STATEMENT BY

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ON BEHALF OF THE

NATIONAL MULTI HOUSING COUNCIL

AND THE

NATIONAL APARTMENT ASSOCIATION

BEFORE THE

SENATE COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP

"Small Business Access to Capital: Challenges Presented by Commercial Real Estate"

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Chairman Landrieu, I am James Arbury, Senior Vice President of Government Affairs of the National Multi Housing Council and National Apartment Association Joint Legislative Program.

NMHC and NAA represent the nation's leading apartment firms. Our combined memberships are engaged in all aspects of the industry, including ownership, development, management and finance. NMHC represents the principal officers of the industry's largest and most prominent firms. NAA is the largest national federation of state and local apartment associations with 170 state and local affiliates comprised of more than 50,000 members. Together they represent just under 6 million apartment homes.

We applaud your efforts to focus attention on the issue of availability of credit for commercial real estate. One-third of American households rent, and over 14 percent of households—16.7 million households—live in a rental apartment (buildings with five or more units). Our industry's ability to meet the nation's rental housing needs depends on reliable and sufficient sources of capital.

Multifamily Capital Markets and Industry Performance

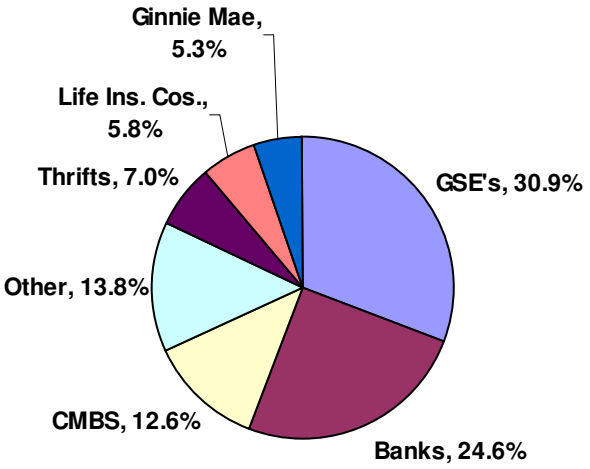
Since the onset of the financial meltdown, virtually all private mortgage lenders left the housing finance market, and the apartment industry has relied heavily on credit either insured or guaranteed by the federal government. Fully 8 out of 10 apartment loans issued in the first six months of 2010 had some form of government credit behind them, namely FHA, Fannie Mae or Freddie Mac. The FHA and Government Sponsored Enterprises (GSEs) are expected to account for 80-90 percent of the $50-$60 billion in credit provided to the apartment sector this year.

Historically, however, the apartment industry has enjoyed access to mortgage credit from a variety of capital sources. In addition to the FHA and GSEs, banks and thrifts, life insurance companies, pension funds and the commercial mortgage-backed securities market have all provided significant amounts of mortgage capital to the apartment industry. Prior to the financial crisis, these capital sources provided our sector with $100-$150 billion annually, reaching as high as $225 billion, to develop, refinance, purchase, renovate and preserve apartment properties.

These market sources have proven to be reliable and durable, with the exception of unique financial situations, such as the current economic crisis and the 1997-1998 Russian financial crisis.

As of the first quarter of 2010, there was approximately $872 billion in outstanding multifamily mortgage debt (see Table 1). In recent years, the industry has shifted from relying on whole loans from banks and life insurance companies to securitized loans. Currently, just under half (49 percent) of outstanding multifamily capital is held in the secondary market (31 percent by the GSEs, 13 percent in CMBS and 5 percent in Ginnie Mae). Nevertheless, banks remain an important capital source, providing nearly one-quarter of the industry's mortgage capital.

Table 1
Multifamily Mortgage Debt Outstanding 2010 Q1

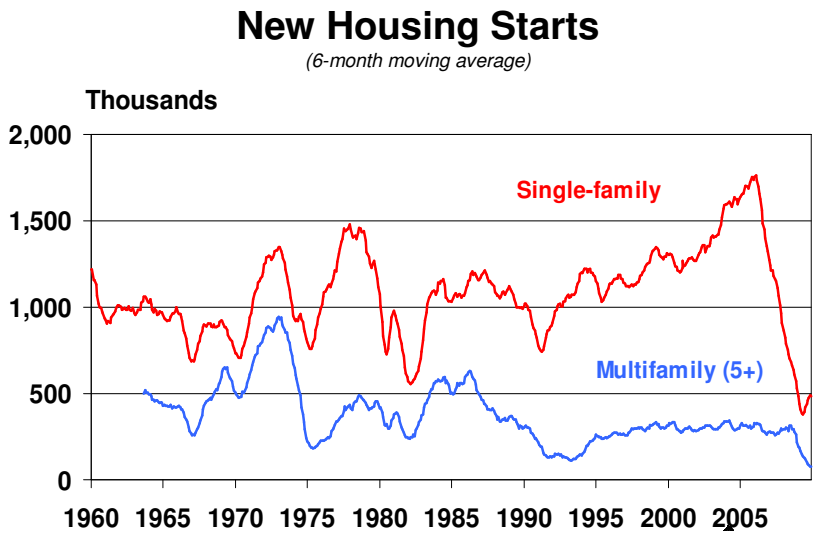


Source: Federal Reserve Outstanding Mortgage Debt 2010

As policymakers consider the causes of, and solutions to, the single-family meltdown, it is important to distinguish between performance in the single-family sector and the multifamily sector. The multifamily industry did not overbuild in the housing boom.

The New Housing Starts table below shows the stark contrast between the single-family housing production/bubble and resulting housing crisis and the relatively constant level of new production in the multifamily housing sector during the same period. Since the mid-1990s, the multifamily industry has started approximately 350,000-375,000 new units annually. During the same period, the single-family market almost doubled its production from around 1 million to 1.75 million units.

Table 2



Source: Census Bureau.

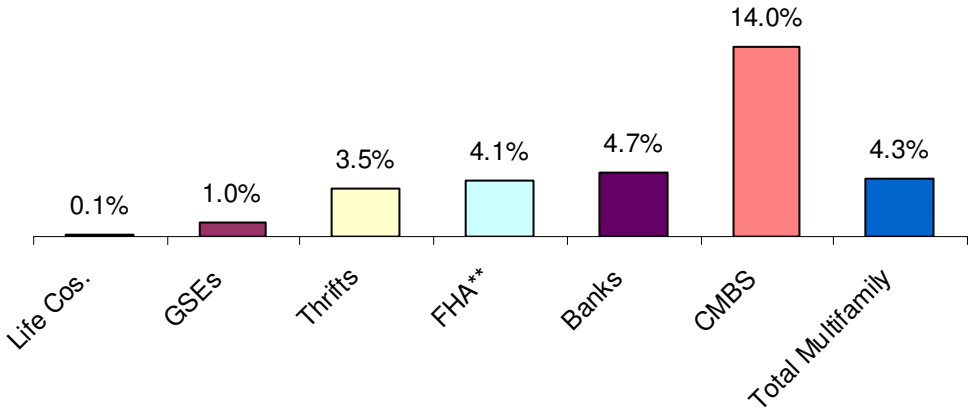
The discipline shown by the apartment industry has translated into stronger portfolio performance as well. Overall loan performance in the $853 billion multifamily sector remains relatively healthy, with delinquencies and default rates only a fraction of those seen in single-family. The 90 day delinquency rate of multifamily loans is estimated to be 4.3 percent or $31 billion. Compared to the single-family residential mortgage market where the mortgage debt outstanding is reported at $10.7 trillion as of March 30, 2010 and a 90-day delinquency rate of 9.2 percent or $984.4 billion.

There has been some stress recorded in bank loans and CMBS, particularly those originated between 2006 and 2008 when more aggressive underwriting and higher leverage was employed. However, that stress is largely a result of the overall economy and the worst job market in 40 years and not due to oversupply.

Many of those problematic loans were taken out to renovate and reposition existing properties. When property values plummeted and unemployment soared, those projects stalled and borrowers lost most of their equity. The problem is especially acute in some markets such as the boroughs of New York City and other major employment centers that have large concentrations of apartment properties.

Nevertheless, many of these distressed loans will be resolved, and most apartment residents will not be affected by loan delinquencies or even defaults, as such situations generally result in a smooth transition to a new operating entity with sufficient capital to maintain the property.

Table 3
Delinquency Rates of Multifamily Credit Sources



Seriously delinquent loans are defined as at least 90 days past due and defaulted FHA multifamily Section 221(d)(4) loans.

Sources: Federal Reserve Outstanding Multifamily Mortgage Debt, 2010 Q1, Fannie Mae, Freddie Mac 10K/10Q SEC Filing Statements, and HUD.

** Data provided for the Federal Housing Administration multifamily portfolio is restricted to market rate Section 221(d)(4) defaulted loans as of July 2010, that total $505 million in defaulted loans. It does not include the full portfolio of multifamily insured loans including hospitals and nursing homes.

The current housing finance system has worked extremely well in providing liquidity to the apartment sector in all economic climates. Here in the U.S. the GSEs, Fannie Mae and Freddie Mac, have remained a critical liquidity source in the domestic multifamily finance field. They have served this role during other capital market dislocations, including the Russian economic collapse in the late 1990s, which caused a collapse of the U.S. commercial mortgage conduit market, and during the 2001-2003 recession.

Maintaining Credit Capacity for the Apartment Market

The bursting of the housing bubble exposed serious flaws in our housing finance system. As policymakers undertake housing finance reform—including creating a framework for a U.S. covered bonds market—we urge you to ensure that any actions taken are not done so at the expense of the much smaller and less understood, but vital, multifamily sector.

Apartments are a critical component of the nation's housing market, and our industry depends on a reliable, reasonably priced and readily available supply of credit to meet the nation's growing demand for rental housing.

The U.S. is on the cusp of fundamental changes in our housing dynamics. Changing demographics are causing a surge in rental demand that will continue long after the economic recovery. This includes 78 million echo boomers entering the housing market, baby boomers downsizing and a dramatic decrease in the number of married couples with children to less than 22 percent of households.

Between 2008 and 2015, nearly two-thirds of new households formed will be renters. That's 6 million new renter households. University of Utah Professor Arthur C. Nelson predicts that half of all new homes built between 2005 and 2030 will have to be rental units. The Harvard University Joint Center for Housing Studies estimates that we already have a shortage of some three million units of affordable rental housing.

Our industry cannot meet the nation's current or future housing needs—or refinance the approximately $200 billion in mortgage debt coming due over the next two years—without a fully functioning secondary mortgage market.

For these reasons it is critically important to maintain the existing level of liquidity for the multifamily market, in good times and bad. The strong performance of the sector, thanks in large part to the robust capital markets supporting it, has attracted an enormous amount of private investment. These investors have supported the expansion of the industry and a marked improvement in its professionalism. It has made the production of millions of units of workforce and market-rate housing possible.

For the past 50 years, the U.S. housing system has been the envy of the world in attracting private capital to meet our nation's housing needs. As lawmakers look for added mortgage credit sources and redesign the secondary mortgage market, we urge them to retain the successful elements of our present system, specifically those which contributed to the strength of the multifamily market, and understand the inherent limitations of new capital sources.

A government-supported secondary market is absolutely critical to the multifamily sector and our industry's ability to continue to meet the nation's demand for affordable and workforce housing. Multifamily may only represent 10 percent on average of the GSEs' mortgage debt, but they currently provide nearly 90 percent of multifamily mortgage capital.

Since 1996, the GSEs have provided more than $535 billion in multifamily mortgage debt. Having this reliable source of capital—in good markets and bad—has provided financing for more than 11 million apartments in that time. This most recent financial crisis underscores the importance of the GSEs to multifamily. Over the past two years, they have provided $94 billion in mortgage debt to our industry at a time when virtually every other capital source left the market.

A Government-Supported Secondary Mortgage Market for Multifamily Housing is Critical

While our industry relies on other sources of capital, including thrifts, banks and life insurance companies, these are not sufficient to provide the capital necessary to keep the apartment sector functioning. Banks are limited by capital requirements. Life insurance companies have always been less than 10 percent of the market, lend primarily only to newer, luxury high-end properties and enter and leave the multifamily market based on economic and capital market conditions. The private-label CMBS market is unlikely to return to the volume and market share it reached a few years ago, and the FHA has exceeded its capacity to meet the sector's capital demands.

The following outlines why it is important to retain a government-supported secondary mortgage market for multifamily in any reform effort.

1. Providing Affordable and Workforce Housing

Fannie Mae and Freddie Mac make immeasurable contributions to housing affordability through their multifamily programs. Between 1999 and 2007 they provided $104 billion in multifamily mortgage financing for apartments affordable to families at or below 80 percent of the area median income (AMI). That's 3.2 million units—half of all units financed during this period. Additionally, half of their mortgages financed during this period were in underserved targeted areas. **The GSEs' multifamily programs have always met and exceeded their special affordable multifamily goals.**

They have been and can continue to be the single largest provider of credit enhancement for multifamily housing bonds used to finance affordable housing.[1]

But their contributions to workforce housing go beyond their affordable housing goals. Few people realize that fully 90 percent of the apartment units financed by Fannie Mae and Freddie Mac over the past 15 years—more than 10 million units—were affordable to working families at or below their communities' AMI. This includes an overwhelming number of market-rate apartment properties with no federal subsidies.

The message here is that nearly ALL of the GSEs' multifamily activities help create affordable and workforce housing, not just the capital they provide to properties designated as affordable.

The vast majority of non-subsidized apartments provide housing to people at or below area median income. That is because multifamily housing is inherently affordable. The median household income of all renters in 2007 was $25,500, well below the national median income of $47,000. The median income of renters in non-subsidized market-rate apartments was $30,000.

The conventional apartment industry's ability to serve renters at or below area median income is a result of the liquidity the sector has had access to for the past 20 years, and that liquidity is the result of a government-supported secondary multifamily mortgage market that has lowered the cost of capital to affordable AND market rate apartment providers. Without that government support, interest rates and debt service costs will rise, rents will have to increase to cover these costs and our market-rate industry will be less able to serve people at or below AMI.

Not only does the presence of a government-supported secondary multifamily mortgage market lower the cost of capital, it is important to understand that it also works to leverage private capital to support affordable housing.

Without a government guarantee of multifamily mortgages or mortgage-backed securities, rents will go up and the supply of affordable housing will go down because other capital sources cannot and will not fill the gap.

- Even if the life insurance companies expand their role in multifamily finance, they have no mandate to take on the additional risk of affordable housing. Their mortgage programs are based on maximizing profits for their investors and policyholders.

[1] They continue to provide credit enhancement, but only for fixed-rate bonds as the variable-rate bond market is unstable and their regulator has prohibited them from taking the variable rate-bond market's liquidity risk.

They will also not step in to fill the financing needs of older properties, properties with subsidy, properties in weaker markets or properties with physical needs.

- A resumption of bank lending will also not fill the gap because stricter portfolio and accounting standards limit their ability to provide development and debt capital. Banks have never been a source of long-term financing (longer than three to five years).
- It is unclear when and to what extent the commercial mortgage-backed securities (CMBS) markets will be able to meet the multifamily sector's capital needs both in the short and long term. Private label CMBS provided 12 percent of net financing capital, or $1 billion a year, in the 10-year period from 1985 to 1994. It grew to 18 percent, or $6.3 billion per year, in the next 10-year period from 1995 through 2004 before peaking at 23 percent, or $17 billion a year, in the housing bubble years of 2005 through 2007. Since the bubble burst in 2007, private-label CMBS have had net flows of -$7.5 billion per annum (-22.3% of net multifamily financing flows) as the market shut down completely.
- The Federal Housing Authority (FHA) is likewise not a replacement, as it has exceeded its capacity to serve a material share of the market. It would take a substantial commitment from the government to fund significant changes to FHA's resources, systems and delivery process for FHA to meet the financing gap. Currently, FHA is changing its multifamily underwriting criteria to reduce, not expand, the number of loans it funds as a result of weakening portfolio performance.

2. Preserving Critical Housing Stock

Another important, and often overlooked, function of the GSEs has been to provide the capital necessary to preserve older apartment properties. Typically, institutional investors overlook “Class B” and “Class C” properties. These are older buildings with fewer amenities, in weaker markets and/or in need of improvements, and they are crucial to meeting the housing needs of millions of Americans seeking affordable decent and safe housing.

Capital for these properties has historically been provided by local banks (now extremely limited), CMBS (now absent), FHA (at or near capacity) and the GSEs through the Low-Income Housing Tax Credit (LIHTC) and other investment funds. Without a strong secondary multifamily mortgage market, there will be insufficient capital to preserve affordable multifamily housing. More rental units will leave the market or be converted/upgraded and the nation will lose more than the 132,000 apartment units it already loses each year to obsolescence.[2]

3. Supporting Industry Standardization

The GSEs have created extensive standardization in the legal, financial underwriting, physical assessment and environmental hazard management (e.g., lead-based paint, asbestos, operations and management protocols, etc.) of multifamily real estate. The banks and insur-

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[2] Based on HUD’s Components of Inventory Change (CINCH) data set. Over the last decade, losses to the stock have averaged 0.71 percent annually. This figure is applied to our estimated apartment stock of 17 million.
Based on a total multifamily housing stock of approximately 17 million units, a loss rate of 0.5% would equal 85,000 units lost annually; a loss rate of 0.8% would equal 136,000 units lost annually.

ance companies also base their work on the GSEs' loan requirements and uniform mortgage documents.

This standardization has made multifamily financing more efficient, has helped lower the cost of capital, and has strengthened general underwriting in the apartment sector. The GSEs have been a leader in attracting worldwide capital sources to the housing industry.

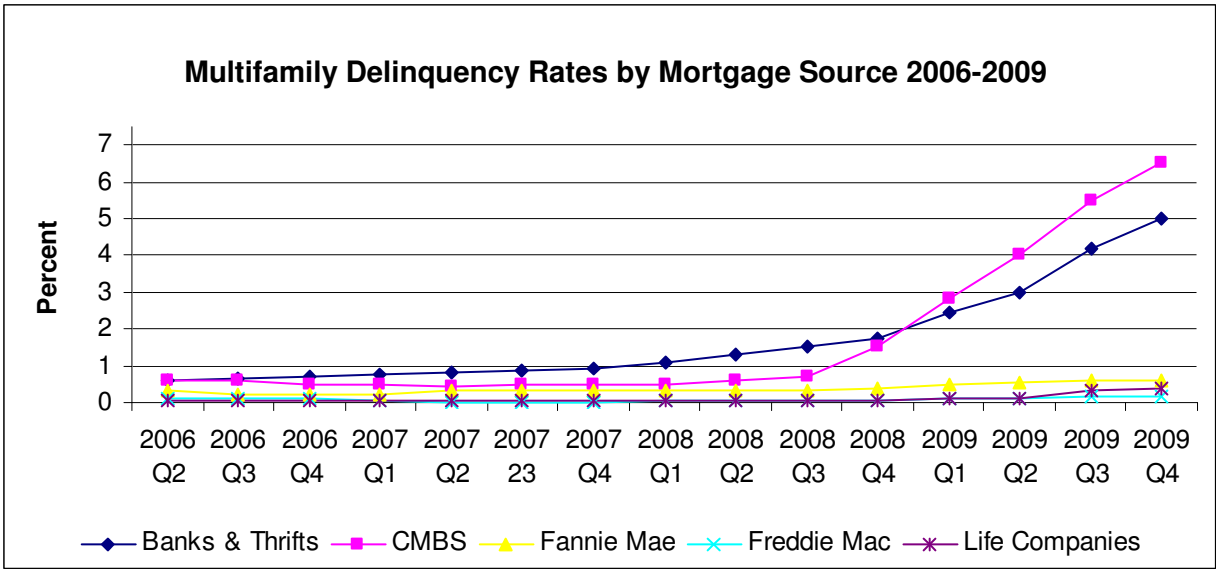
4. Providing Liquidity with Strong Historical Performance

The U.S. housing finance system, with the GSEs playing a central role as the system developed and evolved over the last 60 years, worked extremely well. It allowed the U.S. to enjoy the highest homeownership rate in the world and helped create the broadest and best housing stock on earth. It was the envy of the world.

The secondary market created by the GSEs has repeatedly shown its value as a liquidity source to ensure that the apartment sector had working capital in all market conditions. When credit markets have been impaired for reasons that have nothing to do with multifamily property operating performance, the GSEs have ensured the continued flow of capital to apartments. This was the case during the savings and loan crisis, the 1999 Russian economic crisis, and is the case today. This invaluable system has enabled our sector to continue to meet the nation's housing needs in good times and in bad, an important public policy goal.

Moreover, they have done it with strong historical portfolio performance. Over the past 20 years, their multifamily loan delinquency and defaults have been minimal—less than one fifth of one percent. At the end of 2009, the GSEs' delinquency rates were at or below one-half of one percent (45 bps). This is 14 times less than the CMBS market (6.5 percent) and 11 times less than commercial banks (5 percent). Even the government's FHA multifamily loan insurance program is experiencing higher levels of distress (1.2 percent) than the GSEs.

Table 4



Note: Delinquency is defined as follows: Banks & Thrifts = 90+ days; CMBS = 90+ days; Life Insurance Companies = 90+ days; Fannie Mae = 60+ days; and Freddie Mac = 90+ day.

Sources: Realpoint Research, Fannie Mae, Freddie Mac, Mortgage Bankers Association, U.S. Department of Housing and Urban Development.

There are many reasons for the GSEs' strong performance, including, but not limited to:

- sound and effective credit policy;
- prudent underwriting and loan terms and mortgage requirements;
- effective third-party assessment procedures (as part of the loan underwriting and due diligence process);
- strong contractual agreements with their origination and servicing partners;
- risk-sharing with and risk-retention by origination and servicing partners;
- effective loan portfolio management and oversight;
- standard mortgage documentation; and
- geographic and loan product diversification.

In addition, multifamily loans are generally considered to be less risky than and are expected to outperform other commercial real estate loans. The Congressional Oversight Panel's February 2010 report of commercial real estate noted that overall mortgage defaults in multifamily were less than half of commercial real estate—3.58 percent for multifamily among banks compared to 8.74 percent for all commercial mortgages.

To be sure, the prolonged economic weakness continues to affect apartment firms, and the GSEs are expected to experience an increase in problem loans, delinquencies, defaults and even foreclosures. However, these losses will be quite small compared to their single-family losses, and they will be within manageable levels.

It is important to point out that the GSEs reserved against these losses. Unfortunately, those reserves were used to pay off single-family losses; otherwise, there would be no impact to the taxpayer for the GSEs' multifamily losses. Also important to note is that the multifamily finance business lines of Fannie Mae and Freddie Mac have provided steady and significant profits to the GSEs. **If they, or whatever replaces them, continue to manage their multifamily business as the GSEs have for the past 20 years, and continue to benefit from greater oversight, the risk to the taxpayer will be minimal.**

The Multifamily Apartment Industry is Small Business

More than one-half of multifamily apartment communities (5 or more units) are individually owned. Bureau of the Census data shows that 299,262 multifamily apartment properties are owned by individuals. This represents 55 percent of the nation's 544,621 multifamily properties.

The top fifty owners of multifamily apartment units represent only 16 percent of the nation's 17,453,000 multifamily apartment units:

Table 5

Apartment Ownership Concentration by Units

	Units owned (000)	
Top 10 owners	1,260	7%
Top 25 owners	2,064	12%
Top 50 owners	2,847	16%
All apartments	17,453	100%

Source: NMHC's survey of the top 50 apartment owners and managers: 2010.

Tomorrow's Housing Policy: New Principles

I would also like to take a moment to address our national housing policy more broadly as I feel that it underscores the importance of explicitly considering the multifamily component in a restructured secondary mortgage market.

For decades, the federal government has pursued a "homeownership at any cost" housing policy, ignoring the growing disconnect between the country's housing needs and its housing policy. In the process, many people were enticed into houses they could not afford, which in turn helped fuel a housing bubble that ultimately burst and caused a global economic crisis.

The nation is now paying the price for that misguided policy and learning firsthand that there is such a thing as too much homeownership; that aggressively pushing homeownership was not only disastrous for the hardworking families lured into unsustainable homeownership, but also for our local communities and our national economy.

If there is a silver lining in this situation, it is the opportunity we now have to learn from our mistakes and rethink our housing policy. Housing our diverse nation means having a vibrant rental market along with a functioning ownership market. It's time we adopt a balanced housing policy that doesn't measure success solely by how much homeownership there is.

For many of America's most pressing challenges, from suburban sprawl to affordable housing, apartments are a much better solution. Apartments help create stronger and healthier communities by offering enough housing for the workers that businesses need, by reducing the cost of providing public services like water, sewer and roads and by creating vibrant live/work/play neighborhoods.

They will help us house our booming population without giving up all our green space and adding to pollution and traffic congestion. And they will help us reduce our greenhouse gas emissions by creating more compact communities that enable us to spend less time in our cars.

Elements of a Balanced Housing Policy

NMHC and NAA have joined together to advocate for a more balanced housing policy, one that respects the rights of individuals to choose housing that best meets their financial and lifestyle needs. We urge policymakers at all levels of government to work with the apartment industry to craft a smarter housing policy that:

- Assures that everyone has access to decent and affordable housing, regardless of his or her housing choice;
- Respects the rights of individuals to choose the housing that best meets their financial and lifestyle needs without disadvantaging, financially or otherwise, those who choose apartment living;
- Promotes healthy and livable communities by encouraging responsible land use and promoting the production of all types of housing;
- Recognizes that all decent housing, including apartments, and all citizens, including renters, make positive economic, political and social contributions to their communities; and
- Balances the expected benefits of regulations with their costs to minimize the impact on housing affordability.

I thank you for the opportunity to address the Committee.