MORTGAGE BANKERS ASSOCIATION

July 5, 2021

Sandra L. Thompson
Acting Director
Federal Housing Finance Agency
400 7th Street, SW
Washington, DC 20219

Re: Request for Input on Short-Term Rental Units

Dear Acting Director Thompson:

The Mortgage Bankers Association (MBA)[1] thanks the Federal Housing Finance Agency (FHFA) for the opportunity to respond to its Request for Input (RFI) on the policies maintained by Fannie Mae and Freddie Mac (the Enterprises) with respect to mortgages on properties located in projects that include short-term rental units.[2] As FHFA notes in the RFI, there is confusion in the mortgage industry regarding the existing Enterprise policies for such properties, which leads to differing approaches taken by various lenders based on differing interpretations of the language in the Enterprises' selling guidelines. This portion of the market would function more smoothly and efficiently if lenders could rely on more definitive guidance regarding the eligibility of particular projects.

As such, MBA recommends several areas in which the Enterprises' policies could be clarified. These recommendations cover issues such as the prohibition on "transient" projects, due diligence based on occupancy type, the presence of "hotel-type services," project naming conventions, and the consideration of rental income in the underwriting process.

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 330,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 1,700 companies includes all elements of real estate finance: independent mortgage banks, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies, credit unions, and others in the mortgage lending field. For additional information, visit MBA's website: www.mba.org.

[2] Federal Housing Finance Agency, "Request for Input: Short Term Rental Units in Condominium, Cooperative, and Planned Unit Development Projects," May 6, 2021. Available at: https://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/RFI-Short-Term-Rental-Units.pdf.

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When there is confusion regarding a particular set of Enterprise policies – such as those related to projects that include short-term rentals – lenders will come to differing conclusions as to whether they are able to engage in Enterprise-supported lending for units in those projects. While it is natural and appropriate for lenders to come to different lending decisions with respect to a particular property, these differences should be determined by lender business strategies, risk tolerances, and other related factors. It is unhealthy for these differences to stem from differing interpretations as to whether a property is eligible for an Enterprise-backed mortgage. The Enterprises' eligibility guidelines should be sufficiently clear that lenders consistently arrive at the same conclusions when presented with basic facts about a particular project.

This uncertainty also may lead to situations in which there is unnecessarily tight access to credit for condominiums, cooperatives, or homes in planned unit developments. In many cases, these types of properties represent entry-level homeownership opportunities for low- to moderate-income borrowers. Projects that feature high proportions of short-term rentals often may be perceived as luxury, high-cost projects that cater to affluent borrowers, and while such projects certainly do exist, they do not represent the full range of condominiums, cooperatives, or planned unit developments that serve a diverse set of borrowers across the income and wealth distributions. In many areas that are popular vacation destinations, for example, projects with high proportions of short-term rentals also feature owner-occupied units that serve as affordable housing – often for individuals working in service or hospitality jobs that support tourism.

The need for greater clarity does not, however, imply that the Enterprises need to maintain policies that are perfectly aligned. If the Enterprises have slightly different views as to the types of projects that satisfy their loan acquisition criteria, such differences are consistent with many other portions of their selling guidelines that contain divergent requirements. It is more important that the Enterprise requirements be clear and well understood across the lender community.[3] And while some lenders report that Enterprise representatives have proven helpful in clarifying lender uncertainty in individual situations, direct communications with Enterprise staff are not scalable and introduce the risk of lenders receiving differing guidance from different Enterprise staff – and therefore are not a suitable replacement for clear, written guidance.

[3] As with all Enterprise policies that have the potential to impact prepayment rates, FHFA and the Enterprises should ensure that any divergence in policies regarding short-term rentals across the Enterprises not adversely impact the market for, or performance of, Uniform Mortgage-Backed Securities.

<u>Transient Projects</u>
The Enterprises deem projects ineligible if they are, in the case of the Freddie Mac guidelines, “transient housing” or are, in the case of the Fannie Mae guidelines, “primarily transient in nature.”[4] The differences in the use of the “transient” factor across the Enterprises have caused significant confusion among lenders when seeking to apply this standard.

The Freddie Mac guidelines provide a considerable degree of detail, as they list a series of project characteristics that, if present, require lenders to deem a project to be transient. These factors include a hotel conversion that is not a “gut rehabilitation,” the generation of revenues from “hotel-type services,” or a homeowner association that charges fees when a unit is rented on a short-term basis.

The Fannie Mae guidelines, however, simply note that a project is ineligible if it is deemed “primarily transient in nature.” These guidelines do not further define “transient,” but do separately list many of the features within the Freddie Mac definition of “transient” as other prohibited features.

This construct raises questions as to what it means for a project to be transient under the Fannie Mae guidelines, as there appears to be a distinct – though undefined – definition that is not consistent with that of the Freddie Mac guidelines. If the features that make a project transient for Freddie Mac’s purposes are not those that make a project transient for Fannie Mae’s purposes, then Fannie Mae should amend its guidelines to better clarify what features do trigger this limitation.

<u>Occupancy Type</u>
The Fannie Mae guidelines include several factors that are considered “red flags” that would trigger the need for additional due diligence on the part of the lender. Among these red flags is a scenario in which 75 percent or more of the units in a project are non-owner-occupied (either as investment properties or second homes).

In certain geographic areas, in particular, it is quite common for projects to feature high proportions of non-owner-occupied units. If such projects were excluded from Enterprise eligibility on a widespread basis, it could have a significant, adverse impact on local housing markets. Fannie Mae therefore should clarify that the occupancy ratio of a project is not a factor that would, on its own, disqualify that project.

The determination that a project that previously was considered to be eligible based on the Enterprises’ guidelines is no longer eligible also could have significant impacts on home prices in that project. The lack of availability of Enterprise-supported financing could reduce the set of potential buyers when that unit is put on the market, lowering

[4] All references to the Enterprises’ guidelines are taken from Section 5701.3 of the Freddie Mac Single-Family Seller/Servicer Guide and Section B4-2.1-03 of the Fannie Mae Single-Family Selling Guide.

prices and thereby reducing the equity of the original borrowers. The Enterprises therefore should exercise caution when implementing policy changes that are likely to change the eligibility status of a large number of projects.

Hotel-Type Services

Both Enterprises deem projects ineligible if they feature “hotel-type services.” The Enterprises’ guidelines then go on to list several examples of hotel-type services. It is not clear to many lenders, however, whether the presence of a single amenity considered a hotel-type service is sufficient to disqualify a project, or if multiple such services are needed to disqualify a project (and if so, how many such services).

Some of the features designated as hotel-type services in the Enterprises’ guidelines are common in projects that many lenders believe should not be classified as “condotels.” In other cases, it is not clear if certain features trigger the definition of the hotel-type services prohibited under the Enterprises’ guidelines. The features below, for example, should not – on their own – render a project ineligible:

- the presence of a front desk or concierge desk (particularly when such desk serves a security purpose) and the ability for payments to be accepted at such a desk;
- the listing of certain units within a project by their owners on websites such as Airbnb or Vrbo, as these platforms represent the technological evolution of the short-term rental housing market (it is unclear whether the Freddie Mac restrictions on the presence of a “rental registration website/hosting platform” include the use of external platforms to list certain units); and
- the use of plastic key cards, which is increasingly common for security reasons as these types of locks are more difficult to break and these types of keys are more difficult to duplicate (it is unclear whether such key cards, if issued by a common provider, would constitute a prohibited “central key system”).

The Enterprises should clarify these ambiguities and articulate that these features would not disqualify a project.

Naming Conventions

The Fannie Mae guidelines deem a project ineligible if it has a legal or common name that contains words such as “hotel,” “motel,” or “resort,” unless those words reference a historical use of the building. The Freddie Mac guidelines do not contain specific guidance regarding the naming of projects.

Lenders have reported inquiries from the Enterprises when words other than “hotel,” “motel,” or “resort” – such as “lodge” or “club” – are included in a project’s legal or common name. While it is reasonable for the Enterprises to consider any information provided by a project's name, they should not place significant weight on a project's name when determining eligibility. In many cases, these naming conventions are more representative of the area or region in which the project is located than the use of the building. Lenders, however, often perceive such names as barriers to the Enterprises' acceptance of loans backing units in these projects. The Enterprises should be clear in their communications with lenders that naming conventions other than those specifically contained in their guidelines are unlikely to trigger an adverse decision regarding a project's eligibility.

Impact of Rental Income on Underwriting

In its RFI, FHFA notes that many projects with a high proportion of units that serve as short-term rentals are located in areas with greater exposure to natural disasters. As such, FHFA expresses concern that borrower default risk may be higher due to a loss of future rental income.

While this is a risk that should be considered and monitored, it should not be a factor that causes entire projects to be deemed ineligible. There are many instances in which a borrower can qualify for a mortgage on a unit without consideration of any future rental income that (s)he may accrue. In such cases, it is unclear why the impact of natural disasters on rental income would be relevant to the lending decision.

Further Clarifications

In addition to the recommendations and observations provided above, there are elements of the Enterprises' guidelines in need of further clarification to ensure consistent and sound lending decisions. Relevant questions include:

- How frequently does a property need to be rented on a short-term basis in order to be considered a "short-term rental?"
- Based on the Fannie Mae guidelines, does the presence of a certain number of "red flags" disqualify a project? Similarly, are all "red flags" equal in importance, or do certain factors require more thorough levels of due diligence by lenders?

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The current Enterprise guidelines include significant "gray areas" that cause different well-intentioned lenders to come to different conclusions about the eligibility of the same projects. As such, lender "risk tolerance" has become an exercise in tolerance for the risk that a project is later deemed ineligible by an Enterprise – an unwelcome and unproductive substitute for true risk analysis based on credit risks or other borrower or property factors.

To resolve this inconsistency and provide greater clarity to lenders, the Enterprises can adopt one of two potential approaches. They could make public determinations about the eligibility of particular projects, which would remove all uncertainty and place all lenders on equal footing. Given historical reluctance by the Enterprises to provide eligibility determinations on particular projects, the second option would be for them to implement changes to their guidelines that remove many of the "gray areas," in concert with the recommendations noted above. By doing so, the Enterprises will increase the likelihood of consistent applications of their policies by lenders and decrease the repurchase risk that causes some lenders to avoid this market segment, which results in diminished borrower access to credit.

Thank you in advance for your consideration of these observations and recommendations. Should you have questions or wish to discuss further, please contact Dan Fichtler, Associate Vice President of Housing Finance Policy, at (202) 557-2780 or dfichtler@mba.org.

Sincerely,

Pete Mills
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Residential Policy and Member Engagement
Mortgage Bankers Association