N A A H L
NATIONAL ASSOCIATION OF AFFORDABLE HOUSING LENDERS

July 21, 2010

The Honorable Timothy F. Geithner
Secretary
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Shaun Donovan
Secretary
U.S. Department of Housing and
Urban Development
451 Seventh Street, S.W.
Washington, DC 20410

Dear Secretaries Geithner and Donovan,

Fannie Mae and Freddie Mac received Federal charters several decades ago to facilitate the flow of capital to the U.S. mortgage market by standardizing mortgage documents and practices, and then purchasing qualifying loans so that the cycle could begin again to increase the availability and affordability of mortgage credit. Since their 2008 conservatorship, prominent policymakers such as National Economic Council Chairman Lawrence Summers and House Financial Services Committee Chairman Rep. Barney Frank have questioned the rationale for their current structure. Treasury is inviting comment on establishing a more stable and sound housing finance system. Our comments reflect the considerable experience of our vanguard of community investment practitioners and NAAHL's mission to increase the flow of private capital to underserved areas.

As the Congress considers structural alternatives to Fannie Mae and Freddie Mac, **there is a precedent for restructuring a government sponsored enterprise and sunsetting the Federal charter of a company that was the dominant player in its market.** The Student Loan Marketing Association (Sallie Mae), with the agreement of the Clinton Administration and bipartisan support in both chambers on Capitol Hill, proposed a blueprint for transitioning from GSE to non-GSE business that protected all stakeholders, including taxpayers. That blueprint was amended by Congress, enacted in 1996, and approved by shareholders in 1997 to facilitate an orderly transition away from the GSE structure over the next decade. Sallie Mae's careful transition could provide a useful model for unwinding the Federal government's risks and costs from Fannie Mae and Freddie Mac, while at the same time stabilizing the mortgage market and restoring balance to the mix of federal incentives for rental housing and homeownership.

It is also important to **build on what has worked in mortgage finance, preserve existing well-managed and well-regulated entities, and increase support for financing that helps to leverage private capital to address the needs of low and moderate income persons.** Successful community investment by insured depositories has proven effective in providing responsible mortgages. The Federal Home Loan Banks (FHLBs) have provided liquidity support successfully for housing financed by insured depositories and housing finance agencies. As the Housing and Economic Recovery Act of 2008 directed, the FHLBs should now broaden their focus to provide needed liquidity to long-established, blue chip, Community Development Financial Institutions that are leaders in providing affordable rental housing.

NAAHL answers to Treasury questions are summarized as follows:

1. How should federal housing finance objectives be prioritized in the context of the broader

objectives of housing policy?

Huge gaps in serving housing credit remain. The top federal priorities should be to ensure the availability of responsible, fairly-priced financing for the unserved and the underserved parts of the mortgage market, to fund and preserve affordable, sustainable housing that families are proud to call home. While segments of the mortgage market experienced an excess of credit and irresponsible mortgages, segments such as affordable rental housing continue to be illiquid. The benefits of a government sponsored secondary market, mortgage standardization, liquidity, and affordability, accrued mostly to homebuyers earning much more than area median income, and to renters at and above median income.

This unequal distribution of the benefits of a government sponsored secondary market disadvantaged homebuyers earning less than 80% of median income (AMI), and renters earning less than 60% of AMI. Responsible single family mortgages and multifamily loans on affordable rental housing that receive favorable consideration under the Community Reinvestment Act (CRA) should have broad and consistent support for increased liquidity.

Lessons learned:

- Regulation matters. The same rules, supervision and examination should apply equally both to secondary market and primary market participants. For example, insured depositories are responsible for helping to meet the credit needs of households earning less than 80% of area median income (AMI) and also 60% AMI. As NAAHL documented in our 2001 and 2004 reports on "Practical Solutions to Predatory Lending", explosive mortgages, originated by unregulated originators, were already undermining 20 years of successful community reinvestment and putting entire neighborhoods in jeopardy.

  While banks were subject to examination on loans receiving favorable consideration under the CRA, much capital and even more risk was migrating to the unregulated parts of the market. Fannie Mae and Freddie Mac's "affordable housing goals", focused on much higher incomes than banks' target populations, were fraught with loopholes, including double and triple counting as "affordable" up to $450,000 mortgages on million dollar homes in census tracts that had 30% minority populations, and did not result in much legitimate "affordable housing". HUD's "supervision" of the goals was inadequate, and the safety and soundness examiner was limited in its authority. As a result, the "unregulated network of alternative mortgage originators" and the two GSES functioned largely in a town without a sheriff.

- Liquidity matters. For many years, GSE benefits reduced the interest rate on a single family mortgage by at least 10-25 basis points. On a $400,000 conforming mortgage, affordable only to households earning $150,000 per year who can make monthly payments of about $3800, that $400-$1,000 annual savings may not be noticeable. But for a first time homebuyer with a $40,000 income and monthly payments of $900 on a $100,000 mortgage, $100-$250 in annual savings is significant.

  Non-profit and bank multifamily lenders have for decades complained that the GSEs' refusal to finance multifamily mortgages of less than $3 million, and larger loans from only a few dozen lenders, has constrained greatly the availability of affordable rental housing. Now more than ever the government should address this unmet need.

2. What role should the federal government play in supporting a stable, well-functioning mortgage finance system and what risks should the federal government bear in meeting housing finance objectives?

The federal government must provide a "cop on the beat" for the mortgage finance system.

In addition, heterogeneous and complex loans, such as multifamily mortgages on multi-layered, multi-subsidized properties that provide affordable rental housing, are hard to price and therefore expensive to sell. Multifamily mortgages of less than $3 million financing affordable rental housing have been the orphans of the secondary market. The government should ensure liquidity for all qualifying multifamily loans made by nonprofit and bank lenders with long-term, successful track records.

The federal government should also recognize that a very robust and sophisticated market funneling private capital to affordable housing has evolved, largely independent of the Federal Housing Administration (FHA). This market in private capital evolved from insured depositories' efforts under the CRA to help meet the credit needs of their communities, and succeeded despite the limitations of FHA and lack of support from the Government National Mortgage Administration (GNMA), Fannie Mae and Freddie Mac. Annually until 2009, private capital has funneled more than $60 billion in Community Development lending benefiting LMI, and literally hundreds of billions in conventional single family mortgages.

For loans on properties housing low (under 60% of AMI) and moderate (under 80% AMI) income households, the federal government should support this private capital market with a new program of Federal insurance on leveraged loans. For example, through insuring the top loss on qualifying loans to encourage more public and private investors to finance heterogeneous and complex loans, the government can expand the supply of private capital for affordable rental housing. The State of New York's Mortgage Agency, SONYMA, provides a useful model of how government can provide an insurance fund to stimulate the private capital market for targeted mortgage lending by taking a limited, first-loss position on qualifying single and multifamily loans benefitting the underserved.

The Federal government should increase transparency and publicly available information across the primary and secondary markets, promoting accurate information about loan performance.

In addition, in times of extreme stress when credit becomes scarce, the federal government has demonstrated that it can and should act to facilitate the flow of capital.

Lessons learned:

- Market makers matter. The primary mortgage market increasingly responded to the mortgage market makers' appetite for triple A rated tranches of securities backed by subprime loans, heavily concentrating market risk instead of distributing it.
- Lender of last resort (countercyclical credit facility) matters. Even after the sunset on the Sallie Mae GSE charter, in 2008 through 2009, as securitization markets froze and capital seemed scarce, the student loan market continued to function relatively smoothly through the facility provided by the U.S Department of Education. The recent financial crisis has demonstrated that the federal government plays an important role in times of stress.
- Transparency matters. Loan level information and reliable data on the mortgage market were so rare, and so expensive, that by the time policymakers grasped the distortions in the mortgage market it was too late. The Federal government should increase transparency and publicly available information across the primary and secondary markets, promoting accurate information about loan performance that can lead to more affordable financing.
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3. Should the government approach differ across different segments of the market, and if so how?

The economic crisis was exacerbated by unsupervised, unregulated capital chasing loans with

explosive, anti-consumer features at the same time there was a dearth of capital for responsible loans on affordable housing. Going forward, the federal government should target the housing needs of the unserved and underserved and support the many public and private partnerships that have proven track records in providing affordable rental housing. Targeting the unserved and underserved segments of the mortgage market as the priorities, and also finally aligning the responsibilities of the primary and secondary markets, would increase the flow of capital to rental housing affordable to low and moderate income and also to responsible mortgages made by banks to homebuyers.

4. How should the current organization of the housing finance system be improved?

In addition to an unequal distribution of benefits, the huge gaps in regulation and monitoring, with rules and monitoring that applied to some market participants but not to all must be reformed. The lack of transparency in the mortgage market and the absence of a coordinated system for monitoring risks across the sector exacerbated the problems**. Only when all market participants operate under comparable capital, regulation and examination requirements, can risk be identified and properly distributed rather than concentrated.**

The government should acknowledge the importance of leveraging private capital to address unmet housing needs, and provide incentives for private investors to provide liquidity and capital to lenders that can help meet those needs. In doing so, the government should supplement and support private capital efforts, and reform misalignments and distortions in government policy that undermines private capital.

5. How should the housing finance system support sound market practices?

Building on what works, the system should ensure a level playing field so that risks cannot migrate to those least capable of managing them and disclosing them. One of the keys to a consistent and reliable source of mortgage finance is the promotion of "sound lending practices," where the risks are well understood by the various parties involved in the transaction, properly aligned, and sustainable over various stages of the economic cycle.

Sincerely,

Judy Kennedy
President and CEO

cc: Michael Barr
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