October 8, 2013

Federal Housing Finance Agency
OHRP Multifamily Housing Policy
400 7th Street, S.W., Room 9-261
Washington, DC 20024
multifamilypolicyissues@fhfa.gov

Re: Options for Reducing Fannie Mae's and Freddie Mac's Multifamily Businesses

To Whom It May Concern:

On behalf of Enterprise Community Partners, thank you for the opportunity to comment on the Federal Housing Finance Agency's recent request for "Options for Reducing Fannie Mae's and Freddie Mac's Multifamily Businesses."

Enterprise works with partners nationwide to build opportunity. We create and advocate for affordable homes in thriving communities linked to jobs, good schools, health care and transportation. We lend funds, finance development and manage and build affordable housing, while shaping new strategies, solutions and policy. Over the past 31 years, Enterprise has helped build or preserve 300,000 affordable homes across all 50 states, invested $14 billion into communities and improved millions of lives.[1]

We are a family of companies comprised of Enterprise Community Partners (the parent nonprofit) and its related organizations: Enterprise Community Investment (a financial services company), Enterprise Community Asset Management (a residential asset management firm), Enterprise Community Loan Fund (a registered community development financial institution), Enterprise Homes (a housing developer) and Bellwether-Enterprise Real Estate Capital (a multifamily and commercial mortgage originator). Enterprise is an FHA Multifamily Accelerated Processing (MAP) lender and Ginnie Mae issuer, a Fannie Mae Special Affordable Delegated Lender, a Freddie Mac Program Plus Seller Servicer and Targeted Affordable Housing lender and a U.S. Department of Agriculture Section 538 lender.

For decades Fannie Mae and Freddie Mac (the GSEs) have been important partners in Enterprise's work. Their multifamily businesses are critical sources of capital for affordable housing and essential components of a liquid, stable and affordable U.S. rental market. Any plan to scale back those businesses must be pursued with great care, with an eye toward minimizing the impact on low-income communities and other vulnerable populations.

Below we will address each of the specific questions in FHFA's request for information. But first we would like to take this opportunity to comment broadly on the agency's plan to reduce the GSEs' footprint in the U.S. rental market.

General Comments on Reducing Fannie's and Freddie's Multifamily Businesses

FHFA's 2013 Conservatorship Scorecard includes a performance goal to "reduce the UPB amount of new multifamily business relative to 2012 by at least 10 percent by tightening underwriting, adjusting pricing and limiting product offerings, while not increasing the proportion of the Enterprises' retained risk."[2] To date, FHFA has provided little rationale for this goal, beyond a broad intent to contract the GSEs' "dominant presence in the marketplace" and simplify operations at the companies.

It is unclear how reducing the GSEs' multifamily businesses aligns with FHFA's three-pronged congressional mandate to: a) preserve the assets of the GSEs; b) promote a stable and liquid mortgage market; and c) minimize taxpayer losses. In fact, scaling back these businesses seems to contradict each of these mandates.

First, FHFA's own analysis released earlier this year shows that the GSEs' multifamily businesses—and the government guarantee behind them—bring tremendous benefits to renters and the broader U.S. housing market.[3] According to Freddie Mac's estimates, without the government guarantee on multifamily mortgages the total supply and value of rental homes would fall by as much as 27 percent, while average rents would rise by as much as 2 percent.[4] Put another way, scaling back these businesses would likely make rental housing harder to find and more expensive.

Second, the GSEs' current multifamily businesses are quite profitable—as they have been throughout the recent housing crisis—and have steadily returned money back to the U.S. Treasury in recent years. According to 2012 financial reports, Fannie Mae's multifamily business reported a net income of $1.5 billion last year,[5] while Freddie Mac reported $2.1 billion.[6] So scaling back these businesses will likely *cost* taxpayers money.

Third, these businesses historically pose very little risk to taxpayers and the broader financial system, exemplified by their low default rates. According to the Mortgage Bankers Association, today only about 0.2 percent of Fannie- or Freddie-backed multifamily loans are delinquent by 60 or more days, compared to 2.1 percent for loans held by FDIC-insured banks and thrifts and 7.8 percent for loans in commercial mortgage-backed securities.[7] (Fannie and Freddie multifamily deals also include a significant amount of risk sharing with purely private investors, which further limits taxpayer exposure to risk.)

Fourth, reducing the multifamily businesses sends the wrong message to staff at Fannie and Freddie, which could further deteriorate each company's assets. Both Fannie and Freddie have already experienced significant "brain drain" over the past five years, due in large part to uncertainty over the future.[8] By setting the stage for a gradual wind-down, FHFA could encourage top talent to migrate elsewhere, costing the companies expertise, institutional memory and ultimately money. Such a signal also gives senior management at Fannie and Freddie little incentive to invest in the staff, systems and technology necessary to compete in a constantly evolving mortgage market.

FHFA's strategy seems to be predicated on the assumption that private capital will quickly fill in any gap left by scaling back the GSE multifamily business. But that assumption is inconsistent with the evidence. In FHFA's own words, "there is little inherent value in (Fannie's and Freddie's) current multifamily businesses without the government guarantee," and thus purely-private financial institutions would have little incentive to take on this business as the GSEs reduce their volume.[9]

The logical result of reducing the GSEs' multifamily business would be a smaller, less liquid and more expensive secondary market for multifamily mortgages. That would likely translate into less development of new rental homes, less preservation of currently affordable rental homes and higher housing costs for America's renters.

That additional burden would be felt hardest by lower-income families, who are already facing a growing affordable housing crisis. Housing costs for the typical renter rose by 6 percent between 2008 and 2011, while their income dropped after adjusting for inflation, according to the Center for Housing Policy.[10] Even with the current level of support from the GSEs, demand for affordable rental housing has far outpaced production of new units in recent years.[11] As a result, of the 17.1 million very low-income renters in the U.S. today, 7.1 million spend more than half their income on rent, live in substandard conditions, or both, according to the Department of Housing and Urban Development.[12] All told, 27 percent of renters pay at least half of their monthly income on housing—an all-time high.[13]

Scaling back Fannie and Freddie's multifamily market presence would only deepen this crisis. Last year 67 percent of the rental units financed by Fannie or Freddie were affordable to low-income families (earning less than 80 percent of Area Median Income), while 17 percent were affordable to very low-income families (earning less than 50 percent of AMI).[14]

Since many of these affordable deals do not turn a significant profit, it's highly doubtful that purely private capital would be willing to take on more of this business. This is especially true for developments that historically have been underserved by private capital, including those in low-income communities, rural communities, subsidized affordable rental housing and small multifamily properties.

For the above reasons, we urge FHFA to reconsider its plan to reduce the GSEs' multifamily businesses by 10 percent relative to 2012 levels. That said, if the agency decides to go ahead as planned, we submit the following comments for its consideration, based on the specific questions laid out in the request for information.

Question 1: Loan Terms

We do not believe that FHFA should narrow the range of loan terms purchased by Fannie Mae and Freddie Mac in an effort to reduce the companies' multifamily businesses.

While it is true that the majority of Fannie- and Freddie-backed multifamily loans have terms of seven or 10 years, shorter-term loans play a critical role in the market. For example, Enterprise and our partners often rely on five-year, adjustable-rate loans when we acquire and reposition an at-risk multifamily building. This work would be much more difficult to do if it were required to be locked into a long-term mortgage. And it would likely be very difficult to access reasonably priced financing from sources outside the GSEs, since nearly all of our work is in the “affordable” segment of the market.

By making these short-term, flexible products more difficult to access, FHFA could meaningfully reduce the feasibility of building and preserving affordable housing. And as a general rule, we believe FHFA should avoid any reform that further limits the availability of affordable rental housing.

Question 2: Variety of Loan Products

We do not believe that FHFA should limit the range of loan terms purchased by Fannie Mae and Freddie Mac in an effort to reduce the companies’ multifamily businesses.

Many of the “nontraditional” loan products offered by Fannie and Freddie serve small but important market segments that historically are not well served by private capital, namely small rental properties, subsidized affordable multifamily housing and rural communities. For example, Fannie Mae currently operates a small loan lenders program that focuses on multifamily loans under $3 million (or under $5 million in high-cost markets).

There is little evidence that purely private investors would be willing or able to serve these communities. Banks, thrifts and life insurance companies currently combine for roughly 48 percent of multifamily mortgage debt outstanding in the U.S., according to the Mortgage Bankers Association.[15] But these institutions tend to focus on the lower-risk, higher-quality developments—often referred to as “Class A” properties—in particularly strong housing markets.[16]

Over the years, Fannie and Freddie have developed expertise in serving niche segments of the multifamily market. Part of this is done through working relationships with small community banks, state housing finance agencies and community development financial institutions across the country. It is highly unlikely that purely private investors will quickly and effectively develop this expertise. As a result, any effort to simplify or standardize Fannie’s and Freddie’s multifamily products could further isolate these already-underserved segments of the rental market.

Question 3: Limits on Property Financing

The government guarantee on the GSEs’ multifamily businesses is remarkably valuable. So it make sense for policymakers to target the benefits of that support—namely increased supply and lower rents—to the renters that need it most. We do not believe, however, that loan limits (either by total principal or per-unit cost) or hard caps on rent is the right approach.

Such a rule would add an unnecessary level of bureaucracy to an already-complicated system with no apparent benefit to taxpayers or the housing market. Under the current system, the market does an efficient job of selecting which properties are worth executing through the GSEs and which are better executed via other channels such as the purely private CMBS market, and the GSEs’ underwriting standards are effective in sizing each loan appropriately. It's unclear what problem a hard cap would be trying to solve.

Instead, we recommend that FHFA sets clear rules for the multifamily businesses to target lower-income families on the annual portfolio or loan pool level. To an extent this is already being done through the GSE affordable housing goals, which set targets for the percentage units financed in a given year that are kept affordable to low- and very-low income families. It's worth noting, however, that in recent years FHFA has proposed meaningful reductions in the affordable housing goals, which could limit their impact on the market.[17]

If FHFA is looking for a replacement for the affordable housing goals—which we do not believe is necessary at this point—we recommend a targeted income requirement for GSE multifamily business going forward. For example, a certain percentage of the rental units financed by Fannie or Freddie in a given year must be affordable to families making 80 percent of Area Median Income (AMI) or below at the time of origination, based on a 30-percent affordability standard.

On the higher end of the income distribution, we see no benefit to the GSEs or taxpayers in explicitly banning Fannie or Freddie from financing rental units for households above a certain income level. However, it could be beneficial to incent the GSEs away from higher-income renters and toward more moderate-income renters. For example, FHFA could impose a fee—say, 50 basis points on the associated principal—on any multifamily property the GSEs finance that charges rents that are unaffordable to households earning less than 150 percent of AMI. The agency can then use the proceeds from that fee to fund affordable housing programs through the Housing Trust Fund and the Capital Magnet Fund.

We believe that the above provisions could be enacted without meaningfully impacting liquidity or stability in the U.S. rental market. At the same time, they could significantly improve the availability and affordability of rental housing for lower-income families, making a dent in the affordable housing crisis described above.

Question 4: Limits on Business Activities

We agree that there might be opportunities for Fannie and Freddie to reduce their multifamily footprint by limiting or terminating certain business activities. However, these activities must be selected very carefully.

For example, during the height of the housing bubble, Fannie and Freddie purchased a significant volume of commercial mortgage-backed securities to be held in their investment portfolios. While this may have improved liquidity in upper end of the rental market, there was no apparent benefit to the vast majority of working families in the U.S., so it makes sense to gradually wind down that portion of the portfolio.

We do not, however, believe that all multifamily portfolio purchases should be terminated. Many of these purchases support lower- and middle-end rental housing that is difficult to bundle into securities or loan pools, such as loans on multifamily properties with less than 50 units. These properties are a critical source of affordable housing for working families, so it's essential to maintain a limited multifamily portfolio capacity at the GSEs.

Question 5: Other Alternatives

After five years of conservatorship, just about everyone agrees that the current system of housing finance in the U.S. is unsustainable and needs to be reformed. Many of the biggest decisions regarding the future system—including whether and under what terms the government should offer a guarantee on multifamily mortgages—will be up to Congress to decide. But regardless of the end state, FHFA will be a crucial part of the transition and will likely play a key role in the secondary mortgage market of the future.

In recent white papers and statements, FHFA has expressed interest in reforms to Fannie and Freddie that are "consistent with multiple states of housing finance reform" and "capable of working well with or without various degrees of government involvement."[18] In addition, the agency has asked Fannie and Freddie to asses the feasibility of spinning off their multifamily businesses into separate entities. (The companies found that such a spin-off would be technically feasible, but the businesses would have little to no value without an ongoing government guarantee. [19])

We believe that such a spin-off of the GSEs' multifamily businesses—while preserving the government guarantee—could help attract private capital to the multifamily market by providing much-needed certainty to investors. It would also help the GSEs prepare for the housing finance system of the future, regardless of what that system looks like.

Last month, Enterprise co-authored a detailed plan for multifamily housing finance reform, along with members of the Mortgage Finance Working Group. The plan was drafted as a supplement to the bipartisan Housing Finance Reform and Taxpayer Protection Act of 2013 recently introduced by Sens. Bob Corker (R-TN) and Mark Warner (D-VA), which preserves a limited and paid-for government guarantee on qualifying multifamily securities. Here's a brief overview of our proposal:[20]

- Starting immediately, spin off Fannie's and Freddie's multifamily businesses into two self-contained subsidiaries of their respective corporations. The new entities would maintain the current multifamily products—namely the Fannie Mae DUS Model and the Freddie Mac CME Program K-Series—and contract with Fannie and Freddie to manage the existing multifamily assets.

- During a brief transition period, these entities would continue to purchase, securitize and insure qualifying multifamily mortgage-backed securities, with support from the U.S. Treasury as needed.

- When the public guarantor (called the FMIC under Corker-Warner) is fully operational, the insurance function would be transferred to the federal government. From that point on, the new entities would have the option of purchasing FMIC insurance on the multifamily securities they issue, backed by the full faith and credit of the U.S. government.

- Over time, the new entities would be required to raise private capital with the option of buying out the government's interest. Meanwhile, other government-approved, privately-funded companies would have the option of purchasing FMIC insurance on the multifamily securities they issue. As soon as possible, the FMIC would establish a third issuer (beyond the two new entities) to ensure that smaller banks have access to the secondary market for multifamily mortgages.

- For each approved issuer of FMIC-backed multifamily securities, at least 60 percent of the rental units financed through these securities in a given year must be affordable to families making 80 percent of Area Median Income (AMI) or below at the time of origination, based on a 30 percent affordability standard.

- In addition to the guarantee fee to cover its risk and reserve requirements, the FMIC would charge a 5-10 basis point fee on all multifamily securities it insures to fund affordable housing programs. If the majority of units in a multifamily property financed by a FMIC-backed security are unaffordable to families earning less than 150 percent of AMI, the FMIC will collect an additional 50 basis point fee on the associated principal.

- FMIC oversees the entire secondary multifamily mortgage market for safety and soundness and maintains all multifamily guarantee fees in a separate insurance fund.

- Each approved issuer must develop an annual plan for serving communities and market segments often neglected by private capital, including low-income communities, rural communities, subsidized affordable multifamily housing and small rental properties.

Of course, several of these reforms—including the establishment of the FMIC and the authority to offer government insurance on multifamily securities—must be done through legislation. However, we believe that FHFA has the authority to make many of the necessary changes today without congressional action.

For example, FHFA could immediately order Fannie and Freddie to begin spinning off their multifamily businesses into two self-contained subsidiaries. The new entities would continue to offer Fannie's and Freddie's current multifamily products and contract with the companies to manage all multifamily assets, under the close supervision of FHFA.

By taking action today, FHFA could work with the companies to transition into this system as quickly and smoothly as possible, instead of being bound by deadlines established by Congress. And perhaps most importantly, this spin-off would ensure that Fannie, Freddie and the new multifamily entities maintain the staff, systems and products necessary for any future system of housing finance—regardless of what Congress decides to do with the government guarantee.

Conclusion

We urge FHFA to reconsider its plan to reduce the GSEs' multifamily businesses by 10 percent. These businesses bring tremendous benefits to the U.S. housing market, return profits to the U.S.

Treasury, pose little risk to taxpayers and the broader financial system and are a critical source of capital for affordable housing—which is already at woefully short supply relative to demand.

That said, if FHFA does decide to go ahead with its plan, we urge the agency to set low- and moderate-income renters as a top priority, avoiding any reforms that limit the quality or availability of affordable rental housing. Specifically, we recommend that FHFA maintain the current loan terms, flexible loan products and "nontraditional" business activities that make affordable housing development and preservation possible.

Lastly, short of a new congressional mandate, we do not believe that FHFA should consider replacing the current affordable housing goals for Fannie's and Freddie's multifamily businesses. But if the agency is interested in better targeting government support to lower-income renters, we recommend strict affordability requirements on the annual portfolio or loan-pool level. We do not recommend a hard cap on total or per-unit principal for GSE multifamily loans.

Again, thank you for the opportunity to comment on this important topic. If you have any questions about the above comments, please contact Andrew Jakabovics, Enterprise's Senior Director for Policy Development & Research, at ajakabovics@enterprisecommunity.org or 202-403-8012.

Sincerely,

Enterprise Community Partners, Inc.

ENDNOTES

[1] For more on Enterprise Community Partners, see http://www.enterprisecommunity.com.
[2] Federal Housing Finance Agency, Conservatorship Strategic Plan: Performance Goals for 2013
[3] Federal Housing Finance Agency. News Release: FHFA Releases Fannie and Freddie Reports on Viability of Their Multifamily Business Without Government Guarantees. Attachment: 2012 Conservatorship Scorecard: The Enterprises' Reports on a Multifamily Future State Without a US Government Guarantee. FHFA, 3 May 2013.
[4] Freddie Mac. Report to the Federal Housing Finance Agency: Housing Finance Reform in the Multifamily Mortgage Market. Freddie Mac, December 2012
[5] Fannie Mae. Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. United States Securities and Exchange Commission, December 2012.
[6] Freddie Mac. Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. United States Securities and Exchange Commission, December 2012.
[7] Mortgage Bankers Association. MBA Commercial Real Estate/Multifamily Finance: Mortgage Delinquency Rates For Major Investor Groups: Q2 2013. MBA, August 2013.
[8] Nick Timiraos, "Fannie, Freddie Departures Esecalate," Wall Street Journal, April 30, 2012. Available at http://online.wsj.com/article/SB10001424052702304868004577376340822501510.html
[9] Federal Housing Finance Agency. News Release: FHFA Releases Fannie and Freddie Reports on Viability of Their Multifamily Business Without Government Guarantees. Attachment: 2012 Conservatorship Scorecard: The Enterprises' Reports on a Multifamily Future State Without a US Government Guarantee. FHFA, 3 May 2013.
[10] Janet Viveiros and Maya Brennan. Housing Landscape 2013: An Annual Look at the Housing Affordability Challenges of America's Working Households. National Housing Conference, Center for Housing Policy, May 2013
[11] Joint Center for Housing Studies of Harvard University. Fact Sheet, The State of the Nation's Housing 2013. JCHS, June 2013.
[12] US Department of Housing and Urban Development, Office of Policy Development and Research. Worst Case Housing Needs 2011: Report to Congress. HUD, PD&R, August 2013.
[13] Joint Center for Housing Studies of Harvard University. Fact Sheet, The State of the Nation's Housing 2013. JCHS, June 2013.
[14] Fannie Mae financed 559,000 multifamily units in 2012, 376,000 of which were affordable at 80 AMI or below. Freddie Mac financed 435,000 multifamily units in 2012, 299,000 of which were affordable at 80 AMI or below.
[15] Mortgage Bankers Association. MBA Commercial Real Estate/Multifamily Finance: Mortgage Debt Outstanding: Q2 2013. MBA, September 2013
[16] Fannie Mae, Analysis of the Viability of Fannie Mae's Multifamily Business Operating without a Government Guarantee-Response to FHFA Scorecard Directive, December 2012.
[17] Federal Housing Finance Agency, 12 CFR Part 1282, RIN 2590–AA49, 2012–2014 Enterprise Housing Goals, June 2012.
[18] Federal Housing Finance Agency, Building a New Infrastructure for the Secondary Mortgage Market, October 2012.
[19] Federal Housing Finance Agency. News Release: FHFA Releases Fannie and Freddie Reports on Viability of Their Multifamily Business Without Government Guarantees. Attachment: 2012 Conservatorship Scorecard: The Enterprises' Reports on a Multifamily Future State Without a US Government Guarantee. FHFA, 3 May 2013.
[20] The Working Group's full proposal is available at: http://www.americanprogress.org/wp-content/uploads/2013/08/MFWG-Corker-Warner-multifamily-recommendations-Aug1-FINAL.pdf