September 15, 2011

Edward DeMarco, Acting Director
Federal Housing Finance Agency (FHFA)
1700 G Street, NW
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Re: Affirmatively furthering fair housing in the disposition of REO properties

Dear Mr. DeMarco,

We are writing in response to the "Request for Information" (RFI) recently issued by the Federal Housing Finance Agency and HUD to solicit ideas for disposition of Real Estate Owned (REO) properties held by Fannie Mae, Freddie Mac and FHA.

We are concerned that the RFI makes no mention of "affirmatively furthering fair housing" as one of the listed goals/objectives of the disposition strategy. We assume this is merely an oversight, as this legal obligation to promote racial integration arises out of the Fair Housing Act and applies directly to the FHFA and its REO disposition policies. This comment letter will be largely focused on how this goal can be achieved, and integrated into the detailed aspects of acquisition and development that the RFI discusses.

We believe that the acquisition of REO properties presents FHFA and HUD with a once-in-a-generation opportunity to expand fair housing choice.[1] Given the fact that the foreclosure crisis has hit middle class and suburban communities, as well urban neighborhoods where a high foreclosure rate is customary, REO properties present an opportunity to acquire rental housing for low income families in suburban, higher opportunity (and in many cases racially integrated) neighborhoods where there is little affordable housing and where it is politically difficult to build multifamily developments.

One of the biggest barriers to the acquisition and rehab of REO properties on a scattered site basis is that neither HUD housing programs, the LIHTC program nor conventional sources of financing lend themselves well to acquisition and rehab of single family or small multifamily units.[2]

[1] The Administration should not make the same mistake that it did with the Neighborhood Stabilization Program in failing to incorporate fair housing goals and requirements. In NSP, the silence on fair housing, coupled with the definition of areas of "greatest need" based on volume of foreclosure and subprime activity, deterred HUD, states and local governments from allocating NSP funds for acquisition of properties in higher opportunity areas – a missed opportunity for fair housing. Worse, as we pointed out in civil rights comments on that program, NSP may have exacerbated the problem of concentrated poverty, because the requirement to serve families below 50% of AMI was generally addressed through rental housing, and allowed or encouraged rental housing to be located in the "neediest" areas that already have a concentration of affordable rental housing, instead of more strategically targeting rental housing to high opportunity areas and maximizing homeownership strategies in lower income areas.

[2] See "Analysis of Impediments to Fair Housing in HUD's Affordable Housing Programs" (December 22, 2009), www.prrac.org/pdf/HUD_Impediments_Memo.pdf

A necessary key to getting affordable housing in high opportunity areas, whether through REO disposition or otherwise, is for HUD and FHFA to develop a vehicle for financing portfolios of single family or small multifamily properties. Former FHA Commissioner William Apgar has recommended a series of steps that could be taken in this direction:

> ***Preserve the Existing Stock of Affordable Rental Housing*.** Although public attention now focuses on subsidized rental housing, preserving the stock of affordable, privately owned, unsubsidized single-family and small multifamily rental units is equally critical. Lack of suitable financing vehicles is, however, a major obstacle. Once again, there is a need to explore new wholesale approaches to accessing capital for this section. One approach is to perfect "pooled approaches" where a set of individual properties are financed with a single mortgage transaction. On the equity side, current policy discussions would do well to consider how best to create new types of real estate investment trusts capable of combining private capital with federal state and local resources, and in doing so reduce costs associated with obtaining subsidies on a project by project basis.[3]

Our recommendations include both "passive" regulatory approaches to ensuring more re-purposed REO properties in higher opportunity areas, plus more active programmatic strategies and incentives to embed fair housing goals and outcomes into the federal government's REO disposition policies and strategies.

Among the "passive" regulatory conditions that Treasury/HUD/FHFA could adopt to promote high opportunity rental housing development include:

- A general duty to affirmatively further fair housing – which would need to be further spelled out through measures like those listed below.
- A requirement that disposed properties in higher opportunity areas with a low percentage of affordable rental housing (to be identified by HUD using its Picture of Subsidized Housing database and GIS mapping) should be used for rental housing as the default option. Any proposal for homeownership or non-housing use would require justification and a showing that other uses would better AFFH.
- A prohibition on discrimination based on source of income (including Section 8 vouchers) in acquired REO properties, and/or a set-aside of a number/percentage of properties in high opportunity locations for rent to voucher holders.
- A right of first refusal for PHAs, non-profits, or private owners to purchase properties in high opportunity areas, similar to HUD's Asset Control Area program, with the intent to attach an ACC operating subsidy, project-based vouchers, or plan to lease them to tenant-based voucher holders.
- Require market participants to meet certain affordable housing and fair housing goals for the portfolio that they acquire, such as a specified number or percent of units used for affordable rental. The percentage would be higher in high

[3] William Apgar, *Rethinking Rental Housing: Expanding the Ability of Rental Housing to Serve as a Pathway to Economic and Social Opportunity***,** Harvard Joint Center for Housing Studies (December 2004) W04-11 at 8.

opportunity areas and lower in distressed areas that already have large concentrations of public and assisted housing.
- Affirmative fair housing marketing requirements for sale and rental of properties to households least likely to apply in the area where each property is located, and a prohibition on discriminatory local residency preferences.
- Compliance with other fair housing requirements, including federal, state and local disability accessibility requirements for renovations in single and multi-family housing.

More active measures by which Treasury/HUD/FHFA could provide financing, loan products, subsidies and/or other proactive and programmatic measures to facilitate the use of acquired REO properties in higher opportunity areas for affordable rental use include:

- Development of a loan product that would finance or insure an entire portfolio (or whole packages in a defined geographic area) of REO properties acquired by purchaser. This could be limited to certain purchasers – such as those who commit to reuse the properties for affordable rental housing and to AFFH by certifying that some/most will be located in neighborhoods that meet some opportunity criteria and will be affirmatively marketed, accept vouchers, or be part of a project-based scattered site development. Properties in locations served by high performing schools, low poverty, etc. are likely to be desirable rental properties and sound investments with less risk for the lender/insurer than rentals in high poverty areas with a lot of competing affordable rental housing.
- Making properties in defined high opportunity areas available on a “first look”/non-competitive basis to affordable housing developers/operators who commit to reuse as rental housing in conjunction with a federal or state housing program, e.g. Section 8, replacement public housing, LIHTC, HOME etc. (see above).
- Extending the discounts already offered by FHA to local governments and affordable housing developers to properties located in high opportunity areas as well as in revitalization areas. The discount should be increased to at least 50% if they are expected to find other sources of rehab financing.
- Streamline or grant waivers from current HUD development regulations and procedures to facilitate the use of existing HUD subsidy allocations to purchase REO properties. For example, HUD’s development regulations (24 CFR Part 941) make scattered site acquisition and rehab very cumbersome, if not impossible. PHAs and their development partners should be able to access HUD public housing Capital Funds, Replacement Housing Factor funds, HOPE VI and Choice Neighborhoods funds to acquire properties without first having to identify specific properties and obtain site control. As described above, instead, PHAs should be allowed and encouraged to finance the acquisition of packages of REO properties that will subsequently be identified based on certain location criteria and approved rehab standards. Similarly, the Treasury Department should encourage or require state housing finance agencies that allocate Low Income Housing Tax Credits to relax site control requirements for LIHTC applications and other requirements that impede use of LIHTC in connection with acquisition

of scattered site single family REO properties. These site control requirements should be replaced with more flexible site selection guidelines that do not necessitate site control just to file an LIHTC application.

- Grants to non-profits and local governments and for-profits with a track record of owning and operating affordable housing for predevelopment costs associated with participating in REO acquisitions and for building greater capacity for scattered site property management. These grants could be funded from the proceeds received by the federal government from sales of the REO inventory.
- Management and operation of single family rental properties is often more expensive than management of multi-family properties. Treasury, FHFA, or HUD should take this into account in pricing properties. Alternatively, they should provide a boost in operating subsidies paid to the owners of REOs operated as affordable rental housing through the various HUD subsidy programs (Section 8 contracts, portable vouchers, or ACC operating subsidies). Funding for this boost should ideally come from the proceeds of REO disposition, and not from the regular HUD budgets for these programs.

There are already some small scale examples of PHAs and developers who have been attempting to take advantage of the foreclosure crisis and weak market to acquire properties for rental use, and some have even been located in high opportunity areas.

- Montgomery County, Maryland for example, targeted its application to the state for NSP funds specifically on the acquisition of properties for ownership and management by its PHA (the Housing Opportunity Commission) and reuse of those properties as subsidized rentals.
- In the Baltimore region, the Housing Authority of Baltimore City has provided both capital and operating assistance for the acquisition of REO properties and other properties glutting the market. Some have been located in high opportunity suburbs, while others have been located in stable city neighborhoods that have little or no assisted housing. These units are replacement housing for distressed public housing that was previously demolished, and replacement housing resources such as HOPE VI, Replacement Housing Factor, ACC operating subsidy, and Housing Choice Vouchers have been used to provide the financing packages.

Although these initiatives are small in scale, it should be remembered that they were carried out in an environment that did not facilitate REO acquisition, and instead imposed barriers. With appropriate incentives, resources and streamlined processes, these types of initiatives could achieve greater scale, and help reduce costs of disposition of the REO portfolio.

Creating strong incentives for rental housing acquisition in high opportunity areas will advance fair housing goals, but can also achieve related policy goals. Communities will benefit if properties are put into the hands of responsible affordable housing owners and managers rather than into the hands of speculators willing to pay a higher upfront dollar. Local housing markets will benefit if properties are taken off the market and disposed of for affordable rental use, rather than homeownership, so that they do not compete with properties listed for sale in an already glutted, sluggish market. Even the GSEs and FHA are likely to benefit by selling properties more quickly than bearing the mounting costs of holding and maintaining REO inventory.

Thank you for the opportunity to present these comments, and we would be pleased to meet with your staff to discuss our recommendations in more detail.

Sincerely,

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