NAAHL | National Association of **Affordable Housing Lenders**

January 16, 2024

The Honorable Martin Gruenberg
Chair
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, D.C. 20429

The Honorable Michael Barr
Vice Chair
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave. NW
Washington, D.C. 20551

The Honorable Michael Hsu
Acting Comptroller
Office of the Comptroller of the Currency
400 7th Street SW
Washington, D.C. 20219

Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity: FDIC RIN 3064–AF29; FRB Docket No. R–1813, RIN 7100–AG64; OCC Docket ID OCC–2023–0008

Dear Chair Gruenberg, Vice Chair Barr, and Acting Comptroller Hsu:

The National Association of Affordable Housing Lenders (NAAHL) appreciates the opportunity to comment on the Notice of Proposed Rulemaking (NPR) for regulatory capital rule amendments applicable to large banking organizations and to banking organizations with significant trading activity, or Basel III Endgame, published on July 27, 2023.

NAAHL is the only national alliance of major banks, community development financial institutions (CDFIs), state and local housing finance agencies (HFAs), and other capital providers for affordable housing and inclusive neighborhood revitalization. In 2022, NAAHL members provided more than $200 billion in low- and moderate-income (LMI) financing.

We address the proposed risk weights for two asset classes: Low Income Housing Tax Credit investments; and high-LTV home mortgages.

Low-Income Housing Tax Credit (LIIHTC) equity investments

In recognition of the strong historic performance of LIHTC properties, and the importance of supporting robust investment in affordable housing, we urge you to apply a lower risk weight of 50% to LIHTC properties. This threshold is consistent with what is available to statutory multifamily mortgages, more accurately reflects the risks of LIHTC investment, and would support investment in affordable housing at a time of staggering need.

The Federal Reserve Board has already recognized LIHTC's outstanding performance in setting the Dodd-Frank Act Stress Test risk shocks under a severely adverse scenario. The relative fair value shock assigned to Section 42 (LIHTC) investments is only -4.9%, far lower than the -69.9% for real estate private equity and -28% for real estate debt; and the relative carry fair value shock for unfunded LIHTC equity commitments is only -1.6%.[1]

Background. LIHTC is the federal government's primary policy to mobilize private investment in the production and preservation of affordable rental housing. Since 1987, LIHTC has financed 3.8 million affordable apartments[2] – almost all of the new and substantially rehabilitated affordable housing production in the United States over that period.

Commercial banks subject to the proposed capital rule are the dominant source of LIHTC investment. Banks provide about 85% of all LIHTC equity investments.[3] An analysis of OCC data shows that 98% of national banks' LIHTC investments come from banks with assets >$50 billion.[4] Accordingly, bank capital rules have a material effect on the

[1] Federal Reserve Board, *2023 GMS Component: Severely Adverse Scenario (GICS-Based Data Input)* https://www.federalreserve.gov/supervisionreg/dfa-stress-tests-2023.htm

[2] National Council of State Housing Agencies, *State HFA Factbook: 2022 NCSHA Annual Survey Results*, Tables 3A and 5.

[3] CohnReznick, *Housing Tax Credit Monitor*, December 2023 https://www.cohnreznick.com/insights/housing-tax-credit-monitor

[4] NAAHL analysis based on data at https://www.occ.gov/topics/consumers-and-communities/community-affairs/resource-directories/public-welfare-investments/index-public-welfare-investments-resource-directory.html. The FDIC and Federal Reserve Board do not publish comparable data for the banks they supervise. However, because the OCC supervises most of the largest commercial banks, the OCC data are especially germane.

availability and pricing of LIHTC investments, which in turn will affect the volume and characteristics of affordable housing production and preservation.

LIHTCs are subject to statutory volume caps administered by state housing finance agencies (HFAs). Both the HFAs and private investors underwrite LIHTC projects and monitor their operations on an ongoing basis. The tax credits are claimed over a 10-year period and are subject to a partial recapture of the tax credits if the property ceases to serve low-income residents at restricted rents within a 15-year period. The recapture exposure equals one-third of the credits already claimed and phases out over years 11-15. HFAs and project sponsors also have extended use agreements that govern projects for at least 30 years.

In a typical LIHTC transaction, the investors are limited partners in a partnership where the property developer/operator is the general partner. Virtually all the tax benefits pass through to the limited partner investors.

Tax benefits – LIHTC plus depreciation and other taxable losses – are virtually the sole source of the investors' return. Investors do not expect, and generally do not receive, operating cash or disposition proceeds in excess of their exit taxes. Accordingly, LIHTC investments more closely resemble a fixed-income investment (where the income takes the form of a highly predictable stream of tax benefits) than a traditional real estate equity investment where variable cash flow and speculative capital appreciation constitute the investors' return. Accordingly, LIHTC investor returns – currently 6.28% and generally about 200-400 bps above 10-yearTreasuries[5] – more closely resemble mortgage rates than private equity returns.

Risk Weights. Because LIHTCs qualify as a community development investment under section 24 (Eleventh) of the National Bank Act, the current and proposed policies assign them a 100% risk weight. As the agencies explain:

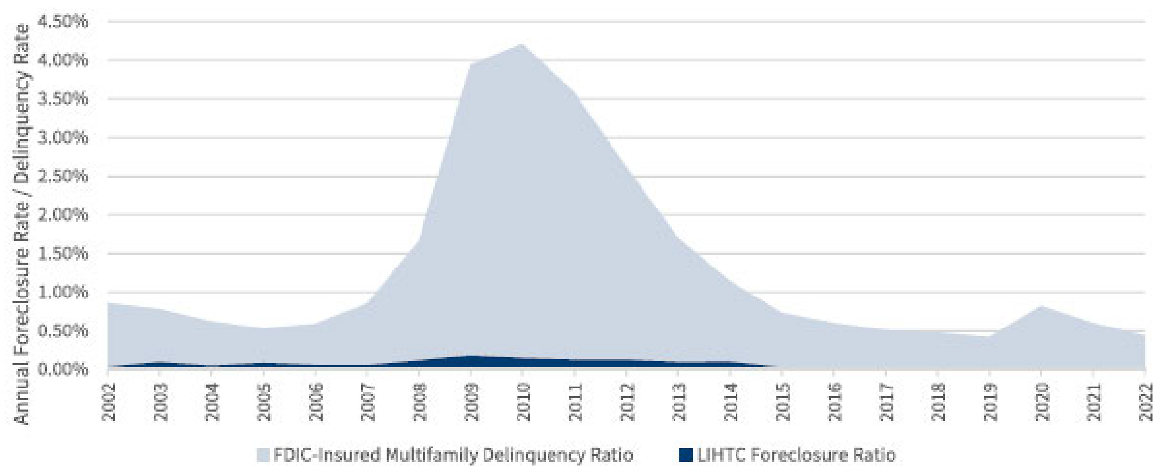
> Equity exposures to community development investments and small business investment companies generally receive favorable tax treatment and/or investment subsidies that make their risk and return characteristics different than equity investments in general. Recognizing this more favorable risk-return structure and the importance of these investments to promoting important public welfare goals, the proposal would effectively retain the treatment of equity exposures that qualify as community development investments and equity

[5] CohnReznick, *Housing Tax Credit Monitor*, December 2023 https://www.cohnreznick.com/insights/housing-tax-credit-monitor

exposures to small business investment companies under the current capital rule and assign such exposures a 100 percent risk weight.[6]

We appreciate this consideration but believe LIHTC's performance justifies a risk weight comparable to statutory multifamily mortgages. While it may seem counterintuitive, LIHTC investments have consistently outperformed multifamily mortgages. The following chart compares the annual LIHTC foreclosure rate with the rate at which multifamily mortgages were either at least 90 days delinquent or in foreclosure since 2002.

Annual LIHTC Foreclosure Rate vs. Conventional Multifamily Delinquency Rate



Source: CohnReznick, *Affordable Housing Credit Study: A Comprehensive LIHTC Property Performance Report*, November 2023, p.80

Multifamily serious delinquencies reached above 4% during the Great Recession, but the LIHTC foreclosure rate has typically stayed below 0.1% since 2002. Similarly, IRS data show the LIHTC recapture rate averaged only 0.08% for tax years 2008-2019, peaking at 0.17% in 2009.[7] These IRS data are especially useful because recapture is the way LIHTC investors incur losses and it reflects both the incidence as well as the severity of loss.

The national accounting firm CohnReznick, which has tracked LIHTC performance for more than 20 years, explains: "Given the pent-up demand for affordable housing, the effective leverage and oversight under the public-private partnership model, and the

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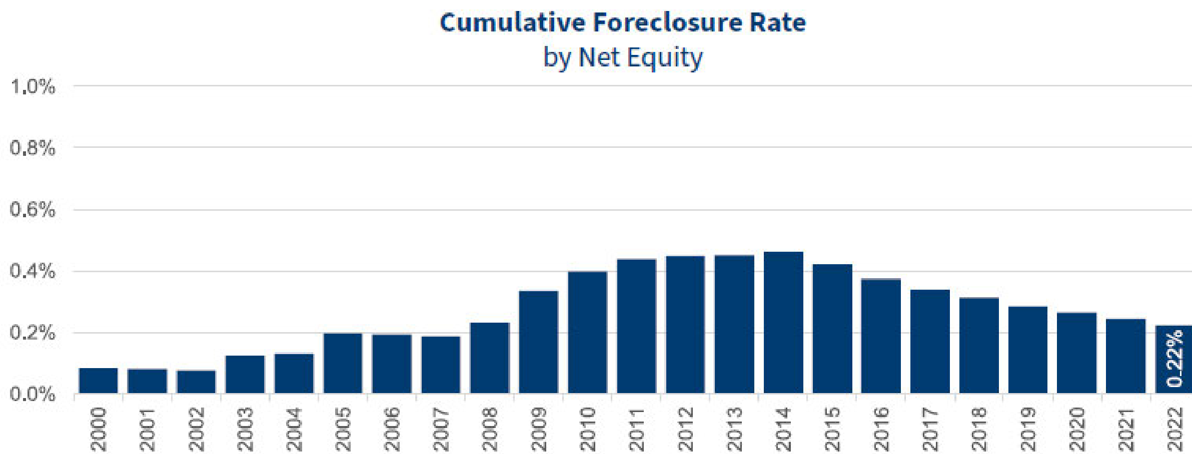
[6] NPR, p. 64077

[7] IRS, *SOI Tax Stats - Corporation Income Tax Returns Line Item Estimates (Publication 5108)*, https://www.irs.gov/statistics/soi-tax-stats-corporation-income-tax-returns-line-item-estimates-publication-5108 The recapture rate equals the LIHTC amount recaptured divided by the LIHTC amount claimed. IRS did not publish LIHTC recapture data for 2020 to protect taxpayer identities.

various mechanisms afforded by housing credit properties to offset underperformance, conventional apartment properties are much more likely to suffer foreclosure."[8]

Another metric, LIHTC's *cumulative* foreclosure rate by net equity (total foreclosed net equity divided by total equity), tells a similar story. As the following chart shows, the cumulative foreclosure rate peaked at a very low level, below 0.5%, in the aftermath of the Great Recession and has decreased to 0.22% by 2022, as more properties have come online and no foreclosures were reported in 2021 and 2022.



Source: CohnReznick, p.79.

CohnReznick reports that relatively few LIHTC properties suffer from severe underperformance.

> Further, underperforming properties can fund their operating deficits through management fee deferral, operating deficit guarantees and reserves, or advances from the general partner or syndicators. In instances of property underperformance, housing tax credit property owners have various options to support or recapitalize their properties financially.
>
> Since the [LIHTC recapture] consequences for owners are very harsh, they are motivated to keep their properties in compliance with housing tax credit program rules and avoid foreclosure at all costs.[9]

[8] CohnReznick, *Affordable Housing Credit Study: A Comprehensive LIHTC Property Performance Report*, November 2023, p.79.

[9] CohnReznick, *Affordable Housing Credit Study: A Comprehensive LIHTC Property Performance Report*, November 2023, p.78.

High-LTV Home Mortgages

NAAHL urges the agencies to adopt the Basel Committee standard for home mortgages, rather than adding 20 percentage points on top of the Basel standard. The proposed 20 percentage points surcharge is *unnecessary* because it would exceed the level needed to protect banks against Great Recession-level losses. The surcharge is *undesirable* because it would disproportionately disadvantage LMI homebuyers and communities, especially people and places of color, contrary to the intent of the Community Reinvestment Act.

Under the NPR, the risk weight for mortgages would increase from the current 50% to a sliding scale based on the LTV and whether the home is owner-occupied or investor-owned. Although the Basel Committee also adopted a sliding scale, the agencies propose to add 20 percentage points to the international standard. For example, a 90-100% LTV loan on an owner-occupied home would carry a risk weight of 50% under both current U.S. rules and the Basel standard, but 70% under the NPR.

The new rules would apply to a limited but important segment of home mortgages. In 2022, banks with assets >$1 billion originated 23% of all HMDA-reported home purchase mortgages, and banks retained 43% of their loans, indicating that banks hold about 10% of all home purchase mortgages.[10] The NPR would affect the portion of these loans with high LTVs.

We appreciate the NPR's assertion that: "The agencies are supportive of home ownership and do not intend the proposal to diminish home affordability or homeownership opportunities, including for low- and moderate-income (LMI) home buyers or other historically underserved markets."[11]

Indeed, high-LTV retained mortgages do play an outsized role in reaching underserved borrowers and communities because such mortgages often do not fit the standard credit boxes established by the GSEs and FHA. Bank portfolio lending is the primary channel for these non-standard loans because most nonbank lenders do not retain the mortgages they originate.

[10] Consumer Financial Protection Bureau, *Data Point: 2022 Mortgage Market Activity and Trends*, September 2023, Table 5A.
[11] NPR, p. 64048.

High-LTV home mortgages are disproportionately important for LMI borrowers and neighborhoods and to Black and Hispanic borrowers. According to the Urban Institute's Laurie Goodman and Jun Zhu:[12]

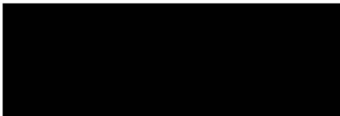
- 13% of all bank mortgages went to LMI neighborhoods, but 19% of high-LTV bank mortgages went to LMI neighborhoods.
- 18% of all bank mortgages went to LMI borrowers, but 28% of high-LTV bank mortgages went to LMI borrowers.
- 5% of all bank mortgages went to Black borrowers, but 9% of high-LTV bank mortgages went to Black borrowers
- 9% of all bank mortgages went to Hispanic borrowers, but 13% of high-LTV bank mortgages went to Hispanic borrowers.

Moreover, Goodman and Zhu undertook a detailed analysis of mortgage loss rates associated with the Great Recession, concluding:

> There is no logical argument for the bank capital requirements proposed in the NPR. They are much higher than the Basel requirements. And our analysis shows they are higher than a repeat of the 2005-08 experience would suggest is necessary to protect the financial system. Moreover, our analysis does not account for post-2008 changes in the loan origination process that require increased documentation, as well as regulatory developments pursuant to the Dodd-Frank Act.[13]

This concludes our comment. For further information, please contact Benson Roberts broberts@naahl.org or Sarah Brundage sbrundage@naahl.org.

Sincerely,



Benson F. Roberts
President and CEO

[12] Laurie Goodman and Jun Zhu, *Bank Capital Notice of Proposed Rulemaking: A Look at the Provisions Affecting Mortgage Loans in Bank Portfolios*, Urban Institute, September 2023, Tables 4A-4D.
[13] Goodman and Zhu, p.11.