NATIONAL MULTIFAMILY HOUSING COUNCIL

NATIONAL APARTMENT ASSOCIATION

November 16, 2018

Alfred M. Pollard
General Counsel
Attention: Comments/RIN 2590–AA95
Federal Housing Finance Agency
Eighth Floor
400 Seventh Street, SW
Washington, DC 20219

Re: Enterprise Capital Requirements; Comments on RIN 2590-AA95

Dear Mr. Pollard:

The National Multifamily Housing Council ("NMHC") and National Apartment Association ("NAA") appreciate the opportunity to comment on the notice of proposed rulemaking on Enterprise Capital Requirements ("Proposed Rule"), published by the Federal Housing Finance Agency ("FHFA") on July 17, 2018.[1]

For more than 20 years, NMHC and NAA have partnered on behalf of America's apartment industry. Drawing on the knowledge and policy expertise of staff in Washington, DC, as well as the advocacy power of more than 160 NAA state and local affiliated associations, NMHC and NAA provide a single voice for developers, owners and operators of multifamily rental housing.

The US housing market is undergoing significant transformation as the increasing demand for rental housing continues to set records. Today, one in three Americans rent, rather than own, their home, and nearly 19 million households are building their lives in apartment homes.[2] Each year for the past five years, a record-setting average of one million families have chosen rental housing. This increasing demand is driving a critical need for 4.6 million new apartments at all price points by 2030.[3] NMHC and NAA believe it is imperative that the apartment industry have access to capital to meet this rapidly increasing demand.

For more than 25 years, Fannie Mae and Freddie Mac (the "Enterprises") have operated vibrant multifamily programs that have played a significant role in providing a continuous and reliable source of liquidity for rental housing. Indeed, the Enterprises' multifamily businesses were a consistent source of liquidity throughout the financial crisis. Together, the Enterprises hold about 37 percent of outstanding multifamily mortgage debt, reflecting their important role as providers of multifamily housing financing. Because Enterprise financing plays an essential role in the

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[1] 83 Fed. Reg. 33312 (July 17, 2018) (notice of proposed rulemaking); 83 Fed. Reg. 38085 (Aug. 3, 2018) (extension of comment period).

[2] *See* "Quick Facts: Resident Demographics," NMHC, *available at* https://www.nmhc.org/research-insight/quick-facts-figures/quick-facts-resident-demographics/ (accessed Nov. 15, 2018).

[3] *See* "Apartment Supply Shortage," NMHC, *available at* https://www.nmhc.org/advocacy/issue-fact-sheet/apartment-supply-shortage-fact-sheet/ (accessed Nov. 15, 2018).

multifamily housing system, NMHC and NAA believe that any new capital framework must be carefully calibrated to avoid negatively impacting the availability of this financing.

Even during normal economic times, private capital alone cannot fully meet the apartment industry's financing demands. While many factors influence the apartment industry's ability to meet the nation's growing demand for rental housing, the availability of consistently reliable and competitively priced capital is absolutely essential. Historically, the apartment industry has relied on a variety of capital sources including life insurance companies, commercial banks, the Federal Housing Administration (FHA), commercial mortgage-backed securities and the Enterprises. Each source has its own focus, strengths and limitations. Together these sources have provided the apartment sector with over $150 billion annually on average – reaching approximately $280 billion in 2017 – to develop, refinance, purchase, renovate and preserve apartment properties.

The Enterprises ensure that multifamily capital is available in all markets at all times, which is particularly critical given that even in normal economic times private capital alone cannot meet the industries financing needs. In fact, their business models weathered the recession, producing a strong credit performance with low delinquencies and losses. The current Enterprise multifamily programs are a key provider of capital for the multifamily industry, have effectively managed their business operations, and managed risk through a select originator network coupled with a risk distribution framework. The differences between the multifamily businesses and the single-family businesses reinforce the clear need for separate consideration of the set of risks associated with each type of program. The multifamily model can provide valuable components that lawmakers and stakeholders can use as a basis for crafting a long-term solution for housing finance reform. The Proposed Rule's multifamily framework assumes a continued post-conservatorships existence of the Enterprises' multifamily programs, however, depending on the outcome of any potential housing reform, there may be different perspectives with regard to a potential regulatory capital framework.

NMHC and NAA believe that the continuous availability of Enterprise financing is essential to enable the apartment industry to meet the country's growing need for apartment housing. To this end, we believe the following principles should guide FHFA as it develops new capital standards for the Enterprises:

1. <u>Recognize that the Enterprises' multifamily programs are separate and distinct from their single-family programs</u>
   - *We recommend that FHFA develop separate capital requirements specifically for the Enterprises' multifamily programs in recognition of the unique risk management characteristics of the multifamily businesses as compared to the single-family businesses.*

2. <u>Provide greater transparency of the risks and data FHFA considered in developing the proposed multifamily capital standards</u>
   - *We recommend that FHFA publish a new notice of proposed rulemaking that discloses the specific risks and data it has relied upon in developing the Proposed Rule.*

3. Apply a fair capital process
   - *We recommend that this new notice of proposed rulemaking include sufficient data to enable a comparative evaluation of the multifamily provisions and capital frameworks applicable to banks and other financial institutions.*

4. Recognize long-standing differences in the Enterprises' multifamily business models
   - *We recommend that FHFA publish a new notice of proposed rulemaking that more appropriately recognizes the differences, including risk-sharing executions, in the Enterprises' multifamily business models.*

For each of these principles, the remainder of our letter provides a comprehensive description of the reasoning behind our recommendations.

1. Recognize that the Enterprises' multifamily programs are separate and distinct from their single-family programs

The Proposed Rule states that it is important to specify separate multifamily capital requirements in order to capture the unique nature of the multifamily lending business and its particular drivers. NMHC and NAA agree with FHFA that it is critical to specify separate multifamily capital requirements that reflect the unique characteristics of multifamily lending; provided, those capital requirements are tailored based upon particular risks.

The Enterprises' single-family and multifamily programs and systems are different from one another, reflecting the nature of the respective marketplaces. For example, in the multifamily business, the borrower of an apartment building loan is generally a company, whereas the borrower of a single-family loan is most often a consumer. During the recent financial crisis, both Enterprises' multifamily businesses were a consistent source of profitability unlike the Enterprises' single-family businesses. These differences, and others, demonstrate the clear need for separate consideration of the set of risks associated with each type of program. Depending on the outcome of any potential housing reform, there may be different needs with regard to a potential regulatory capital framework.

NMHC and NAA agree with FHFA that "[i]t is important to specify separate multifamily capital requirements in order to capture the unique nature of the multifamily lending business and its particular risk drivers" – in other words, to distinguish between the single-family and multifamily business segments. We also agree that Enterprise capital requirements should "account for differences in the Enterprises' multifamily business models" (in order to distinguish between each Enterprise's different multifamily business model).[4]

- **Recommendation:** FHFA should develop separate capital requirements specifically for the Enterprises' multifamily programs in recognition of the unique risk management characteristics of the multifamily businesses as compared to the single-family businesses.

[4] *See* 83 Fed. Reg. at 33363-33364.

2. <u>Provide greater transparency of the risks and data FHFA considered in developing the proposed multifamily capital standards</u>

The Proposed Rule would create a new regulatory capital framework for the Enterprises that is intended to provide transparency about FHFA's supervisory views of capital adequacy.[5] The Proposed Rule would establish new risk-based capital requirements for the Enterprises' multifamily businesses that would apply to multifamily whole loans, guarantees, and related securities held for investment. The Enterprises would use a set of multifamily grids and risk multipliers in calculating capital requirements for credit risk and various formulas in calculating capital requirements for market risk, operational risk and a going-concern buffer.

NMHC and NAA support transparency regarding FHFA's supervisory views of capital adequacy, but we do not believe the Proposed Rule provides sufficient information about the risks and data underpinning the proposed multifamily provisions to allow for meaningful analysis and comments.

A. Information That Should Be Considered

A proposed rule that provides sufficient information would describe the specific risks that FHFA has observed in the last twelve years, and how these risks would be addressed by the proposed multifamily capital requirements. This 12-year timeframe provides a strong context for determining whether a particular capital approach is likely to be successful: the timeframe includes pre-crisis, financial crisis, and post-crisis, and encompasses the Enterprises' current multifamily operations, which entail stronger underwriting and lending programs relative to earlier time periods.

The multifamily sector poses relatively low risk to the Enterprises and, in fact, was consistently low-risk and profitable during the recent financial crisis. During the height of the financial crisis, the Enterprises' multifamily segments' annual delinquency rates remained low – Fannie Mae and Freddie Mac had delinquency rates of 0.7 percent and 0.3 percent of book, respectively, in 2010. Before and after the financial crisis, these rates were even lower. Accordingly, FHFA should disclose the timeframe and data that it considered to facilitate assessment of the proposed multifamily capital framework.

B. Information Sources Referenced in the Proposed Rule

The Proposed Rule does not provide specific relevant information regarding the Conservatorship Capital Framework, which FHFA describes as "the foundation for FHFA's proposed capital regulation."[6] FHFA notes that the levels at which it set the multifamily-specific stress scenarios are "consistent with market conditions observed during the recent financial crisis, views from

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[5] In testimony before the House Financial Services Committee, the FHFA Director stated that FHFA considers the Proposed Rule an effort "to start a healthy, robust and much-needed discussion about the amount of capital the Enterprises should have given the risks inherent in their businesses." Statement of Melvin L. Watt, Director, FHFA, Before the U.S. House of Representatives Committee on Financial Services (Sept. 27, 2018).

[6] *See* 83 Fed. Reg. at 33313.

third-party market participants and data vendors, and assumptions behind the Dodd-Frank Act Stress Test (DFAST) severely adverse scenario."[7]

The Proposed Rule, however, does not identify specifically what risks and what data FHFA considered in setting the stress scenario assumptions. Similarly, the Proposed Rule does not describe the multifamily market conditions observed during the financial crisis or the market participants' views, and does not provide calculations that demonstrate that the proposed stress levels reflect the perceived risks. NMHC and NAA believe that FHFA should state what risks and what data it considered that are reflected in the development of the grid and its components, whether the grid's assumptions have been tested, and the results of those tests.

C. Limited Information About Multifamily Businesses

The Proposed Rule provides data and details regarding the Enterprises' single-family businesses, but does not provide comparable transparency regarding their multifamily businesses. The particular multifamily business segment risks in the Proposed Rule are ambiguous. Unlike the discussion in the Proposed Rule regarding issues arising from the single-family business segments, FHFA provides limited comparable discussion of risks arising from multifamily business segments during the financial crisis.[8] Providing greater transparency regarding the risks and data that form the basis for the multifamily provisions, including what the anticipated impact of the Proposed Rule would be on the multifamily business segment, in a manner similar to how FHFA has addressed the single-family business segment in the Proposed Rule, would better facilitate consideration of the proposed framework.

The "Impact of the Proposed Rule" considers the Enterprises' single-family businesses but does not specifically describe potential risks arising from their multifamily businesses. FHFA explains that it provided this description "to inform commenters about the impact the proposed rule would have on the Enterprises' capital requirements both leading up to the crisis and under the Enterprises' current operations in Conservatorship."[9] Yet, the analysis regarding the "Impact of the Proposed Rule at the End of 2007" focuses on the Enterprises' single-family business segment losses, and does not expressly discuss the Enterprises' multifamily businesses.[10] The analysis regarding the "Impact of the Proposed Rule as of September 30, 2017" includes one line (in table 6) that provides a combined estimated risk-based capital requirement for the Enterprises' multifamily whole loans, guarantees, and related securities, but does not otherwise discuss the multifamily businesses.[11]

- **Recommendation**: To offer a meaningful opportunity for comments on new multifamily capital standards, FHFA should publish a new notice of proposed rulemaking that discloses the specific risks and data it has relied upon in developing the multifamily capital standards in

[7] *Id.* at 33364.
[8] *See, e.g., id.* at 33317-33318.
[9] *Id.* at 33326.
[10] *See id.* at 33326-33329.
[11] *Id.* at 33329-33330.

the Proposed Rule. Disclosing this information is necessary to facilitate consideration of new multifamily credit risk and other capital requirements.

NMHC and NAA believe that greater transparency regarding the basis for the proposed multifamily business capital requirements is necessary to facilitate meaningful evaluation and public comment. We believe that through a revised notice of proposed rulemaking, FHFA should explain the specific potential risks arising from the Enterprises' current multifamily programs, provide lessons learned from the financial crisis about the Enterprises' multifamily programs, and delineate how such considerations would be addressed.

3. Apply a fair capital process

FHFA states that a key consideration in developing the Proposed Rule was that "[t]he Enterprises should operate under a robust capital framework that is similar to capital frameworks applicable to banks and other financial institutions, but appropriately differentiates from other capital requirements based on the actual risks associated with the Enterprises' businesses."[12]

FHFA states that the new approach in the Proposed Rule, which contrasts with the Basel III approach applicable to many regulated financial institutions, "would represent a substantial step forward in articulating the relative risk levels of mortgage loans and quantifying the associated capital requirements for the Enterprises."[13] The multifamily capital provisions in the Proposed Rule differ from the capital requirements applicable to other financial institutions, and it is not at all clear from the discussion in the Proposed Rule whether the proposed approach appropriately reflects the potential risks of the Enterprises' current multifamily businesses. The Proposed Rule suggests a procyclical framework that would require significantly more capital to be raised on the Enterprises' existing book of business during market downturns. A procyclical framework could effectively eliminate the Enterprises' ability to provide critical countercyclical support to the multifamily market when that support is needed most.

The proposed Enterprise multifamily capital requirements are not "similar to capital frameworks applicable to banks and other financial institutions,"[14] as suggested by FHFA. In fact, there is no direct bank comparison. The multifamily capital framework in the Proposed Rule is fundamentally different from the frameworks applicable to other financial institutions for multifamily loans.

To illustrate this point, a bank that is subject to the standardized approach under Basel III would apply a 50 percent risk weight to multifamily mortgage assets.[15] In contrast, each Enterprise would "use a series of approaches, which include base grids, risk multipliers, assessments of counterparty risk, and capital relief due to credit risk transfer transactions, to produce tailored capital requirements for mortgage loans, guarantees, and securities."[16] Each Enterprise would then be required to apply the calculated asset-specific capital requirements to each book of business to

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[12] *Id.* at 33325.

[13] 83 Fed. Reg. at 33314.

[14] *See id.* at 33325.

[15] *See, e.g.*, 12 C.F.R. § 3.32(i).

[16] 83 Fed. Reg. at 33314.

produce a "total risk-based capital requirement." Moreover, this Enterprise credit risk approach effectively requires mark-to-market consideration for Enterprises for seasoned loans, which is not required of banks. The base grid in the Proposed Rule uses mark-to-market acquisition debt-service coverage ratios and mark-to-market loan-to-value ratios. Commercial banks that are subject to the Basel III standardized approach, however, consider the principal amount of the loan at origination instead.[17]

- **Recommendation:** NMHC and NAA believe that the Proposed Rule should apply a fair capital process to the Enterprises' multifamily business segments. To offer a meaningful opportunity for comments on new multifamily capital standards, we recommend that FHFA publish a new notice of proposed rulemaking with sufficient data regarding the Enterprises' multifamily businesses to enable an evaluation of comparable capital frameworks applicable to banks and other financial institutions.

4. Recognize the differences in the Enterprises' multifamily business models

The Enterprises have separate and distinct multifamily business models that are broadly accepted in the marketplace. Freddie Mac's multifamily business model generally involves the purchase and securitization of multifamily loans from Freddie Mac's Program Plus lender network. For a significant portion of its multifamily business, Freddie Mac shares credit risk by issuing classes of securities that are backed by multifamily mortgages for which the investor bears the credit risk. Fannie Mae's multifamily business model involves a Delegated Underwriting and Servicing ("DUS") lender network, which is the principal source of Fannie Mae's acquisition of multifamily loans. Lenders in the DUS network are preapproved by Fannie Mae and are authorized to underwrite and service multifamily loans in accordance with Fannie Mae's requirements. For a significant portion of its business, Fannie Mae shares multifamily credit risk with DUS lenders.

FHFA asks what modifications it should consider regarding the proposed approaches for calculating multifamily credit risk transfer capital relief and regarding multifamily counterparty haircuts, and indicates that the credit risk provisions are intended to "accommodate" both Enterprises' multifamily programs.[18] While the Proposed Rule describes the Enterprises' different approaches to multifamily lending,[19] the Proposed Rule does not otherwise adequately recognize differences between the business models.

FHFA recently issued supplementary tables regarding the Enterprises' estimated multifamily risk-based capital requirements, explaining that it "believes that given the distinct nature of each Enterprise's multifamily business model, it is important to provide the public with a more granular breakdown of the impact of the proposed capital requirements on each business model."[20] The supplementary tables demonstrate that the Proposed Rule would require Fannie Mae to hold

[17] *See, e.g.*, 12 C.F.R. § 3.2 (definition of "Statutory multifamily mortgage").

[18] *See* 83 Fed. Reg. at 33364 ("the proposed rule would accommodate both Enterprises' current lending practices"), 33371 ("The proposed approach is general enough to accommodate the variable nature of CRTs" and "[d]espite these differences in the Enterprises' multifamily business models, the proposed rule accommodates both Enterprises' lending practices.").

[19] *See id.* at 33385.

[20] "Proposed Rule On Enterprise Capital Multifamily Supplementary Tables," FHFA (Nov. 6, 2018).

estimated risk-based capital that is nearly two times greater than Freddie Mac is required to hold (total capital requirement of 354 basis points compared with 192 basis points).[21]

This difference in estimated risk-based capital suggests that the credit risk transfer capital relief calculation could be improved. The Proposed Rule does not adequately take into consideration the credit risk transfer and counterparty risks of each Enterprise's multifamily business model. NMHC and NAA believe that greater transparency on how FHFA developed the proposed multifamily capital framework is necessary to support meaningful analysis by stakeholders, particularly with regard to periods in which the Enterprises' multifamily programs performed well.

NMHC and NAA believe the multifamily capital standards should reflect the differences between the Enterprises' programs rather than simply be designed so as "not [to] limit an Enterprise to a particular approach."[22] Even without expressly limiting the Enterprises to a particular approach, the proposed capital provisions may nonetheless effectively achieve the same result, and the Proposed Rule does not address this outcome.

For example, the Proposed Rule overstates the potential counterparty risk in Enterprise loss-sharing credit risk transfers, perhaps due to FHFA concerns that underestimation of capital could occur if the proposed approach overestimates the amount of capital relief attributed to credit risk transfer transactions.[23] We believe that FHFA should not disadvantage one multifamily platform over the other, and there is potential for the proposed framework to create market incentives toward one business model over the other.

- **Recommendation:** To offer a meaningful opportunity for comments on new multifamily capital standards, we recommend that FHFA publish a new notice of proposed rulemaking that discloses its analysis of the costs and benefits of the proposed framework on each of the Enterprises' multifamily businesses. FHFA should also disclose any testing and evaluations of the approach to counterparty risk.

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We thank you for the opportunity to comment on the Proposed Rule. In closing, NMHC and NAA believe that any regulatory framework applicable to the Enterprises' multifamily programs should reflect the following three principles. First, the framework should be consistent with maintaining an explicit federal guarantee for multifamily mortgage-backed securities. Second, the framework should recognize the unique multifamily risk management characteristics of the multifamily business compared to the single-family business, along with the distinctions between the two Enterprises in their risk sharing executions without advantaging one over the other. We agree with FHFA when it states that any Enterprise capital requirements rule should "account for differences in the Enterprises' multifamily business models,"[24] however, the Proposed Rule does not achieve

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[21] *See id.* at Supplementary Tables S1 and S2.
[22] *See id.*
[23] *Id.* at 33314.
[24] *See id.* at 33364.

that purpose. Third, the framework should retain the successful components of the Enterprises' existing multifamily programs.

We would welcome the opportunity to discuss our comments. If you have any questions, please contact David Borsos (NMHC) at 202-974-2336.

Sincerely,

Doug Bibby	Robert Pinnegar, CAE
President	President & CEO
National Multifamily Housing Council	National Apartment Association