



August 3, 2001

The Honorable Susan Molinari, Co-Chair
Mr. Richard Ravitch, Co-Chair
Millennial Housing Commission
800 North Capitol Street Suite 680
Washington, D.C. 20002

To the Honorable Susan Molinari and Mr. Richard Ravitch:

In response to your letter of April 4, 2001, Fannie Mae is pleased to provide you with our views on national housing policies that the Millennial Housing Commission may want to consider as you carry out your Congressional mandate. I want to thank you for this opportunity to comment on the Commission's work. The following document provides you with a variety of policy proposals and perspectives that we hope will aid in the task you have before you.

First, let me give you two perspectives from which Fannie Mae views the issues under consideration – that of partner to many in the housing industry across this country and that of significant participant in the capital markets. Fannie Mae is a private company with a public mission. Congress chartered Fannie Mae as an instrument of federal housing policy and we take our public purposes very seriously. Fannie Mae's mission is to tear down barriers, lower costs, and increase the opportunities for homeownership and affordable rental housing for all Americans.

We try to achieve this mission by linking single-family and multifamily lenders to the lower cost financing available in international capital markets, by providing liquidity to these same lenders for their mortgage products, and by managing interest rate risk and credit risk for the housing finance sector. Through our partnerships with lenders we have a presence in nearly every community in America. Through the work of the Company's 600-person strong Housing and Community Development (HCD) division, Fannie Mae has accumulated significant expertise and experience with housing and community development programs at the federal, state, and local levels. Through our wide array of local partnerships and products tailored to address different local circumstances, Fannie Mae's different business units have at one time or another interfaced with the many delivery systems of housing assistance and the vehicles of housing policy. We interact with a robust and varied delivery system for housing finance. While there are many ways in which it can be improved, our nation's housing system reflects an enormous commitment to affordable housing in this country.

To sustain this commitment to affordable housing, the housing system will require substantial capital in the years to come. The market we serve – mortgage debt – is going to continue to boom as a result of several factors – strong population growth and

household formation, rising homeownership rates and home values, and increased consumer use of home equity wealth. Current estimates are that the demand for investment in residential real estate will more than double by 2010, growing faster than the nineties and much faster than the whole economy. This raises a series of very important questions for consideration by the Commission: Where will all of the capital required to meet this need come from? And, how will the country ensure the availability of low-cost capital to keep housing affordable?

As you consider these and other important questions before you, it may be helpful to consider establishing a set of principles to evaluate the many proposals that you will receive for improving the nation's affordable housing efforts. We have taken the liberty of suggesting such principles. We also make a series of more specific policy recommendations for consideration by the Commission in the areas of closing homeownership gaps, expanding affordable rental housing opportunities, and strengthening communities.

I. Principles for Approaching Housing Policy

In evaluating competing policy options for addressing the outstanding housing needs, Fannie Mae recommends that the Millennial Housing Commission adopt the following principles:

- Promote Public-Private Partnerships. The private market cannot solve the remaining housing needs alone. The public sector can provide subsidies and take risks that would otherwise constrain a private sector entity. Effective use of public subsidy dollars can leverage private investment and bring more resources to bear in addressing housing problems. Competition and market incentives can play a valuable role in creating efficiencies in service delivery and in reducing costs to consumers. Effective program delivery should strive to engender public-private partnerships that build on the strengths of each sector.
- Bolster State and Local Flexibility. Housing and community development needs vary considerably from place-to-place. Likewise, the solutions to these types of problems will derive from a complex matrix of local institutions, programs, and laws. The federal government plays a vital role in solving these problems. We believe the federal role works best if it provides guiding principles but preserves local flexibility to tailor the ultimate solutions.
- Support a Mix of Strategies. The debate around the allocation of federal resources for housing has often broken down into a debate over the relative merits of new housing production versus preservation of the existing inventory versus allocating resources to Section 8 vouchers. Varying market conditions argue for providing tools and resources for all three housing strategies and the flexibility for communities to utilize the different tools based on those local market conditions and needs.

- Encourage Choice. The appropriate mix of policies should work to assist households with housing needs to become *either* well-housed renters or homeowners. In its deliberations, the Commission should consider policy proposals that maximize housing choices, including opportunities to attain homeownership where appropriate and affordable. The benefits that homeownership can bring to household wealth creation as well as neighborhood stability argue for a strong endorsement of homeownership strategies. Renters who move to homeownership facilitate some filtering of the affordable rental inventory. The effects of policies that increase housing supply on price and availability are the same whether the housing tenure that results is for homeownership or for rental housing.
- Focus on Cost Reduction Strategies. In a constrained resource environment, strategies to reduce costs and create efficiencies can have the effect of expanding available resources. Federal housing programs at times suffer from excessive regulatory and administrative burdens that increase program costs. The impact of federal programs could go further by reducing the complexity of affordable housing transactions with multiple subsidies, and by working to align program rules and regulations across various programs with similar objectives. The Commission should urge HUD to work with other federal, state, and local agencies to reduce unnecessary regulations that drive up the cost of housing and waste scarce subsidy dollars.
- Invest in Effective Programs. Several existing federal programs that Congress has already enacted are very effective. The Commission should recommend that the Congress increase the resources for effective programs like the Low-Income Housing Tax Credit, private activity housing bonds, the HOME program, and the Section 8 voucher program. These programs encourage public/private partnerships, use market incentives, provide for state and local flexibility, and serve to meet the outstanding needs. While Congress and the Administration could make improvements in all of these programs, providing additional resources would be money well spent.
- Do No Harm. The Commission should take a strong stand in opposition to those who would argue that the nation invests too much in housing. So long as millions of Americans face significant rent burdens and many millions more have not yet achieved the dream of homeownership, placing a high priority on housing investment is sound. The Commission should apply the following, straight-forward questions to any proposals for changes to the housing finance system as well as the housing assistance delivery system: Do the proposals reduce costs for consumers? Do they improve the safety and soundness of the housing finance system? Do they expand opportunities for homeownership or affordable rental housing? Do they allow innovation in the market without cumbersome regulatory requirements? Proposals that reduce competition, drive up the cost of housing, or undermine efforts to increase affordable housing opportunity are contrary to the work of the Commission.

III. Policy Proposals

Cornerstone Programs that Work

Congress has enacted several major programs that appear to have withstood the tests of time and are doing a good job of addressing the nation's outstanding housing needs. The Low-Income Housing Tax Credit (LIHTC), the HOME Investment Partnership program (HOME), multifamily housing bonds (MFHBs) and Mortgage Revenue Bonds (MRBs), and the Section 8 housing voucher program can each work alone to meet certain housing needs or can work together to target assistance to the very poor and the hard to house. These programs should form the foundation the nation's housing policy.

Fannie Mae strongly recommends that the Commission make a statement in support of these programs. Unfortunately, the achievements of these programs are not well understood by policy makers and the public. The Commission could strengthen the housing system by providing a strong endorsement of successes of these programs. Expanding the resources for each of these programs would go a long way toward meeting the outstanding housing needs in this country.

The LIHTC has evolved into a very effective vehicle for affordable housing production. State agencies generally manage the credit allocations well and do an effective job of administering the program. In the instances where developments require gap funds, state and local governments allocate funds made available through the HOME program. HOME also has the flexibility to allow state and local governments to support rehabilitation, homeownership assistance, and other forms of housing assistance where modest amounts of subsidy are required. Likewise, MFHBs used in conjunction with tax credits or alone, are a valuable source of low-interest debt financing that serves to make rental housing more affordable by lowering debt service costs.

The Section 8 voucher program provides an income supplement to very low-income families to allow them to afford the units at rents that can support the tax credit projects. Section 8 vouchers work very well to provide housing opportunities to very low-income households, providing these households with increased buying power to rent privately-owned units in the open market.

The combination of the LIHTC, HOME, private activity housing bonds, and Section 8 vouchers should form the core of the strategy to address the nation's toughest remaining housing problems. Clearly, all four programs could benefit from modest changes to increase efficiencies and make them easier to use in tandem.

The strong role of the states in delivering this basic program structure suggests that this delivery system should work to address the housing needs of rural areas. However, the Commission with want to consider the extent to which the public sector should advance and strengthen a parallel system dedicated to rural housing needs.

With respect to populations with special needs, Fannie Mae would recommend that the Commission strongly urge that the federal government take steps to increase the responsibilities of federal social service agencies like Health and Human Services (HHS) to meet the service needs of residents in affordable housing, while at the same time reducing the use of scarce affordable housing subsidies to pay for service programs.

As illustrated in Table I, Fannie Mae would further recommend that the Commission adopt the same range of tools – investor tax credits, flexible gap funds, low-interest debt, consumer-based assistance, and service dollars where needed – to address homeownership needs. Some pieces of the structure are already in place: MRBs and the HOME program are already making significant contributions to affordable homeownership opportunities, and HUD is implementing new authority for Section 8 homeownership vouchers. The enactment of a single-family housing tax credit similar to the one proposed by the Bush Administration for the production of affordable homeownership housing would create a complete and parallel structure.

TABLE I
Strategies for Affordable Housing

Intervention	Rental Housing	Homeownership
Increase the Supply, Substantial Rehabilitation, Preservation	Low-Income Housing Tax Credit	Single-Family Housing Tax Credit
Preservation, Moderate Rehabilitation, Short-Term Rental Assistance	HOME Program	HOME Program
Affordability, Inadequate Wealth and Income	Section 8 Rental Assistance	Section 8 Homeownership
Operating Costs and Debt Service Reduction	Multifamily Housing Bonds (Multifamily)	Mortgage Revenue Bonds (Single-family)
Service Dollars for Households with Special Needs	Health and Human Services	Health and Human Services

Other Specific New Policy Proposals

Based on Fannie Mae's experience working in communities with a wide range of affordable housing and community development challenges, we believe that the following proposals would strengthen the country's efforts to increase homeownership and close homeownership gaps, expanded affordable rental housing opportunities, and strengthen communities:

➤ ***Increasing Homeownership and Closing Homeownership Gaps.***

- **Employer-Assisted Housing.** Through tax incentives for employer participation in meeting the housing needs of employees, the government would bring new partners and new resources to the nation's housing efforts.
- **FHA Single-Family Risk-Sharing.** FHA should consider a risk-sharing program that would marry the government's ability to take a higher level of risk than the private sector with the private sector's ability to better measure and manage risk. The Commission could consider looking at Fannie Mae's partnership with Self-Help and the Ford Foundation as a model.
- **HOME Model Programs.** The government could increase the effectiveness of the HOME program as a second mortgage tool if HUD used its model program authorities to encourage standardization across participating jurisdictions.
- **10-year Rule.** Repeal of the 10-year rule in the MRB program would greatly expand the availability of low-interest mortgage funds.
- **Regulatory Barriers.** The government has available to it low-cost strategies to decrease the impact of federal, state, and local regulations that drive up the cost of affordable housing. An effort to provide incentives to localities to lower regulatory barriers holds significant potential for increasing housing affordability and enhancing the redevelopment of older neighborhoods.
- **Housing Counseling Assistance.** The challenge of predatory lending should serve to enhance policy interest in the role of housing counseling and education programs as well as training in financial literacy. It is possible that HUD could enhance resources for housing counseling by allowing fees for services in conjunction with its grants and by testing efforts to raise private matching funds from the lending community.

➤ ***Expanding Affordable Rental Housing Opportunities.***

- **Risk-Sharing Pilots for Small Multifamily and Single-Family Rental.** Housing policy should place greater emphasis on the small rental property inventory. This inventory provides the majority of affordable rental housing opportunities in this

country. FHA risk-sharing pilots could increase lender and secondary market participation and advance understanding about the financing needs of this stock.

- Simplify Subsidy Layering. Affordable housing developments often require multiple partners and subsidy sources. These structures add complexity and cost. At the same time, other rules inhibit the provision of both debt and equity resources by the same investor in tax credit properties. The Commission could greatly enhance efficiencies in affordable housing production by focusing on ways to improve the ability of different subsidy programs to work together.
- Section 236 and Risk-Sharing. HUD policies that prohibit the combination of its multifamily risk-sharing program and Section 236 properties undermine opportunities to preserve some of the older affordable housing stock.
- Tax Credit Property Transfers. The IRS requires an LIHTC property owner to purchase an insurance company bond at a significant premium to cover the compliance risk for the remainder of the 15-year term when the existing owner transfers the LIHTC property to a new owner. Eliminating the bonding requirement could allow some current owners to self-insure and save transaction costs.
- Better Market Information. The public sector could greatly improve market efficiency and market participation in affordable housing lending and investment by collecting and disseminating aggregated key statistics on multifamily markets.

➤ *Strengthening Communities.*

- Land Aggregation. One of the biggest challenges to community development in older communities is the ability to aggregate sufficient land for redevelopment. Policies and resources to support this aspect of community development and to facilitate brownfields redevelopment are important.
- Importance of Community Context. Policy should emphasize that affordable housing developments cannot succeed without strong communities around them – safe neighborhoods, good schools, and access to job opportunities. Likewise, community development efforts will prosper if homeownership can increase and will fail if the community does not have available, affordable rental and homeownership housing opportunities.
- Smart Growth. The Commission should urge policy makers to avoid growth management policies that exacerbate the nation’s affordable housing problems.
- Renewal Communities and New Markets Tax Credits. The Renewal Communities and the New Markets Tax Credits programs represent potentially valuable new tools for community development practitioners. It is now important

that the Administration implement these flexibly to encourage innovation and private sector investor participation.

VI. Conclusions

This letter has suggested a policy framework and a series of policy proposals to further the national housing goal of a decent, safe, and affordable home for all Americans. Fannie Mae hopes that this letter has provided useful policy ideas and insights that will help shape the Millennial Housing Commission's work. We have developed a longer document providing more detail on each of the policy proposals mentioned above and would be pleased to share this with you or your staff if you thought it useful. Our employees are also available to provide you with their insights and expertise.

As the country continues to make progress toward our national housing goals, the remaining housing needs become more complicated and intractable. Solving these problems will require public resources. At the same time, the private sector can bring expertise, additional resources, and operational efficiencies to bear in helping to tackle these housing problems. The best policy environment includes one where the public sector continues to build on effective partnerships with the for-profit and the not-for-profit communities. A strong, effective public sector role in the provision of resources, in sharing risks, and in lowering the costs of regulations is essential for success.

The task you have before you is daunting. We hope that the discussion and recommendations in this document add value to your deliberations and provide you with practical and pragmatic advice. Fannie Mae stands ready to assist you in your task in any way we can.

Sincerely,

Franklin D. Raines
Chairman