UNDERSERVED MORTGAGE MARKETS COALITION

Targeted Equity Investments are Legal and Essential

to Reach Many Underserved Markets

In the statute establishing Duty to Serve ("DTS") in 2009, Congress identified "grants and investments" as one of four explicit criteria that the Federal Housing Finance Agency must use in evaluating Enterprise DTS performance, along with outreach, loan product development, and loan purchases. By including investments as one of four statutory DTS evaluation factors, Congress has clearly affirmed that the Enterprises have the authority to make targeted DTS equity investments (12 U.S.C. § 4565(d)(2)(D) 2020). Nevertheless, our understanding is that under the current reading of the statute by FHFA's general counsel, the Enterprises are prohibited from making targeted equity investments (TEIs). We believe FHFA has the authority to also permit TEIs as part of an Equitable Housing Finance Plan.

The current reading was likely influenced in part by Fannie Mae's abuse of its often nontargeted equity investment authority in the 1990s through the "American Community Fund" (ACF), an aggressive Fannie Mae investment strategy that raised questions about excessive risk and encroachment into markets beyond the Enterprises' Congressional charter. The Enterprises have never repeated such overreach. Regardless, the ACF experience has created ongoing concern regarding investment overreach that appears to negatively impact the Enterprises' TEI authority.

The DTS language clearly states that the Enterprises are allowed to make equity investments under their charters; it also suggests an intent to limit those investments to a very specific and constrained set of circumstances that support the Enterprises' requirement to reach underserved markets.

As a matter of policy, we propose FHFA adopt two guiding principles for TEIs. First, mission return should be distinct in a market that is otherwise difficult for the Enterprises to penetrate, whether because the primary market is not originating enough loans for the Enterprises to engage or because of other market conditions. Second, the TEI should be clearly distinguishable from a grant. While a TEI need not produce any financial return for the Enterprises beyond the principal, the investee should repay the principal, except when a TEI is used as credit enhancement and an associated loan product development pilot uses some or all the TEI to cover credit losses sustained in the process.

Adhering to our proposed criteria would ensure that the Enterprises can exercise their limited investment authority without exposure to the risk, breadth, or volume of the ill-fated ACF investment portfolio. In simultaneously affirming and targeting this investment authority, Congress presumably understood that many of the DTS markets are currently unable to produce a reliable pipeline of salable mortgage loans; that equity investments are essential to reaching many DTS markets; and that serving these markets is critical to both the health of the nation's housing markets and to meeting the Enterprises' affordable mission obligations.

Targeted Equity Investments are Essential to Reaching Many Underserved Markets

Relatively small TEIs by the Enterprises can have an outsized impact on improving liquidity in many underserved markets. Examples include the Texas Colonias, Appalachia, and the market for owner-occupied sites within manufactured housing community, to name a few. TEIs can help the Enterprises increase activity in these or almost any other market lacking sufficient origination volume. Without TEIs, these households and communities will be much harder to reach, especially at scale, according to conversations with multiple stakeholders.

The following pages provide a small sample of the wide range of current opportunities for the Enterprises to make TEIs that reach underserved markets and satisfy DTS objectives. We highlight TEIs that would invest in specific *projects* rather than specific *entities*, recognizing that it may be easier for FHFA or an Enterprise to confirm that a project supports a charter-compliant activity. Several of these examples will require detail and refinement to move forward.

Examples of Targeted Equity Investments that Can Reach Underserved Markets

(1) Objective: Increase the supply of manufactured homes affordable to households with low and moderate incomes. The Enterprises could make TEIs in select manufactured housing projects. For example, private developer EquityPlus is partnering with Next Step, a nationally recognized nonprofit that promotes affordable, energy-efficient manufactured homes, to undertake predevelopment with secured land in Harrisonburg, Virginia, to build Bluestone Town Center. Upon zoning approval, Bluestone Town Center will provide up to 300 new manufactured homes with an anticipated sales price of $250,000 and will largely target homebuyers who earn between 80% and 120% AMI. The total project cost is $32 million, and the developers are seeking $3 million in mezzanine debt, which could come from a TEI. Proceeds from home sales would repay the TEI after repayment to the first-mortgage construction lender. The term and repayment schedule are negotiable. Next Step will provide homebuyer education services and all the homes will meet Next Step's quality and energy-efficiency standards.

As part of the financing package, the Enterprises could require the developers to guarantee that the homebuyers receive mortgage loans that conform to the product guidelines of Fannie Mae's "MH Advantage" and/or Freddie Mac's "First Choice" programs to ensure quality and establish a pipeline of salable loans. Depending on the financing structure, the equity could remain in the deal and convert to either down payment assistance or development subsidy to lower the homebuyer's costs and achieve lower income targets.

(2) Objective: Increase affordable homeownership opportunities in the Colonias and other "high-needs rural regions." The Enterprises could make a TEI in a portfolio of first mortgage loans organized by cdcb, the leading CDFI in the Texas Colonias, a Fannie Mae– and Freddie Mac–approved seller-servicer and correspondent lender for Wells Fargo. cdcb has pioneered an innovative "Mi Casita" modular-construction home that can "grow over time" as the homeowner becomes able to afford additional rooms. To facilitate the purchase of Mi Casita homes, cdcb offers a unique first mortgage loan that uses more flexible underwriting criteria than traditional mortgage products and is serviced by cdcb. An Enterprise TEI in the portfolio would provide cdcb with more cash to originate these loans, all of which are in a "high-needs rural region" where the number of primary market loans for the Enterprises to purchase is currently limited. For example, a $10 million TEI in the portfolio would allow cdcb to originate about 110 loans to first-time homebuyers in the Colonias (based on the $90,000 minimum price of a Mi Casita home).

Notably, the Enterprises have similar opportunities to invest in portfolios of loans originated by CDFIs in the Appalachian region, in Native American communities, and in other "high-needs rural regions." TEIs in these areas would jumpstart their primary mortgage market and generate enough loans for purchase to help the Enterprises to fulfill their responsibility to reach these underserved markets.

(3) <u>Objective:</u> Increase low-income residents' ownership of manufactured housing communities. The Enterprises could make a TEI in a "Special Purpose Vehicle" established by ROC USA, a CDFI and the nation's leading authority on converting manufactured housing communities to resident ownership. ROC USA would use the TEI to finance the unsecured subordinate tranches of the acquisition loans, thereby reducing the senior, secured mortgage to a combined LTV of less than 90%. This secured mortgage would then be eligible for purchase by the Enterprises as a multifamily loan and could be included in the Enterprises' standard securitizations.

With an annual Enterprise TEI of $20 million, ROC USA estimates that it could annually finance 20 conversions of manufactured housing communities to resident ownership, representing about 1,500 homeowners with low and moderate incomes. ROC USA could also leverage additional debt to further expand total lending and leverage low-cost Enterprise securitized loans. Such an approach would also allow homeowners to better compete with investors who, anomalously, already have access to Enterprise financing. Notably, ROC USA confirmed that a TEI is the only way a CDFI can raise capital for relending on an unsecured basis and meet this need.

<u>(4) Objectives:</u> Increase accessibility and affordability of homeownership opportunities for low- and moderate-income households and preserve affordable single-family homes for purchase by owner-occupants. An Enterprise TEI could facilitate an increased number of LMI homebuyer purchases in a variety of ways with oversight from the National Community Stabilization Trust (NCST), the nation's leading nonprofit organization that works to expand the supply of affordable single-family homes to stabilize neighborhoods, build community wealth, and advance racial equity.

Specifically, the equity could fund bridge financing to owner-occupant homebuyers, enabling them to better compete for REO/distressed properties with financing restrictions—such as on auction platforms, which are often dominated by institutional investors and cash buyers. The bridge loans would subsequently be refinanced into a conforming loan product, taking out the TEI. NCST estimates that a $10 million Enterprise TEI could support 600 LMI owner-occupant purchases over three years. Utilizing these or other resources for a rate buy-down or other down payment assistance could further expand the breadth of this program and its scale potential.

These mechanisms would help to combat the acute affordability challenges faced by LMI homebuyers in the home-sales market today. The homebuyer financing and acquisition assistance made possible by the Enterprises' equity investment could be offered in conjunction with the disposition of Enterprise REO through NCST's proprietary *REOMatch*™ platform, thereby helping to facilitate additional owner-occupant purchases of affordable homes prior to going to auction. That would reduce related disposition costs, establish a new pipeline of salable, conventional loans, and increase market liquidity.

(5) Objective: Increase access to affordable homes and energy-efficiency upgrades for households with low and moderate incomes. Select CDFIs offer energy-efficiency-improvement mortgage products to support households with low and moderate incomes to both become homeowners and make their homes more energy efficient. These mortgage products may be like those offered by the Enterprises—HomeStyle® Energy and GreenCHOICE®—but are not currently salable to the Enterprises because their underwriting guidelines are more flexible. With an Enterprise TEI, a credit enhancement pool could be established to enable the loans to become eligible for purchase by the Enterprises.

The TEI would reduce the mortgage risk and the Enterprises might realize a return on investment from servicing income or secondary market sales. For example, a $10 million investment could cover roughly 600 energy-efficiency improvement mortgage loans and enable CDFIs to serve homeowners otherwise unable to access a conforming mortgage product. RMI, an independent nonprofit organization that transforms global energy systems through market-driven solutions, could support CDFIs by identifying opportunities to create a pipeline of salable mortgage loans. This type of investment could promote energy-efficiency upgrades that meet DTS criteria and lessen the long-term cost of homeownership. That applies especially to households with low and moderate incomes, whose rising utility bills represent a greater portion of total homeownership costs.