COVERED BONDS

NMHC/NAA Viewpoint
NMHC/NAA support legislative efforts to create a regulatory framework for a covered bond market in the U.S. However, a covered bond system would only meet a small percentage of the $100-$150 billion in apartment financing needed each year.

Apartments are a capital-intensive business that requires a diversity of debt sources to provide mortgage financing for a wide array of properties. Without reliable access to this type of credit, the industry cannot function properly to meet the housing needs of the 37 million Americans who live in apartments.

As lawmakers seek ways to reduce the industry's reliance on government-backed financing sources, some have proposed developing a covered bond market to provide an additional source of liquidity for the U.S. housing market. While a covered bond market could, under the right circumstances, create additional liquidity in the overall housing finance system, it is unclear how much, if any, of that additional capital would benefit the apartment industry.

Covered bonds are relied on heavily in Europe as a source of mortgage finance, and they work similar to a mortgage-backed securities (MBS) market. Under both systems, a financial institution buys individual loans from lenders, pools them and then sells risk-based tranches to investors. However, unlike MBS, covered bond loans remain on a bank's balance sheet.

Multifamily originations are on pace to top $160 billion in 2013. Meeting those capital needs requires a diverse and robust housing finance system.

The bank retains control of the assets and makes bond payments from their general revenue. While this makes covered bonds a safer and more desirable investment, it also limits how much banks can lend because they must hold the loans on their balance sheets and retain capital reserves in case of losses. Because of this limitation, banks would be more likely to simply replace some of their existing whole loans with covered bonds rather than add significant new lending capacity.

Moreover, the bulk of any liquidity created by a covered bond market would likely support the single-family residential home-mortgage market and not apartments, as has been the case in Europe, unless allocation and diversification requirements are put in place for covered bond issuers.

For these reasons, a covered bond market might augment the financing sources currently active in the U.S. multifamily finance marketplace, including the commercial mortgage-backed securities (CMBS) market, government-sponsored enterprises (GSEs), life companies, banks and other balance sheet lenders, but it could not adequately replace any of them.

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