Testimony of Nancy O. Andrews
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I am Nancy Andrews, President and Chief Executive Officer of the Low Income Investment Fund (or LIIF), a national community development financial institution (CDFI) based in San Francisco, California. LIIF provides capital to community-based projects by linking capital markets to distressed neighborhoods. We focus our capital resources on affordable housing projects, child care centers, schools and other vital community revitalization efforts.

Thank you, Chairman Shelby and Ranking Minority Senator Sarbanes for including the perspective of community development lenders in this important hearing. I want to make three key points in my testimony today:

- First, having strong, functioning GSEs focused squarely on the mission of providing affordable homeownership and rental housing for the broader market and low income populations is essential.

- Second, we endorse the approach of both strengthening the affordable housing goals and the utilization of 5 percent of GSE profits for direct investments in new deeply targeted housing activities.

- Finally, we believe that these new funding mechanisms could revolutionize the role of community development lenders by having the GSEs play a lead role in the creation of secondary market vehicles, bringing the volume and pricing efficiency of capital markets into the community development finance sector. The GSEs could also expand our reach by providing high-leverage equity grants and investments into our institutions.

Background on the Low Income Investment Fund

Over its 20-year history, LIIF has provided approximately $500 million in financing for projects benefiting low income communities throughout the country. Fully three-fourths of our projects serve very low income families. This is truly deep reach lending. Yet in 20 years, LIIF has suffered capital losses totaling only $192,000 or 0.12 percent – that's one-eighth of one percent. This prudent and sound deployment of private capital has leveraged additional capital investments of over $3.7 billion. LIIF's capital has supported:

- 50,000 homes for families and kids;
- 20,000 spaces of safe, high quality child care;
- 12,000 desks in schools where children can get a good education; and,
- Over 2 million square feet of commercial space.

Last year, LIIF provided nearly $86 million in loans and grants to organizations working to further our mission of poverty alleviation. LIIF's flexibility and willingness to innovate creates a crucial link between distressed communities and capital markets.

Our track record as a CDFI is strong, but not unusual. We are joined by dozens of other community-based lenders, each with equally sound histories and experiences. There are 170 CDFIs that form the National Community Capital Association, with more than $3 billion in capital under management. Many of these organizations have experiences similar to LIIF's history.

By using capital in innovative ways, LIIF has helped to create affordable housing for the working poor; special needs housing and services for the homeless; housing for victims of domestic violence and people with disabilities; unique homeownership developments; and community facilities such as child care centers and charter schools.

Healthy GSEs are Essential for Affordable Housing Mission

Thank you for giving me the opportunity to testify today regarding the proposed legislative reforms of the Government Sponsored Enterprises. Let me start out by saying that we believe a strong and sound GSE system is essential for efficient flows of capital to housing markets in general and to affordable housing markets in particular. We understand that the balance between effective regulation and continued innovation in mission-related housing is as important as it is hard to get right.

We are concerned that some of the restrictions currently being considered could limit the GSE's ability to fulfill their affordability mission. The removal of GSE federal advantages or curtailment in their business activities could reduce their capacity to invest in mission affordable housing. In particular, a significant change in the current program approval process, which allows Fannie Mae and Freddie Mac to bring new and innovative products to the market quickly, could undermine their continued innovation in mission activities. The bottom line is that a healthy GSE climate is essential to the achievement of their affordability mission.

Reed Amendment Offers Important Advances in Affordable Activity

LIIF strongly supports the approach offered by Senators Sarbanes and Reed to improve the targeting of GSE mission activities. We support strengthening the goals and obligations of GSEs to provide credit and capital to underserved markets, particularly for very low income people and sub-prime borrowers, including activities that earn less of an economic return than the conventional GSE products.

We also strongly endorse the approach in last year's Reed Amendment that would set aside five percent of the profits of Fannie Mae and Freddie Mac to provide targeted housing production grants, as well as credit enhancements, guarantees and securitizations for affordable housing developments that are currently underserved by the conventional capital markets. We strongly support allocating these funds into two broad uses: 50 percent in grants for highly targeted housing production and capital leveraging; and the remaining 50 percent to create flexible products and underwriting standards, that would open up a secondary market for the deeply targeted portfolios of organizations like mine, thereby leveraging significant additional funds through the capital markets.

This latter point is especially important to us and requires amplification. The GSEs are in a unique position to pilot new approaches and underwriting. This kind of innovation does not easily lend itself to external administration. Internalizing the funds envisioned in the Reed and Sarbanes' proposal, with regulatory oversight and review, will ensure that the GSEs remain invested in these activities and will allow for successful innovation to spill over into the mainstream business practices of the GSEs, a central goal of the legislation.

The Community Reinvestment Act experience is instructive in this regard. By incubating more aggressive products and enterprises within the banking system itself, CRA has significantly expanded the underwriting flexibility and resources provided by the banks' "conventional" lending and investments.

How the Affordable Housing Community Can Leverage New GSE Funds

Now let me provide you with three very concrete examples of how the Reed and Sarbanes' proposals could be used to dramatically enhance mission-driven work. The three ideas are:

- a GSE "wrap" or securitization of highly targeted but high-performing portfolios, like LIIF's;
- equity grants for high-performing nonprofit housing development and financial institutions;
- low interest loans with long terms to high-performing community development financial institutions.

Let's take these ideas one at a time.

Piloting Secondary Market Products for Community Development Loans

First, last year's Reed Amendment Underserved Market Fund could be used by the GSEs to credit enhance and securitize the non-conforming, but high-performing portfolios of community lenders and housing developers across the country. This would truly revolutionize the flow of capital to communities by creating an effective secondary market for our deep-reach work. Here's how it would work:

A GSE would make a commitment to buy pools of loans from high-performing CDFIs like LIIF – and others such as the Enterprise Foundation, the Reinvestment Fund, and Self-Help – which finance housing for extremely low income populations. These loans are considered "non-conforming" because they do not meet the very structured traditional underwriting standards of the banking community of the GSEs. Yet they perform like the highest quality assets. While these loans are perceived as risky, the truth is that our industry has a loss rate of less than 1 percent with more than 20 years of history behind us.

The GSE would agree in advance to buy, say, $100 million of these loans and would establish a special loss reserve pool or "credit enhancement" from the GSE Underserved Market fund. The GSE would then pool these funds into a mortgage-backed security and provide a credit enhancement that would confer its AAA bond rating on the pooled security. This security could then be sold in the capital markets.

It is important to point out that while any individual loan may bear some risk, the exposure of the GSE would be limited and highly diversified. First, the organizations selling the loans would likely provide a top-loss guarantee, probably 5 percent. We would be on the hook, ensuring disciplined lending. Second, these loans all have substantial collateral, which could be used to absorb capital losses. And finally, the special loan loss reserve established by the GSE would be tapped before there is any impact on the GSE. Given that the historic loss rate on these portfolios is less than 1 percent, it is unlikely that any losses would trickle down to the GSE. The leveraging potential is enormous. The social return on investment is enormous.

LIIF has already structured this kind of transaction in New York working with the State of New York Mortgage Agency (SONYMA). LIIF established a guarantee of $260,000 to leverage SONYMA insurance for a $2.6 million loan to a homeless shelter in New York City. The investor was the United Methodist Pension Fund. Given the quality of the credit enhancement from SONYMA – which was double A – LIIF could induce the most hard-boiled, profit-oriented firm on Wall Street to invest in this shelter on Staten Island. In this example, you see the real power of leveraging and credit enhancement. You see a way to multiply the bang for the buck.

These kinds of transactions would have enormous positive implications for distressed communities across America. GSE securitization would provide our institutions with much needed capital liquidity to be able to make greater volumes of loans for deeply targeted housing. With the GSE credit rating in place, it would bring the longest terms (30 years) and the best prices of the capital markets to bear in a highly targeted project, in a safe and sound fashion. This idea would yield leveraging of perhaps $100 for every dollar committed, given our record of capital losses. The cost to the public at the end of the day would be negligible, yet the community benefits would be tremendous.

High Leverage Equity Grants and Low Cost, Long Term Debt

The second way the GSE Affordable Housing Funds could be used is as "equity grants" for nonprofit community developers and lenders. These grants would allow us to induce banks and others to invest capital directly in our projects. In other words, LIIF would receive a grant that it could use to entice capital from banks and other private financial institutions. I would estimate that we could raise $5 for each $1we received from the GSEs. We would then place this capital in loans to finance very low income housing. Our loan would induce other capital sources to co-invest in these projects, with ultimate leverage ratios approaching 30:1. These are the standard types of housing we routinely finance, but are generally unattractive to banks and other private sector lenders.

This type of leverage grant funding is consistent with how the Department of Education has structured its financing program for charter schools. For example, LIIF recently received a $3 million credit enhancement grant from the U.S. Department of Education to help finance the construction and acquisition of charter school facilities. With this grant capitalizing a loan loss reserve, we are now leveraging investments of between $50 and $60 million from Citibank, Wells Fargo, Prudential and other mainstream investment houses. These dollars will go directly into schools servicing disadvantaged children. We believe that GSE leverage grants could allow us to leverage similar amounts of funding from banks for financing deeply targeted affordable housing.

The third way LIIF and other community development organizations could leverage GSE funding is through investments in the form of, for example, long-term, low-interest loans, subordinated debt, and the like, for re-lending directly into deep-reach projects in distressed communities. The GSE would invest the money in LIIF at a low rate (say 2-3%), unsecured by real estate but 'secured' by LIIF's total assets, with terms of 10 years or longer. This funding would be leveraged at an estimated 7:1 and we could use this money to lend directly for the kinds of affordable housing projects described earlier.

In addition to these ideas, we also support proposals that have been advanced to enable CDFIs to become members of the Federal Home Loan Bank system. Access to their capital system could provide needed liquidity to community development projects in a safe and sound fashion. Liquidity is a top priority for the large, better-capitalized CDFIs, and the Federal Home Loan Banks are well positioned to meet this challenge. However, without legislative action compelling the banks to address more aggressively the credit needs of underserved markets, access to the FHLB system will be meaningless because of the stringent collateral and underwriting requirements. .

Conclusion

In short, we believe that the GSEs can and must play a critical and enhanced role in the financing of affordable housing. But there is a part of the housing production spectrum they are not yet reaching. We lend to these deep-reach projects every day, and have done so for 20 years with almost no losses. We know how to safely and soundly introduce these opportunities to the capital markets. The GSEs are the missing link in the chain. We urge you to allow us to make the GSEs our partners and to complete the chain. The GSEs are in the exclusive position of creating effective secondary markets for the kind of community development lending that mainstream banks and lending institutions will not play in financing deeply targeted affordable housing.

Thanks again for the opportunity to testify today. I'd be happy to respond to any questions you may have.