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VIA E-MAIL AND
FEDERAL EXPRESS

Federal Housing Finance Agency
OHRP Multifamily Housing Policy
400 7th Street, S.W., Room 9-261
Washington, DC 20024
multifamilypolicyissues@fhfa.gov

RE: ***Proposed Reduction of Fannie Mae and Freddie Mac Multifamily Businesses***

Ladies and Gentlemen:

On behalf of RED Capital Group, LLC ("RED") and its stockholders and employees, we respond with this letter to the request for comments, dated August 9, 2013 (the "RFC"), issued by the Federal Housing Finance Agency ("FHFA" or the "Agency") regarding a proposed reduction in Fannie Mae and Freddie Mac (the "Enterprises" or "GSEs") multifamily lending authority in 2014. By way of background, RED is a licensed Fannie Mae Delegated Underwriting and Servicing ("DUS") and Federal Housing Administration ("FHA") lender headquartered in Columbus, Ohio. Since 1990, the firm and its predecessors have provided in excess of $52 billion of capital to the multifamily and seniors housing industries, including more than $17 billion of loans guaranteed by Fannie Mae. RED currently services nearly 2,000 Fannie Mae and FHA apartment and senior housing and health care loans with total outstanding principal balances exceeding $17 billion.

Before responding to the RFC, we would like to express our gratitude to the FHFA for its admirable performance as conservator during challenging times. Over the past five years, the Agency has guided the GSEs with a steady hand and a deft touch, successfully balancing the needs of the housing industry for liquidity and funding and the interests of taxpayers for safe and sound operations. We commend the FHFA for restoring confidence in the Nation's housing finance market and for preserving Enterprise assets and human capital. RED also would like to express our thanks to the Agency for granting us the opportunity to respond to this proposed reduction in GSE lending authority.

As a threshold matter, we wish to address whether further reduction in Enterprise multifamily lending authority is advisable and in the best interests of the American public. On balance, we contend that it is not.

The GSE multifamily lines of business ("GSE LoB") are critical components of the Nation's multifamily credit markets that provide liquidity and stability at all points of the credit cycle and to geographic and product markets in which private capital is often limited or non-existent. The FHFA will do well to employ its power as conservator to preserve the capabilities of the GSE LoB and refrain from taking action that may diminish their economic value.

Congress chartered the Enterprises to provide liquidity, stability and affordability to the U.S. housing and mortgage markets. This mission was augmented in conservatorship to include a safety and soundness provision intended to protect the interests of American taxpayers. In the multifamily sector, the GSE LoB are fulfilling this dual mission precisely as intended: originating strong, carefully underwritten, low-risk loans and providing needed liquidity to the market, while accommodating private capital initiative.

With respect to credit exposure, there is little evidence that the GSE programs pose a material risk to taxpayers. Historical and current asset performance in both portfolios is excellent: the rates of 60-day delinquency in the Freddie and Fannie multifamily programs during the first quarter 2013 were 0.16% and 0.39%, respectively, and defaulted loans account for less than 0.6% of Freddie Mac's total book of business. Moreover, neither the Fannie DUS nor the Freddie Program Plus lending program ever generated an annual loss to their respective Enterprise. Indeed, during the first three years of the conservatorship period, the programs generated more than $7 billion of pre-tax profit, funds that now benefit the Treasury directly.

The credit performance of GSE LoB portfolios is attributable to the best-in-class underwriting guidelines that govern GSE lending; the close alignment of interests that exists between the GSE LoB and their lending agents; and the prudent loan underwriting that this alignment of interests gives rise to. The risk-sharing and private capital participation elements incorporated in the DUS and Program Plus lending channels represent models to be reinforced and emulated rather than constrained.

Nor does one find clear evidence that the Enterprises are inhibiting or dis-incentivizing private capital participation in the market. Rather, life insurance companies, securitization conduits, commercial banks and finance companies are building market share at the expense of the GSE programs as the multifamily property and capital markets recover and grow.

Data compiled by the Mortgage Bankers Association support this assertion. According to the MBA, the GSE LoB originated 59 percent of multifamily mortgage credit during the height of the credit crunch in 2009, but only 41 percent in 2012. Furthermore, preliminary data for the first half of 2013 indicate that GSE market share decreased significantly again. Indeed, we see commercial banks and insurance companies competing fiercely for multifamily product, often offering more competitive loan terms than the GSE LoB.

As a result, GSE multifamily portfolios are no longer expanding on a net basis even as industry credit demand has grown significantly. According to data published by the Federal Reserve Board (*Accounts of the United States Table L.219*), GSE LoB loan portfolios increased by about $600 million (0.2 percent) between March 31, 2012 and March 31, 2013, while total U.S. multifamily mortgages outstanding increased by a net of $30.7 billion (3.7 percent). Moreover, preliminary data suggest that GSE LoB portfolio balances were unchanged in the first half 2013 as portfolio maturities offset new loan originations.

At the same time, the need for capital in the multifamily housing sector never has been greater. The Census Bureau reports that the number of American renter households increased by 3.6 million over the past four years, while the number of homeowner households declined by more than one million. During this period, rental occupancy rates increased significantly and the resulting tight markets have given rise to rent increases significantly exceeding the rate of inflation, adding to the cost burden of renter families.

Due to a combination of demographic and economic changes and long-term shifts in household housing preferences, the demand for rental housing is likely to continue to grow at a rapid pace. In our view, satisfying this demand for rental housing will be impossible without the full participation of the GSE LoB. Were we to fail as a nation to meet this challenge, the result will be increased household rent burdens; decreased worker mobility; reduced consumer choice; and slower economic growth.

We agree that private capital should assume the preponderance of risk associated with real estate development, investment, lending and management and believe that it does. However, private capital initiative alone is not sufficient to accomplish all of society's housing policy goals; nor is it capable of providing adequate capital to the broader market at all points of the credit cycle.

Rather, the Enterprise multifamily programs have proven, through the loan products, terms and structures they offer, to be essential elements of the mortgage capital markets, ensuring liquidity and lending capacity under all economic circumstances and to every industry segment and geographic area. The FHFA will do well to preserve these critical sources of capital and refrain from undertaking policy changes that may impair their competitive capabilities, damage their relationships with borrower clients, or otherwise diminish their economic value.

Arguably, a public policy objective can be identified for contracting the GSE multifamily footprint: to prepare for a reformed housing finance market that will evolve along the lines drawn in future Congressional lawmaking. Although the outlines of such legislation can only be imagined, a recent proposed bill sponsored by Senators Bob Corker of Tennessee and Mark Warner of Virginia provides an architectural blueprint of reform that has received broad conceptual support from the Obama Administration and the housing industry. The draft proposal recognizes the critical role played by the GSE multifamily programs; distinguishes them from the single-family lending programs on the basis of their strong underwriting and existing risk-sharing elements; and explicitly provides for their preservation as components of the proposed Federal Mortgage Insurance Corporation. In consideration of the endorsement of the Enterprise multifamily programs in the Corker-Warner legislation, we believe that it would be imprudent for the FHFA to take action that may prove contradictory to the will of Congress.

Addressing Proposed Alternatives for Reducing Enterprise Multifamily Business in 2014

Should the FHFA nevertheless choose to take action to further contract GSE lending authorities, we recommend that it proceed with the following principles in mind:

- Act only in ways that will not materially harm existing business relationships between borrower clients, the Enterprises and program lenders;
- Maintain GSE LoB market competitiveness and relevance, and desist from actions that will contribute to the loss of existing human capital and expertise;
- Preserve the ability of the GSE LoB to address market dislocations, disruptions and distress;
- Refrain from taking actions that will stifle innovation and structural creativity and thereby hinder the GSE from crafting strategic financial solutions for borrower clients;
- Avoid ending powers that Congress in future legislation may consider necessary and prudent for the GSE LoB;
- Preserve the asset value of the Enterprises under its control in accordance with its fiduciary duty as conservator; and
- Move with due caution and careful deliberation to limit unintended consequences of policy shifts.

Limiting Permissible Loan Maturities

The RFC identifies four potential areas where GSE LoB authorities could be limited with a view toward encouraging greater private capital participation in the mortgage market. The first option for which the FHFA requests comment involves limiting the range of terms to maturity that the Enterprise lines of business may offer. Specifically, the RFC proposes that the GSEs be proscribed from making loans with maturities shorter than seven years.

The RFC correctly points out that short-term loans account for a small percentage of GSE LoB lending volume and may be considered a non-core business activity. Moreover, commercial banks are active lenders in the "mini-perm" segment of the market, which naturally complements their construction and bridge loan activities, perhaps negating the need for GSE participation.

But truth is more complex. We hold the view that it is imprudent to prohibit the GSE LoB from engaging in shorter-term lending as it may hinder risk-taking by property developers and equity investors and thereby inhibit new apartment supply, and increase balloon refinancing risks, especially during periods of high or rising interest rates.

It is important to recognize that 'mini-perm' products are often used by 'merchant builders,' developers who follow a strategy of building new properties and selling them only when the operations of the property are fully-stabilized, a period that often extends beyond the term of standard construction loans. The willingness and ability of merchant builders to pursue this strategy is critical to encouraging sources of equity capital to assume apartment construction and lease-up risks. Access to advantageously priced, fixed-rate financing that is not encumbered by long-dated prepayment penalties is essential to the success of this strategy.

Likewise, intermediate-term fixed-rate products are essential tools for investors with shorter-term investment horizons. Participation by investors that do not have long-term hold objectives provides an important source of liquidity to the property markets that encourages developers and equity investors to take on risk.

In addition, during periods of high or rising interest rates, short-maturity loans may represent the most advantageous borrowing option for property owners as they often bear lower interest rates than longer maturity alternatives. Indeed, mini-perm loans may represent the only viable method to refinance maturing debt when interest rates are high. A scarcity of mini-perm debt during periods of interest rate stress could increase balloon maturity defaults.

Overreliance on commercial banks to provide mini-perm financing places this important market in jeopardy as the appetite among banks for intermediate-term, fixed-rate assets with commercial real estate exposure varies over time due to regulatory credit risk and risk-based capital considerations and changing asset/liability management objectives. Enterprise short-term lending authority plays an important supplemental role in the mini-perm market and the FHFA would be wise to maintain this capability.

Prohibiting Certain Specially-tailored Loan Products

The second line of inquiry by the FHFA involves eliminating certain "specially-tailored" loan structures. The RFC mentions interest-only provisions, credit facilities and supplemental loans specifically as loan products that may be prohibited.

We contend that it would materially diminish the market competitiveness of the GSE LoB were they prohibited from offering interest-only structures, loan credit facilities and supplemental loans, common lending options that provide strategic benefits to investors bidding on properties for sale or undertaking rehabilitation and repositioning projects. Indeed, virtually all of RED's balance sheet lending is structured on an interest-only basis for this reason. Ending this authority will serve only to limit borrower options; reduce healthy competition among lenders in the acquisition and development loan segment; inhibit financial innovation; and dilute the franchise value of the GSE LoB to the detriment of the taxpayers.

This section also mentions standardizing competing Fannie Mae and Freddie Mac programs to allow private capital sources to compete by way of innovation and flexibility. The narrative suggests that diverse GSE LoB product lines may discourage development of alternative sources of financing.

We do not believe this to be the case. The market has consistently demonstrated that the singular approaches of Fannie and Freddie Mac are complementary rather than duplicative. By the same token, the varying approaches to the business pursued by Fannie Mae and Freddie Mac have not discouraged development of alternative channels as demonstrated by the market share gains made by private securitization conduits at the expense of the GSE LoB at various times over the past twenty years.

It would not serve the interests of borrowers or the taxpayers to eliminate one or the other method of doing business. It also should be noted that the draft language of the Corker-Warner legislation explicitly provides for the preservation of both the DUS and Program Plus lending platforms following conservatorship resolution. Therefore, it would be imprudent, in our view, to act pre-emptively by eliminating one program or merging the separate platforms into a single hybrid through product standardization or adopting common loan terms.

Property Type or Loan Balance per Unit Constraints

The third proposed method of shrinking Enterprise lending involves more narrowly defining the range of property types that may be financed. Specifically, the RFC cites properties with rent levels affordable only to upper income households and properties where the ratio of loan balance to property units is unusually high as business opportunities from which the Enterprises could be prohibited.

We are sympathetic to the notion that entities that benefit from a real or perceived credit subsidy from the federal government and the taxpayers should focus largely on activities that serve to forward social policy goals. Indeed, the Enterprises meet this test as the overwhelming percentage of their multifamily lending activities is concentrated in assets that are affordable to households earning the area median income or less. By the same token, healthy markets consist of housing that meets the needs and expectations of the full-spectrum of American households, and it does not serve the public interest to prohibit the flow of capital into any segment of the market where prudent lending is possible, particularly during periods of credit market stress when private capital sources may be unwilling or unable to participate.

Limits on Refinance Activity and Portfolio Lending

The fourth proposed means of reducing the Enterprise footprint is to reduce the scope of GSE LoB product offerings. Specifically, the RFC cites lending that does not create new liquidity in the marketplace; involves the purchase of seasoned loan portfolios or creates loan products that cannot be securitized and sold to investors.

The first proposal appears to refer to maturing loan refinance. We believe that prohibiting the Enterprises from engaging in refinance activity would significantly add to refinance risk in the marketplace and thereby have a chilling effect on all segments of multifamily finance, from equity accumulation to construction and permanent lending.

With respect to the purchase of seasoned loan portfolios, we do not perceive any benefit in prohibiting this practice so long as the loans may be securitized and sold by the Enterprises in the normal course of business. Providing for an efficient secondary market in multifamily loans is among the Enterprises' primary functions. To prohibit the practice of providing liquidity to commercial bank and other originators will only serve to reduce their ability to offer new loans to creditworthy borrowers and reduce the volume of available capital.

By contrast, we believe that the Enterprise's current practice of originating only loans that can be securitized and sold to investors is prudent and consistent with the public interest. Were the FHFA to require securitization and sale as a matter of policy, we do not believe that it would have a material detrimental impact on GSE LoB operations. On the other hand, we recommend any policy of this nature should include exceptions for special products related to affordable housing or furtherance of some other social policy objective.

Other Suggestions to Reduce GSE Multifamily Lending

Finally, the FHFA asks commenters to suggest other means of achieving the strategic goal of reducing Enterprise lending volumes. As we have expressed previously, we recommend that the Agency refrain from taking action that directly affects Enterprise lending flexibility and creativity. If a constraint on GSE LoB lending authority must be chosen, a quantitative method is preferable. Quantitative constraints will give LoB executives discretion to manage their lending activities and client relationships in the least disruptive manner possible and thereby carryout their mission to provide liquidity and stability to the market while preserving valuable systems and human capital in place and protecting franchise value.

We believe that a market share constraint would be the most effective quantitative method of reducing the GSE LoB footprint. The FHFA may wish to articulate an "a priori" market share objective for 2014 and continually monitor production levels and portfolio growth for conformity with the target. When production is inconsistent with the previously announced goal, the Agency could take action to restrict lending authority for the remainder of the calendar year.

This approach would have a three-fold benefit. First, it would achieve FHFA lending volume objectives, an outcome that is not assured by a policy of restricting product or collateral lending powers. By the same token, it would not diminish franchise value or necessarily deprive the market of needed capital. Finally, it would provide the FHFA with greater flexibility to change course during the year to adjust to changed market circumstances.

RED appreciates the opportunity to comment on this vital matter. We hope that our contribution is helpful to the Agency and its staff in their efforts to develop policy that forwards the best interests of Americans and the multifamily housing industry. Please feel free to reach out to us to further this discussion (614-857-1400).

Respectfully,

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