



National Community
Stabilization Trust

**Testimony before the Federal Housing Finance Agency
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December 2, 2019**

The National Community Stabilization Trust (NCST) is grateful for the opportunity to comment on Fannie Mae and Freddie Mac's Duty to Serve plans.

NCST is a national, non-profit organization that works to restore vacant and abandoned properties to productive use, prevent blight, and support affordable homeownership. Established in 2008, NCST has enabled the rehabilitation of almost 27,000 REO properties, including approximately 6,500 properties acquired through the Neighborhood Stabilization Initiative partnership among FHFA, NCST, Fannie Mae, and Freddie Mac.

DUTY TO SERVE PROGRESS TO DATE

NCST commends FHFA for the robust and inclusive process it has undertaken beginning in 2016 with the revised proposed rule for the Duty to Serve requirement established by the Housing and Economic Recovery Act of 2008. Throughout its implementation of Duty to Serve, FHFA has run a remarkably open and accessible process, enabling external stakeholders to provide input into activities of the utmost importance to individuals and markets currently underserved by the Enterprises. We greatly appreciate this level of engagement. The stakeholder outreach, the listening sessions, and the Duty to Serve website have all made it much easier for stakeholders to understand what the Enterprises are being asked to do by FHFA, and what their plans are.

Events since 2008 have demonstrated exactly why there should be public obligations for the Enterprises in exchange for their government backing. Congress chose priorities for Duty to Serve that have been perennial challenges in the affordable housing space: rural areas, manufactured housing and affordable housing preservation. These areas are in the statute because it has been difficult to deploy capital to support them, and Congress wanted the scale and market sophistication of the Enterprises brought to bear to improve our system. As the Enterprises continue into their second decade of government conservatorship the logic of Duty to Serve remains: there should be public benefits in exchange for the Enterprises' government backstop.

As we reflect on the evolution of Duty to Serve since 2016, we would like to offer a few observations about both the process and the outcomes to date. With regard to the Duty to Serve process, it's critical to have a robust and transparent planning process that includes significant input from stakeholders and the public and that

results in meaningful metrics and plans for outreach and engagement with stakeholders. FHFA's work on this has been thorough and thoughtful.

It's also important to have significant accountability, including an evaluation mechanism that rewards the Enterprises for tackling the tougher challenges and detailed reporting that is released to the public. Reporting also helps stakeholders work with the Enterprises and learn from their successes and failures. In future Duty to Serve plans, it would be helpful for FHFA to emphasize that the plans should be concise, which would make them more accessible to stakeholders. It also would also be helpful to emphasize outcomes rather than to belabor process steps. It is less important that the plans be prescriptive about how a goal is to be accomplished than they clear about metrics and outcomes.

NCST did see outcomes resulting from Fannie Mae's decision to choose the Neighborhood Stabilization Regulatory Activity as part of its current Duty to Serve plan. For example, there was some progress on the creation of a Renovation Loan product that can be used by nonprofit developers. NCST commended Fannie Mae for including this regulatory activity in their Duty to Serve Plan, and we remain extremely committed to helping in any way that we can to ensure success in this area. This is an example of how the Duty to Serve process elevates housing challenges and allows access to resources and management focus that these challenges might not otherwise get.

ENTERPRISE PRIORITIES GOING FORWARD

As we look forward to 2020 and beyond, NCST believes that Neighborhood Stabilization is a critical issue that merits being included in both Enterprises' Duty to Serve plans. To this end, NCST recommends the Enterprises undertake the following initiatives:

- Continue to promote renovation mortgages for nonprofits as well as for homeowners, including more effectively recruiting lenders to offer these mortgages.
- Change the definition of "distressed properties" to include all vacant or distressed properties, not just new foreclosures.
- Invest in CDFIs that finance nonprofit acquisition and rehab of distressed properties.
- Pilot new approaches to encourage lenders to make small-balance mortgages.
- Finance affordable, responsibly managed, single-family rental in all geographies.

NCST stands ready to partner with both Enterprises to assist them in conducting outreach and implementing new products and approaches in those neighborhoods whose housing markets remain weak.

WHY NEIGHBORHOOD STABILIZATION

Eleven years after the foreclosure crisis, vacancies continue to plague numerous communities regardless of the rate of REO flow, especially communities of color, those in legacy cities, and those with low income families. As Alan Mallach notes in his report *The Empty House Next Door*, although vacancies have declined from the height of the crisis, they are still significantly elevated: there were 3.7 million vacant properties in 2005 yet 5.8 million in 2016.¹ Many of these vacancies are in areas suffering from what Mallach terms “hypervacancy,” a phenomenon experienced by areas with vacancy rates over 20 percent, where housing markets are far less likely to recover without intervention.²

Although the rates of new REO have declined, vacancies and distressed properties remain a significant challenge for many neighborhoods. Back in 2008, the steep elevation in the vacancy rate was largely due to massive numbers of foreclosures and a correspondingly dramatic increase in new REO inventory. More than a decade later, much of the housing market has fully recovered and the flow of new REO properties is quite low. One reason for that is that delinquencies and foreclosure starts are low due to much tighter credit and a lengthy economic expansion plus historically low unemployment rates. Another reason is that investors are increasingly buying properties before they are taken into REO portfolios, either purchasing them at foreclosure auctions or acquiring them pre-foreclosure as nonperforming loans.

Consequently, vacant properties today are much less likely to be REO or “zombie” properties stuck in the mortgage foreclosure pipeline. Instead, most of these vacant homes are investor-owned. In some cases, the investor is simply waiting for the market to recover before flipping the property. Even if the owner has secured the property and is mowing the lawn on schedule, unoccupied homes (especially those in colder or damper geographies) invariably deteriorate due to weather and lack of maintenance. In other cases, the owners have walked away from the property entirely and written it off, leaving it to the municipality to secure. Many of these properties have cycled through the tax lien/foreclosure/auction cycle multiple times. Still other properties are vacant or abandoned after a natural disaster such as a hurricane or fire.

¹ Alan Mallach, *The Empty House Next Door*, Lincoln Institute of Land Policy and Center for Community Progress (May 2018), p. 4, available at <https://www.lincolninst.edu/sites/default/files/pubfiles/empty-house-next-door-full.pdf>.

² *Id.*, p. 5.

Vacant homes without a mortgage come back on the market for a variety of reasons, including but not limited to the following:

- Tax delinquency and subsequent foreclosure by the local taxing authority or by the owner of a tax lien.
- Being put into receivership due to the owner's failure to remediate code violations.
- Being sold after a lawsuit for nuisance abatement.
- Acquisition due to asset forfeiture in criminal justice situations.

And of course, many vacant homes are sold simply because the market has changed (or appears that it will never change) and the investor is ready to sell.

Additionally, the US housing stock is aging and repair needs are accumulating. According to the Joint Center for Housing Studies, 40% of the US housing stock is at least 50 years old.³ In neighborhoods with lower income or more elderly residents, the homes have often experienced years or even decades of deferred maintenance. Many of these homes were rented out by slumlord investors who failed to make repairs even while tenants were in place.

Regardless of the reason for the vacancy or the sale, older homes are virtually all going to require some level of repair or rehab before they are ready for occupancy. A home that sits vacant for more than six months in most parts of the United States will almost invariably suffer from water intrusion, mold, and/or damage by squatters or thieves.

Critical to preservation of affordable housing in these struggling neighborhoods of older homes is increasing access to competitive financing for nonprofits seeking to acquire and rehabilitate distressed properties. In many markets, nonprofits struggle to compete with for-profit cash investors to purchase these properties. With limited access to funding, especially to equity capital and to reasonably priced debt, responsible, community-minded nonprofit organizations lose out on these properties to private investors and developers looking to maximize rental incomes while putting as little as possible into rehab and maintenance or to flip properties as soon as values rise.

For any neighborhood stabilization program – whether related to Duty to Serve or not – both Enterprises should use a definition of “distressed properties” that encompasses all the dimensions of the problem described above.

³ *Improving America's Housing 2019*, Joint Center for Housing Studies at Harvard University, available at https://www.jchs.harvard.edu/sites/default/files/Harvard_JCHS_Improving_Americas_Housing_2019.pdf.

INVESTMENTS IN CDFIs

NCST believe the Enterprises should resume investing in CDFIs (as well as other nonprofits, land banks and Housing Finance Agencies) that support mission-focused developers seeking to acquire, rehab and resell or rent vacant single-family properties. We are aware that the Enterprises have been restricted from investing in this manner while under conservatorship, but we think the time is right for FHFA not only to permit these critical investments, but to encourage them. Other financial institutions continue to back away from lending in distressed communities, and nonprofits seeking smaller credit facilities are struggling.

Direct investment by the Enterprises in CDFIs will more efficiently and effectively serve the affordable housing preservation market than almost any other initiative. Providing significantly increased access to low or market rate funding for nonprofit affordable housing developers will encourage scalable operations, which in turn would enable those developers to access trades or materials with negotiated terms and/or payments that would lower their total development cost.

Providing direct investment capital is already an element of the Enterprises' Plans in other activities. For example, Fannie Mae proposes to "provide investment capital to non-LIHTC properties that support the preservation of multifamily rental properties that are affordable to workforce families."⁴ Fannie Mae also proposes serving the Rural Housing market by making investments in nonprofits and CDFIs that focus on high-needs rural populations.⁵

CDFIs that work with nonprofit community developers are also in need of this capital. We appreciate that Fannie Mae's Plan acknowledges the need for work in this area, and hope that its revised Plan will provide investment in the immediate or near term.

SMALL BALANCE MORTGAGES

As FHFA has recognized in the past through its Scorecard, many markets lack access to financing for small-balance mortgages. Mortgage lenders, particularly large national banks, have never originated mortgages below \$100,000 at remotely the same scale as they originate larger mortgages, but in recent years, according to the Urban Institute, the numbers have dropped even more.⁶ This credit gap has a disproportionate effect on distressed areas where property values remain low and even larger homes sell for fairly low prices. Not only does lack of access to credit provide an obstacle to homeownership, but it also opens the doors to predatory products that can leave families significantly worse off, such as land installment

⁴ Fannie Mae Plan, p. 114

⁵ Fannie Mae Plan, p. 163

⁶ Ellen Seidman, "Where Have All the Small Loans Gone," (Urban Institute, 4/18/2017), available at <http://www.urban.org/urban-wire/where-have-all-small-loans-gone>

contracts.

This problem most likely stems from two structural aspects of the mortgage market. First, compensation in the mortgage industry – realtors, mortgage brokers, and servicers, among others – is largely based on percentage commissions rather than on salaries or flat fees. There are some interesting exceptions at large banks or mortgage lenders that pay loan officers a salary to work in the “affordable” sector, but by and large the most capable loan officers gravitate to the commission structure where there is more money to be made.

Second, mortgage origination costs are largely fixed regardless of home price, and therefore a lender sees a larger profit when selling a larger mortgage. While there are robust conversations taking place regarding ways to reduce compliance costs and other origination costs, even if the fixed costs are reduced, that change will not fundamentally change the nature of the problem.⁷

Fannie Mae and Freddie Mac have tools that could help push against the tendency of lenders to avoid small balance lending. For example, the Enterprises could reduce guarantee fees (or at least the risk-based LLPA fees) for these loans, as they have for their low-down-payment, affordable-homeownership products. Or, they could require that lenders selling loans to them deliver a certain percentage of small balance loans calibrated to the lenders’ service areas.

It is also noteworthy that small balance loans are often a specialty of CDFIs and HFAs, so the investment opportunities discussed above could also help to address the access to small balance credit problem that continues to cripple distressed housing markets.

AFFORDABLE AND RESPONSIBLY MANAGED SINGLE FAMILY RENTAL

More than half of all renters reside in single-family homes (defined as properties with one to four living units).⁸ The market has grown dramatically since the foreclosure crisis, as it appears many families who lost their homes during the crisis moved into another single-family home rather than an apartment.⁹ In many neighborhoods, single-family homes constitute the greatest source of naturally occurring affordable rental housing.

Unfortunately, current record-high rents and a shortage of units enable landlords – who often do not live in the same community – to rent out distressed properties

⁷ Most proposals for reducing fixed costs include some kind of deregulation, which could leave the market vulnerable to another crisis.

⁸ U.S. Census Bureau, “Historical Census of Housing Tables,” available at <https://www.census.gov/hhes/www/housing/census/historic/units.html>

⁹ Aaron Terrazas, “Own-to-Rent: The Foreclosure Crisis and Single-Family Home Rentals,” August 2, 2016, Zillow, available at <https://www.zillow.com/research/single-family-home-rentals-12933/>

without any market pressure to repair them. In some instances,¹⁰ owners of distressed properties pass off their responsibility to maintain rental units onto the tenants under the guise of predatory products such as "rent-to-own" schemes or land installment contracts.¹¹ Unscrupulous investors are further aided by online auction sites,¹² which enable people around the globe to source low-value properties¹³ on the cheap, either collecting rent payments until the home falls apart¹⁴ or simply waiting until home values rise to flip them.

In our view, the Duty to Serve mandate to preserve affordable housing should include addressing the severe abuses and waste taking place in the single-family rental market as described above. For this reason, NCST recommends that Fannie Mae and Freddie Mac explore how best to support nonprofits or other mission-driven organizations that desire to enter into the single-family, scattered-site rental market to provide better affordability, habitability, and tenant protections than private operators. NCST works with hundreds of mission-based nonprofits and developers who purchase and rehabilitate distressed properties, and some of these groups also would like to scale up their work in the single-family rental market — but only if they can access capital at a price that makes their good work achievable.

CONCLUSION

Duty to Serve was developed by policymakers specifically because the areas on which it focuses are inherently more difficult and complex than standard mortgage lending. Over the first couple of years of this work, the Enterprises have repeatedly discovered how challenging these issues are. This level of challenge should not be a reason to ease up on Duty to Serve efforts, but rather a reminder that this work requires intensive effort. To help the Enterprises manage this difficult work better, NCST recommends that FHFA give the Enterprises broader flexibility to alter their strategies as they learn, while still using clear metrics to determine whether

¹⁰ Alexandra Stevenson and Matthew Goodstein, "Rent-to-Own Homes: A Win-Win for Landlords, a Risk for Struggling Tenants," *New York Times: DealBook*, August 21, 2016, available at <https://www.nytimes.com/2016/08/22/business/dealbook/rent-to-own-homes-a-win-win-for-landlords-a-risk-for-struggling-tenants.html>

¹¹ Sarah Edelman, Michela Zonta and Julia Gordon, "Lease Purchase Failed Before – Can It Work Now?" (Washington: Center for American Progress, 2015), available at <https://www.americanprogress.org/issues/economy/reports/2015/04/29/112014/lease-purchase-failed-before-can-it-work-now/>

¹² Christopher E. Herbert, Irene Lew and Rocio Sanchez-Moyano, "The Role of Investors in Acquiring Foreclosed Properties in Low- and Moderate-Income Neighborhoods: A Review of Findings from Four Case Studies," (Joint Center for Housing Studies, Harvard University, 2015), available at http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/w13-11_herbert_lew_moyano.pdf

¹³ Justin Weir, "Out-of-state homeowners hinder fight on blight," (Youngstown, Ohio: *Vindicator*, September 25, 2016), available at <http://www.vindy.com/news/2016/sep/25/out-state-homeowners-hinder-youngstowns-fight-blig/?print>

¹⁴ Frank Ford, *et al.*, "The Role of Investors in The One-To-Three Family REO Market: The Case of Cleveland," (Joint Center for Housing Studies, Harvard University, 2013), available at http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/w13-12_cleveland_0.pdf

Enterprise performance was satisfactory in order to achieve the outcomes we all would like to see. Thank you again for the opportunity to share our thoughts concerning the Duty to Serve requirements.