Creating Affordable Housing Opportunity through a Preferred Partnership between the New Secondary Mortgage Market and State Housing Finance Agencies

The National Council of State Housing Agencies (NCSHA) and the state Housing Finance Agencies (HFAs) it represents call on the Administration and the Congress to seize the opportunity of housing finance reform to:

- Design a strong, federally backed secondary mortgage market system;
- Establish within that system a powerful commitment to affordable housing; and
- Deploy the highly effective and time-tested HFA delivery system to fulfill this commitment in a safe and sound manner.

We further appeal to you to also work with NCSHA to more fully realize the affordable housing promise of other parts of our federally supported housing finance system, most notably the Federal Housing Administration (FHA) and its Ginnie Mae securitization platform and the Federal Home Loan Banks. While these entities are making important contributions to affordable housing today, we believe they could do much more, especially by engaging with HFAs in more expansive and advantaged partnerships.

The Essential Secondary Mortgage Market

NCSHA believes a strong secondary mortgage market is an essential component of our country's housing finance system that must be preserved and fortified to ensure the widespread availability of and ready access to mortgage capital. We further contend that some degree of federal government support of this market is necessary to ensure the constant and stable flow of capital to all housing markets at all times, including during periods of economic downturn.

Few would deny that Fannie Mae and Freddie Mac, before their financial collapse and even since, have lent vital support to the housing market. The Administration and Congress have the opportunity now to assess fully the strengths and flaws in the structure and operations of these enterprises and to remake a secondary market system that preserves and builds upon the strengths of the previous system, while minimizing risk to the federal government, compelling public benefits in return for federal support, creating a more robust role for the private sector, and ensuring effective oversight and regulation.

We urge that this transformation be undertaken with great care and deliberation, so as not to disrupt the housing finance system, just as the housing recovery is gaining momentum. Confidence in the housing recovery must not be shaken by quick and radical changes to or abandonment of a secondary market system that has long played and continues to perform a critical role in our housing finance system.

Regardless of the new secondary market system's structure or the number of entities of which it is ultimately comprised, its relationship with the federal government must be clear and transparent. Any federal financial backing of the system must be explicit.

Federal support for the system must carry with it an affirmative obligation on the part of the system to meet certain public purpose responsibilities. These responsibilities must be clearly defined in law and regulation, and the system must be held accountable for fulfilling them.

A strong, independent regulator should be established to oversee and regulate effectively the new secondary market in a manner that effectively balances safety and soundness with the fulfillment of the system's overall mission, including its public purposes. The system's governing body should include state HFAs and other industry representatives that will help ensure that its public purposes are met and not subordinated to other interests.

Its Affordable Housing Responsibility

Principal among the new secondary market system's public purpose responsibilities must be the duty to finance affordable and sustainable homes and to reach underserved people and markets, including low- and moderate-income people, persons with special needs, and low-income and rural communities. Affordable housing need in this country is great and growing. Our response will determine not only the critical matter of shelter for the needy and vulnerable among us, but also the health of our communities, the potential of our children, the strength of our economy, and our promise as a nation.

We urge the Administration and Congress to establish and articulate clearly in housing finance reform legislation and regulation the new system's affordable housing responsibility. This duty must not be relegated to a goal to which the system simply aspires without consequence should it fail to fulfill it. It must be an obligation, which the system must meet to continue to receive federal support.

NCSHA also feels strongly that the new secondary market system's effective fulfillment of its affordable housing obligations requires it to integrate wholly within its business culture and throughout its operations a dedication to affordable housing and underserved market financing. The system should pursue these activities broadly and consistently, not as a side or niche business.

Though NCSHA supports a state-administered national housing trust fund and believes its potential capitalization by the new secondary market system should be seriously explored, we see the fund as complementing and supporting the system's affordable housing financing activities and not as an alternative to them.

We understand that some say the new secondary market system should not invest in affordable housing, because that is what caused Fannie Mae's and Freddie Mac's demise and contributed so significantly to the housing market's collapse. Though NCSHA is not in a position to assess independently the truth of this assertion, much credible research has been conducted by the Federal Reserve System and others that effectively refutes it.

Our own view is that purchasing affordable loans is not what got Fannie Mae and Freddie Mac into financial trouble; purchasing bad loans did. At the same time the enterprises ramped up their investment in subprime, Alt-A, and other nontraditional mortgages at the housing market's peak, they were also buying safe and sound HFA mortgages, which have performed exceedingly well.

And, though the enterprises' affordable housing goals are often blamed for inspiring their risky investments, those same goals motivated them to purchase large volumes of HFA loans that have outperformed their larger books of mortgage business. In fact, Fannie Mae in recent years has been so impressed with HFA lending practices and the high quality of the loans those practices produce that it has entered into several unprecedented, exclusive arrangements with HFAs, offering HFA customers preferred mortgage pricing and terms, with no resulting deterioration in HFA loan performance.

NCSHA also knows that some argue affordable housing financing is FHA's job and not that of any new secondary market system that may emerge from housing finance reform. We disagree. To be clear, HFAs greatly value their relationship with FHA. As governmental and quasi-governmental entities, HFAs have long enjoyed a preferred partnership with FHA that allows them to provide second loans on FHA single-family mortgages to finance down payments that would otherwise prevent many creditworthy working families from purchasing homes.

HFAs are proud that their FHA single-family loans, including those with down payment assistance, consistently outperform FHA loans generally. On the multifamily side, HFAs have operated successfully for nearly two decades a risk-sharing program with FHA that also has produced superior performing loans. In fact, this program has been so successful that the Administration and NCSHA are working to increase its impact by seeking from Congress authority for Ginnie Mae to securitize loans made under it.

But, it would be imprudent to rely on FHA as the sole significant source of support for affordable housing lending in this country. Many argue FHA's market share has already grown too large as a result of the financial crisis and credit crunch. Others routinely cite FHA's lack of capacity to take on more or to even handle what it has. And, HFAs wisely do not want to be limited to a single lending execution that may not meet the various needs of their diverse borrowers at all times.

Finally, some say that affordable housing needs in this country should be addressed with government subsidies. Certainly, federal housing assistance, both in the form of direct subsidies and tax incentives, plays an indispensable role in the provision of affordable housing. But, while NCSHA is fully committed to continuing to work with the Administration and Congress to protect and strengthen federal housing resources, it is unrealistic to suggest that these resources alone could possibly meet all of our affordable housing needs, especially given the reductions they have suffered in recent years and the risk of further cut-backs they confront from federal deficit reduction and tax reform efforts.

Today's harsh reality is that only about one-quarter of those eligible for federal housing help receive it. This percentage is almost certain to decline, as federal resources at best hold steady and the number of families who qualify for help continues to increase, due in large part to the prolonged economic downturn and its associated job losses, income deterioration, and home foreclosures.

Finally, the reach of many federal housing programs, like the Low Income Housing Tax Credit (Housing Credit) and HOME, for example, would be far more limited, without good options for generating affordable mortgage financing for the rental developments and home purchases they support, an area in which the secondary market has long played a crucial role.

Deploy the Proven and Powerful HFA Delivery System

The Administration and Congress have an unprecedented opportunity in housing finance reform not only to rebuild and make more effective the secondary mortgage market system and to provide through it much-needed affordable housing, but also to utilize in state HFAs a proven and powerful delivery system to help the system fulfill its affordable housing mandate. You have consistently and repeatedly demonstrated confidence in the HFA delivery system, as evidenced by the billions of dollars in federal affordable housing resources you have entrusted to HFAs over the last several decades and the billions more in housing recovery resources you have committed to them in recent years, including Treasury's $15 billion investment in HFA bonds.

NCSHA urges the Administration and Congress to once again turn to state HFAs, this time to help carry out the new secondary market system's affordable housing responsibilities. We ask that you establish HFAs as preferred partners of the system, eligible to receive unique benefits from it in return for using those benefits to create affordable housing opportunity within their jurisdictions in furtherance of the affordable housing mission HFAs share with the system.

Why State HFAs?

State HFAs are uniquely positioned to serve as the new secondary market system's preferred partner in affordable housing. HFAs have in common a mission-driven public purpose to provide affordable housing, which aligns perfectly with the affordable housing responsibility we propose be conferred upon the new system.

State HFAs are affordable housing finance experts, with most specializing in this field for more than four decades. In strong and weak economies, HFAs have been a constant, reliable source of flexible, affordable mortgage money for low- and moderate-income homebuyers and affordable rental home developments.

Through a well-honed and time-tested combination of homeownership counseling, low-cost financing, prudent underwriting, diligent loan documentation, down payment and closing cost assistance, and proactive servicing, state HFAs have established a strong track record of top home mortgage lending performance, known for its low delinquency and default rates. They have never engaged in subprime or other high-risk lending, offering largely traditional fixed-rate, long-term mortgage products. They apply the same expertise and discipline to their multifamily lending, with the same outstanding success.

State HFAs possess highly sophisticated finance, underwriting, and asset management skills and capacity. They are investment-grade rated and publicly accountable. They largely operate as self-sufficient businesses, which reinvest their earnings in their affordable housing work.

State HFAs have the ability to reach every jurisdiction in the country, bringing valuable statewide perspective and focus, along with a deep understanding of the needs of their local markets. They have long-standing relationships and successfully partner with local governments, the private sector, nonprofits, resident and community groups, and service providers to address the diverse housing challenges they confront. Through comprehensive and coordinated state, regional, and local planning, HFAs make sure that affordable housing is developed where it is most needed.

They are able to leverage the many federal and other housing resources they administer and to ensure that housing resources are integrated with other public investments in our physical, economic, and human infrastructure. Since they work at the state level, HFAs are able to consider housing needs and solutions along with employment, commercial development, transportation, and human service needs.

How Would a Preferred Partnership Work?

For the many compelling reasons cited above, NCSHA urges the Administration and Congress to establish state HFAs in housing finance reform legislation as the new secondary market system's preferred partner in affordable housing. This designation would enable HFAs to receive unique benefits from the system, such as advantaged pricing, which would, in turn, allow them to engage in lending activity that advances the affordable housing mission they share with the system.

For this preferred partnership not only to succeed, but to achieve its boldest potential, the new system and HFAs must be given maximum flexibility to operate within it. Housing needs vary widely across the country and require a broad range of responses. Narrowly defined purposes and overly rigid income targeting and other rules will limit the partnership's results. Instead, the legislation and regulation should establish broad affordable housing objectives and program parameters, understanding that HFAs' inherent mission will always drive them to focus on the most pressing housing needs within their jurisdictions.

We also appeal to you to provide the new system and its HFA partners the freedom to design financing solutions that support the full spectrum of affordable housing need, both for homeownership and rental housing, and including, but not limited to, single-family home purchases, repair, and reconstruction; rental housing predevelopment, acquisition, construction, rehabilitation, development, and preservation; mixed-used and mixed-income housing; and manufactured housing. The system should allow HFAs to innovate and to respond nimbly to changing housing needs.

While it is important that the new system's affordable housing efforts support and complement federal housing assistance programs, it is also critical to keep in mind that income eligibility and other rules vary greatly across federal housing programs and when applied in some markets, deny assistance to people with housing needs not being met by the private market. For example, in some especially low-income rural areas, a two minimum wage earner family's income exceeds the Housing Credit income limit but is insufficient to support a market-rate rent. Therefore, we urge that income targeting and other eligibility rules be determined by the system's HFA partners.

Given the complexity of affordable housing finance today and the fast pace at which it must respond to changing market needs and circumstances, it is also essential that housing finance reform legislation and regulation not limit the lending tools and executions available through the new system to HFAs. Affordable housing financing often requires the use of multiple resources and executions. HFAs themselves have greatly diversified their lending executions in recent years, in response to the financial crisis and weakened bond market. The new system and state HFAs must work together to produce a broad menu of financing strategies, including but not limited to, mortgage purchases and securitization, lines of credit, loan and bond guarantees, and other forms of credit enhancement, all with advantaged pricing and other terms that allow HFAs to reach people and places that the system is otherwise not serving.

The new secondary market system should also be free to support HFAs in other ways, such as by making low-cost capital available to them to help fund their down payment programs and close multifamily financing gaps and by investing in the Housing Credit and Housing Bonds when it is economical for it to do so.

Finally, NCSHA asks the Administration and Congress in defining this preferred relationship, and the new secondary market system in executing it, to respect HFAs' expertise, experience, and judgment, which they have so long successfully employed. We implore you not to impose on HFAs, or allow the system to force on them, rigid, one-size-fits-all lending standards that will severely limit the reach of their activities. We especially appeal to you to strongly resist the suggestion from some to draw a tight mortgage box into which all homebuyers must fit, or you will make homeownership unattainable for many worthy working families.

Overly prescriptive underwriting standards could prevent, for example, the kinds of high Loan-to-Value (LTV) mortgages HFAs have long made successfully to first-time homebuyers to help them overcome what is often the single greatest barrier they confront to homeownership—the down payment. With the rise of house prices in recent decades, it has become very difficult and sometimes impossible for families with qualifying incomes, strong employment history, good credit scores, and little or no debt, to jump the down payment hurdle. Yet, HFAs find families with this profile are the most likely to sustain homeownership over the long term, even after making no or small down payments. In fact, HFA loans, most of which are high LTV loans, have historically consistently outperformed conventional market loans, with lower delinquency and default rates.

Even today's more affordable home prices will not eliminate the down payment obstacle for many. However, the high LTV loan products HFAs uniquely and judiciously offer will allow more families to take advantage of this new affordability.

NCSHA and our state HFA members are confident that a preferred affordable housing partnership between the new secondary market system and HFAs will not only work but will greatly expand affordable housing opportunity in this country. We know this because we have had the opportunity to test such a partnership in recent years with Fannie Mae with great success.

The Administration and Congress have the chance now not only to get an affordable housing return on the federal government's investment in a new, stronger secondary mortgage market system, but also to ensure the best possible return through state HFAs.

What Are State HFAs?

HFAs are state-chartered housing agencies that operate in every state. Though they vary widely in their characteristics, including their relationship to state government, HFAs have in common their public-purpose mission to provide affordable housing to the people of their states who need it.

What Is NCSHA?

NCSHA is a national nonprofit, nonpartisan association that represents the interests of the HFAs of the 50 states, the District of Columbia, New York City, Puerto Rico, and the U.S. Virgin Islands in Washington before the Administration and the Congress. In addition to its policy and advocacy work, NCSHA provides HFAs education and training and facilitates best practice exchange among them.