

May 9, 2012

Regulations Division
Office of General Counsel
Department of Housing and Urban Development
451 7th Street, S.W., Room 10276
Washington, D.C. 20410-0500

Re: Changes in Certain Multifamily Housing and Health Care Facility Mortgage Insurance Premiums
for Fiscal Year 2013 Notice
Docket No. FR-5634-N-01

Dear Sir or Madam:

On behalf of the undersigned organizations, we would like to submit comments on the above-referenced Notice. Our organizations represent thousands of members involved in the development, construction, ownership, and management of market rate and affordable multifamily rental housing and health care facilities. Our members have long-supported the U.S. Department of Housing and Urban Development's (HUD) Federal Housing Administration (FHA) multifamily and health care mortgage insurance programs. These programs provide financing in all markets and under all economic conditions, thus filling a critical role in maintaining liquidity in the mortgage markets for rental housing production and preservation and the provision of quality health care facilities.

The Notice announces increases of mortgage insurance premiums (MIPs) for certain FHA multifamily housing, health care facilities, and hospital mortgage insurance programs for commitments to be issued or reissued in FY2013. The Notice states that, "These MIP increases will not only provide additional protection for the GI/SRI fund and increase receipts to the Treasury, but will also encourage private lending to return to the market by ensuring FHA is not under-pricing its risk."

Our organizations do not believe that HUD has provided compelling justification for the increases. The purpose of the MIPs is not to increase receipts to the Treasury, nor to adjust FHA's pricing of credit risk relative to current private market pricing. Increasing the MIPs will not serve to build a buffer against future losses, because there is no segregated fund and excess income is returned to the Treasury each year. These higher MIPs will only add to property owners' costs, thereby affecting rents. In the current economic environment, where rents are increasing, higher MIPs will only speed the upward trending of rents. We believe it is extremely important that any increase in the mortgage insurance premium be supported and preceded by a careful analysis of the need and impact of the change. HUD's Notice provides no analysis of the need and impact of the proposed increase on borrowers, lenders or renters who live in properties insured under the programs.

Our detailed comments are provided below.

Background on Steps Taken to Improve Risk Management of FHA Multifamily Programs

Early in the current housing crisis, HUD underscored that FHA would continue to provide liquidity to the market and quickly took steps to provide support for multifamily by instituting a waiver of the three-year rule for refinancings and extended that waiver twice. HUD also instituted a waiver to allow projects already under construction, with certain conditions, to apply for FHA financing.

As overall market conditions deteriorated, HUD announced its intentions to institute a new risk management protocol for the multifamily insurance programs. In June 2010, a Mortgagee Letter was issued announcing significant tightening of the underwriting requirements for the Section 221(d)(4) new

construction/substantial rehabilitation and Section 223(f) acquisition and refinancing programs. In addition to the underwriting changes, a national loan review committee was established, delegation to the field was modified, and FHA began a process of substantial credit policy and work flow management changes. HUD also has established a strong credit approach to application processing. In addition, HUD revised and tightened lender capitalization, licensing and monitoring requirements, made significant changes as part of the update of the loan closing documents, and finalized several changes to the regulations governing the FHA multifamily mortgage insurance programs.

HUD has also taken steps to mitigate risk related to large multifamily loans. In late December 2011, HUD issued a Mortgagee Letter regarding the underwriting of large loans, defined as those at or above \$40 million. While only a small number of loans overall, HUD was concerned that a few defaults of large loans could have an overwhelming impact on the portfolio. Debt service coverage, loan-to-cost and reserve requirements were tightened considerably for large loans (over and above the tightening already put into place). Also included in the new policy is additional scrutiny of sponsors asking for loans of \$25 million or larger. Sponsors' creditworthiness, experience with large developments and past performance on FHA-insured properties will be examined much more closely before any loan applications are accepted.

All of these actions were intended to strengthen risk management practices related to the FHA multifamily mortgage insurance programs, ensure the health of the FHA multifamily portfolio and attract high quality borrowers. While as stakeholders, we did not agree with every aspect of these actions, overall we have supported HUD's objectives and have worked to ensure that borrowers and lenders understand the changes, and we have offered suggestions for improvements in a number of areas.

The Proposed MIP Increases

The Administration's proposed FY2013 budget included an increase in the mortgage insurance premiums for most of the FHA multifamily mortgage insurance programs financing market rate loans. No premium increases are proposed for projects that are financed with Low Income Housing Tax Credits (LIHTCs), have project-based rental assistance or are financed by FHA-risk sharing loans.

HUD is moving forward on the following proposed increases, as announced in the above-referenced Notice:

- Section 221(d)(4) new construction/substantial rehab - increase of 20 basis points (bps) from 45 to 65
- Section 220 urban renewal – increase of 20 bps from 50 to 70
- Section 231 elderly housing – increase of 20 bps from 50 to 70
- Section 223(f) acquisition and refinance – increase of 15 bps from 45 to 60
- Section 223(a)(7) refinancing of FHA-insured – increase of five bps from 45 to 50
- Section 232 new construction/substantial rehabilitation of health care facilities – increase of 20 bps from 57 to 77
- Section 232/223(f) refinance of health care facilities - increase of 15 bps from 50 to 65 bps
- Section 232/223(a)(7) refinance of health care facilities – increase of 5 bps from 50 to 55 bps
- Section 242 hospitals – increase of 20 bps from 50 to 70 bps

As described above, justification for the proposed increases is that they will not only provide additional protection for the GI/SRI fund and increase receipts to the Treasury, but will also encourage private lending to return to the market by ensuring FHA is not under-pricing its risk.

HUD's Basis for the Proposed Increase Significantly Departs from Current Policy

Historically, HUD has not raised the MIP to generate revenue beyond that needed to cover expected credit losses and associated program costs. Currently, the MIP is set at a level where the programs will break even (i.e., no credit subsidy is required) providing only a minimal amount of excess income. This level is established based on an economic model, as required under the Federal Credit Reform Act of 1990 (FCRA), that takes into account the risks and costs of the program. The Notice makes no mention of any technical or actuarial defects of the model. If such defects exist, the Department should be transparent and indicate such as a reason for increasing the MIPs. Absent any information to this effect, we would presume that the Department believes the risk model is working appropriately.

As indicated in the Notice, the MIP announced for FY 2013 would provide funds in excess of that needed to operate the programs. Those excess funds would go to the Treasury, into the overall federal budget for unspecified spending. We believe that such action sets a precedent for poor public policy making and has a significant negative impact on national housing policy. We do not support raising the cost of producing rental housing and health care facilities to raise money for purposes unrelated to these programs.

Congress did not intend the FHA MIP to be based on what the market would bear. Rather, Congress, in FCRA, set out a framework for Federal insurance and guarantee programs "that would assure the government accounted for these guarantees in an appropriate manner." Originally, this calculation resulted in the need for an appropriation by Congress for the FHA multifamily programs. However, the credit subsidy calculation which has been used by HUD for the last 10 years has set the MIP for most of the multifamily and healthcare programs at a level that would allow them to break even and not require an appropriation of credit subsidy. In fact, the multifamily programs have generated substantial negative credit subsidy for HUD over the years. As noted earlier, the current MIP increase runs counter to the Credit Reform Act, as it sets the MIP at what the Administration considers a rate more in line with the private sector. We believe it is more appropriate to set the FHA MIP based on FHA's costs and experience with FHA's portfolio of loans.

Some years ago, the industry worked with then-FHA Commissioner John Weicher to implement improvements to the economic model used to determine the MIPs every year. Every effort was made to ensure the model captured all of the direct costs (other than staffing costs which are specifically excluded from the credit subsidy calculation under FCRA) as well as the risk factors appropriate to the programs. The calculation sets the MIP at a level sufficient to protect the integrity of the Guaranteed Insurance/Special Risk Insurance fund (GI/SRI). Currently, virtually all of the FHA multifamily insurance programs cover their credit losses.

It should be noted that in the most recent past, the default rate used by HUD in the credit subsidy calculation has, in fact, gone down. In the case of the new construction program, according to the Federal Credit Supplement of the recently released FY2013 Budget Proposal, the FY2012 budget had a default rate of 19.11 percent, while the FY2013 budget saw that rate fall to 13.18—a significant

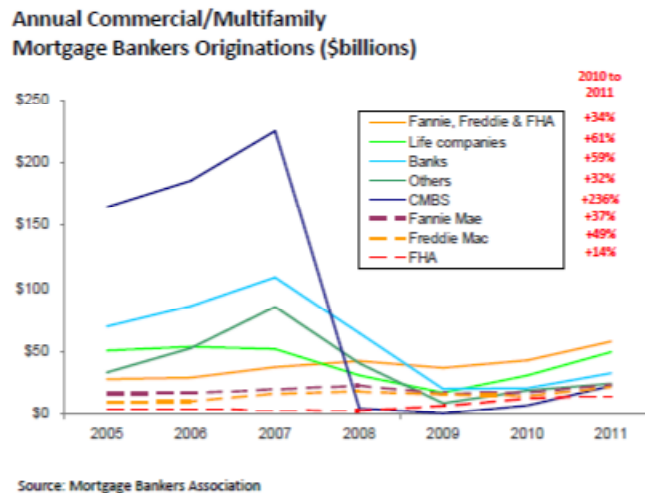
decrease. Similarly, the default rate for the multifamily refinance program dropped from 12.64 percent to 4.22—a stunning decrease.

The need for an MIP increase in the face of reduced defaults has not been demonstrated and would be a de facto tax on rental housing.

FHA Is Not Crowding Out the Private Market

FHA significantly increased its role in the multifamily market during the recession as other market participants pulled back. As is demonstrated in the charts below, the volume of multifamily loan originations by CMBS issuers, banks, life companies and other lenders reached their peaks in 2007 and dramatically decreased in 2008 and 2009 (Chart 1). Many capital providers began reentering the market in 2009 and have steadily increased in 2010 and 2011. On the other hand, Fannie Mae, Freddie Mac and FHA stayed in the markets and even increased their volumes in 2008, 2009, 2010 and 2011.

Chart 1



Looking specifically at FHA volumes (Chart 2), the chart indicates the countercyclical nature of the FHA business, with volume lows during the years when the CMBS market was lending in large volumes and banks and life companies were also heavy purchasers of multifamily debt. But the FHA volumes began to increase as the private market pulled back and actually peaked in FY2010 for the two major programs for purchase/acquisition (223(f)) and new construction/substantial rehabilitation of apartments (221(d)). (The 223(a)(7) program is somewhat of an anomaly because it involves solely the refinancing of loans with FHA-insured mortgages, similar to a loan modification.)

Chart 2

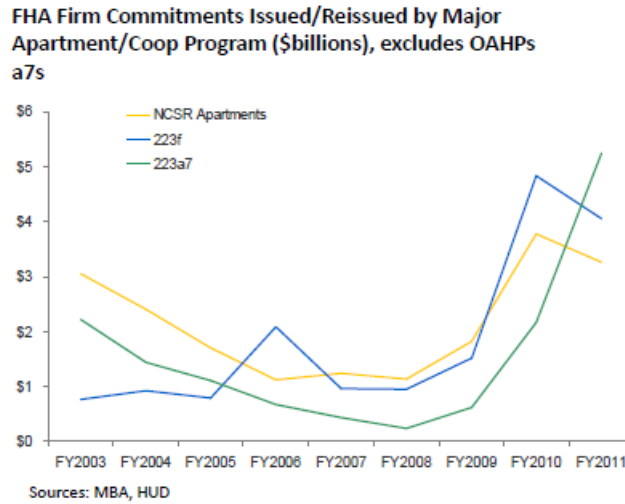
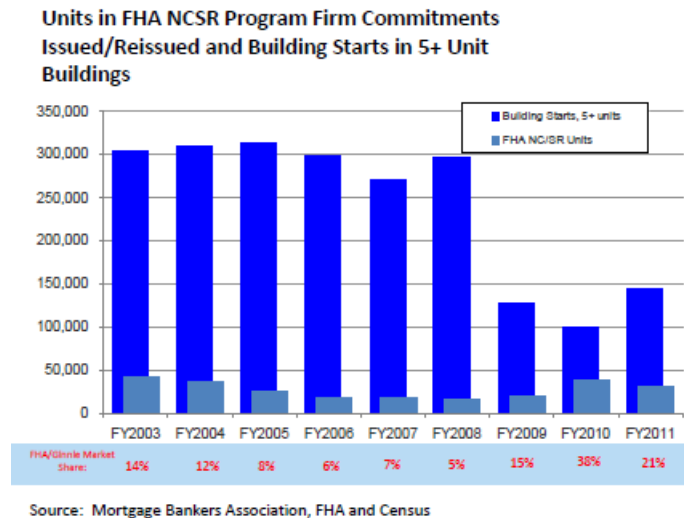


Chart 3 shows the share of the new construction market that FHA occupies and demonstrates that, while the volume of multifamily lending by FHA increased in FY 2008 through 2010, both the absolute volume as well as the market share of FHA decreased in FY2011 as other investors returned to the market. And we have been told by FHA staff recently that the new construction program volume in FY2012 is running about 10 percent behind FY2011 volumes. These data demonstrate that FHA is operating as it was designed to operate, providing liquidity when other market participants are pulling back and decreasing its market share as other lenders return to the market.

Chart 3



In addition, FHA financing is often used in smaller markets where the GSEs and other market participants are less active and has filled the niche that local banks and thrifts have retreated from in recent years. Without FHA, many of the rental housing properties that need rehabilitation would not be able to achieve the necessary capital, and new rental housing would not be able to be built.

As conventional lenders have returned to the market, FHA's market share has declined because these financing sources are more flexible and less costly to pursue. This is occurring naturally without the need to unnecessarily increase costs through an increase in the MIP.

Market-rate Properties Should Not Be Disadvantaged

HUD should not discourage market rate housing by imposing higher MIPs on these loans. Congress intended the FHA multifamily insurance programs to have a broad scope, rather than focus solely on lower-income families. The legislation authorizing the multifamily programs nowhere indicates a requirement or even a preference for assisted housing. In fact, Congress has repeatedly increased the maximum loan limits for the programs which are the only targeting mechanism for the multifamily insurance programs. If Congress had intended to disadvantage market rate housing, legislation would have been enacted to that effect.

Moreover, rental housing in general — whether market rate or otherwise — is inherently affordable in character, and many of the properties financed and refinanced under the FHA multifamily programs are affordable to families at 60 to 80 percent of area median income without any type of direct federal or state subsidy. These types of properties are routinely financed by FHA-insured loans, particularly in the 223(f) and 223(a)(7) programs, and these properties will be disadvantaged by the imposition of higher MIPs.

In addition, the proposed increases will disproportionately affect market rental properties in secondary and tertiary markets. Private capital (banks, pension funds and insurance companies) currently is focusing lending activities in the strongest markets and for the most well-capitalized large developers. Access to capital in the secondary and tertiary markets is much more limited, and FHA has always played a significant role in providing liquidity in these areas. HUD does not differentiate among markets in setting the MIPs, thus the increases penalize the borrowers who need HUD financing the most.

Conclusion

The undersigned organizations do not believe that HUD has provided compelling justification for increasing the multifamily mortgage insurance premiums. Of critical importance to our organizations, we are concerned about setting a precedent of using premiums as a means to raise funds for unrelated purposes. FHA MIPs have been, and should continue to be, based on the management of risk to the government of the potential and severity of mortgage losses. The demonstrated strong performance of the programs, the implementation of processing changes to tighten credit review, improved legal documents and changes in the credit underwriting and loan requirements — all run counter to the proposed increase in the MIP.

We urge the Administration not to implement these changes at a time when demand for rental housing is increasing and preserving and investing in our stock of rental housing is critical. Maintaining mortgage

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liquidity is important to the housing stock and to support job creation through development and investment in rental housing.

Should you have further questions or require additional information, please do not hesitate to contact David Cardwell, Vice President of Capital Markets, National Multi Housing Council, at dcardwell@nmhc.org or Claudia Kedda, Senior Director, Multifamily and Affordable Housing Finance, National Association of Home Builders, at ckedda@nahb.org on behalf of the undersigned.

Sincerely,

American Seniors Housing Association
Committee on Healthcare Financing
Council for Affordable Rural Housing
Institute of Real Estate Management
Leading Age
Mortgage Bankers Association of America
National Affordable Housing Management Association
National Apartment Association
National Association of Home Builders
National Association of Housing Cooperatives
National Leased Housing Association
National Multi Housing Council