

July 10, 2017

Jim Gray  
Duty to Serve Program Manager  
Federal Housing Finance Agency  
400 Seventh Street SW  
Room 10276  
Washington, DC 20219

Re: Duty To Serve draft Underserved Markets plans

Dear Jim,

The National Housing Conference is pleased to see the Duty to Serve implementation moving forward and we welcome the opportunity to comment on the draft plans. The draft plans represent many hours of work by staff at Fannie Mae and Freddie Mac, FHFA, and stakeholders participating in the process. All of that effort aims to bring affordable housing opportunities to people and places that the market currently does not serve well. We support fully that aim and offer the comments presented here to guide and improve the efforts of Fannie Mae and Freddie Mac.

The two plans have natural and expected similarities, given the similar and competing roles of the two enterprises. This letter presents comments to both Fannie Mae and Freddie Mac plans. Where the plans are similar, we offer comment that apply to both are similar. Where the plans differ, we offer comments specific to each plan.

Overall, our comments recommend ways for Fannie Mae and Freddie Mac to set achievable and impactful objectives in their plans that will drive innovation and better access to mortgage capital, beyond what is available now. The table below outlines our comments:

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## **I. About the National Housing Conference**

Everyone in America should have equal opportunity to live in a quality, affordable home in a thriving community. The National Housing Conference educates decision makers and the public about housing policies and practices to move housing forward together. NHC convenes and collaborates with our diverse membership and the broader housing and community development sectors to advance our policy, research and communications initiatives to effect positive change at the federal, state and local levels. Founded in 1931, we are a nonpartisan, 501(c)3 nonprofit organization. NHC’s research team operated as the Center for Housing Policy until the organizations merged in 2013.

## **II. Improve functionality of Duty to Serve plans**

This is the first iteration of the Duty to Serve plans. By the nature of the process, these should improve over time through a process of comment, finalization, implementation, review, and iteration. We recommend changes to the approach and presentation of the plans to aid the process of improvement and help the enterprises reach their aims more effectively.

### **A. Set achievable and impactful objectives matched to points**

Duty to Serve plans should set goals for the enterprises that drive business decisions toward expanding access to the lending that enables greater access to affordable homes. Since both Fannie Mae and Freddie Mac do good work already, it is no small challenge to define objectives that go beyond what the enterprises already do and yet are also predictably achievable. Unachievable objectives would set the enterprises up for failure. Objectives that describe activities already underway bring little assistance to the nation’s affordability challenges.

There are a number of areas within each plan that appear to err on the side of achievability rather than ambition. The three year duration of the plan too easily lends itself to a structure of one year to write a report, one year to develop a pilot, and then a third year to implement. The result is that actual loan purchases are three years out, although often the preliminary activities could be completed in far less time. Where appropriate to each plan, we identify areas to move quicker to loan purchases and to process pilot programs and data collection in parallel.

The points allocated to each activity should match the effort required and the expected impact. Activities that are valuable only as preliminary steps to loan purchase should receive very little points, while actual loan

purchases should receive much more. In short, scoring should motivate effort toward areas of most impact. The table below shows an example reconfiguration:

<i>Activity</i>	<i>Enterprise proposed concept score</i>	<i>Concept score scaled to effort and impact</i>
Produce a white paper	30	10
Design a pilot new product	30	20
Market and do outreach for new product	40	20
Purchase loans	50	30-50 (scaled by volume)
Total	150	80-100

The table above is a stylized example, and different activities may require different points depending on expected effort required and impact on underserved markets. Notice that the lower point total motive compressing activity now projected for two years into a single year—for instance, writing a white paper and designing a pilot together in the first year to earn the same first year points. Year two could see marketing and outreach begin quickly leading to loan purchases, with year three having a fully operational pilot with a longer history and likely greater volume of loans purchased.

We observe that the Evaluation Guidance does not allow objectives with concept scores below 30 points to receive extra credit. This perhaps explains why virtually none of the activities proposed by either enterprise have a concept score less than 30. This feature of the guidance, however, should not cause the plans to inflate concept scores, especially for intermediate steps like research or product design. Indeed, the primary way to see significant over-performance in an intermediate step would be by the resulting loan purchases and economic impact.

## **B. Make plans accessible to stakeholders**

To gather helpful comment from stakeholders, the plans should be easy to comprehend, navigate, and comment upon. Neither plan does particularly well on this score, which creates a significant barrier for stakeholders who might comment.

Plans should be more concise. Freddie Mac’s plan is 109 pages long, and Fannie Mae’s is 239 pages. Both excessively repeat information. For instance, summary tables span dozens of pages because they include large blocks of text copied entirely from the narrative, yet in some places lack key details like proposed concept score. For example, Fannie Mae’s Attachment A summarizing the rural section is alone 30 pages long. The result is not a useful summary. As a further example, every page of Freddie Mac’s plan contains a three line footer (Fannie’s is smaller type and therefore two lines) declaring that it will not be effective until it receives a non-objection from FHFA and is subject to change. The single disclaimer at the beginning would suffice, surely.

The plans cover a wide range of activities, and few if any stakeholders have detailed knowledge of all of them. Imagine the challenge for a small nonprofit housing developer who specializes in rural preservation trying first to realize that there is a section of the plan relevant to their work, then to find it, and then to comment on it

constructively. The final plans and future iterations should provide much clearer and more precise presentation to help elicit the stakeholder feedback that can aid the enterprises in Duty to Serve work.

Fannie Mae did hold an outreach event to explain its Duty to Serve plan, for which we commend it. That outreach is not a substitute for a clear and accessible document, however.

### III. Affordable Housing Preservation

As conceived in the Duty to Serve rule, affordable housing preservation encompasses many areas of policy: single-family housing, multifamily housing, energy and water efficiency, residential economic diversity, and more.

#### A. Affordable rental housing

##### 1. Loans for LIHTC and Section 8 properties

Both plans correctly identify LIHTC as the primary affordable housing production program and Section 8 rental assistance as the primary means by which properties can serve extremely low income households. Properties using these programs are appropriate targets for significant effort by the enterprises. The Freddie Mac plan proposes volume targets as Activity 1, Objective A, a streamlined offering as Objective B, and a capital gaps product as Objective C. Fannie Mae proposes increased purchases of loans and product improvements in D., Objective 1.

LIHTC and Section 8 also make these properties highly desirable borrowers within the universe of affordable housing properties. LIHTC equity investment means there is a syndicator and one or more equity investors with a strong interest in seeing the property perform as projected through year 15. Syndicators and investors will monitor closely to ensure performance and in rare extremes step in to rectify property-level failures and prevent default. As a result, mortgage defaults are extremely rare over the more than 30 year history of the program.

A property-based Section 8 contract means the federal government agrees to pay the difference between each tenant's share (set at 30% of income) and the contracted rent. The primary credit risk therefore rests on the federal government, which has consistently paid Section 8 contracts. Occupancy at Section 8 properties is generally higher than that of unassisted properties. In short, there is significantly less volatility and credit risk in Section 8 properties.

Evidence of the desirability of these loans is clear from the amount Fannie Mae and Freddie Mac are already doing, as presented in the plans. Better service to this market should focus on creating an easier process that reduces transaction costs, thereby freeing up resources for developers, lenders, and other participants to do more mission work. Freddie Mac's Objective B correctly aspires to this. Fannie Mae's proposed product improvements are slightly less specific.

Both plans could do more not only to improve their own processes but to work with other participants in the process to better align property underwriting, regulatory requirements, and mortgage debt. For instance, aligning reserve requirements among state allocating agencies, originating lenders, and the enterprises could help borrowers navigate the loan process more efficiently.

Freddie Mac's Objective C proposes a secondary market mechanism to help close capital gaps. This sounds appealing but remains enigmatic. Capital gaps exist in affordable housing because the sum of first mortgage debt supportable at affordable rents and equity capital (often from LIHTC investors) is still less than total development cost. By definition, there is little or no additional property income with which to support debt, so subsidy (soft loans and grants from government or philanthropy) usually fills the gap. The description offered in the plan does not explain what would pay the yield on gap-filler securities.

It is not clear, however, that loan purchase objectives (Freddie Mac Objective A, Fannie Mae Objective 1) is actually separate. Freddie Mac has a strong baseline activity serving this segment of the market. It should strive to do so better, and Objectives B and C suggest means to do so.

We therefore recommend that the loan purchase measures become part of the means to measure the success of process improvement without receiving separate points. We further recommend that the evaluation of process improvements attempt to measure whether there are meaningful savings in transaction costs. The focus should be on measures like total time from application until closing and total soft costs in addition to loan to value ratio, debt service coverage, loan term and amortization. Evaluation should compare loans under the new process to loans originated before it was put in place.

Targets should not be too low based on a short-term expectation of a decline in LIHTC pricing. The blip in LIHTC pricing seems much more related to negotiating techniques by a few investors than a widespread change in investor expectations. Even in the short time since the proposed plans arrived, LIHTC expectations appear to be stabilizing. Rather than anticipate a major decline, it would be wiser to base goals on a steady state LIHTC market and allow for readjustment of targets with FHFA if significant market changes occur, just as is possible for any goal in the plan.

The same logic applies to loan purchase and process improvement for Section 8 properties (Freddie Mac Activity 2, Fannie Mae Activity A Objective 1). We recommend the same changes. Specific to Fannie Mae, it should not require an entire year to analyze whether updating guidance could increase Section 8 property loan purchases, especially since the plan anticipates an increase in purchases.

## ***2. Rental Assistance Demonstration (RAD) loans***

(Fannie Mae Activity J, Freddie Mac Activity 3, Objective A) Freddie Mac's proposed scoring for RAD loan purchases is an example of an objective where potential concept scores are clearly scaled to impact. The plan lays out a baseline based on market data and steps from concept scores from 30 to 50.

The gap between what is needed for a score of 30 and a score of 50 is too small, however, at only 2 transactions and 50 units. Closing one additional RAD transaction with 50 units would be enough to change the concept score by 20 points, which would be disproportionate. The higher concept score should function as a more scaled stretch goal.

Fannie Mae should similarly set more aggressive and specific targets using unit totals as well as loan purchases. Its proposed three year outreach process does not specifically identify what barriers to its participation will be addressed or how it might overcome them.

We recommend adjusting the distance between concept scores of 30 and 50 to a range of 100 units and 4 transactions in 2018 and 50 units and 2 transactions for 2019 and 2020. Since the publication of the plan, Congress has increased the RAD cap, which should stimulate more activity earlier. As discussed above, the concerns about a decline in LIHTC activity should not depress these goals so much.

### **3. *Small multifamily loans***

(Freddie Mac's Activity 5, Fannie Mae Activity F) Both plans identify small multifamily loans rightly as an area for innovation and expanded liquidity. In Freddie Mac's plan, the first three objectives proposed are mechanisms for providing liquidity to this segment, and the fourth objective is loan purchases through these channels. We commend Freddie Mac for proposing multiple objectives to increase liquidity in this space and hope it will pursue all of them. The ultimate value to the field, however, is in loans purchased, not solely in product development on its own.

We recommend adjusting the concept scores for Objectives A, B, and C to 30 points. Any scaling above 30 should be based on purchase volume of loans specifically through that channel. Objective D, loan purchases, may still be useful if Freddie Mac plans to use other channels in addition to the three identified here to support small multifamily loans. If the plan retains Objective D, it should be careful not to double-count small multifamily loans scored in A, B, and C.

Fannie Mae's plan seems to focus primarily on existing DUS lenders and entities of national scope. We encourage Fannie Mae to extend its outreach to regional entities, including CDFIs, who may have a helpful combination of detailed market knowledge and loan origination capacity within a specific area. Working in even a handful of major metro areas could be a useful step to building capacity at Fannie Mae and in the field.

### **4. *Investment through trusted mission intermediaries***

Fannie Mae and Freddie Mac have each used trusted originators to deploy capital at scale in the conventional single-family and multifamily mortgage arenas. Originators bring specific knowledge of properties, asset classes, markets, and borrowers that the enterprises cannot match, and the enterprises supply efficient access to capital. They should use a similar approach for part of Duty to Serve by supplying capital to trusted intermediaries like Community Development Financial Institutions (CDFIs) for deployment into affordable housing. Intermediaries may make individual loans, target equity investments, create loan pools, or use other tools. The Enterprises could supply capital via forward commitments, lines of credit, or working capital loans, for instance, to enable trusted mission intermediaries to expand their support for affordable housing.

Freddie Mac proposes some of this activity with respect to small multifamily loans. Fannie Mae mentions CDFIs but only of national scope. Both could expand their approaches through these channels beyond the small multifamily arena.

## **B. Residential economic diversity**

Neither enterprise offers much detail on how they plan to track whether and how their activities contribute to residential economic diversity. However, during the rule development process, we heard many assertions that residential economic diversity is difficult to measure and to correlate with individual loans. Both plans should specify how they will track performance in this area relative to FHFA criteria and identify any barriers they need to overcome.

Freddie Mac's plan asserts in several places that preservation of affordable housing in high-opportunity areas will contribute, which is reasonable. It offers no specifics or targets for loan purchases, which would provide more confidence.

Fannie Mae's plan sets targets for loan purchases meeting residential economic diversity criteria within many of its activities. Specific targets help motivate fulfillment of objectives and maintain awareness of the extra credit objective throughout the work. We commend this approach generally and encourage both GSEs to become more specific as the plans progress.

### **C. Low income housing tax credits (LIHTC) equity investments**

Both Fannie Mae and Freddie Mac propose returning to an active role purchasing Low Income Housing Tax Credit equity (Fannie Mae Regulatory Activity B for high-needs rural regions, Freddie Mac Rural Housing Activity 2).

The decision whether to allow LIHTC investment or not is based on conservatorship, not Duty to Serve. However, FHFA should be aware that it is very difficult for an enterprise to make LIHTC investments just in underserved areas. Like any investment portfolio, an LIHTC portfolio should diversify risk and return. Setting an objective for LIHTC investment in underserved areas may naturally lead to requests to engage in LIHTC investment generally.

The enterprise should only receive Duty to Serve credit for LIHTC purchases that expand opportunity in underserved areas. If they are simply displacing existing LIHTC investors without bringing significantly better (from the property perspective) investment or more demand for investment in underserved areas, FHFA should not award much if any Duty to Serve credit.

Investors buy the overall national allocation of LIHTC every year—credits are not going wanting. Rural LIHTC allocations are successful every year. More might be possible, although state allocating agencies may be wisely limiting their allocations to projects that are feasible. Adding additional investor demand from Fannie Mae and Freddie Mac could improve pricing, or it could simply push some smaller investors out of the market. FHFA should consult with state LIHTC allocators and other knowledgeable stakeholders when evaluating Duty to Serve performance to determine what impact, if any, the enterprise's investment had on allocations or pricing in underserved areas.

### **D. Shared equity homeownership**

(Freddie Mac Activity 8, Fannie Mae Regulatory Activity I) Both enterprises offer cautious plans with limited specificity for expanding efforts in shared equity homeownership lending, which includes various forms: shared appreciation, shared equity, ground leases, community land trusts, limited equity cooperatives, and more. We recognize the difficulty of expanding standardized liquidity-based solutions into this specialized affordable housing niche. However, both plans could set more ambitious goals and build on existing knowledge in the field.

We recommend working with skilled intermediaries in this sector: lenders, CDFIs, and community-based nonprofits. Outreach through trusted partners will be more effective with these specialized shared equity loans than will broadcast-style notices to, for instance, all single-family DUS lenders. Freddie Mac's plan embraces this trusted partners approach explicitly, although with limited details. Both enterprises should consider ways to

expanded participation by lenders specialized in shared equity while maintaining a strong commitment to credit quality and institutional responsibility.

As in other areas of Duty to Serve, we recommend that the enterprises gather knowledge through practice. There have been many surveys of the field done by practitioners like Grounded Solutions Network, researchers like the Urban Institute, and NHC itself. Any additional research the enterprises plan to do in this space should occur in parallel to product development and testing, not as a preliminary step. The field will only find ways to make standardized processes work with specialized shared equity loans through active testing.

Both enterprises should attempt to set clear, measurable goals for participation in the shared equity market. If lack of data on either enterprise's portfolio is a barrier to setting that goal, they should consider using market-wide estimates. Absent measurable goals, the path of least resistance may simply be a mixture of further study and generalized worry about risk without progressing to specific actions to minimize risk and expand affordable homeownership.

### **E. Neighborhood stabilization**

There are still many neighborhoods struggling to recover from the Great Recession and from sometimes earlier decades of disinvestment. Both enterprises have the capacity and experience to provide capital solutions in these neighborhoods, and both should include the neighborhood stabilization regulatory activity in their plans with ambitious, measurable goals.

Freddie Mac does not include the activity at all, but it should. Fannie Mae, to its credit, included neighborhood stabilization. The proposed activity (Fannie Mae Activity K), focuses primarily on the existing HomeStyle Renovation product, which has had limited uptake. The proposed objectives focus on research and outreach in the first two years, and the proposed loan purchases reach a maximum of only 300 loans in year 3.

We recommend that both enterprises set more ambitious loan purchase goals in year 1 to encourage learning by doing and building on existing efforts. Partnerships with specialized neighborhood stabilization organizations, such as CDFIs, will be a source of loan originations, product improvements, and geographically-specific insight.

Work in neighborhood stabilization will overlap productively for the enterprises in small-balance lending, shared equity, and relationships with mission-focused intermediaries.

### **F. Energy and water efficiency**

NHC has separately coordinated a comment letter through our Green Affordable Housing Coalition, drafted by our Housing, Health and Energy Working Group. We commend that to your attention rather than reproducing the content here.

## **IV. Manufactured Housing**

Both plans include compelling data on the role of manufactured housing as inexpensive, often entry-level housing and the challenges of improving access to capital in this sector.

## A. Purchase of manufactured housing community loans

(Fannie Mae Activity C, Freddie Mac Activity 3) Both enterprises set very cautious goals for expanding purchase of loans for manufactured housing communities. Fannie Mae’s approach appears to spend three years mostly in market assessment and product development resulting in loan purchases affecting no more than 300 units. This is hard to square with the plan’s statement that “Fannie Mae has served the MHC market for nearly 18 years, has purchased just under \$11 billion in MHC loans since 1999, and has a solid familiarity with the numerous stakeholders across the MHC industry.” Freddie Mac’s plan emphasizes the idiosyncrasies of the MHC market and the need for greater understanding. It proposes issuing a product offering in year 2 but predicts minimal volume of no more than four transactions totaling \$10 million.

We recommend both enterprises begin loan purchases in year 1 on a transaction-by-transaction basis as a way to develop a more standardized product offering. Active and early engagement in such an idiosyncratic market is the best way to develop the knowledge necessary to create a product offering. Rural CDFIs and similar mission intermediaries may be useful partners, both for early action and product development.

## B. Communities with lease pad protections

(Freddie Mac, Activity 4, Fannie Mae Activity D) We understand that the FHFA requirements for specific lease pad protections does not map easily to state laws, even in states with substantial protections. Both Enterprises, however, propose that it will take a year of research to target their efforts, although other parts of the plan demonstrate that they have already reviewed in some detail. For instance, Fannie Mae’s plan proposes in Year One to “Research the laws to determine which States or localities with significant MHC require, in whole or in substantial part, pad lease protections that meet FHFA Pad Requirements.” On the next page, the plan asserts “Based on Fannie Mae’s initial research, there are no States or localities that require all or substantially all of the FHFA Pad Requirements.” The plan concludes that Fannie Mae will need to market “a product enhancement that incents MHC owners to adopt” lease pad protections. Similarly, Freddie Mac proposes devoting an entire year to a tenant protection survey before implementing a pilot, which seems excessive.

We urge both enterprises to move swiftly to product development with research into state laws and existing tenant protections occurring in parallel as needed. If a full survey is truly a necessary step, the two agencies could consider preparing and publishing one jointly or contracting a provider to do so, since the information used will reside primarily in public record.

## V. Rural Housing

Rural housing need is an enduring challenge in America, as both plans describe effectively. Solutions are likely to be geographically and situationally specific. Our comments focus on just two areas connected to our expertise, recognizing that other commenters will likely bring more in this area.

### A. Section 515 preservation

Both plans (Freddie Mac Activity 4, Fannie Mae Activity C) target USDA Section 515 properties for preservation. Freddie Mac’s plan correctly acknowledges the challenges in this portfolio and is enigmatically optimistic about its ability to overcome them. It proposes Objective A, a new product offering, and Objective B, loan purchases. Fannie Mae proposes developing a new work plan followed by loan purchases in years 2 and 3.

It is somewhat puzzling that neither organization can point to any specific knowledge of Section 515 transaction experience to create a baseline. If the combination of staff turnover and lack of documentation of past transactions has thoroughly erased knowledge of this market segment, both plans should be more specific about how the enterprises will rebuild that knowledge through a combination of targeted hiring and partnership with entities who specialize in Section 515 preservation. Furthermore, ongoing revision is needed to calibrate the objectives as more data are available.

A new product offering is a means to an end. A product offering that results in few or no loans has little value. Measuring progress in the multi-year plan is useful, however, so we recommend that objectives tied specifically to research and product development receive much lower concept scores compared to concept scores for loan purchases.

### **B. Rural single-family loans**

Both plans set low numerical targets based largely on the enterprises limited footprint in this market segment currently. Since this rural market segment is 1) under-served by traditional capital channels, 2) specialized geographically and technically, and 3) partly served by smaller scale lenders with expertise, we recommend that the enterprises design their plans with these features in mind. They should consider setting measurable targets based on the overall market, rather than just one enterprises' experience. They should develop and expand relationships with specialized lenders, including CDFIs, that give them the flexibility to use lending strategies and products tailored to rural areas. And they should measure success both against the enterprises' own efforts (that is, expansion over past levels) and against the market as a whole.

## **VI. Conclusion**

The National Housing Conference reiterates our appreciation to FHFA, Fannie Mae and Freddie Mac for their commitment to the mission of affordable housing. We look forward to seeing revised plans demonstrating that commitment and laying out a path to create more affordable housing opportunities in the places least well served by mortgage markets today. The deep and diverse expertise of the staff at Fannie Mae and Freddie Mac are well suited to this endeavor and we have confidence they will expand that expertise as Duty to Serve develops.

We would be happy to discuss any of these comments in greater detail. Please direct follow-up questions to Ethan Handelman, Vice President for Policy and Advocacy, [ehandelman@nhc.org](mailto:ehandelman@nhc.org), 202-466-2121 x238.

Sincerely,



Chris Estes  
President and CEO