August 12, 2016

Administrator Tony Hernandez
Rural Housing Service
United States Department of Agriculture
Room 5014, Mailstop 0701
1400 Independence Avenue, S.W.
Washington, DC 20250

Dear Administrator Hernandez:

Thank you for your May 31, 2016 response to CARH's April 13, 2016 letter on several items regarding the Section 538 Guaranteed Rural Rental Housing Program. The undersigned write to ask the Rural Housing Service (RHS) to give further consideration to the four program improvement suggestions outlined in CARH's April letter. In addition, we are concerned with reports that you cannot issue any additional guarantees this fiscal year because you have exhausted the authority given to you in the Consolidated Appropriations Act, 2016 (P.L. 114-113).

The four improvement requests discussed in the above-noted letters are: i) eliminate the NOFA and NOSA process to allow smoother, year-long underwriting and origination; ii) reduce the annual guarantee fee commensurate with similar loan products; iii) use the Section 538 program for refinances; and iv) allow the "continuous guarantees" to be underwritten with Ginnie Mae's 70 percent loan-to-cost ratio.

The undersigned seek to voice further support for the elimination of the NOFA and NOSA process and reduce the annual guarantee fee commensurate with similar loan products. We believe that these efforts will help smooth out Section 538 originations and make for a more accessible and cost effective program. The NOFA/NOSA has caused delays and in some cases confusion as to the intent of NOFA/NOSA language relative to the 7CFR 3565 regulations. Eliminating this unnecessary step will bring program efficiency. Reducing the annual fee will create cost savings and lessen material operating cost. We understand the need for the annual fee, and believe that it is essential for the program as Section 538 is not funded through appropriations, but we also believe the fee should be no higher than necessary.

As to the two other points, we ask RHS to consider further our requests to use the Section 538 program for refinancing and for continuous guarantee for construction and permanent loans. The 70% loan-to-cost adjustment was the key step in modernizing the Section 538 program and bringing it close in application to other lending programs. The industry had expected RHS would extend this change to all Section 538 loan products, but it has not.

We understand the continuous guarantee is called "Option Three" under 7 C.F.R. Section 3565.52(c). This process allows an applicant to apply to a RHS approved lender for a loan guarantee that would function from the start of construction all the way to completion of construction and implementation of the permanent loan. Multifamily housing is generally financed with different lenders for the construction loan phase and for the (non-construction) permanent loan phase. Some lenders provide underwriting for both phases, with loan terms from construction into lease-up and the permanent loan; this is the FHA-Ginnie Mae model. Access to this form of credit is extremely important in the preservation of existing housing that is going through rehabilitation, as well as new construction. This form of credit is also very limited or nonexistent in rural areas.

We ask that RHS allow Section 538 transactions to benefit from the 70% loan-to-cost ratio that exists for other types of Section 538 loans. Indeed, this would allow Section 538 loans to join the state of the art lending processes used in modern multifamily lending so Section 538 can be used for straight refinancing. We understand that the 70% loan-to-cost ratio was fully approved by Ginnie Mae and we thank you for RHS's efforts to provide data to Ginnie Mae to support this new policy. We also understand that the new 70% loan-to-cost approval has not been successful yet because applicants need this form of financing and Section 538 is not providing at a loan-to-cost that is readily financeable.

RHS limits the Section 538 program to low loan-to-cost ratios. That said, 70 percent is already a low loan-to-cost ratio program. Loan-to-cost limits in other programs for similarly sized affordable housing loans range from 80% to 90%. (See HUD Mortgagee Letter 2014-18). Keeping the 50% loan-to-cost ratio for continuous guarantees creates an unnecessary barrier to credit in rural areas. Therefore, we submit that RHS should revise its policy so as not to have lower loan-to-cost ratios on the continuous guarantee than on other guarantees.

Separately, we also ask RHS to reconsider its response regarding refinancing. We appreciate RHS's work on mortgage modifications and refinancing of existing Section 538 loans to benefit from market efficiencies like lower interest rates. We appreciate that Rural Development is now allowing a simple and rapid note modification process, which generally addresses owner needs to refinance existing Section 538 loans. However, lenders working with the Section 538 program report significant interest from potential borrowers other than existing Section 538 borrowers to refinance existing non-Section 538 loans with Section 538 loan product. Refinancing existing loans tends to result in extremely stable new loans as they are underwritten with actual property performance, enhancing loan performance predictability and contribute to the mission of supporting affordable rural rental housing.

We understand that RHS operates under the 7 CFR 3565.206 rule that limits Section 538 loan proceeds to refinancing outstanding debt to situations where the refinancing is in the government's interest or furthers the objectives of the program. We recommend that RHS confirm that refinancing existing Section 538 loans or Section 515 loans that are allowed to prepay, or other existing affordable rental rural housing loans to more reasonable terms would bring much needed credit to rural areas and would further the government's interests as well as further the objectives of the program. The multifamily property industry continues to struggle with credit availability in rural areas, even as many urban areas have access to many affordable housing and market rate loan product. The Section 538 program is built to address this credit issue. As such, this refinancing request is well within existing regulatory limits.

We also have one other important housekeeping point. We ask RHS to advise the industry on the current availability of authority for new Section 538 guarantees on a quarterly basis, with real-time updates as each fiscal year closes. We understand that the authority has been used for the 2016 fiscal year. No doubt this creates a crisis for transactions seeking to close in August, September and possibly later this year since it appears that it will be several months into FY 2017 before a full year appropriation bill is passed by Congress and signed into law. The industry would appreciate disclosure of this information so as to know the expected needs for next year. As you know, the Administration has requested higher Section 538 program authority for FY2017. Current usage information would be extremely helpful in explaining to Congress that RHS is now using its full year allotment within and before the end of the fiscal year.

We appreciate your continued, progressive assessment of the Section 538 program and we hope to hear soon about the above requests. If you have any questions or need further information, please do not hesitate to contact Colleen Fisher, Executive Director of the Council for Affordable and Rural Housing at (703) 837-9001.

Sincerely,

Council for Affordable and Rural Housing
Mortgage Bankers Association
National Affordable Housing Management Association
National Apartment Association
National Leased Housing Association
National Multifamily Housing Council

cc: Bryan Hooper, Deputy Administrator, Multifamily Housing
David Lipsetz,, Associate Administrator, Rural Housing and Community Facilities
Michael l Steininger, Director, Multifamily Housing