by encouraging more sustainable financing of manufactured housing that serves low- and moderate-income residents.

FHFA proposes that GSEs receive credit for activities related to all real property loans on manufactured housing (a too-rare loan type that should be encourage) and loans on manufactured housing communities that are:

- 150 pads or fewer, or
- Owned by government, a non-profit, or residents, or
- Protected by a minimum set of pad lease provisions

We offer a few recommendations to adjust these criteria.

A. Focus on liquidity and standard setting in defined geographies

As discussed above, GSEs can affect housing outcomes primarily through secondary market actions that provide liquidity and set standards. Those mechanisms are most effective when operated at scale, which means GSEs must strike a balance between setting standards too low and not achieving enough improvement for residents and setting standards too high standards and not reaching many properties.

We recommend setting standards for acceptable manufactured housing communities in clear, easy-to-implement terms that many jurisdictions and providers can adopt. Requiring a detailed set of lease provisions, for instance, could be a barrier to widespread adoption. In contrast, a set of principles that matched protections already established by states that have been most effective in supporting sustainable manufactured housing could be modeled by other states or localities.

Setting standards that match defined geographies also helps the GSEs plan their activities at scale. Knowing that any manufactured housing loan in a particular state will qualify for Duty to Serve credit makes planning a business strategy much simpler. It is also easier to scale up GSE activities if other states adopt matching standards. (question 18)

B. Maintain criteria for ownership type

Nonprofit, resident cooperative, or government ownership is a powerful mechanism for sustaining affordable manufactured housing communities. Breaking the dysfunctional pattern in which the pad (which can appreciate in value) is financially separated from the structure (which depreciates in value) corrects a major problem afflicting manufactured housing. It is also a simple definition for the GSEs to implement as liquidity providers.

FHFA should maintain the ownership criterion as proposed.

C. Reconsider the 150-pad criterion

It is not clear that simply getting more GSE financing into smaller manufactured housing communities would provide sufficient benefit to justify Duty to Serve credit. If the goal is to expand the GSE lending presence in the smaller end of the market as a way to improve lease terms for residents and property condition generally, it would be better to focus on expanding lending to smaller communities that also have the protections discussed above. Otherwise, there is substantial risk that property sizes adjust through development planning or simply subdivision to take advantage of favorable GSE financing. Once GSE financing is in place, there may be no significant improvement in tenant protections or property condition, depending on choices made by the property owner.

FHFA should reconsider the 150-pad criteria as a stand-alone criterion and instead combine it with the modified lease protection criterion described above. (question 17)

VIII. Residential economic diversity

NHC welcomes FHFA's attention to residential economic diversity in the proposed rule. Long-standing patterns of residential segregation created by a combination of government policy and private actions over decades are an ongoing challenge for communities nationwide. When people have more choices of where to live near work, school, family, and other opportunities, we all prosper. To achieve greater choice, we must invest more to create opportunities where people already live and support pathways to places of opportunity for people who wish to move. There are too many people and too many places in need for us not to pursue both strategies.

From a policy perspective, residential economic diversity is a complex issue that is receiving renewed attention in several ways. The recent Supreme Court decision in *ICP v. Texas* affirmed the applicability of the disparate impact standard for evaluating fair housing claims, and all of the opinions in the cases stated the need both to create affordable housing in wealthier communities that lack it and to revitalize areas of economic distress. HUD's final rule implementing the Fair Housing Act's requirement to affirmatively further fair housing has reinvigorated efforts in many communities to examine the source of their patterns of residential segregation and the means to change them. Citizen protest in places like Ferguson, Missouri, and Baltimore, Maryland, has highlighted the long-term dysfunctionality of residential segregation.

FHFA is correct to incorporate residential economic diversity into the Duty to Serve obligation so that GSE innovations can better align with other change ongoing in housing policy.

A. Treat as extra credit

FHFA's basic approach of treating residential economic diversity as extra credit is appropriate. Housing policymakers at all levels of government are still grappling with the complex issues involved in addressing long-standing patterns of residential segregation. Responses will continue to emerge over time. Given how challenging the other housing issues addressed by Duty to Serve are, the rule should not penalize the GSEs for focusing primarily on problems they can solve, like lack of liquidity for affordable housing. Providing extra credit for activities that address residential economic diversity, however, creates an incentive for the GSEs to understand other policy changes at the local, state, and federal level and align Duty to Serve activities when opportunities present.

B. Revisit definition of high opportunity areas over time

FHFA proposes offering extra credit for Duty to Serve activities that also provide either a) affordable housing in high opportunity areas, or b) mixed-income housing in areas of concentrated poverty. FHFA proposes to use HUD's Difficult to Develop Areas (DDA) definition, which starting this year will use census tracts as the unit of analysis. The DDA is a poor measure of opportunity, since it focuses on construction costs rather than opportunity directly. It is also likely too narrow, excluding areas of moderate wealth and construction costs that are still much higher opportunity than places of economic distress.

However, NHC does not know of an obviously superior definition to use that is nationwide, easily available, and systematic enough for Duty to Serve evaluation use. We recommend FHFA evaluate the results of using DDAs in the first cycle of Duty to Serve and revisit the question.

C. Focus on revitalization efforts rather than mixed-income

In the second part of the definition, FHFA should focus on revitalization efforts rather than on mixed-income housing. Mixed-income housing may or may not be the best way to stimulate economic activity or investment in a community. In many places, it can be much more difficult to achieve within a single property than within a neighborhood. The complex financing, subsidy, and regulatory structure needed for a mixed income property often becomes prohibitive outside of the densest, most competitive rental markets.

Instead, other indicators of concerted efforts to revitalize distressed areas will be more useful. State and locally defined plans will be better attuned to local needs. FHFA is correct to note that state definitions vary in their detail and rigor, but that variation is not so large as to make the definition unusable. Most states in their qualified allocation plans for LIHTC define revitalization efforts, so it should be possible for the GSEs to incorporate state-level definitions. Federal revitalization efforts such as Choice Neighborhoods and Promise Zones should also qualify, but they are so limited in the number of places they can reach that they should not be the only means to qualify.

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IX. Conclusion

NHC commends FHFA for putting forward this proposed Duty to Serve rule. Getting the process envisioned by the Housing and Economic Recovery Act of 2008 on track after the vicissitudes of the Great Recession is essential to create more affordable housing opportunities nationwide. NHC would be glad to assist FHFA and the GSEs in their efforts to do so.

Sincerely,

Chris Estes
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