

July 7, 2004

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

Attention: Docket No. FR-4790-P-01

Proposed GSE Housing Goals for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) for the Years 2005-2008 and Amendments to HUD's Regulation of Fannie Mae and Freddie Mac

BACKGROUND

Members of the National Association of Affordable Housing Lenders (NAAHL) appreciate the opportunity to comment on HUD's proposed housing goals for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) for the years 2005-2008, and the amendments to HUD's regulation.

NAAHL represents America's leaders in moving private capital to those in need. Our nearly 200 member organizations include 75 insured depository institutions, 50 of the nation's top non-profit providers, GSEs, insurance companies, pension funds, foundations and others committed to increasing private capital lending and investing in low- and moderate-income (LMI) communities.

Over the past 20 years, primary market lenders, both non-profit and for-profit, have made enormous progress in increasing lending and investing in LMI communities. This progress is all the more remarkable given their limited access to the secondary market benefits the GSEs have brought to other prime market financing and borrowers. Nonetheless, the current GSE goals have clearly had an impact on GSE loan purchases.

We strongly support HUD's continued effort to close the existing gaps by designing affordable housing goals that would result in the GSEs leading the market for financing affordable rental housing and homeownership. Increased liquidity for mortgages on affordable homes could dramatically increase the resources available to provide more housing.

To that end, we commented in May, 2000 on the proposed GSE goals for 2001-2004. While those final goals clearly directed the GSEs' attention to some underserved markets, we agree with HUD's assessment that the goals should be strengthened. This will summarize NAAHL members' experience and recommendations for resetting the goals.

1. The GSE goals and responsibilities need to be aligned with primary lenders' requirements under the Community Reinvestment Act (CRA).

As we pointed out four years ago:

“Alignment of GSE and primary lenders' responsibilities would provide a more consistent framework for evaluation, avoid duplications or inefficiencies, enhance liquidity, and thereby lower costs to LMI borrowers and communities. As a result, we strongly support changes which conform GSE goals to CRA requirements of primary lenders, such as the redefinition of “underserved areas” to be below 80% of area median income.”

HUD's assessment of the extent to which the GSEs still lag the primary market for LMI loans reaffirms the importance of aligning GSE responsibilities with those of insured depository institutions. For example, to match CRA requirements, GSEs would be required to demonstrate the extent to which they meet the credit needs of low-income (less than 50% of area median income, or AMI) households separately from those of moderate-income (50% to less than 80% of AMI). Because it is much easier to meet a goal that is “low- and moderate” in the aggregate, a specific affirmative obligation increases the probability that GSE benefits will accrue to rental housing affordable to low-income households and in targeted areas needing increased activity.

Aligning the GSE goals with CRA requirements should also permit the GSEs to receive credit for tax credit investments, and ensure that the “performance context” in which they operate is taken into consideration in their performance evaluation.

Policy differences between the GSEs and HUD have highlighted the need for transparency in goals' attainment. Equally important, the public should be able to determine if their communities are accessing GSE secondary market benefits, just as the public now has publicly available the bank regulators' evaluations and data on banks' CRA performance. The HUD regulations should specify that the GSEs' performance evaluations and underlying data are available to the public within a reasonable time frame.

2. Unless and until GSE goals are fully aligned with CRA, existing goals that work against providing GSE secondary market benefits to LMI communities should be reworked.

Despite the bonus points in the 2001-2003 goals, few of our members have been able to sell what are considered “small” multifamily mortgages for properties that are restricted to, or occupied by, households with incomes under 80% of area median income to the GSEs. Only a small fraction of our non-profit lender members have been able to sell mortgages to the GSEs, despite successful track records of lending for a decade or more with no, or a fraction of 1%, losses. Insured depository institution members also report little success in selling CRA-eligible, small multifamily loans to the GSEs. Reasons for this problem and proposed solutions are as follows.

First, HUD's special affordable sub-goal for multifamily loans provides no inducement for buying the small multifamily mortgages on the properties that provide housing affordable to LMI

households in so many communities. The goal is expressed in dollars, rather than families housed, units, or number of mortgages, so it is most easily achieved with larger loans. Both Fannie Mae and Freddie Mac have easily exceeded HUD's multifamily special affordable goals for them each year.

The relatively small loan sizes associated with conventionally-financed, affordable rental housing are disadvantaged by denominating this sub-goal in dollars. Much affordable rental housing involves conventional mortgages of under \$1 million and up to \$2 million dollars. Lacking a secondary market, banks have held these loans in portfolio, confident of their soundness but unable to recycle loan sales' proceeds into more loans. Non-profit lenders have found spot purchasers among banks, insurance companies, and even a Federal Home Loan Bank.

In recognition of the tremendous importance of smaller property loans to rental housing that is affordable to those with incomes less than 80% AMI, to preservation of assisted housing, and to targeted areas, we recommend that the special affordable sub-goal for multifamily loans be revised to reflect LMI families housed, or that HUD establish specific sub-goals for loans up to \$1 million, from \$1-2 million, and from \$2-3 million dollars.

Second, GSEs receive goals' credit for mortgages on properties that may be located in "underserved" areas with incomes of up to 120% of AMI, even if rents are unaffordable to LMI households. Moreover, a loan can count in more than one goals category. We recommend that loans in "underserved areas" only receive credit if they are on properties that principally benefit (i.e., rents on most units are affordable to) LMI households.

Third, members involved in multifamily affordable housing have suggested that the GSEs' underwriting and servicing criteria do not yet reflect the experience of the past decade. The primary market has evolved into a very sophisticated manager of credit risk for LMI borrowers and communities. Insured depository institutions and their non-profit partners have forged new paths to financing housing affordable to LMI households. These partnerships and risk-sharing structures have dramatically increased the supply of affordable homes with de minimis losses and decent returns. The secondary market has not kept pace with these developments in LMI communities. Strengthening GSE goals should encourage the GSEs to update their underwriting criteria by reaching out to successful lenders whose track records confirm that the GSEs have been leaving a lot of good business on the table.

3. The statute envisioned GSE leadership at Lake Wobegon level, but some of the goals only reflect average achievement.

Despite strong language to the contrary, HUD's goals do not appear to require the GSEs to lead the market but rather to catch up to the primary market. The goals by and large reflect what HUD projects the market share of LMI customers to be. Such goals ask the GSEs to be average, not leaders. HUD's own analysis of the LMI market confirms primary lenders' impressions that the GSEs should have no difficulty greatly increasing their "goals business", the "numerator" of purchases of loans on affordable housing, with GSE benefits conferred on many more CRA-eligible mortgages from conventional lenders, and perhaps on more manufactured housing and subprime loans.

Credit for meeting goals should be limited to providing real GSE secondary market benefits and liquidity to the market, not for activities that simply give the appearance of providing liquidity. Just as insured depository institutions are required to meet the credit needs of their communities, the GSEs' charters require them to:

“Provide ongoing assistance to the secondary market for residential mortgages (including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities)...”

This statutory directive to provide “ongoing assistance” should preclude the GSEs from meeting their goals through the purchase mostly, or only, of seasoned mortgages. Similarly, the HUD goals should not provide the GSEs full credit if they extract special concessions in return for conferring GSE secondary market benefits, such as purchasing LMI mortgages only with recourse back to the primary lender should the loan default, or only after being reinsured by a third party.

It also appears as though the GSEs have not availed themselves of the statute’s permission to accept a lower return on equity to support LMI lending, which CRA-covered lenders often do. Finally, the GSEs should be required to purchase newly originated loans as a significant proportion of their goals, and not just seasoned loans whose payment history and/or loan-to-value ratio suggest that they carry virtually no risk.

4. HUD should establish an industry advisory board to review the impact of the GSEs on lending and investing in low- and moderate-income communities.

Because the GSEs are a duopoly, there is concern among our primary market lenders that the GSEs could demand that lenders deliver specified mortgages to the GSEs to meet their housing goals, whether or not the lender can achieve better secondary market execution elsewhere, such as with the Federal Home Loan Banks or Ginnie Mae. Similarly, given the GSEs’ concerns about the size of the market HUD has estimated and/or economic conditions, it would be important for the GSEs and HUD to have the opportunity to consult with non-profit and for-profit primary market lenders, and perhaps others involved in LMI communities, on a regular basis. In these discussions, the participants can assess what actual economic, demographic and market conditions have materialized during the period, discuss what challenges have been presented in meeting the higher goal levels, and review the extent to which GSE secondary market benefits are being provided on LMI loans.

We are happy to discuss these recommendations in more detail, at your convenience.

Sincerely,

Judith A. Kennedy
President