September 18, 2009

Alfred M. Pollard, General Counsel
Attention: Comments/RIN 2590-AA27
Federal Housing Finance Agency
Fourth Floor
1700 G Street, NW
Washington DC 20552

<u>Re: Duty to Serve Underserved Markets for Enterprises; Proposed Rule. 12 CFR Part 1282, RIN 2590-AA27. Delivered via email.</u>

Dear Mr. Pollard:

We respectfully submit these comments on the Federal Housing Finance Agency's (FHFA) proposed rule 12 CFR Part 1282, RIN 2590-1127, concerning the duty to serve requirements imposed on Fannie Mae and Freddie Mac. These comments are submitted on behalf of the Center for Responsible Lending, Consumer Federation of America, and the National Consumer Law Center.

As national housing, civil rights, and consumer organizations we have strong interest in promoting effective policies that help expand affordable home purchase and rental housing opportunities for low-income, minority, and other underserved households and communities.

FHFA seeks comments on several overriding issues relating to the evaluation of performance of all of the duties to serve. Our comments follow the organization of the ANPR.

<u>Evaluation</u>

Loan Product Test: this test requires evaluation of the Enterprises' "development of loan products, more flexible underwriting guidelines, and other innovative approaches to providing financing to each" underserved market. In general, the Enterprises should be encouraged to develop products that meet the following tests in order to qualify for consideration under the duty to serve requirements:

1. Underwriting terms that exceed standard underwriting definitions for products. Lower down payments, more flexible interpretations of credit-worthiness or the use of alternative forms of credit documentation should all be considered when evaluating performance under this test. In addition, the Enterprises should be judged on their willingness to assume higher levels of risk in order to identify and test new market opportunities and to extend credit to meet their duty to serve. This could include accepting a lower modeled rate of return on the product, for instance, while still projecting a positive return overall. Similarly, this could include absorbing more credit risk by reducing reliance on private mortgage insurance or other forms of credit enhancement when underwriting such loans. FHFA should specifically consider whether the Enterprises

should have the ability in limited circumstances regulated by FHFA to self-insure such acquisitions as an exception to the general statutory authority for the Enterprises to maintain third party credit enhancements when financing debt that exceeds 80 percent of the collateral's value. It is important for FHFA to closely monitor these innovations and modifications to insure that the Enterprises do not layer risks in ways that recent experience has proved can be harmful to borrowers, such as combining low credit scores with very low down payments and high debt to income ratios. In addition, loans that qualify for inclusion under the duty to serve requirements for all underserved groups should conform to a high standard of care on the Enterprises' part to insure that loan terms are suitable to the borrowers and include only loans where the originating lender and the Enterprises have assured that borrowers are able to repay them, using conservative estimates of borrower income and using the permissible payment terms under the note that would result in the highest payment by the borrower.

2. Loans acquired from nontraditional issuers, such as community development finance institutions (CDFIs), and consortia sponsored by banks, local and state governments, or others should qualify under the duty to serve. These products may have non-traditional terms, use nonstandard underwriting features, or have other characteristics that make them ineligible for the Enterprises' basic market programs, or which are too small in volume to attract their attention. They may include seasoned loans for the preservation or development of affordable rental housing or homeownership. The Enterprises should be encouraged through the duty to serve obligation to accept lower margins on small volume loans. They also should be encouraged through this test either to reduce charged fees that make small transactions economically infeasible for sponsors or to absorb these costs internally rather than passing them onto the borrower.
3. Loans acquired through state and local housing finance agencies should count under this test of the duty to serve. These agencies often offer specialized products geared to first time homebuyers. The Enterprises should be encouraged through the duty to serve to provide a secondary market outlet for such loans in order to help expand their ability to meet specific market needs that the agencies themselves may identify, and to help encourage these agencies to actively provide credit for activities under the duty to serve, such as rural housing and affordable housing preservation.
4. In underwriting loans that support multifamily housing preservation, this test should only count loans that differ significantly from the Enterprises' standard multifamily financing products. In particular, loans with requirements for burdensome reserves to protect against appropriations risk in programs like Section 8 should not count toward fulfillment of the duty to serve, nor should loans that discount the value of future streams of Section 8 rental assistance payments. Loans for preservation should only count to the extent that the post-rehab rents remain affordable to the tenants in place, and will conform to the requirements of any existing federal assistance contracts.

Outreach Test: The statute requires an assessment of the "the extent of outreach [by the Enterprises] to qualified loan sellers and other market participants" in each of the specific underserved markets. Beyond the Enterprises' normal marketing activities, FHFA should assess the degree to which the

Enterprises actively participate in industry conferences, workshops and seminars to describe and market their specific products designed to assist in fulfilling the duty to serve. FHFA should require each Enterprise to report annually on these contacts and participation. These should include not only national events, but those held regionally, locally and on the state level to insure that smaller market participants are included in the outreach. The Enterprises should use their normal advisory council meetings and outreach to identify, publicize and carry out specific outreach activities. Additionally, the Enterprises should offer information on their websites; provide access to listservs and regular email lists to interested parties through which product and marketing information can be made available; and should report to FHFA on how these tools were used and how frequently interested parties were contacted during the reporting period. FHFA should consider requiring each Enterprise annually to publish a comprehensive report detailing their activities in the underserved areas, identifying the products and services that have been developed in response to the duty to serve, and detailing specific results from these efforts so that interested parties can learn more effectively about them. FHFA should consider requiring each Enterprise to identify a specific officer-level executive that will be responsible for marketing and outreach efforts under each of the duties to serve, and to annually review that person's responsibilities, activities over the reporting period, and self assessment of the success and efficacy of the outreach efforts undertaken. FHFA also should consider convening on a semi-annual or annual basis its own advisory group of organizations and individuals knowledgeable in the underserved areas to provide outside perspective on the Enterprises' efforts to meet their duty to serve and the marketing and outreach activities undertaken to fulfill them.

Purchase Test: FHA should assess the specific accomplishments of the Enterprises in meeting their duty to serve through the acquisition and securitizing of actual loans. We recommend that these be counted in units. We believe that providing affordable rental and owner-occupied homes through the duty to serve represents the most important outcome that FHFA should monitor. Assessing performance by the number of mortgages could mask an underweighting of loans financing multifamily rental homes, for instance, while over-weighting the impact that single family programs. Similarly, using unpaid principal balance could unduly encourage performance through financing for larger rental housing properties, at the expense of both single family and smaller multifamily.

While the amount of mortgage financing is clearly an important desirable outcome of the duty to serve, we believe that increasing the number of rental and owner-occupied homes is the most important outcome to be measured.

Counting the number of units does have the potential disadvantage of encouraging pursuit of the duty to serve through relatively few, large multifamily transactions. This could be particularly true in fulfilling the duty to serve preservation efforts. However, we believe that FHFA could overcome this particular drawback by closely monitoring and reporting on the kinds of units counted in assessing each Enterprise's performance.

FHFA also might consider using multiple measures that combine elements of housing units, mortgages and outstanding principal balance, depending on which goal is being measured and what effort is being

tracked. In the manufactured housing area, for instance, FHFA should consider combining an evaluation based on the number of units financed with a measure of the number and size of any loans to CDFI's or other financial intermediaries that they finance to assist in the preservation of affordable manufactured housing sites. A similar combination of measures also might be helpful in the preservation area, where special attention to smaller loans that finance un-assisted but affordable existing rental housing might be an important contribution that should be encouraged through the duty to serve. While the number of units affected through such loans might be relatively small, by measuring the number and size of such loans FHFA could assess the degree to which the Enterprises are meeting the loan product test.

In assessing performance against the manufactured housing goal, we recommend that FHFA *not* count chattel loans. While we recognize that chattel lending comprises a significant share of the current manufactured housing market, and in some states is the only alternative, we do not believe that the duty to serve should include them. Both Enterprises can finance such loans in the normal course of their business. But we believe one purpose of the duty to serve is to encourage the flow of more traditional mortgage credit into this field. Including chattel mortgages would not serve this purpose.

Grants Test

In evaluating "the amount of investments and grants in projects which assist in meeting the needs of such underserved markets," FHFA should examine funds made available both through any charitable giving as well as through business-related expenses. FHFA should especially track the relative size and scale of these two different types of giving. While the Enterprises might have both internal and external incentives to publicize charitable giving, without an explicit requirement to report other forms of assistance provided as "business investments" FHFA and the public will not be able to determine the full scale of the Enterprises' giving or the relative importance of the one versus the other. For instance, large amounts spent to underwrite industry conferences, or through marketing efforts with lender customers or their trade associations might not be readily evident. Yet it is possible that these untargeted expenditures designed to increase access to broad classes of mortgage products might dwarf better publicized expenditures aimed at helping to meet the duty to serve. The balance between these expenditures, both relatively and nominally, ought to be a factor in FHFA's evaluation of how well the Enterprises are fulfilling congressional intent.

Sizing the Market

In considering its responsibility to size the market for the purpose of the purchase goal, FHFA seeks comment on how to do so and whether there are any loans that should be excluded from the market estimates. As a general rule, we believe that any loans that are generally not accessible to the Enterprises, such as loans insured by the FHA and VA, should not be included in any estimates of the market. FHFA should consider, however, whether permitting full or partial credit for FHA and VA loans that meet the duty to serve requirements would help the Enterprises expand their reach into these areas. For instance, given the retreat of private mortgage insurers, these programs may provide the only reasonable credit enhancements for loans to credit worthy borrowers who need low down

payments. FHA insurance can be particularly valuable in the multifamily market as well as manufactured housing. If FHFA determines to allow credit for these loans for the duty to serve, then such loans should be included in the market sizing estimates. Only loans that meet the standards set out in Regulation Z should count under the duty to serve, whether or not they qualify as "high cost loans," and loans with potentially injurious features such as prepayment penalties and yield spread premiums should not count for goals credit.

We note that attempts to "size the market" under previous rulemakings for the Enterprises' housing goals have been fraught with difficulties and controversies. Any estimate that will be used to set expectations must necessarily forecast conditions in the future based on data that is available from the past. This can be notoriously unreliable. In addition, the only generally available data on mortgage lending is published eight to nine months after the fact through the Home Mortgage Disclosure Act (HMDA), adding yet another level of complication to market sizing attempts. These data are particularly weak in assessing mortgage activity in rural areas, where HMDA's coverage is less comprehensive than in metropolitan areas, and for manufactured housing lending, which often has been financed by non-HMDA reporting entities. FHFA can draw on the multiple experiences of HUD's own rulemakings from 1993 through 2004 in this regard, and hopefully can improve upon those experiences. Finally, the data supporting multifamily investment in particular is weak, incomplete and unreliable for the purpose of setting specific numeric goals.

Regardless of how FHFA proceeds in this rulemaking, we urge FHFA to work with other financial overseers such as the Federal Reserve and Comptroller of the Currency to identify ways to establish more helpful and current tracking of loan originations activity that would enable more effective monitoring of those markets and assist in understanding the role that the Enterprises play in providing liquidity. The current system neither provides sufficient information – conspicuously lacking information on loan to value ratios and other features of home loans – nor provides it on a sufficiently timely basis to be optimally helpful in assessing secondary market influence.

We believe that it is important to have such a market estimate, but to be more cautious than in the past in setting specific "point" references against which to measure results in the duty to serve area. Understanding the range of likely market sizes given expected market conditions can give FHFA a benchmark against which performance will be measured. But this benchmark should be the starting point, rather than the end point, against which an ultimate evaluation is made.

In the preservation area, HUD has data about the physical, financial and regulatory status of all the properties receiving assistance in its various subsidy programs that are enumerated in the statute and ANPR, and Rural Development with USDA has similar information for rental projects in rural areas. Neither agency has significant information on un-subsidized affordable rental housing, although this stock is by far the most important affordable housing resource for renters in the market today. Also, state housing finance agencies have information on expiring subsidies and use restrictions for properties developed under the Section 42 Low Income Housing Tax Credit program. FHFA should collect information from all of these agencies to provide a specific benchmark of preservation needs across the

country, in both rural and metro areas, and use this as part of its evaluation of the Enterprises' performance against the duty to serve. FHFA should consider establishing a benchmark test for the Enterprises' engagement that would measure their participation in preservation against the total inventory in any one year, or over a span of years. Their participation in the multifamily preservation area should not be lower relative to that specific market than it is relative to the larger multifamily market. In other words, if the Enterprises together account for 35 percent of all multifamily finance over the last three years, FHFA should consider expecting at least a similar percentage of all multifamily preservation to be provided by them, as well.

FHFA also should consider the Enterprises' performance over time in measuring compliance. Their participation should improve over time until it reaches a sustainable level of engagement. We believe a reasonable expectation would be for their performance in meeting their duty to serve to match their overall level of participation relative to other market sources over a reasonable period of time, and then be sustained. FHFA should consider evaluating performance year-over-year in the context of broader market trends and the financial conditions of the Enterprises.

Evaluating Compliance

We recommend that FHFA give equal weight to each of the three underserved areas in its initial rulemaking and consider shifting this in subsequent rulemakings after it has gained experience with the rule and the Enterprises' performance. We believe all three areas require additional effort by both Enterprises; weighting among them at this time is, we believe, premature.

With regard to loan purchases, loan products, outreach and grant making, we believe that FHFA should place a higher emphasis in judging performance on loan purchases, for perhaps 50 percent of any rating, with outreach and grant making accounting for another 30 percent and the loan products themselves accounting for the remaining 20 percent. While the development of new and more flexible loan products should be an important component of FHFA's evaluation, we believe that the test of their effectiveness will be on loan purchases that result from either their current, standard products or those that are developed specifically in response to the duty to serve obligation.

Mortgages qualified for duty to serve

In general, we believe that any loans that qualify to be counted against the basic housing goals for the Enterprises should be eligible under the duty to serve. The one exception, which is noted above, is chattel mortgages for manufactured housing.

In addition, we believe there are transactions that are *not* currently eligible for fulfilling the base housing goals that *should* be included in the evaluation of the Enterprises' performance of their duty to serve underserved markets. Only "mortgage purchases" qualify under the current housing goals rules. But the duty to serve appropriately envisions a much broader participation by the Enterprises in the fulfillment of critical priorities in underserved areas. As a consequence, the rule should permit the

counting of a variety of investments, including but not limited to all of the following kinds of transactions that currently are not eligible for housing goals counting purposes in assessing performance against the duty to serve:

- Low income housing tax credits
- New Markets tax credits
- Loans for energy retrofits and improvements in properties that support the other duties to serve
- Loans to CDFI's and other third parties for specific purposes to further the duty to serve, such as loans to finance ownership of manufactured housing parks by residents or entities dedicated to preserving their use for affordable housing, for preservation purposes, etc.
- Equity investments or equity-like investments in CDFI's to pursue activities in pursuit of the duty to serve
- Lines of credit to CDFI's and others to pursue activities in pursuit of the duty to serve
- Credit enhancements to facilitate borrowing by CDFIs, state and local governments and their agencies, and other market participants directly investing in qualified activities under the duty to serve
- Reserve funds set aside to accommodate lower returns/higher risks on new products specifically targeted to meeting the needs of underserved areas or underserved populations.

The rule should accommodate assigning a value to loans and lines of credit made on terms that are below current market rates and count such concessions in calculating the duty to serve. As noted earlier, FHFA should count the number of units financed through these techniques in measuring the Enterprises' performance, taking into account instances where considering the size and number of mortgages financed would add a greater measure of understanding or provide a more useful measurement.

Manufactured Housing

Manufactured housing is an important source of affordable housing, especially in rural areas. Unfortunately, the industry has been organized to provide financing that is more like auto financing than real estate financing. There are an estimated 8.6 million manufactured housing units in place today, and roughly 60,000-70,000 additional units are placed each year. As many as five out of every six manufactured housing transactions today involve existing units, and often existing owners.

Buyers would benefit from easier access to longer term, less expensive credit than is normally available today. The Enterprises could assist in reaching this goal by developing effective financing tools that measure the risks of manufactured housing more appropriately than is the case in the market today.

One of these risks is caused by the frequent alienation of title to the land on which manufactured housing is sited and the housing itself. Once sited, these properties are difficult to relocate. But where the land on which the home is sited is rented, there is a long term risk that the property might be converted to other uses, displacing the homeowner and endangering the collateral's security. The Enterprises have engaged in some pilot programs to provide effective financing for the conversion of manufactured housing parks to resident or nonprofit ownership that is committed to the long term preservation of the land for housing use. Entities like CDFIs that specialize in this lending would benefit from the Enterprises offering cost-effective access to senior debt to assist in these efforts.

Because manufactured housing loans are difficult to securitize, FHFA should consider encouraging the Enterprises to acquire and hold such loans in their portfolios. FHFA also should consider exempting them from any cap on their portfolios to encourage them to do so. The Enterprises' investments in manufactured housing should conform to the same overall requirements for disclosure, standard of care, and borrower benefits that apply to their more conventional business. The duty to serve should not encourage the expansion or maintenance of lending practices in manufactured housing that trap borrowers in disadvantageous terms.

Loans that count toward the duty to serve in this underserved area should be required to include basic protections for the borrower from predatory or unreasonable terms, especially with regard to their rights in land-lease situations. Lenders' interests also should be protected through requiring a right to cure defaults on ground leases and allowing lenders to sell the homes on site in the case of foreclosure.

Affordable Housing Preservation

The preservation of existing affordable rental housing is a critical housing policy and housing finance issue. The duty to serve requirement presents an important opportunity for the Enterprises to expand their current role in financing preservation. We believe that this duty to serve should be extended through the rulemaking to include not only existing affordable rental housing that receives federal subsidies, but also privately owned, unsubsidized housing that provides the vast majority of affordable rental units for lower income households, as well.

FHFA's ANPR specifically asks for comments on the inclusion of units under this duty to serve that are assisted under the Neighborhood Stabilization Program (NSP). We support including financings that the Enterprises undertake in conjunction with the NSP program, including both end loans to new buyers and to nonprofits and state and local governments for the purpose of leveraging NSP dollars and securing and preserving foreclosed properties for low and moderate income use. The Enterprises can assist in the NSP effort in the following ways, which we believe should be included in the activities that count under the duty to serve:

1. End loans to new buyers, either to owner occupants or to investor owners that will offer the homes for rent to low and moderate income buyers

2. Multifamily loans for properties that will provide homes for extremely low income residents under the specific obligations of the NSP program. Inasmuch as much of this stock will be in smaller multifamily properties where the Enterprises have not been successful partners in the past, inclusion of such loans under the duty to serve could be a useful incentive for them to adopt their rental financing programs to accommodate their needs.
3. Lines of credit for senior debt to CDFIs that are acquiring and repairing foreclosed properties in the NSP program. Such financing can be an important bridge financing tool to enable nonprofit and others to acquire properties and do the necessary work while awaiting award of NSP funds from the local or state grantee, and could enable the NSP funds to be leveraged.
4. Guarantees through letters of credit or other means to credit enhance financing from other private sources.
5. Advances to state and local governments to enable a continuing and efficient flow of funds between draws on NSP funds, much as Fannie Mae has provided added liquidity to public housing authorities through their Modernization Express© and Community Express© products.

One obstacle to greater current use of the Enterprises' debt facilities for federally assisted properties that receive rent subsidies through Section 8 is their requirement to discount the future cash flows from this assistance program and/or to require additional reserves to protect against appropriation risk. This added burden, which we believe protects against a minimal risk, can add significant costs to preservation financing and jeopardize a project's success. FHFA should consider denying credit under the duty to serve for loans that include these extra charges.

The Enterprises also could support preservation objectives through lines of credit, equity-like investments, and lending to CDFI's and state and local governments to facilitate the acquisition of at-risk properties and enable the financing of predevelopment expenses. The current economic climate has reduced the urgency of available acquisition financing somewhat because of less competition for at-risk properties from those seeking to convert them to market rate uses. However, preservation buyers need access to ready sources of capital in order to take advantage of opportunities when they arise, and CDFIs and state and local governments can provide it. The Enterprises can facilitate this access by providing capital, preferably at rates that reflect their lower borrowing costs, and terms that are reasonable and dependable. Anecdotal evidence from CDFIs indicates that the Enterprises have offered lines of credit but have made it extremely difficult to draw funds when needed by adding additional layers of risk considerations. The Enterprises only should receive credit under the duty to serve for funds actually drawn down, not merely for commitments issued.

The Enterprises currently can count loan modifications made in their own portfolios and on loans held in their MBS for the purposes of the base housing goals. We support inclusion of these in measuring progress in meeting the duty to serve in affordable housing preservation, but believe this should be restricted to loan modifications made to borrowers who meet the low and moderate income tests of the basic goals.

Thank you for this opportunity to comment on the ANPR.

Sincerely,

Center for Responsible Lending
Consumer Federation of America
National Consumer Law Center