Statement
of
Judith A. Kennedy
President and CEO

National Association of Affordable Housing Lenders
on
"Legislative Proposals on GSE Reform"

House Committee on Financial Services
U.S. House of Representatives

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NAAHL represents America's leaders in moving private capital to those in need, 200 organizations committed to increasing lending and investing private capital in low- and moderate-income (LMI) communities. This "who's who" of private sector lenders and investors includes 50 major banks, 50 blue-chip non-profit lenders, and others in the vanguard of affordable housing, including insurance companies, community development corporations, mortgage companies, financial intermediaries, pension funds, and foundations. I have worked in the field of affordable housing and community development for nearly 30 years, for HUD, the U.S. Congress, Freddie Mac, and now the National Association of Affordable Housing Lenders (NAAHL).

NAAHL strongly supports improved GSE regulation. Congress has bestowed upon Fannie Mae and Freddie Mac very substantial proprietary advantages. The challenge for government is to channel the GSEs to follow the path forged by primary lenders to provide private capital, on fair terms, for affordable housing. Given the GSEs' inexperience and resistance to linking capital markets to underserved areas, that will involve prohibiting certain actions, compelling certain other actions, with a strong and enforceable legal and regulatory scheme, and a highly capable regulator. Our experience of OFHEO Director Jim Lockhart suggests that he is just such a regulator.

THE PATH IS CLEAR, NEITHER PRIMROSE NOR YELLOW BRICK ROAD

One of our California non-profit lenders often says, "We're all in love with the problem!" of the *lack of affordable housing*, but it is way past time to get from being "in love" to solving this problem in very practical ways. We all know that it is a deepening national crisis, with millions of Americans experiencing severe housing problems, from high cost burden to overcrowding, poor quality, and even homelessness. At least 65 million Americans with housing problems have household incomes of 80% or less of area median income. Moderate income families are "driving 'till they qualify", to purchase a home, consuming transportation infrastructure and clogging roads when they could be with their families or contributing to their home communities. Employers having trouble attracting employees who need affordable housing often leave high cost areas, while governments and hospitals that can't leave are increasingly stressed for skilled workers.

Seniors subsisting on Social Security income want to live near their grandchildren. We know that these problems and many more are forcing trade-offs that not only erode quality of life as essential expenditures for food, health care, transportation and clothing must be reduced, but also undermine our communities and our social fabric.

Thirty years ago, the Community Reinvestment Act (CRA) was signed into law directing, FDIC-insured institutions to help meet the credit needs of their communities. Determined that if there is a will, there is a way, Congress made clear with CRA the expectation that the deposits gathered from individuals and businesses be put to work to make loans in underserved parts of the community. Since enactment in 1977, CRA has provided a regulatory incentive for funneling literally hundreds of billions of dollars into low and moderate income communities.

This infusion of private capital leverages public subsidy as much as 10-25 times, so more affordable homes can be built with a limited amount of government support. In an era of shrinking federal subsidy, an active and growing primary market for affordable housing lending is key to achieving homes affordable to persons whose income is classified as “low” (those under 50% of area median income) and “moderate” (those under 80%). Every academic study of CRA has confirmed that the law has been enormously successful. This increased lending and equity investing have spurred economic growth and demand, thereby increasing banks’ opportunities to make even more loans and sell more services.

Pioneering lenders, both insured institutions and their non-profit business partners, have over time forged a clear path, *one pebble at a time*, that is helping to meet the credit needs of the underserved and increase the availability of affordable homes. They do this often by leveraging increasingly scarce public subsidies, but also by understanding and managing the risks associated with lending private capital, with or without subsidy, to qualified borrowers who may have little cash to bring to the table. Affordable housing lending has become increasingly sophisticated as experienced practitioners develop new products and share best practices. Given two decades of innovation and solid experience, financing affordable housing is now a very well marked, established path in many states, limited only by lenders’ needs to replenish their supply of loan funds so that the cycle can begin again.

HOW LONG CAN THIS KEEP GOING ON?

Thirty years after enactment of CRA, and nearly 15 years after Congress directed Fannie Mae and Freddie Mac to "lead the industry" in ensuring that access to mortgage credit is available for very low, and low and moderate income families, Fannie Mae and Freddie Mac have not yet brought the benefits of the government sponsored secondary market to most CRA loans.

The huge profits these GSEs generated for years made it clear that the companies, like banks, could generate strong returns while complying with their charter mandate to focus on affordable housing, even if the return "is less than the return earned on their other activities". But highly respected researchers William Apgar and John Weicker, HUD appointees in Democratic and Republican administrations, have documented that both GSEs continued to lag far behind the primary market in financing consumer-friendly mortgages on affordable housing. Primary lenders find that both companies continue to ignore not only CRA loans, but even the “triple-A-rated” tranches of securities backed by seasoned multifamily mortgages on properties affordable to under 60% of area median income, saying they are 'too small" and "not profitable enough", even when the return exceeded most institutional investors’ expected return by one-half of one percent. As one of our lenders put it: “I’ve spent too much of my 15-year career in this stuff bringing the GSEs to the table, only to be exhausted, disappointed and insulted many times by the response”.

Worse, for the past several years, Fannie and Freddie's own seller/servicers have complained to the GSEs that while the government-sponsored companies refuse to help primary lenders to meet the credit needs of their entire community through purchasing or securitizing consumer-friendly CRA-eligible conventional, prime loans, so that lenders can replenish their supply of loan funds, both companies finance the subprime competitors of their best seller/servicers by investing in MBS backed by subprime, often exploitative loans. There have been unfortunate consequences of Fannie Mae and Freddie Mac ignoring these increasingly sophisticated primary markets in both single family and multifamily CRA-eligible mortgages on affordable housing.

First, lacking the benefits of the government-sponsored secondary market for loans on houses and apartments that low and moderate income borrowers are proud to call home, the primary market for CRA loans is increasingly "constipated" for lack of capital. Billions of dollars in CRA-eligible loans remain on the books of the originating lenders, unless and until the lenders peddle their loans like Fuller Brush men to pension funds, insurance companies, and other investors through expensive, time consuming private placements.

Second, since experienced lenders in both the for-profit and non-profit sectors characterize the GSEs' underwriting and servicing guidelines as outdated, extremely conservative, and unrealistic, they believe that the GSEs continue to leave a lot of good, LMI business on the table across the country. Yet Fannie and Freddie have fueled the extreme increase in subprime loans through their "flirting and skirting" of "affordable housing goals" that one commentator called "superficial", and are at best characterized as a "Gentleman's C".

Finally, by losing touch with their obligations to help other lenders to meet the credit needs of their communities, they perpetuate past practices. Fannie Mae and Freddie Mac's resistance to making a market in loans on homes affordable to households earning under 50% and 80% of area median income is reminiscent of earlier foot-dragging. Until policymakers insisted, both GSEs had resisted buying "small", i.e. "low balance" single family mortgages, just as they continue to resist (either through outright refusal to purchase or inappropriate pricing) the low balance multifamily loans ($1-3 million dollars) that are the bread and butter of affordable housing in many major cities and rural areas, and also single family mortgages that don't fit the GSEs' mold.

WHERE IS THE OUTRAGE?

> *"But fundamentally, it's wasted money, a dead-weight loss. It's thousands of jobs and millions of dollars being wasted on work that is no more productive than raking leaves. It's money that could have gone not only to shareholders, but also to support **low-income housing** and the Fannie Mae foundation, the company's charitable arm, which is struggling through cutbacks."* (Washington Post 5/15/06)

Unlike the hue and cry that erupted over the GSEs' financial accounting and the cost of developing accurate statements, reaction to reports of how Fannie Mae and Freddie Mac fudged claims of achieving even their "Gentleman's C" affordable housing goals has been strangely muted. Both this committee and the media documented some of the lengths to which Fannie Mae and Freddie Mac went to avoid making a market in prime, performing, conventional loans on affordable housing. These included: 1) double and triple counting one loan in multiple goal categories and in multiple years; 2) "renting" eligible mortgages at the end of a goals' period that are returned to the primary lender in the next period; 3) counting the same loan in different periods; and 4) emphasis on "jumbo" multifamily and even single family loans on million dollar homes that met existing definitions, to the exclusion of lower balance mortgages.

As an industry paper opined:

> *"The GSEs are notorious for avoiding any risk and making sure the lender is on the hook if anything goes wrong. Fannie and Freddie also are well known for refusing to disclose real numbers on purchases of specific loan product. They generally conceal such information in the mist of "proprietary information" and keep it out of the hands of the press and the public domain...with loan products that generate press releases, some initial hoopla, and barely an echo in the mortgage market".*
> (National Mortgage News)

It has recently become clear that the GSEs were the major financiers of private label, mortgage-backed securities backed by subprime loans, while billions of prime, consumer-friendly CRA-eligible mortgages piled up on lenders' books. OFHEO's website indicates that one-third, or about $500 billion in GSE debt issued was to invest in mortgage-backed securities, half of which were private label securities backed by subprime loans. Published market data report that in 2004 Fannie and Freddie together purchased 44% of the $401 billion in securities backed by subprime loans issued that year, 35% of the $507 billion issued in 2005, and 25% of the total subprime MBS sold. Consumer advocates believe that the vast majority of these loans are potentially "explosive", and Freddie Mac has estimated that half of all subprime borrowers qualified for a prime loan.

Finally, it appears that "a healthy chunk" of these subprime MBS were used by Fannie Mae and Freddie Mac for "affordable housing" goals' credit.

> "Several experts call Fannie Mae and Freddie Mac key enablers of sub-prime excess. 'What are they doing,' Chuck Cross, a former Washington State official, asked rhetorically, 'buying loans from a company that just suffered the second-biggest predatory-lending settlement in history?' Fannie Mae has said it never supports predatory lending. Freddie Mac has said it refuses 'to do business with financial institutions that engage in predatory lending.' Federal investigators, however, have found that Fannie Mae and Freddie Mac have failed to meet industry standards of ethics. In 2003, the investigators said, Freddie Mac cast aside accounting rules, internal controls, disclosure standards, and the public trust in the pursuit of steady earnings growth." (LA Times 1/8/07)

RETURNING TO THE PATH

Among other important charter changes, H.R. 1427 proposes to get the GSEs back on the path of increasing the availability of funds for affordable housing.

- It recognizes that after decades of primary lenders' success in lending on homes for those under 50% and 80% of area median income, the GSEs should help to link underserved areas with capital markets – and on fair terms.

- It directs the GSEs to purchase "small" as well as large multifamily loans. Most affordable rental housing in America result from loans to "Ma and Pa landlords" to purchase and renovate existing buildings. The GSEs have left much of this profitable business on the table. But "small" $1-$3 million dollar mortgages are critical to keeping housing affordable in states like New York and Massachusetts, as much as in Alabama, Utah, Florida and Indiana.

- It puts a cop on the beat of enforcing legitimate affordable housing goals.

History has taught us that linking Wall Street to communities' low- and moderate-income neighborhoods and persons is too important to be a discretionary activity, available only to a favored few. We look forward to working with you and the GSEs to develop a national secondary market that helps to meet the credit needs of all communities and all Americans.

Nonprofit Lenders Meeting Local Affordable Housing Need
A Few Examples

In only seven years, the Alabama Multifamily Loan Consortium has originated more than $70 million in mortgages financing over 2,000 affordable apartments across the state, 10 percent of which must be accessible to tenants with disabilities (See attachment 1).

Over 15 years, Massachusetts Housing Investment Corporation has provided over $1 billion in financing for over 11,000 units of affordable housing (See attachment 2).

The California Community Reinvestment Corporation in 17 years has provided more than $800 million in affordable housing loans and made 26,000 apartments available to residents who earn 60 percent or less of area median income (AMI) (See attachment 3).

Attachment 1

Rosa Parks Place – Montgomery, Alabama
56 seniors apartments – financed in 2001

First affordable housing for seniors and the disabled in Montgomery, Alabama.

Attachment 2
Alexander Magnolia Cooperative in Boston

Designed to look like a large single-family house, this is a two-family building where each family has their own entrance, driveway, and backyard. The housing was built on scattered vacant lots donated by the city, and is 100% affordable.

1213, 1215 West 39th Street

727, 729, 731, 733 West 47th Street
Preservation of at-risk HUD 236 and Section 8 apartments.

831, 833 West 41st Street

860, 866, 868, 870 West 42nd Place
Preservation of at-risk HUD 236 and Section 8 apartments.

897 West Vernon Ave.

903 West Vernon Ave.
Preservation of at-risk HUD 236 and Section 8 apartments.

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VIEWPOINTS

Fostering Multifamily Purchases by GSEs

JUDITH A. KENNEDY

Congress sponsored Fannie Mae and then Freddie Mac to increase the availability of credit for low- and moderate-income borrowers.

But the devil has truly been in the details; decades later the benefits of a government-sponsored secondary market have yet to accrue to many low- and middle-income borrowers, despite two decades of primary market progress.

Through staunch leadership by House Financial Services Committee Chairman Michael Oxley, R-Ohio, and Rep. Bob Ney, R-Ohio, that may be fixed. They have spearheaded successful efforts to have the House pass HR 1461, which would reform the affordable-housing goals for Fannie and Freddie.

The Senate should follow the House's lead by amending S 190 to conform with the House bill.

The House bill makes clear that GSEs have a duty to serve low- and moderate-income people, defined as those with incomes of under 50% and 80% of the area median — people whose credit needs insured depository institutions are also expected to serve.

Significantly, the bill requires the GSEs to purchase mortgages on rental properties affordable to low and moderate-income people, and it directs their regulator to ensure that Fannie and Freddie purchase "small" ($1 million-$3 million) multifamily mortgages that are the bread and butter of affordable rental housing everywhere.

The bill sets out regulatory authority — with teeth — to make it all happen.

This would begin to align GSEs' affordable-housing goals with primary lenders' Community Reinvestment Act responsibilities for helping to meet these credit needs.

For years, banks and nonprofit lenders (many of them members of my organization) have originated and now hold on their books billions of dollars of conventional, multifamily mortgages that provide housing for the elderly and disabled, among others.

Because the GSEs have not been required to purchase these loans, the increasingly sophisticated primary market has lacked the secondary-market liquidity that would have meant more funds for many more, profitable affordable-housing loans.

NAAHL members are sitting on billions of multifamily mortgages, good business that Fannie and Freddie leave on the table. Access to the government-sponsored, national secondary market that GSEs pioneered for other products would dramatically, and almost immediately, increase funds available to underserved borrowers and communities, and ultimately reduce costs.

Those of us who work to channel private capital into our nation's neediest neighborhoods see this as a rare opportunity to bring the benefits of Wall Street to help Main Street — good business for both.

Will it happen? The Senate should remove the question mark by passing a bill like HR 1461 that directs the GSEs to look for loans in the right places.

Ms. Kennedy is the president of the National Association of Affordable Housing Lenders in Washington. Its member lenders include financial institutions and state, local, and national nonprofit organizations.