

**Department of the Treasury
Department of Housing and Urban Development
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Re: Notice and Request for Information: Public Input on Reform of the Housing Finance System

July 21, 2010

Thank you for the opportunity for The Community Builders, Inc., to submit comments on reform of the housing finance system, as published in the Federal Register notice on April 22, 2010.

Our comments are offered from our perspective as one of the nation's largest and most accomplished nonprofit developers of affordable and mixed-income housing over a 45-year history. During this time we have successfully developed over 25,000 units of mostly rental housing across 15 states. In many cases, we have developed or sponsored complementary single-family homes for ownership in nearby adjacencies. We also have developed a fair amount of special needs housing. In the process, we have assembled over \$2.3 billion in project financing, tapping nearly every public and private housing debt, subsidy and equity program available since the 1960s. As our name suggests, we are careful to undertake our housing activities in response to local market needs and requirements.

In the course of our work, we have found the housing finance system to be increasingly oriented to supporting home ownership. Since the 1980s, outside of the Low Income Housing Tax Credit vehicle, the Affordable Housing Program of the Federal Home Loan Bank and the HOPE VI public housing replacement initiative, there have been few, if any, new programs to support the production of affordable and mixed-income housing.

Due to this relative lack of support, existing public multifamily debt and equity financing vehicles are under-developed, and little conventional or private financing supports affordable multifamily housing production. To execute multifamily projects of any scale, developers must assemble several layers and multiple phases of financing. For the most part, special multifamily debt products offered by the large, national Government-Sponsored Enterprises (GSEs) and the Federal Housing Administration (FHA) pose complex underwriting requirements and high transaction costs. Aside from niche insurance programs, many FHA multifamily initiatives are not promoted and are underutilized from year to year. Few of these programs are coordinated with other public sources of multifamily capital such as the tax credit and bond financing programs administered by state housing finance agencies, the Community Development Block Grant and Neighborhood Stabilization Programs (CDBG and NSP, respectively), or the Home Ownership Made Easy and other HUD-administered programs.

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The net effect of these constraints is that the multifamily housing financing products available to support affordable, mixed-income housing are typically cumbersome, cost-ineffective, tailored to meet certain market segments and unresponsive to varied market demands. In short, the current housing financing system significantly under-serves the affordable multifamily market. A revamped housing finance system must correct these imbalances and shortfalls.

Community Builders, Inc., would like to offer some observations and recommendations of an expanded multifamily financing system in four inter-related categories: 1) Actors; 2) Products; 3) Public and Regulatory Roles; and 4) Strategies. We would be happy to elaborate and develop more fully some or all of the ideas if helpful to the coming deliberative process.

Actors. Given funding constraints and other priorities, aside from active implementation of the HOPE VI program, HUD has played a limited role in innovating and implementing new multifamily programs over the last 25 or so years. With the responsibility for administering the Section 42 Low Income Tax Credit (LIHTC) program in the late 1980s, state housing finance agencies (HFAs) stepped somewhat into the breach of multifamily program design and development, offering initiatives tailored to the needs of regional and local markets. At the same time, without active support from HUD, the capacity of local governments and public housing authorities to guide and execute large-scale assisted and public housing developments waned.

A revamped housing finance system should foster high-functioning institutional capacity at all levels of government—federal, state and local—and tap the undeveloped potential of the Federal Home Loan Bank system as regionally-focused GSEs. Four steps should be encouraged to enhance the capacity of these actors to expand proven programs and create new initiatives in support of affordable multifamily housing development.

First, at the federal level, while still constrained by budget realities, new leadership at HUD and the within the FHA Office of Multifamily Programs is beginning to move in needed new directions. Promising new initiatives including the Preservation, Enhancement and Transformation of Rental Assistance (PETRA), NSP, and Choice Neighborhoods, and advancing of under-utilized tools, such as transferring project-based Section 8 subsidies from obsolete or deteriorated properties to support more viable properties and making inventory in enforcement more readily accessible to preservation-oriented developers, are coming into play. These activities not only promote affordable housing directly but also enable local governments and housing authorities to re-energize their roles and build their capacities to implement much needed, larger-scale multifamily preservation and re-development projects. For example, PETRA would, if authorized by Congress, allow PHAs that convert traditional public housing operating subsidies to project-based rental assistances to access and leverage billions of dollars in private debt and equity in the years to come.

Second, state and local HFAs should be encouraged to deploy increasing amounts of the Private Activity Volume Cap under their control to directly finance affordable multifamily housing development. This sort of development is the only allowable use of tax-exempt bonds that brings with it the added substantial benefit of LIHTCs, but it typically utilizes a minority of the available volume cap.

Third, the regional system of Federal Home Loan Banks (FHLBs) should amplify its “close-to-the-customer” infrastructure in support of a range of affordable multifamily development products that go beyond its useful but limited Affordable Housing Program. With the implied federal backing as regionally-chartered GSEs, FHLBs have considerable undeveloped potential to direct more of their capital into new initiatives—particularly in light of the near-term retirement of its REFCORP bond obligations, which consumes 20 percent of its current income. We would urge that FHLBs retain their government-sponsored status. In return, they should be expected to play a more expansive role by directing increased resources and initiatives to affordable and mixed-income multifamily development and financing.

Finally, as the Administration and Congress deliberate over the mission and focus of the national GSEs currently under the direction of the Federal Housing Finance Agency, and look to correct the “private gain yet public loss” structure of Fannie Mae and Freddie Mac, they should preserve the capacity that the national GSEs demonstrated over the last 30 years to innovate large-scale, high volume multifamily financing initiatives while making them more accessible to the full range of affordable housing developers.

Products. As the capacity and focus of federal, state, regional and local actors to fund, guide and help execute needed multifamily development is reinvigorated, a robust set of new programs could be designed and implemented. We have outlined below some ideas based on Community Builders’ finance and development experience—and constraints that we struggle with—and hope to continue discussing them with policy makers at all levels.

At the federal level, even prior to the current financial crisis and economic recession, the considerable limitations of the Section 42 LIHTC programs in supporting large-scale multifamily development were readily apparent. Given the depth of demand for deep-subsidy 9% LIHTCs to support new development and substantially rehabilitate or replace the aging stock of public and assisted housing—typically with well-designed and managed mixed-income housing desired in most communities today—nearly all HFAs arbitrarily impose maximum unit and/or dollar limits on the amount of tax credit authority that they will allocate in a given round to single developer or project. The-all-too frequent result of this practice is that large-scale multifamily developments must be carved up into two, three or even four development phases across nearly the same number of years to execute a typical 250-unit development. The resulting inefficiencies from multi-phase financial packaging, redundant transaction costs and prolonged start-and-stop construction cycles are an extraordinary and unnecessary drag on the bottom line of affordable multifamily developments.

At root, serious rethinking, revision and expansion of Section 42 and the HFA allocation system is needed to address this and other problems evident with this nearly 25-year old program. However, a few remedies could be pursued in the near term.

First, on the supply side, Congress could authorize Treasury to allow HFAs to effectively “double-up” available—and often unused—4% as-of-right LIHTCs and offer them to investors to provide deeper tax credit subsidies. Similar to the 30 percent basis boost for Qualified Census Tracts and other state-determined Difficult to Develop Areas

currently allowed, such subsidies could be limited and highly targeted to specific, currently unmet multifamily needs, such as the one-for-one replacement of the aging public and assisted stock.

Also on the supply side, as suggested above, HFAs under existing authority could be encouraged to allocate additional amounts of their Private Activity Volume Cap authority to tax-exempt bonds for affordable multifamily housing, which are coupled with 4% LIHTCs awarded on an as-of-right basis. As these 4% credits are above and beyond the LIHTCs awarded to states on a per capita basis, they augment rather than compete with the award of scarce 9% LIHTCs. With other federal and conventional programs offering historic low interest rates for home mortgages, too much volume cap authority remains directed to single-family tax exempt bonds and economic development projects where it realizes modest leverage and impact. Redirecting a considerable portion to multifamily products would increase the leverage of this authority—as multifamily debt is nearly always coupled with secondary financing and investor equity—and be a more optimal use of volume cap in these times.

Second, to spur investor demand, FHLBs could be encouraged to utilize their liquidity capacity to enable interested member banks to make increased LIHTC investments. Design of a FHLB “Advance” product that accepts as collateral member LIHTC investment interests could give these members a low cost source of debt to fund tax credit equity investments with higher returns. As financial institutions comprise the main market for tax credits investments, this would potentially significantly expand investment by core investors.

To further spur investor demand, HUD-FHA and/or the national and regional GSEs could offer a fee-based LIHTC guarantee program to prospective tax credit investors similar to those available to a very limited degree in the private market. This would potentially enable more non-financial corporations to invest and take advantage of preferable accounting treatment.

Finally, to increase both the amount and range of the flow of funds from investors to LIHTC investment vehicles, public, conventional and GSE lenders should be encouraged to design a set of bridge lending products that recognize and standardize tax credit investment interests as eligible collateral. The new Capital Magnet Fund program within Treasury’s Community Development Financial Institutions Fund could be used for an important new initiative in this regard.

Public & Regulatory Roles. The products outlined above indicate several new or expanded program and regulatory roles for public bodies and GSEs. For HUD generally and the FHA Office of Multifamily Programs specifically, advancing new program initiatives such as NSP, PETRA, Choice Neighborhoods and the new National Housing Trust Fund will be partly dependent upon its ability to successfully advocate the importance of such initiatives with Congress and the Office of Management and Budget. HUD is to be commended for seeking new, if limited, authorizations for such programs. Within Treasury, it is disappointing that the promising new Capital Magnet Fund was not put forward for an additional request in the FY 2011 budget.

Regardless of whether Congress and the Administration maintain Fannie Mae and Freddie Mac as GSEs with access to federal resources, insurance and other forms of

guarantees, both their successor entities and any regional GSEs should be encouraged and rewarded for innovations that respond to market needs for affordable multifamily financing products. In re-engineering their roles, much can be learned from the structure and functioning of the FHLBs as regional GSEs. Like the FHLBs, their primary function should be to provide liquidity across markets; they should be organized and governed according to some form of mutual association or cooperative membership; all functions and activities should require a portion of members' capital to be at risk; a required function of all members should be to participate in a simplified, consistent form of subsidy generation to support under-served markets and market segments; and all members, relative to their size, should be expected to contribute to the achievement of national goals for serving such markets and market segments.

Strategies. The Congress, HUD, Treasury and the national and regional GSEs should be encouraged to adopt and coalesce around a set of national strategies to support affordable multifamily development, which seems to be increasingly embraced by a broad range of housing interests and constituencies. These include: (1) preserving the public and assisted housing stock that is economically viable and currently meets community needs; (2) modifying as necessary the structure of the public and assisted inventory that currently does not adequately serve local needs and/or is economically non-viable; (3) converting limited conventional stock that is economically non-viable to affordable, mixed-income housing, while offering adversely affected tenants mobility options; and (4) producing new affordable multifamily housing in support of national objectives and local market conditions (e.g., sustainable communities, energy-efficiency, brownfield development, neighborhood revitalization plans) and federal, state and local resources (e.g., National Housing Trust Fund, maximizing use of tax-exempt bond authority and as-of-right 4% LIHTCs, use of local TIFs in support of "eds/meds" development areas, etc.).

Specific recommendations are offered below in responses to the seven questions detailed in the notice and request for information.

Question 1: Housing Policy and Finance Objectives

In concert with calls by many, we strongly urge the rebalancing of the housing finance system to prioritize both home ownership and affordable multifamily housing production and preservation. Overall, a 2009 Congressional Budget Office report found that total budget and tax outlays supporting home ownership were four times that for affordable rental housing outlays. At the same time, current estimates are that for one-third of households, including a disproportionate number of low-income households, renting is the preferred or only option.

As outlined above, there are multiple actors and several promising new and potential products that could be used to rebalance the level of needed support for affordable multifamily housing. These include: (1) advancing new HUD-FHA programs such as PETRA, Choice Neighborhoods and the National Housing Trust Fund; (2) amplifying the "close-the-customer" infrastructure of FHLBs in support of new products, including an "Advance" product that could be used by members to increase LIHTC investments; (3) more effectively utilizing state-administered Private Activity Volume cap and 4% "as-of-right" LIHTCs, and possibly offering a doubling of 4% LIHTCs to support

targeted uses; (4) enabling HUD-FHA and the national and regional GSEs to offer more flexible debt guarantees and equity guarantees similar to that offered on a limited basis; (5) developing new public and private bridge loan products to increase and accelerate the flow of funds from investors to LIHTC investment vehicles; and (6) encouraging all actors to innovate in ways that will better respond to local markets and market segments.

Additionally, it will be critical for Congress, HUD, Treasury and the national and regional GSEs to coalesce around a set of national strategies to support affordable multifamily development. These strategies should include the preservation of the affordable stock, modification of outmoded public and assisted inventory as needed, conversion of some conventional stock to mixed-income housing, and production of new affordable and mixed-income housing.

Question 2: Role of Federal Government

Congress, HUD, and Treasury should work together to set national policy goals and strategies, provide additional resources and enhance inter-governmental capacity and coordination to increase the flow of public and private capital in support affordable multifamily development in under-served areas in response to local market needs and requirements. This inter-governmental coordination should explicitly include the national and regional GSEs.

In addition to increasing existing resources and generating a range of new, responsive programs for multifamily housing development, HUD-FHA and the national and regional GSEs should, also as suggested above, offer new and more accessible forms of fee-funded debt and equity guarantees. Both the national and regional GSEs should be directed to participate in a simplified, consistent form of subsidy generation to support under-served markets and market segments; and all members, relative to their size, should be expected to contribute to the achievement of national goals for serving such markets and market segments.

One specific inter-governmental responsibility should be to ensure that current and new public financing tools are streamlined and coordinated with existing multifamily resources to simplify and standardize underwriting, accommodate layered financing and reduce often redundant transaction costs. (Recent efforts such as the cooperation between HUD and Treasury to assess and improve the integration of multifamily programs with LIHTCs should be the norm, not a result of an act of Congress). One simple approach would be to require subordinate forms of financing to adopt the principles underlying the underwriting (or, better yet, the actual underwriting) of the dominant form of equity or debt financing in a transaction.

To promote cohesion, all efforts to balance the retention and distribution of risk should be aligned with the goals and strategies of the newly passed financial reform bill.

Question 3: Market Segments

The best way for the government to respond to varied segments in the multifamily market would be to (1) encourage all public and private actors to coalesce around the affordable multifamily housing strategies suggested above, with an emphasis on under-served markets, and (2) re-invigorate, enhance capacity as needed and encourage the governmental (federal-state-local) and private regional network of conventional

financial institutions involved in the housing finance system to expand existing offerings and design new products that respond to varied market requirements. Such products should address the differences in strong versus weak markets, in preferences for types and densities of housing in urban-suburban-rural settings, and in demand across market segments in a given locale for special needs housing. As the mission and roles of the national GSEs are re-engineered, they too should be encouraged to vary product offerings according to regional or market segment demand.

While a uniform form of subsidy generation should be encouraged across financial institutions, the design and allocation of such subsidies should be left to regional, state and local actors who can best respond to market-specific needs.

Question 4: System Organization

For the most part, the current organization of the inter-governmental, GSE and private financing system, which tends to regional organization even among large, national financial institutions, should be left intact. Within this system, a “close to the customer” lead role in designing and delivering financial products, including subsidy products, should be encouraged as the best means to respond to varied and under-served market segments.

Question 5: Sound Market Practices

In addition to the many elements of the new financial reform legislation that will now reshape the financial markets, policymakers could look to the structure of the FHLB system to improve market practices more generally. As suggested above, many components of the FHLB system have helped it undertake sound market practices over the years. They are worthy of review for potential application at different points within the private—and public—financing system. These components include (1) providing liquidity across markets as a primary function; (2) organizing and governing themselves according to a member-based mutual association; (3) requiring that all financial functions and activities put a portion of members’ capital at risk; (4) requiring that all members participate in a simplified, consistent form of subsidy generation to support under-served markets and market segments; and (5) expecting that all members, relative to their size, contribute to the achievement of national and regional goals for serving such markets and market segments.

Question 6: Consumer Protection

The recently passed financial reform legislation seems to have fully addressed this question, and Congress and the Administration should allow for full implementation of these measures before considering further protections.

Question 7: Other Countries

The experiences of several other advanced Western democracies have demonstrated that it does not appear necessary to direct an exceptionally high level of public subsidy to encourage and sustain a high level of home ownership, particularly when those subsidies favor higher incomes and larger mortgages. Rather, it would be prudent to redirect a fair portion of such tax expenditures (perhaps realized by limiting the amount of mortgage interest deductions and capital gains exclusions that could be claimed by any one

household to a single residence and an amount capped at median home values in a region) in support of affordable multifamily development.

Sincerely,

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President and Chief Executive Officer