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Potential Housing Finance Reform Puts Fannie, Freddie in the Spotlight

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When the Great Recession hit in 2007 and 2008, Fannie Mae and Freddie Mac were collateral damage–entering conservatorship in 2008 and changing the marketplace for investing in low-income housing tax credits (LIHTCs).

Housing finance reform is possibly on the menu for 2020, but insiders suggest it won't be nearly as drastic.

The two government-sponsored entities (GSEs) play a significant role in the affordable housing world, both on the lending and investing side. Compared to 2008, though, the market is positioned better.

"Their role is not as big as it used to be," said Peter Lawrence, Novogradac's director of public policy and government relations. "In the mid-2000s, 35 to 40 percent of the [LIHTC] equity investment market was from Fannie and Freddie. It's unlikely that it will get like that again."

Buzz Roberts, president and CEO of the National Association of Affordable Housing Lenders, agreed.

"Things were quite different [in 2008], because Fannie and Freddie had 40 percent of the LIHTC equity market," Roberts said. "They pulled out precipitously and it was very disruptive to the investment market. These days, they play a much smaller part."

However, both GSEs remain significant, particularly when it comes to affordable multifamily property mortgages.

"They're truly important. More on the lending side than equity, but they make a significant impact," Roberts said.

Phil Melton, the executive vice president and national director of affordable housing and Federal Housing Administration lending at Bellwether Enterprise, sees Fannie and Freddie in crucial roles.

"I think Fannie and Freddie have been key drivers on long-term permanent financing," Melton said. "Banks have CRA [Community Reinvestment Act]

continued on page 2

continued from page 1

needs, but banks have other views on long-term debt in their books. They prefer shorter term, building loans. Fannie and Freddie have been part of a longer view."

In 2020, Fannie and Freddie could begin to emerge from conservatorship, which could affect the GSEs' investment in affordable housing, their duty-to-serve requirements and what they contribute to the Housing Trust Fund (HTF) and Capital Magnet Fund (CMF).

How Reform Will Happen

The Federal Housing Finance Agency (FHFA) oversees the GSEs under the leadership of Mark Calabria, the FHFA director. Reform could come through legislation and/or administrative action.

Lawrence said the FHFA assuming administrative reform is the way to go, largely because of the difficulty in finding legislative solutions during a presidential election year.

Roberts agreed.

"In terms of legislation, nobody expects anything before the 2020 election," Roberts said. "After that, we'll have to see how the lineup looks. We're cautiously optimistic that we can do legislation. There will be a focus on getting Fannie and Freddie to leave conservatorship with the objective to build up their net worth."

If legislation happens–most likely after the November election–Roberts identified priorities for affordable housing.

"For affordable housing, there are three (legislative) things," Roberts said. "First is [Fannie's and Freddie's] role in multifamily lending, the second is any affordable housing goals or duty-to-serve requirements and third is the size and terms for contributions to the HTF and CMF."

Lawrence said it's unlikely that Calabria is eager to make massive changes at Fannie or Freddie. However, some questions remain.

Investment in LIHTCs

About one issue, there is no dispute. When Fannie and Freddie dropped out of the LIHTC investor market in 2008, it caused difficulties.

"The loss of them in the market was a serious disruption," Melton said. "We saw prices drop to the 60s and low 70s (cents per dollar of credit), but then the market stabilized. Now we see prices from 88 to 92 cents, higher in CRA markets. When they left the market, it created a huge gap and the federal government had to reach out to prop it up."

The GSEs were forbidden to invest in LIHTCs until the ban was lifted in 2017. That made 2018 the first full year that GSEs invested in LIHTCs, with a ceiling of $500 million each–$200 million each of which would be reserved for mission-related investments, requiring FHFA approval that ended up going mostly to rural properties. Both GSEs have said they invested the full amount.

The return to market of the GSEs helped stabilize the LIHTC market, particularly in a year when a large reduction in the corporate tax rate otherwise decreased appetite for credits. Observers say, though, that one lesson from the conservatorship situation is that the market is healthier with more investors and less of the market held by the GSEs.

"It was unhealthy to have two investors with such a large share of the market," Roberts said. "It made the market vulnerable to a very fast withdrawal. These days, that kind of impact is limited because of the size and the other investors."

continued on page 3

continued from page 2

Melton agreed.

"It's always good to have more competition," Melton said. "The positive for them having that much [of the market] is that the pricing was firm, but more players in the business looking for that resource, the better. Would we like to see Fannie and Freddie have more liquidity? Yes, because they're not CRA-driven. They might not have as much competition in those markets."

The CRA is a significant factor in LIHTC investment, driving financing into markets where banks get CRA credit. According to the Affordable Housing Investors Council, 85 percent of annual LIHTC investment is driven by CRA-motivated banks. The fact that Freddie and Fannie aren't motivated by the CRA considerations means that they make other investments.

"They came back in with $500 million [each]," Melton said. "They're not looking to compete in CRA markets. They're looking at secondary and tertiary markets, to serve the underserved markets."

Duty to Serve Requirements

Fannie and Freddie must follow duty-to-serve requirements implemented by the Housing and Economic Recovery Act of 2008. That includes manufactured housing, affordable housing preservation and rural housing.

"If they leave conservatorship, the duty to serve is still on the books," Lawrence said.

Melton hopes that housing finance reform would mean even more service.

"They have a commitment to 37.5 percent mission-driven business, which is seen as a minimum," Melton said. "I would like to see continued focus and see more and more mission-driven. We'd like to see them lead the charge."

Melton sees the duty-to-serve requirements as crucial.

"I think as long as the FHFA has a mission-driven focus, they will find a way for Fannie and Freddie to retain some duty-to-serve requirements," Melton said. "I'd be somewhat surprised if there's not some requirements from the FHFA [after conservatorship], because they want Fannie and Freddie to be in the market. They want to be sure that Fannie and Freddie are spending a specific portion in that area."

CMF, HTF Contributions

Another element that could change with housing finance reform is the requirement that Fannie and Freddie contribute to the federal HTF and CMF.

"The CMF and HTF are quite important," Roberts said. "Each serves a unique role in the industry. The CMF is the only source of substantial grant money for Community Financial Development Institutions and nonprofit housing developers to use to build on their organizational strength. There is significant impact. Mark Calabria has indicated that he plans to keep the contributions going unless Fannie or Freddie fails."

What's Ahead?

In seeing what the future hold for the GSEs, Roberts said a key number to watch is the amount of multifamily lending by Fannie and Freddie.

In September 2019, the FHFA announced a requirement for $100 billion in multifamily loans over the subsequent five quarters–with a mandate that 37.5 percent goes to affordable multifamily.

"It will be interesting to see how the guidelines for multifamily lending work out," Roberts said. "Three-

continued on page 4

continued from page 3

eighths has to serve affordable multifamily properties, so how that shakes out will be important to watch. Will they exceed that minimum significantly?"

Melton is optimistic, but expects it to take a while. He also expects FHFA oversight to continue.

"They'll both be targeting exiting conservatorship within two or three years," Melton said. "Both would be happy to be in a place of independence in that timeline. My hunch is that FHFA isn't going through all this with conservatorship to not have any oversight. I see both as robust players and I think there will also be more workforce housing, up to 120 percent of the AMI."

Melton said he is looking for the GSEs to increase creativity.

"I think Fannie and Freddie are continually looking for ways to be innovative and getting out of conservatorship may help, because it stymies creativity," Melton said. "I hope as they become independent, it creates more opportunity to be creative and flexible and meet the needs of the marketplace without all the oversight of the past 10 years." ❖

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