N A A H L
NATIONAL ASSOCIATION OF AFFORDABLE HOUSING LENDERS

January 3, 2014

Regulations Division
Office of General Counsel
Department of Housing and Urban Development
451 7th Street SW, Room 10276
Washington, DC 20410-0500
Docket No. FR-5728-N-01

Re: Small Multifamily Building Risk Share Initiative Request for Comment

Dear Madams/Sirs,

The National Association of Affordable Housing Lenders (NAAHL) represents lenders and investors who are committed to increasing the supply of private capital in low- and moderate-income (LMI) communities and underserved areas. Our membership includes community development practitioners from major banks, blue-chip mission-based lenders like multi-bank consortia, CDFIs, and others in the vanguard of affordable housing and community economic development.

Introduction

We welcome this chance to comment on the Small Multifamily Building Risk Share Initiative, a streamlined FHA insurance pilot for mortgages on small multifamily properties. We very much appreciate this effort toward ensuring a stable, reliable source of credit. As you know, FHA insurance is a great tool, but it has not been accessible to small property landlords, whom HUD Secretary Shaun Donovan recently called "the unsung heroes of the rental market." NAAHL strongly supports the pilot to help address the gap in financing for small rental buildings.

As former FHA Commissioner John Weicher has documented, 90 percent of affordable rental units are in properties with fewer than 49 units, 55 percent of which are outside central cities. Harvard University's Joint Center for Housing Studies recently reported an urgent crisis in rental housing affordability with half of U.S. renters paying more than 30 percent of their income on rent, and 27 percent of renters spending more than 50 percent.

We offer these comments to make the pilot even more useful for ensuring access to credit for carefully underwritten, affordable, small rental properties. We have addressed what we see as potential obstacles in the Notice to participation in the pilot by qualified lenders and small property owners. We also agree that legislation to authorize Ginnie Mae to securitize loans on small buildings made under Section 542(b) is key to providing a secondary market. Securitization would greatly enhance access to credit for small rental properties.

NAAHL OFFICE
1667 K Street, NW, Suite 210, Washington, D.C. 20006 / Tel (202) 293-9850 Fax (202) 293-9852 http://www.naahl.org

Reducing Barriers to Program Participation

Certification of Financial Capacity: Ensuring a Deep Pool of Qualified Applicants

- *Minimum Financial Capacity Standard…All lenders under this initiative must meet certain minimum financial capacity standards similar to those promulgated by [FHFA] in 2010 as conditions for CDFIs to become members of the Federal Home Loan Banking [FHLB] System, specifically net asset ratio, earnings, loan loss reserves, and liquidity. Any Applicant not meeting…requirement can provide HUD with additional information…*

  We agree that the Qualified Participating Entities (QPEs) that will work with local small property mortgagors should be robust lenders with strong track records.

  1. As FHLB members must meet very high financial standards, we agree that CDFIs that are FHLB members automatically be certified as having the financial capacity to qualify.
  2. We also strongly recommend that CDFIs that have met the FHLB standards and been approved for FHLB membership, but are not yet members, should also be automatically certified. Among NAAHL members, at least two high-performing, mission-based lenders were approved for membership, but FHLB circumstances precluded their joining.
  3. For those mission-based lenders that have not applied for FHLB membership, or may not under existing law, the proposed application information requests on financial capacity seem reasonable. It will be critical that FHA evaluate each applicant's unique balance sheet, considering each lender's operating objectives, business model, and loan loss history. Mission-based small property lenders must have the opportunity to explain the offsets and alternative means to demonstrate sound financial condition. For example:

     Net Asset Ratio. NAAHL recommends that the Notice be adjusted to reflect that the net asset ratio apply only to those assets for which the QPE is liable. For a CDFI with $20 million in net assets and total assets of about $220 million, a simple calculation would peg its net asset ratio at slightly less than 10%, beneath a 20% net asset benchmark. But according to the lender's contractual agreements with its investors, it has essentially no liability for the $200 million in mortgages in which they have invested, since virtually all losses flow through to the investors. As both the CDFI Fund and one FHLB acknowledged, the actual net asset ratio for this CDFI was 46%, well above the 20% benchmark.

     Another bank-funded, mission-based, nonprofit lender with a record of $1 billion in affordable multifamily loans over the past 20 years with no loan losses has approximately $43 million in net assets and total assets of about $500 million. The net asset ratio

calculation would be 8.6%. Yet the lender's contractual agreements with its capital funding sources provide it with strictly limited liability for the $400 million in loan assets on its balance sheet. The lender can make a very strong case that it operates in a sound financial condition because its asset risk exposure is well contained.

30% Loan Loss Reserves. Similar to the net asset ratio, the loan loss reserve calculation should be applied only to those loans for which the QPE retains liability.

Program Flexibility: Avoiding Undue Burdens

Just as a cookie-cutter application of financial capacity standards would prevent many robust lenders from participating in the pilot, unnecessary constraints on the reach of the pilot could undermine its effectiveness. For this initiative to succeed, HUD must have the flexibility to offer a product that property owners will be willing and financially able to use.

- *Qualified CDFIs and other mission-driven lenders approved to participate in the initiative would be authorized to originate, underwrite, and service loans for HUD multifamily mortgage insurance for project refinancing, rehabilitation, substantial rehabilitation, or equity take outs, but exclude new construction.*

  The pilot should not exclude the financing of new construction. There are many parts of the country where development of new small rental properties is as critical as renovation of existing ones. With access to the pilot, small property lenders can help to meet the pent-up needs for affordable rental housing from rural areas, senior citizens, and the disabled.

- *…Refinancing is permissible when…project occupancy is not less than 93 percent.*

  This occupancy requirement for refinancing would exclude many small properties. For example, a 10-unit property with a single vacancy would not meet the 93 percent threshold and would be ineligible for refinancing. There is a good precedent among HUD programs for permitting refinancing at lower occupancy rates, such as Section 223(f), that requires 85 percent occupancy.

- *Requires the project owner to maintain complete project books and financial records, and provide the QPE with annual audited financial statements…The cost certification provided by the mortgagor must be audited…All projects…must comply with the environmental requirements of 24 CFR Part 50…anticipated that QPEs will use consultants to compile environmental information and prepare environmental analysis…mortgagor must certify to QPE…will not discriminate…*

The risk-share initiative is intended to increase mortgage lending for small rental properties, but the Notice assumes expenses that may discourage small property borrowers and lenders. We recommend that HUD "right-size" its expectations of applicants to better attract those who are operating most successfully in the market now.

Small property owners are often local entrepreneurs who are developing their properties in addition to their full-time jobs. As a consequence, they are running their businesses relatively simply, and are deterred by loans involving extraordinary paperwork or expense. For example:

> **Audited Financial Statements**. Small property owners do produce financial statements that lenders review, but they are not audited statements. If the originating lender is willing to share the risk of the loan, HUD should not mandate audits.
>
> **Third-Party Services**. Flexibility will give lenders the option to use consultants or existing business partners, depending on the expertise of their own staff members. The reality is that lenders and owners/landlords of small properties are usually working with their own employees on loans, construction and local approvals, as well as appraisals, environmental analysis, and legal review. Also, small property owners adhere to existing anti-discrimination statutes, and would certify that they do not discriminate, but they typically do not have Affirmative Fair Housing Marketing plans.
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> In addition, the proposal's presumption that all mission-based lenders will all have operating manuals on a variety of matters is inaccurate, although they do follow their operating procedures. For example, one NAAHL lender undertakes a Phase I Environmental Audit, as defined by Fannie Mae, on the following properties: 1) any loan of $1,000,000 or more; 2) any mixed-use property; 3) any property about to become a part of the lender's Real Estate Owned inventory; and 4) any loan for new construction.

- *All lenders under this initiative must be approved as FHA lenders…The officer who will be in charge of the FHA operation must have at least 3 years of experience in FHA mortgage operations…Describe the counsel on staff or retained…who is experienced in real estate transactions…If any architectural, engineering or cost functions are contracted out, describe the qualification and experience requirements for contractors in each skill…*

In general, lenders participating in this program will not be large operations with highly-specialized staff members. These organizations will have staff members

with many years of in-depth experience in multifamily lending, but they may not, for example, possess specific FHA mortgage expertise.

Relevant multifamily lending experience should be an acceptable substitute for FHA mortgage experience. If FHA experience remains mandatory, applicants should be able to use consultants, and/or utilize an existing relationship they may have with an FHA lender or local mortgage broker, or a retained counsel.

- *The mortgage must provide for complete amortization…over the term of the mortgage.*

  We recommend establishing a minimum loan term of at least 10 years and amortization that could extend up to 25-35 years. The purpose of this initiative is to facilitate access to credit for 5-49 unit properties, so the program should not require a complete amortization of the loan within the loan term.

  Many of our member lenders have strong relationships with local banks that may be interested in purchasing the FHA-insured loans that are originated under this pilot. Requiring full amortization of risk-share loans, with, for example, 35-year mortgages on 35-year amortization schedules, would make such loans much less attractive to banks. It would be much easier for CDFIs and other mission-based lenders to find investors for 10-, 15-, and 20-year mortgages, and this flexibility is especially important if these mortgages cannot be securitized through Ginnie Mae. There is a precedent in the current 542(b) program that allows Fannie Mae and Freddie Mac to offer loans of 15 years or more.

Common Sense Approach to Affordability Requirements

- *Affordable housing must meet the standards of the Risk Sharing Program, as is generally consistent with the requirements of the Section 42 Low Income Housing Tax Credit program.*

  As almost all small properties are naturally affordable, we appreciate the Notice's flexibility in mandating that these affordability requirements be satisfied primarily through an affordability restriction placed on the title, without requiring ongoing rent recertifications.

  In addition, we want to confirm that the affordability obligation is across the turnover in the building as a whole, rather than requiring a specific unit to be affordable at all times. Income targeting should be aimed at the entire building, not particular units. Permitting affordability to "float" across the universe of the building gives landlords greater ability to rent units, as they become available, to LMI individuals.

Conclusion

Thank you for the opportunity to provide our practitioners' input to make this pilot more effective. We look forward to working with you to increase the flow of private capital to underserved areas in sustainable ways.

Sincerely,

Judith A. Kennedy
President and CEO