



June 30, 2004

Regulations Division
Office of General Counsel
Room 10276
Department of Housing and
Urban Development
451 7th Street, SW
Washington, DC 20410

Docket No. FR-4790-P-01: HUD's Proposed Housing Goals for the Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac) for the Years 2005-2008 and Amendments to HUD's Regulation of Fannie Mae and Freddie Mac

Dear Sir or Madam:

The Enterprise Foundation and the Local Initiatives Support Corporation (LISC) are pleased to submit these comments on HUD's proposed housing goals for Fannie Mae and Freddie Mac.

We greatly appreciate HUD's commitment to expanding the participation of these Government Sponsored Enterprises (GSEs) in providing capital for low-income families and communities. With HUD's encouragement, we believe that the GSEs have done much to expand mortgage credit for low-income people and communities since affordable housing goals were first established. The GSEs also have played a substantial leadership role in the affordable housing industry in ways the goals do not recognize, such as their investment in Low Income Housing Tax Credits, the largest federal program for producing new affordable housing for low-income working families. We believe that these GSEs can and should be required to do even more in the future, with appropriate flexibility and incentives to do so. At the same time, when implementing the GSEs' mission requirements, the Department must strike the proper balance between strong, stretch requirements and mandates that will compel the GSEs to make bad business decisions for themselves and the housing finance system.

LISC helps neighbors build communities. Since 1980, LISC has raised \$5.7 billion from the private sector. It has used these resources to help 2,400 nonprofit community development corporations (CDCs) to produce 147,000 homes and 22 million feet of economic development and community service facilities. LISC works in many of the

most distressed urban and rural communities in America. LISC operates through 35 offices and a nationwide rural program.

The Enterprise Foundation is a national nonprofit organization that puts private capital to work in low-income communities to provide affordable housing and expand access to opportunity. Enterprise and its affiliated organizations have invested more than \$5 billion to finance more than 160,000 affordable homes, help 40,000 “hard to employ” find jobs and strengthen hundreds of community-based organizations. Enterprise works through a network of 2,500 grassroots groups nationwide.

Fannie Mae and Freddie Mac play crucial roles in the communities our organizations serve. First, the flow of mortgage credit is essential to the economic health of the low-income neighborhoods where we work, as it is for all neighborhoods. Second, the GSEs are directly involved in buying loans and making investments in countless specific projects in which our organizations are also involved, through nonprofit community development corporations. Third, the GSEs provide capital directly to Enterprise and LISC, which we use to serve low-income families and communities. On all three of these levels, our work would be significantly less effective without the deep and broad involvement of Fannie Mae and Freddie Mac. The GSEs have deployed their unsurpassed resources and expertise to work with us to serve especially needy families and communities, making the most of the flexibility the current regulation provides them to forge innovative partnerships.

We have a tremendous stake in affordable housing goals that are ambitious, yet achievable. Our organizations were among the leading advocates for the 1992 enabling legislation, and our interest in the proposed regulation reflects a continuing commitment to its purpose. We would note that the *current* goal levels are very demanding, and increased in effect significantly for 2004 even in the absence of a regulatory revision, as a result of the expiration of bonus points at the end of last year. It is well known that neither GSE would have met its goals in any of the last three years without bonus points.

We offer the following comments on the proposed rule.

Low- and Moderate-Income Housing Goal

We are mindful of broad disagreement among HUD, the GSEs, and other observers about the probable size of the mortgage market and whether the proposed goal for low- and moderate-income mortgage (LMI) purchases is reasonably attainable. LISC and Enterprise do not have the technical capacity to assess these competing views. However, we do recognize the importance of this issue. If the goals are set too low, they will not motivate the GSEs to do their best. If the goals are set too high, the GSEs might be compelled to undertake activities in ways that distort the market. We recommend that HUD take the following steps to improve the accuracy of market projections and to reduce the effects of unforeseeable economic conditions – especially mortgage interest rates – on how challenging the goals will be.

First, we understand that the Residential Finance Survey is one of the most important sources for the proposed rule. Unfortunately, the 1991 version of the RFS is the latest information available. The residential mortgage market has changed in many ways since that time. The Census Bureau is expected to publish new data this summer. We recommend that the rule reflect this new data.

Second, we urge that separate sub-goals be established for purchase money mortgages (PMMs) with refinance mortgages. We believe that the LMI goal should be designed so as to minimize the effect of interest rate changes on the GSEs' ability to achieve the goal. Predictable goals will best advance the public policy objective of increasing capital availability for LMI families and communities, and enable the GSEs to plan and implement programs to achieve the goals. Prevailing interest rates greatly affect the mix between PMMs and refinancing activity. Moreover, since LMI borrowers comprise a significantly larger share of PMMs than of refinancings, a given LMI goal will be easier to meet when interest rates rise and refinancing activity drops, and harder to meet when interest rates fall and refinancing activity increases. We believe the LMI goal under the current rule is poorly designed insofar as it combines these two products with very different income profiles.

We commend HUD for beginning to address this problem by proposing a separate sub-goal for PMMs (including those for owner-occupied homes and for multifamily properties). However, retaining the overall goal structure with a fixed volume target that combines PMMs and refinancings does not address the broader problem. A preferable approach would be to have separate sub-goals for PMMs and refinancings, and then set the overall LMI goal as the weighted average of the three components.

Some observers have raised the possibility of eliminating all consideration of refinancings. However, we would have two objections to that. We believe that refinancings are an important and beneficial part of the overall mortgage market; that LMI borrowers should have full access to this resource; and that the GSEs should be encouraged to serve LMI borrowers with this product.

Perhaps more urgent, predatory subprime lending is plaguing LMI borrowers and communities, and most predatory lending takes the form of refinancings, not PMMs. A primary way to isolate and drive out predatory subprime lending is to encourage responsible subprime lending, and the GSEs have much to contribute in this regard, especially if the affordable housing goals are structured to facilitate that. We are confident that the GSEs will be motivated to avoid purchasing predatory loans, and are encouraged by the steps they have already undertaken to encourage responsible subprime lending and to discourage predatory lending.

With respect to the PMM sub-goal, we urge HUD to include non-metropolitan lending. We understand that lending data for non-metropolitan areas are limited, but HUD has nonetheless found a way to include non-metropolitan areas in setting goals for underserved areas. To exclude non-metropolitan areas from the PMM sub-goal would be a substantial setback for many of the most underserved borrowers in the nation.

Underserved Areas Housing Goal

We urge HUD to narrow the criteria for underserved areas. Under the proposed goals, most of the nation's population would live in "underserved areas." We do not agree that most areas in the United States are underserved with respect to mortgage credit. So broad a definition of under-service undermines the purpose of this goal to encourage the GSEs to provide capital to areas that truly need it. Obviously, if HUD decides to reduce the number of underserved areas, it would be necessary to adjust the goal target levels accordingly.

With respect to metropolitan areas, we recommend that underserved areas be defined as census tracts where the median income is below 80 percent of the area median (instead of 90 percent under the current and proposed rules), and tracts with over 50 percent minority population and a median income below 100 percent of the area median (instead of 30 percent minority population and a tract income below 120 percent of the area median). These changes would focus the GSEs on more seriously underserved areas. Our experience in communities nationwide suggests that the residential mortgage markets adequately serve middle-income white neighborhoods and above-average-income neighborhoods where racial minorities do not predominate. Table B.3 in Appendix B to the proposed rule appears to support this observation. It shows that census tracts with 30-50 percent minority populations and a median income 90 percent-120 percent of area median have average mortgage denial rates and above-average mortgage origination rates. However, lower-income tracts and majority-minority moderate-income tracts have significantly high denial rates and low origination rates.

Moreover, using tracts with median incomes below 80 percent of the area median would bring the affordable housing goals into much better alignment with other federal policies, most notably including: the Community Reinvestment Act, which regulates many mortgage originators; Community Development Block Grants, HUD's primary program for revitalizing underserved areas; and New Markets Tax Credits, which are designed to stimulate the economic development of distressed communities.

Indeed, other federal policies designed to support community revitalization are even more narrowly targeted, including Empowerment Zones, Renewal Communities and qualified census tract provisions of Low Income Housing Tax Credits. The current and proposed GSE affordable housing goals are the notable exception, and only dilute the concentrated focus on areas with greater levels of distress and under-service.

We generally support HUD's approach to focus the definition under-service within metropolitan areas at the census tract level, rather than to include the entirety of central cities regardless of the characteristics of the individual tract. We agree that central city tracts that are neither low-income nor majority-minority are generally not underserved.

The question of underserved rural areas is more complicated. Many rural areas are underserved, but low-income and racial minority populations tend to be less concentrated

within rural areas than within metropolitan areas. To its credit, HUD defines nonmetropolitan tracts with reference to a national standard as well as a state standard, so as to capture entire nonmetropolitan regions and states that are economically distressed. Yet, Appendix B illustrates the limits of this targeting. While these tracts do reflect socio-economic disadvantage, they do not reflect lower homeownership or housing affordability. We have found that rural areas differ widely in their indicia of need. Appalachia, the upper Midwest, the Colonias along the Mexico border, northern New England, Indian country, the Mid-South Delta and Alaska all have serious affordable housing problems, but are very different in important ways. Some have high rates of poverty. Others have experienced substantial long-term out-migration. Construction and utility costs are very high in some areas. Still others are experiencing severe affordability problems as they become attractive recreational areas or exurban bedroom communities.

Compounding the rural issue is that the new census includes many traditional rural areas within metropolitan areas. For example, the Grand Canyon is now within the Flagstaff, AZ metropolitan area. Whereas before, rural areas generally fell outside metropolitan areas, that is now the case less often under the new census definitions.

Accordingly, neither the metropolitan nor the nonmetropolitan area targeting proposed by HUD will adequately capture rural areas that may be genuinely underserved. A different approach may be more appropriate. For example, USDA's Rural Housing Service programs accommodate some areas within metropolitan areas in addition to many nonmetropolitan areas.

We support the establishment of the proposed underserved areas home purchase sub-goal. We believe that home purchase financing is extremely important to the revitalization of distressed communities. This new sub-goal would be an important advance.

Special Affordable Housing Goal

We generally support the special affordable housing goal and the multifamily sub-goal. Small multifamily properties (those with 5 – 50 units) constitute up to 40 percent of the overall multifamily market and are often of particular importance to community-based revitalization strategies. Despite this substantial share, small multifamily properties often struggle to find financing. These properties typically have high underwriting costs compared to their mortgage amounts. They do not fit easily within the GSEs' standard models. The financing that is available tends to come in different products from different originators than operate in other segments of the market. Failed efforts by the Federal Housing Administration and private mortgage conduit companies have pointed out the challenges of providing financing for small multifamily properties. Fannie Mae and Freddie Mac have an important role to play in serving this market, and should receive appropriate incentives to compensate them for the higher complexity and costs.

Bonus Points

An important provision of the current regulation (which expired at the end of 2003) is the availability of bonus points for purchasing mortgages on small multifamily properties and units in 2-4 unit owner-occupied properties. Bonus points have helped encourage the GSEs to meet needs in those hard-to-serve segments of the mortgage market; even the Department has noted their effectiveness. We are disappointed that the Department has not taken the opportunity to continue the bonus points for these areas (which are still in need of financing) or propose bonus points under the goals to help meet other pressing needs, such as affordable rental housing in need of preservation; housing for the homeless and other special needs populations; housing for Native American and isolated rural communities; and housing for households with low wealth or impaired or nontraditional credit

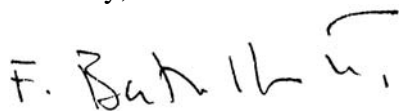
Predatory Lending

The GSEs have helped lead the private sector's response to predatory lending. The current regulation prohibits the GSEs from counting loans toward their affordable housing goals if the loans have points and fees of more than 5 percent of the loan amount, if the loans contain single premium credit insurance or if the loans are subprime and are made to borrowers creditworthy for prime loans. The revised goals regulation should add to that list subprime loans with mandatory arbitration or loans with prepayment penalties beyond three years. The GSEs have agreed not to purchase such loans and HUD's codification of that strong stand would buttress their leadership in this area.

Conclusion

Thank you for this opportunity to comment. For additional information, please feel free to contact Benson F. Roberts (LISC – 202-739-9264) or Stockton Williams (Enterprise – 202-543-4599).

Sincerely,



F. Barton Harvey III
Chairman of the Board
and Chief Executive Officer
The Enterprise Foundation

Michael Rubinger
President

Local Initiatives Support Corporation