LIHTC
WORKING GROUP

March 17, 2016

Alfred M. Pollard, Esq.
General Counsel
Federal Housing Finance Agency
400 Seventh Street SW, 8th floor
Washington, DC 20024

Re: Comments on RIN 2590-AA27 — Proposed Rule on Enterprise Duty to Serve Underserved Markets

Dear Mr. Pollard:

The LIHTC Working Group was established by Novogradac & Company LLP to provide low-income housing tax credit (LIHTC) industry participants a platform to work together to resolve technical and administrative LIHTC program issues. On behalf of the members of the LIHTC Working Group, we respectfully submit our comments on the Federal Housing Finance Agency (FHFA) Proposed Rule on Enterprises Duty to Serve Underserved Markets (Proposed Rule). This proposed regulation implements the duty for the Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac), hereafter collectively referred to as the Enterprises, to serve the following underserved markets—affordable housing preservation, rural housing, and manufactured housing (Duty to Serve)—as established by the Housing and Economic Recovery Act of 2008 (HERA, Public Law 110-289).

The members of the LIHTC Working Group strive to make the LIHTC program even more efficient in delivering benefits to help build affordable rental housing throughout the nation in a wide variety of different housing markets. Our group includes nonprofit and for-profit developers, property managers, lenders, syndicators, investors, accountants, lawyers and other LIHTC professionals.

We commend you for the approach taken in implementing the Duty to Serve provisions of HERA, in particular with regards to affordable housing preservation and rural housing. Combined with the Enterprise's affordable housing goals, the Housing Trust Fund, and Capital Magnet Fund, the Proposed Rule would help direct the Enterprise's activities toward affordable housing investments to address the nation's most challenging and underserved markets.

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Given that nearly 13 percent of the nation's affordable housing stock has been lost due to demolition, obsolescence, or conversion to market rate housing,[1] it is important that the Enterprises provide low-cost financing and innovative financial products to assist in the preservation of the existing U.S. affordable housing inventory.

For rural housing, the Proposed Rule would direct Enterprise financing to historically underserved communities where housing costs may be relatively low compared to the rest of the nation, but where housing affordability is still a considerable problem and where Enterprise investment can be particularly impactful.

Both of these objectives—advancing rural housing and affordable housing preservation are important policy goals, and the most important source for capital for affordable rental housing preservation and rural rental housing development is the LIHTC. We will focus our comments on the provisions generally and questions 41 through 45 in the Proposed Rule regarding LIHTC.

Background

The LIHTC is the most important capital resource for affordable rental housing development, financing nearly 3 million affordable rental homes since its inception in 1987 and about 90,000-100,000 built, rehabilitated, or preserved annually in recent years. [2] Virtually all new rental housing affordable to households earning at or below 60 percent of the area median income constructed or rehabilitated since 1987 nationwide have depended on the LIHTC as its principal financing source.

In particular, it is a critical resource for preserving affordable rental housing. In 2007 before the recession, the LIHTC was responsible for the preservation and rehabilitation of about 65,000 affordable apartments with long-term affordability use restrictions, according to the National Housing Trust. In 2013, as the nation was slowly continuing to recover from recession, preservation represented over a third of LIHTC annual production[3].

LIHTC is also very important for the construction and preservation of rural housing. According to the National Rural Housing Coalition, more than 270,000 affordable rental homes in rural America developed during 1987-2010 were financed by the

[1] "America's Rental Housing: Evolving Markets and Needs," Joint Center on Housing Studies, Harvard University, December 2013

[2] "State Housing Finance Agency Factbook: 2013 NCSHA Annual Survey Results," National Council of State Housing Agencies (NCSHA)

[3] Ibid.

LIHTC, and in 2012, more than $250 million in LIHTC equity comprised nearly half (48 percent) of all available financing for the development of rural rental housing.[4]

The Enterprises were significant equity investors in the LIHTC marketplace prior to 2008, comprising 35 to 40 percent of the total LIHTC annual investment market,[5] but slowed investment when Fannie Mae[6] and Freddie Mac[7] became subject to the corporate alternative minimum tax (AMT) in 2007 and then halted investment as a result of being placed into government conservatorship a year later. Unlike most LIHTC investors, Fannie Mae and Freddie Mac were not motivated by the Community Reinvestment Act (CRA), and as a result they were more able to invest in rural areas, which tend to be outside CRA assessment areas.

Comments

In general, there are three separate and distinct policy considerations with regard to the LIHTC and the Enterprises. First, there is the question whether the Enterprise should be able to reenter the LIHTC investment market in any fashion. Second, if the Enterprises are allowed to reenter the LIHTC investment market, should they be allowed to guarantee LIHTC investments, become limited partner equity owners, or both? Lastly, there is the question of whether the Enterprises should receive credit under the Duty to Serve Proposed Rule for eligible activities involving LIHTC investments.

We will respond in further detail to the specific questions FHFA asked below, but on the three main policy considerations outlined above, we believe that the Enterprises should be allowed to reenter the LIHTC market with limitations, and they should be allowed to guarantee LIHTC investments. With regard to LIHTC equity investments as limited partner owners, we believe that FHFA should develop qualitative policies that encourage the Enterprises to focus in specific areas or development types where there is less LIHTC investment demand or during market dislocation events where Enterprise LIHTC investment could provide a helpful counter-cyclical role. Lastly, we believe that FHFA should award Duty to Serve credit for any LIHTC-related investment in rural or affordable rental housing preservation developments on similar terms to any credit awarded for mortgage finance-related investments.

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[4] "The Low-Income Housing Tax Credit: Overcoming Barriers to Affordable Housing in Rural America," Rapoza Associates, August 2013
[5] "Innovative Ideas for Revitalizing the LIHTC Market," The Federal Reserve Bank of St. Louis, November 2009
[6] See Fannie Mae's 2007 10-K filing at http://www.fanniemae.com/resources/file/ir/pdf/proxy-statements/form10k_022708.pdf
[7] See Freddie Mac's 2007 Annual Report at http://www.freddiemac.com/investors/ar/pdf/2007annualrpt.pdf

We would encourage FHFA to engage the affordable housing community on an ongoing basis to develop the qualitative assessment of the LIHTC investment market conditions and use that assessment to determine any Enterprise LIHTC investment limitations or special considerations. The LIHTC investment market is dynamic and changes based on just a few quantitative measures will present an incomplete picture of the state of LIHTC equity investment.

Response to FHFA Questions

41. Should FHFA allow the Enterprises to resume LIHTC equity investments? Would the resumption of LIHTC equity investments by the Enterprises benefit the financial feasibility of certain LIHTC projects or would it substitute Enterprise equity funding for private investment capital without materially benefitting projects?

As noted above, we believe the Enterprises should be allowed to reenter the LIHTC investment market as limited partner equity owners in certain circumstances. Currently, the LIHTC investment market is very robust, with equity generally available in all areas of the nation and average equity pricing at near-record levels. According to the *Journal of Tax Credits*, average project-level LIHTC equity pricing per tax credit dollar is approximately 97 cents.[8] Such robust investment demand has also helped to narrow the pricing differential between the areas with the greatest CRA-motivated demand where the nation's largest financial institutions have a preponderance of CRA assessment areas, and the areas where there is less demand. We believe this narrowing of the pricing differential is likely, in part, a result of the entrance of smaller regional banks as well as modest CRA guidance changes which helped to clarify the circumstances where CRA credit may be claimed. In such a competitive and robust market as we currently have, the resumption of Enterprise LIHTC equity investment without any limits would likely displace investment by others and not substantially benefit the financial feasibility of most LIHTC developments.

However, the plentiful availability of equity throughout the country and these robust pricing levels and narrowed pricing differential may not be sustained over the long term, and policy for the Enterprises should not be predicated on the assumption that it will. The sharp economic downturn and recession in 2008 was not widely foreseen when pricing levels were last as robust as they are today, and while we are not predicting a similar recession, there are many factors that could cause LIHTC pricing to decline. As noted above, FHFA should develop a qualitative assessment of the LIHTC

[8] See Novogradac's Affordable Housing Resource Center LIHTC equity pricing chart, available online at http://www.novoco.com/low_income_housing/facts_figures/index.php#pricing-trends

investment market and be prepared to allow the Enterprises to become equity investors should market conditions warrant.

In addition to developing policies on when and to what extent the Enterprises should be allowed to reenter the market and increase equity investment, FHFA should consider instituting policies that would limit the extent to which the Enterprises would exit the market, so as to stabilize the market during economic dislocations.

42. If FHFA allows the Enterprises to resume LIHTC investments, should FHFA limit investments to support for difficult to develop projects in segments of the market with less investor demand, such as projects in markets outside of the assessment areas of large banks or in rural markets of for preservation of projects with expiring subsidies? Are there other issues that FHFA should consider if limiting the types of LITHC projects appropriate for equity investment by the Enterprises?

As noted above, given the robust state of the current LIHTC investment market, we do not see a market need for the Enterprise to enter the market as LIHTC equity investors at present, even for rural areas or development types such as affordable housing preservation that have less demand. While it is uncertain how long these robust market conditions will last, it is likely that the conditions won't last indefinitely. The difference in availability of equity and the spread between LIHTC equity pricing for developments in major CRA assessment areas and those outside will grow. Similarly, the difference in availability of equity and the difference in LIHTC equity pricing for new construction and affordable housing preservation could widen as well. Particular consideration should be given to the adequacy of investment capital for tax-exempt bond tax credit developments, particularly mixed-income developments. Any FHFA policies on Enterprise LIHTC investment should also account for changing market conditions and permit Enterprise LIHTC equity investment accordingly.

Furthermore, we also don't believe FHFA should explicitly limit or exclude specific geographies or development types as being eligible for Enterprise LIHTC investment. As discussed, the LIHTC investment market is dynamic, and FHFA policies on allowing Enterprise LIHTC investment should be able to adjust to market conditions, even to where the Enterprises could make equity investments in new construction developments in CRA assessment areas if conditions warrant it. Although the recession-caused LIHTC investment market downturn was more dramatic for properties in non-CRA assessment areas, developments in CRA assessment areas were also affected. The Enterprises have historically played an important counter-cyclical role in mortgage finance and they should also be allowed a similar role in LIHTC equity investment.

43. If FHFA permits the resumption of LIHTC equity investments, should Duty to Serve credit be provided only for LIHTC equity investments in projects with expiring subsidies or projects in need of refinancing, or Duty to Serve credit also be given for LIHTC equity investments in new construction projects with regulatory agreements that assure long-term rental affordability?

We are aware that FHFA is soliciting comments on whether Duty to Serve credit for serving affordable housing preservation generally should be awarded for new construction projects with long-term affordability. We believe that FHFA should award any credit for Enterprise LIHTC equity investment or guaranteed LIHTC investment on the same terms as FHFA offers credit for mortgage finance-related investments. As FHFA is aware, LIHTC developments generally are statutorily required to be rent- and income-restricted for at least 30 years, with only very limited exceptions. There should be no differing policy based on the type of assistance that the Enterprises provide.

It bears noting that HUD's Rental Assistance Demonstration, Choice Neighborhood Initiative (as well as its predecessor program, HOPE VI), and other similar mixed finance redevelopments sometimes involve the replacement of existing housing with new construction. Similarly, HUD authorizes the transfer of project-based assistance in certain circumstances from existing buildings to new ones. In all of these circumstances, federal assistance to specific units with long-term use restrictions is being "preserved" even if the buildings themselves are not. We believe that Enterprise investments in these circumstances should qualify under the Duty to Serve affordable housing preservation.

It also bears pointing out that LIHTC investment in new construction development in rural areas, as defined by the Proposed Rule, should also be provided Duty to Serve credit as per the mandate to serve underserved rural markets, whether or not such activities would qualify under the mandate to serve affordable housing preservation.

44. If FHFA allows the Enterprises to resume LIHTC investments, should FHFA limit such investments to those that promote residential economic diversity, for example, by investing in LIHTC properties located in high opportunity areas, as proposed to be defined in § 1282.1, to address

concerns raised about the disproportionate siting of LIHTC housing (non-senior) in low-income areas and the effect on residential segregation?

As we noted in response to question 42, we do not believe that FHFA should explicitly limit or exclude specific geographies or developments types as being eligible for Enterprise LIHTC investment. While we understand the motivation of FHFA and other federal agencies to promote affordable housing in high opportunity areas as proposed to be defined and believe it is a laudable goal, we don't believe that LIHTC investment or Enterprise Duty to Serve credit should be limited to just those areas. Indeed, the statutory mandate to serve affordable housing preservation would be undermined by such a limitation, as many federally and state-assisted affordable housing developments are not in high-opportunity areas.

We also disagree with the notion that LIHTC investments promote the ***siting*** of LIHTC housing in racially or ethnically concentrated areas of poverty. That argument often conflates the use of LIHTC investment for affordable housing preservation, where siting decisions were made by others, as long as several decades or more prior to the LIHTC investment, with LIHTC investment in competitively allocated new construction developments. Novogradac & Company LLP is researching the geographic distribution of new construction development competitively allocated LIHTC assistance where siting decisions are being made.

45. Should FHFA consider permitting the Enterprises to act as the guarantor of equity investments in projects by third-party investors provided any such guarantee is safe and sound and consistent with the Enterprise's Charter Act? If so, what types of guarantees should the Enterprises offer?

We believe FHFA should permit the Enterprises to act as a guarantor of LIHTC equity investments of third party investors, provided such guarantees are safe and sound. Such a guarantee is consistent with the Enterprises' charters and mission, and was an important part of the Enterprise's affordable housing activities prior to conservatorship.

Guaranteeing LIHTC investments is not likely to displace existing private LIHTC investment guarantees, in part, because such guarantees are not eligible for CRA consideration. While it is possible that existing LIHTC investors not motivated by CRA may choose to invest in Enterprise guaranteed LIHTC funds as opposed to unguaranteed funds, we don't believe it would be to an extent that it would outweigh the entrance of new non-CRA motivated investors over the long term. Conversely, investments in guaranteed funds could provide an easier on ramp for new non-CRA motivated to take their first step towards investing in LIHTC properties.

Guaranteed LIHTC investment funds are more attractive to some non-traditional LIHTC investors, as such investors often lack LIHTC investment expertise. Allowing the Enterprises to offer LIHTC investment guarantees would further diversify the LIHTC investment base, provide greater liquidity for the secondary market and bring in more capital for affordable housing investment over the long term.

Conclusion

We appreciate efforts to improve the LIHTC program and the opportunity to comment on the Duty to Serve Proposed Rule. We look forward to working with the FHFA as it finalizes it.

Please do not hesitate to contact me at Michael.Novogradac@novoco.com or (415) 356-8000 if you have any questions regarding our comments or if we can be of further assistance.

THE LIHTC WORKING GROUP

Very truly yours,

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