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Comment on the FHFA's Small Multifamily Subgoal

David J Reiss, *Brooklyn Law School*
Jeffrey Lederman, *Brooklyn Law School*

BROOKLYN LAW SCHOOL
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David J. Reiss
Professor of Law
Research Director, Center for Urban Business Entrepreneurship

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Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
400 Seventh Street SW., 8th floor
Washington DC, 20024

Re: Comments/RIN 2590-AA65:
<u>Low Income Housing Subgoal for Small Multifamily Properties</u>

Dear Mr. Pollard:

The FHFA has requested input on its proposed housing goals for Fannie Mae and Freddie Mac (The Enterprises) for 2015-2017. We write to comment on the subgoal for small multifamily properties.

The charters of the Enterprises impose special duties upon them. Fannie Mae's charter, for instance, specifies that it is to

> Provide ongoing assistance to the secondary market for residential mortgages (including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing; and…Promote access to mortgage credit throughout the Nation (including central cities, rural areas, and underserved areas)….[1]

In the 1970's HUD, as the Enterprises' regulator, set non-binding affordable housing goals for the two companies. Over time, "concerns mounted that they were contributing to

[1] 12 U.S.C. § 1716(3)-(4) (2014); Freddie has a comparable set of duties. *See* 12 U.S.C. §1451(Note) (2014).

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DAVID.REISS@BROOKLAW.EDU

redlining . . .."[2] Congress responded to these concerns by setting housing goals for the two companies in the Housing Enterprise Financial Safety and Soundness Act of 1992.[3]

HUD established three housing goals pursuant the 1992 Act: (1) a "low- and moderate-income housing goal;" (2) a "central cities, rural areas, and other underserved areas housing goal;" and (3) a "special affordable housing goal."[4] The housing goals have proved to be somewhat controversial, but it is unclear whether they have had much of an effect on the behavior of the Enterprises in any case.[5] To the extent they do have an effect, they should be used to maximize the amount of affordable housing that is built and maintained.

The FHFA is, required to establish specific annual housing goals for single-family and multifamily mortgages purchased by the Enterprises. The proposed rule updates the benchmarks for previously determined goals and subgoals for 2015-2017. It also would, for the first time, establish a new housing subgoal for small multifamily properties affordable.

This proposed subgoal is flawed. First, it is inefficient to divert resources from larger multifamily properties to small multifamily properties. Second, new subgoals should not be advanced without a convincing rationale for diverting resources from other housing goals. Finally, the description of the subgoal is misleading because it only targets the biggest of the small multifamily buildings.

The Problem:

Many of those in need of affordable housing live in multifamily units. Small multifamily properties represent a large percentage of all multifamily rental units.[6] And as the proposed rule notes, units in small multifamily buildings are often available for lower rents than those in larger properties. The proposed rule also notes that the Enterprises have historically failed to originate many mortgages for small multifamily buildings.

The Proposed Solution: A Subgoal for Small Multifamily Units

The proposed rule would establish for the first time a separate subgoal for rental units that are affordable to families with incomes no greater than 80 percent AMI in small multifamily properties (5 to 50 units) with mortgages purchased by an Enterprise. The proposed goals are as follows:

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[2] Adam J. Levitin and Jannecke Ratcliffe, *Rethinking Duties to Serve*, at 12-13, in HOMEOWNERSHIP BUILT TO LAST: LESSONS FROM THE HOUSING CRISIS ON SUSTAINING HOMEOWNERSHIP FOR LOW-INCOME AND MINORITY FAMILIES (Eric S. Belsky, Christopher E. Herbert, and Jennifer H. Molinsky eds., Brookings Institution Press with the Joint Center for Housing Studies of Harvard, 2014), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2391815.

[3] Pub. L. 102-550, title XIII,, 106 Stat. 3941. The Housing and Economic Recovery Act of 2008 modified the 1992 housing goals to some extent. Levitin & Ratcliffe, *supra* note 2, at 12-13.

[4] 24 C.F.R. § 81.12-14 (2014).

[5] *See, e.g.,* Valentin Bolotnyy, *The Government-Sponsored Enterprises and the Mortgage Crisis: The Role of the Affordable Housing Goals* (FEDS Working Paper, March 22, 2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2045725.

[6] See *U.S. Census Bureau, 2011 American Community Survey, General Housing Data, Table C–01–AH*, *available at* http://www.census.gov/content/dam/Census/programs-surveys/ahs/data/2011/h150-11.pdf.

2015: Fannie Mae - (20,000); Freddie Mac – (5,000);
2016: Fannie Mae - (25,000); Freddie Mac – (10,000); and
2017: Fannie Mae - (30,000); Freddie Mac – (15,000).

Recommendations:

1. Withdraw the Proposed Subgoal

The FHFA's proposal does not fully acknowledge the reality that mortgages for small multifamily properties are significantly more expensive to originate than larger properties. The proposed rule minimizes this, stating that, "while small multifamily properties may tend to be more affordable than larger properties, it *may* be relatively less profitable to originate and service small loans."[7] Because of the fixed underwriting costs, it is, in fact, more expensive to originate mortgages for small multifamily properties compared to large multifamily properties on a per unit basis.[8]

David Reiss, one of the authors of this comment, has detailed in *Landlords of Last Resort* how small multifamily properties are less uniform than larger multifamily properties, leading to increased underwriting costs for lenders. The proposed rule has not satisfactorily answered the key question necessary to justify such a subgoal - why should smaller multifamily buildings be favored by the subgoal at the expense of larger multifamily buildings? It is true that small multifamily properties represent a sizable percentage of rental units and are potentially cheaper to rent than those in larger properties. But that does not mean that resources should be diverted to benefit them at the expense of larger buildings.

This proposed rule appears to derive from a logical fallacy: because small multifamily buildings provide lots of affordable housing, the government should assist those buildings. But this does not follow. The right question is -- what is the most efficient way to provide affordable housing? If large multifamily buildings have a competitive advantage over small buildings, why should the FHFA interfere as between the two types of buildings? Such interference would decrease the efficiency of the government's efforts to incentivize the creation and preservation of affordable housing over the long run.

2. Conduct More Research

The FHFA has not explained why the small multifamily subgoal should divert resources away from other providers of affordable rental housing. It should. If it cannot, it should study the rationale for the subgoal further before acting.

[7] 2015-2017 Enterprise Housing Goals, 79 Fed. Reg. 54481, 54498 (Sept. 11, 2014).
[8] See David Reiss, *Landlords of Last Resort: Should the Government Subsidize the Mortgages of Privately-Owned, Small Multifamily Buildings?*, 31 W. NEW ENG. L. REV. 915 (2009).

3. Accurately Label Subgoal

The name of the subgoal misrepresents the type of units the subgoal claims to be assisting. The FHFA proposal states, "While the low income subgoal would include all properties with 5 to 50 units, FHFA expects that most Enterprise purchases of mortgages on small multifamily properties will be on properties will be on properties between 25 and 50 units."[9] In addition to being somewhat misleading, the proposed rule implies that the FHFA is aware of the inefficiency involved in favoring small buildings generally.

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Conclusion

As the FHFA sets the housing goals for future years, it should focus on maximizing the creation and preservation of affordable housing. Less efficient proposed subgoals should be rejected unless the FHFA has explicitly identified a compelling rationale to adopt them. The FHFA has not identified one in this case. As such, the proposed small multifamily subgoal should be withdrawn.

Sincerely,

David Reiss

Jeffrey Lederman

Post-Graduate Fellow, Center for Urban Business Entrepreneurship (CUBE) Brooklyn Law School

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[9] 2015-2017 Enterprise Housing Goals, 79 Fed. Reg. 54481 (proposed September 11, 2014) (to be codified at 12 C.F.R 1282), at 54498.