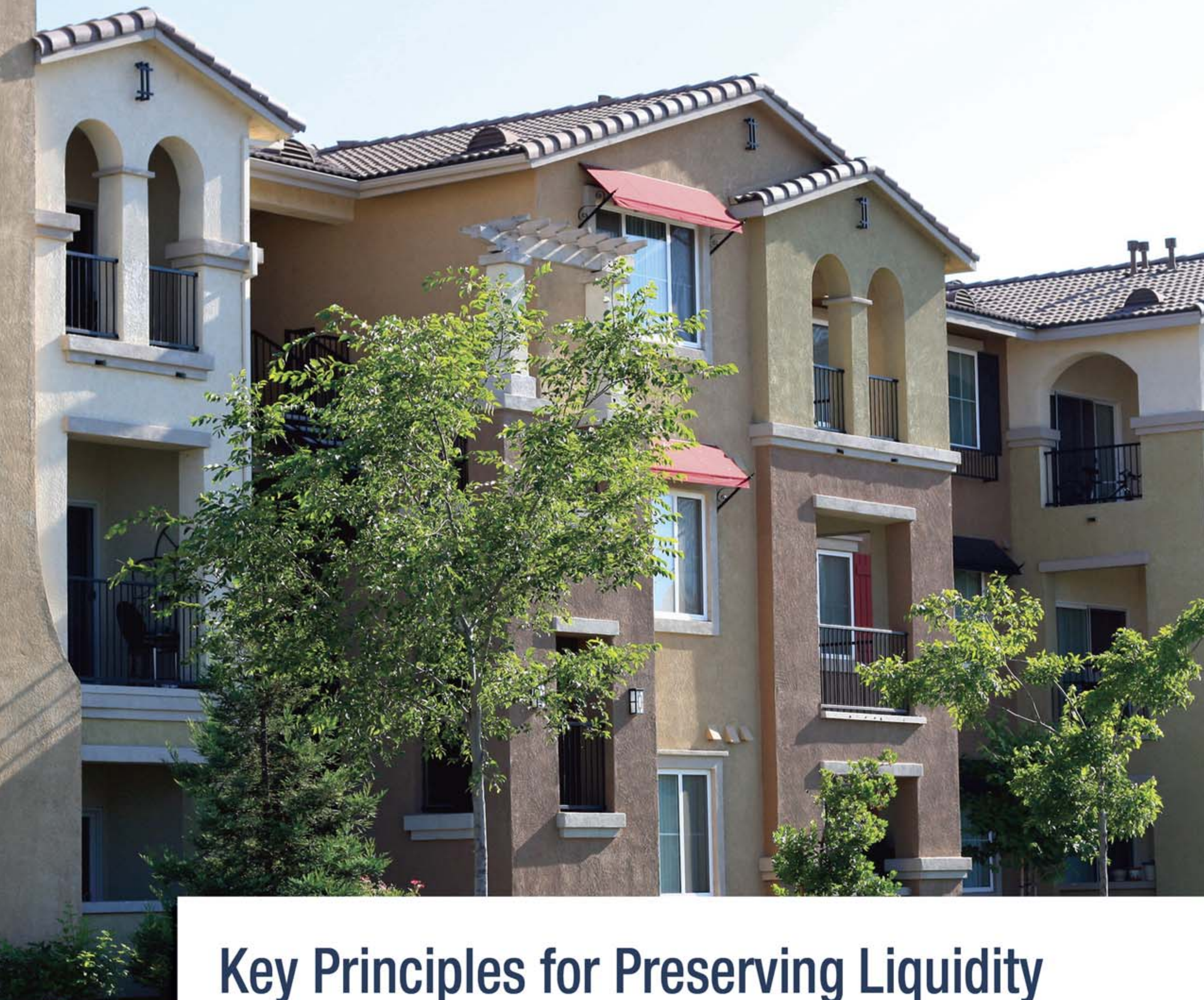


Key Principles for Preserving Liquidity and Stability for Multifamily in a Reformed Housing Finance System

NMHC National Multi Housing Council®
Apartments: Smart Communities, Smarter Living

NAA National Apartment Association

NMHC National Multi Housing Council®

Apartments: Smart Communities, Smarter Living

NMHC is a national association representing the interests of the larger and most prominent apartment firms in the U.S. NMHC's members are the principal officers of firms engaged in all aspects of the apartment industry, including ownership, development, management, and financing. NMHC advocates on behalf of rental housing, conducts apartment-related research, encourages the exchange of strategic business information, and promotes the desirability of apartment living.

www.nmhc.org

NAA National Apartment Association

NAA is the nation's largest and leading professional organization with 58,000 members of affiliated associations representing 6.5 million apartment units. Our members are recognized industry leaders who uphold the highest integrity and business practices through our Educational Institute's professional designations. NAA's advocacy initiatives span legislative and regulatory public policy at all levels of government to ensure apartment homes are a national priority.

www.naahq.org

Overview

One in three Americans rent, and 17 million of those households are building their lives in an apartment.[1] Apartments are helping meet the housing needs of people across all income levels in every corner of the country, from our cities to our smaller inner-ring suburbs and even to our rural communities.

Renters include young professionals; empty-nesters looking to downsize; people who want to live near their work; seniors on a fixed income; married couples without children; families working their way up the economic ladder; and even higher-income households who value the convenience or mobility that renting offers.

Today's apartment industry is a competitive and robust sector of our economy. In 2011, the most recent year for which full data are available, spending by the industry and the residents who live in their buildings generated a $1.1 trillion contribution to the national economy and supported 25.7 million jobs.[2]

> One in three Americans rent, and apartments are helping meet the housing needs of 17 million households across all income levels in every corner of the country.

Many factors influence the apartment industry's health and its ability to meet the nation's growing demand for rental housing, but the availability of consistently reliable and competitively priced capital is perhaps the most essential.

The bursting of the housing bubble exposed serious flaws in our nation's housing finance system. But those flaws were largely confined to the single-family sector. The Government-Sponsored Enterprises' (GSE) (i.e., Fannie Mae and Freddie Mac) very successful multifamily programs were not part of the meltdown and have actually generated $7 billion in net profits to the government since conservatorship.[3]

More than just performing well, the GSEs' multifamily programs serve a critical public policy role by addressing a market failure in the housing finance system that results in an abundance of capital for high-end properties in top-tier markets, but leaves secondary and tertiary markets like Indianapolis, IN, or Topeka, KS, underserved. The GSEs ensure that multifamily capital was available in all markets and at all times, so the apartment industry can address the broad range of America's housing needs from coast to coast and everywhere in between.

Although there has been much discussion about reforming, and perhaps eliminating, the GSEs, there is no consensus as to how to move forward. As policymakers craft solutions to fix the single-family housing problems, they should be mindful not to do so at the expense of the much smaller and less understood, but vital, multifamily sector.

Multifamily finance operates very differently from single-family finance, and preserving liquidity for the multifamily sector requires a distinct and separate solution. Although that solution may come as part of a comprehensive housing finance reform measure that addresses both single-family and multifamily housing finance, a one-size-fits-all solution would have disastrous consequences for the nation's supply of workforce housing.

The National Multi Housing Council (NMHC) and the National Apartment Association (NAA) urge lawmakers not only to pursue a separate solution for multifamily that recognizes the industry's unique needs, but also to retain the successful components of the existing multifamily programs in whatever succeeds them. We believe the goals of a reformed housing finance system for the multifamily sector should be to:

1. ensure mortgage liquidity in all markets at all times;
2. ensure capital availability for the wide range of properties, sponsors and renters;
3. expand private capital participation;
4. limit/mitigate market disruptions; and
5. insulate taxpayers from losses.

Background

Rental Housing Helps Build Lives and Communities, But Demand Is Surpassing New Supply

Communities across the country, both big and small, need access to a mix of housing options for their local economy to grow and prosper. Increasingly, that includes apartments. From year-end 2004 through year-end 2011, more than 5.4 million net new renter households were formed, growing their ranks from 33.0 million to 38.4 million, according to the U.S. Census Bureau.

> Without consistently reliable and competitively priced capital, the apartment industry cannot meet the nation's growing demand for rental housing.

Renter households are expected to become an even larger portion of our overall housing picture going forward. The combined effect of population growth, demographic shifts, economic challenges and changing consumer preferences means renters could comprise fully half of all new households by the end of this decade, up to seven million additional renter households.[4]

To meet this expected demand, the industry must build at least 300,000 units annually and as many as 400,000 depending on economic conditions and the rate of new household formations.[5] Yet new development virtually halted for two years during the capital market collapse and still remains below average. The number of apartments started in 2011—167,400—was just barely enough to replace the units lost to destruction, demolition and obsolescence.[6] New apartment properties are needed in communities large and small in virtually every state to house all these new renters. A reformed housing finance system must ensure that reliable and appropriately priced capital is available to support this demand.

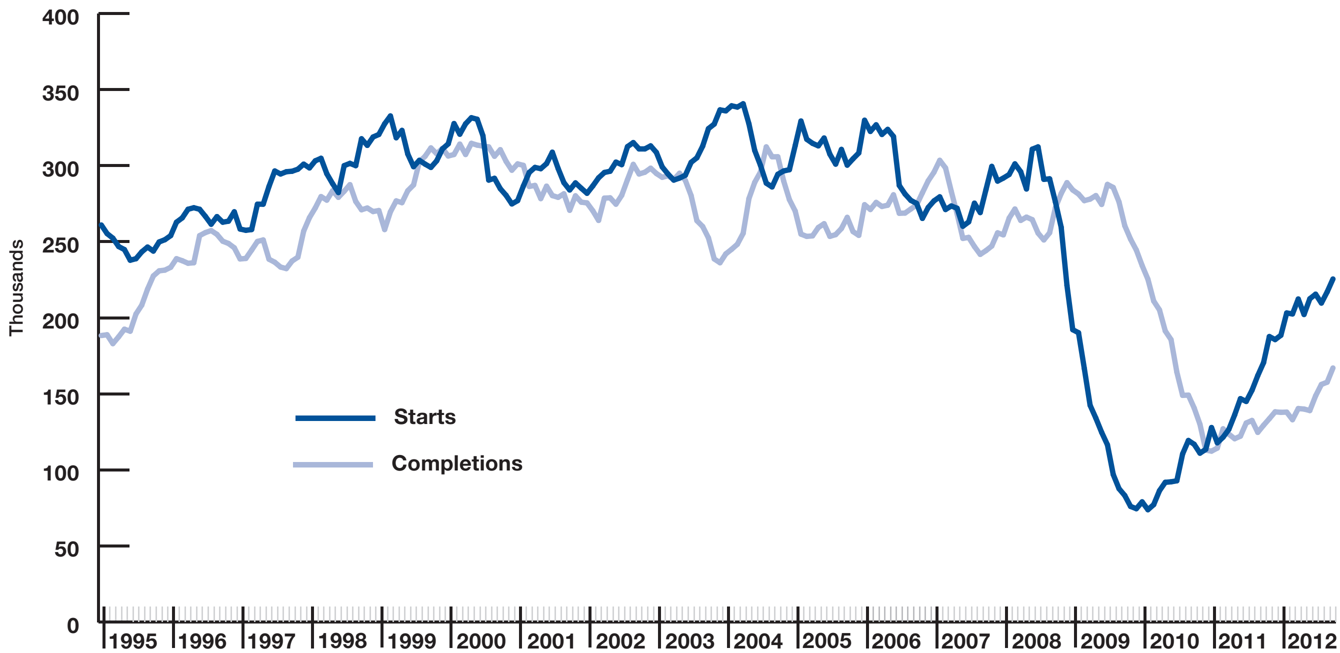
Liquidity Market Failure Underscores Role for Public Policy

Preserving liquidity for multifamily is about more than just building new apartments, however. It is also about ensuring there is sufficient capital to refinance the billions of dollars worth of existing mortgages that mature each year. Failure to do so puts millions of renters at risk.

Unlike residential mortgages, which are typically for 30-year terms, most multifamily mortgages are for a period of seven to 10 years. In 2013 alone, an estimated $100

Multifamily Starts and Completions Are Rebounding, But Remain Below Average and Demand

Multifamily (5+ units) Construction (6-month moving average)



Source: U.S. Census Bureau

billion in multifamily mortgages will need to be refinanced, many of which are not in areas that attract private capital.[7]

Institutional capital typically limits itself to top-tier markets and trophy assets. It is far less interested in secondary and tertiary markets, places like Tulsa, OK, and Schenectady, NY. Even in large urban areas where institutional capital is available, it is not available to all property types and in all submarkets. Yet these properties make up a significant portion of the nation's workforce housing.

The GSEs' multifamily programs have provided the capital for thousands of properties over the past 20 years that otherwise would not have been able to find a lender to refinance their mortgage when it came due. Without them, even though these properties were capable of covering their debt, they would likely have faced foreclosure, putting millions of renters at risk of losing their housing.

The market failure the GSEs' multifamily programs addressed was ensuring capital reaches markets deemed undesirable by institutional capital. It is imperative that a reformed system continue to fill this important public policy need.

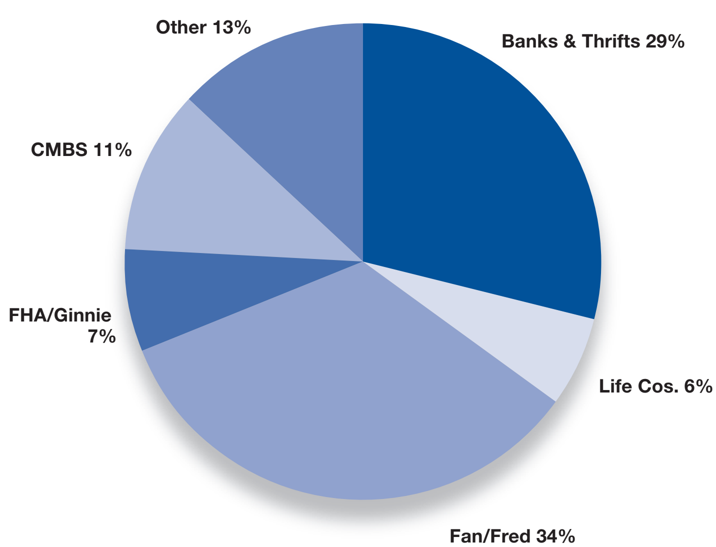
Private Capital Is Necessary, But a "Private-Only" System Leaves Vast Amounts of the Country Underfunded

Private capital is certainly an integral part of the multifamily housing finance system, and we support the return to a marketplace dominated by private capital. The apartment sector has historically relied on a wide range of capital sources outside of the GSEs. They include commercial banks, life insurance companies, commercial mortgage-backed securities (CMBS) and the Federal Housing Administration's (FHA) multifamily programs. But each of these has its own focus, strengths and limitations. Collectively, however, even during healthy economic times, these private-market sources simply have been unwilling or unable to meet all of the rental housing industry's capital needs.

Banks are limited by capital requirements and have rarely been a source of long-term financing. Life insurance companies have typically comprised less than 10 percent of the market, lend primarily to newer, high-end properties and enter and exit the multifamily market based on their investment needs and economic conditions. FHA has exceeded its capacity. The private-label CMBS market will be an important capital source, but because of the stricter regulatory environment post-financial crisis, it is unlikely to return to the volume it reached pre-crisis.

We are encouraged by the thawing in the private capital markets, but we are unconvinced by the claims of some private capital providers that they can fully replace the liquidity offered by the GSEs. Already in this recovery we are seeing the historical pattern of uneven access to capital repeat itself. The new private capital coming into the apartment sector is concentrating in a handful of cities and on trophy assets.

Who Holds the $844 Billion in Outstanding Multifamily Debt?



Source: Federal Reserve Board

Even with the increased role for the GSEs in the most recent financial crisis, private capital provides more than half of the outstanding mortgage debt. The GSEs account for approximately one third.

Apartment firms providing critical housing in secondary and tertiary markets and rural areas are not benefiting from the resurgence in private capital. Even in the larger markets, firms providing workforce housing find themselves equally shut out. A private-capital-only solution leaves vast amounts of the country out—places like Kansas City or Indianapolis. Affordable properties in these markets are not the only ones overlooked. Securing capital for conventional, market-rate properties in these smaller markets is difficult if not impossible; and where it is available, it is significantly more costly.

A "Private Only" System Leaves the Nation's Housing Vulnerable to Market Dislocations

The programs created by the GSEs also serve as a critical backstop that ensure the continued flow of capital to apartments when credit markets become impaired for reasons that have nothing to do with multifamily property operating performance.

This most recent financial crisis underscores the significance of the public policy goals the GSEs have served in providing liquidity. When virtually every other capital source left the market, the GSEs kept liquidity in the market and prevented a widespread rental housing depression. They played a similar role during the 1997-1998 Russian financial crisis and in the post-9/11 recession in 2001.[8]

Given the importance of housing, in particular for America's working families, there is a vital public policy role for government to play in preserving this liquidity. Whatever succeeds Fannie Mae and Freddie Mac should serve a similar role in the future as we design a new housing finance system.

A Separate Solution for Multifamily

While policymakers are understandably focused on reforming the GSEs' single-family programs, they must also understand the unique needs of the multifamily housing sector. The two sectors operate differently, have divergent performance records and require distinct reform solutions.

The businesses of multifamily finance and single-family finance differ in many ways. The capital sources for multifamily are not as wide or as deep as those financing single-family, and the loans themselves are not as easily commoditized. Moreover, the financing process; mortgage instruments; legal framework; loan terms and requirements; origination; secondary market investors; underlying assets; business expertise; and systems are all separate and unique from single-family home mortgage activities.

As a result, there are two distinct secondary markets for single-family and multifamily mortgage products, and each requires its own approach to reform. NMHC/NAA were pleased that the Federal Housing Finance Agency (FHFA) recognized in its February 21, 2012, strategic plan for privatizing the GSEs that "generating potential value for taxpayers and contracting the Enterprises' multifamily market footprint should be approached differently from single-family, and it may be accomplished using a much different and more direct method."

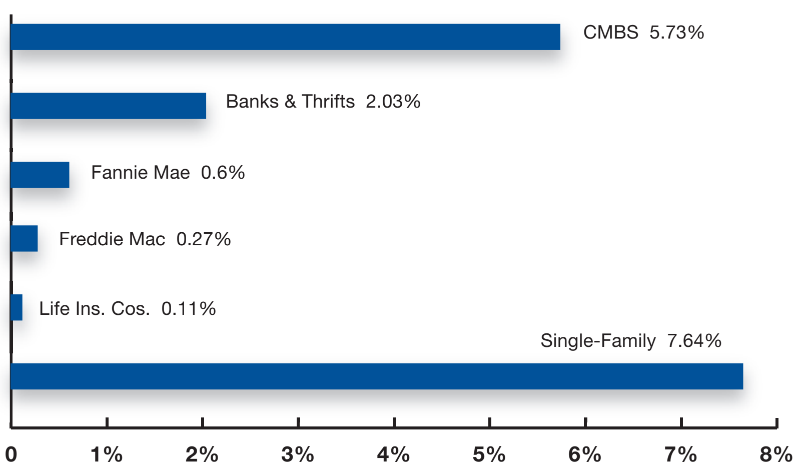
A Model That Works

As lawmakers look ahead to reforming Fannie Mae and Freddie Mac, they should recognize the critical role they have played in supporting the development of a strong, private apartment industry that is vital to meeting the housing needs of millions of Americans across the country.

The apartment industry did not overbuild in the housing boom, and the GSEs' multifamily programs did not contribute to the housing meltdown and are not broken. Unfortunately, the losses experienced in their single-family divisions have overshadowed the strong performance of their multifamily programs.

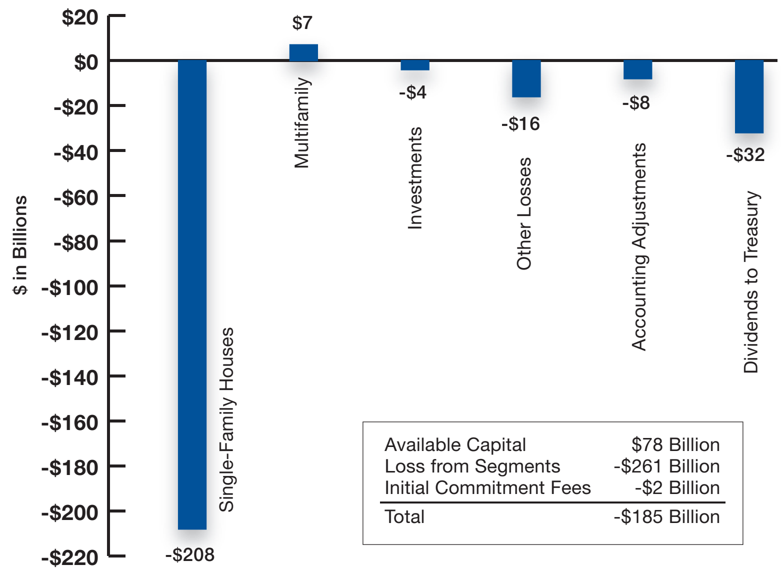
Thanks to strong credit risk management practices, the GSEs' multifamily programs have a serious delinquency/default rate of 0.51 percent compared to 8.7 percent for single-family mortgages. The GSEs have also outperformed all other sources of multifamily debt, including commercial banks, CMBS and FHA.

Delinquency Rates of Multifamily Debt Providers: GSEs Outperform Most Others



CMBS figures as of 10/30/2012; Fannie Mae and Freddie Mac as of 3Q 2012; banks, thrifts and life insurance companies as of 2Q 2012; single-family as of 10/30/212. **Sources:** Morningstar Monthly CMBS Delinquency Report 10/24/12; Federal Deposit Insurance Corporation, September 2012; Fannie Mae and Freddie Mac Third Quarter 10Q Filing; ACLI, July 2012; and MBA National Delinquency Survey, October 2012.

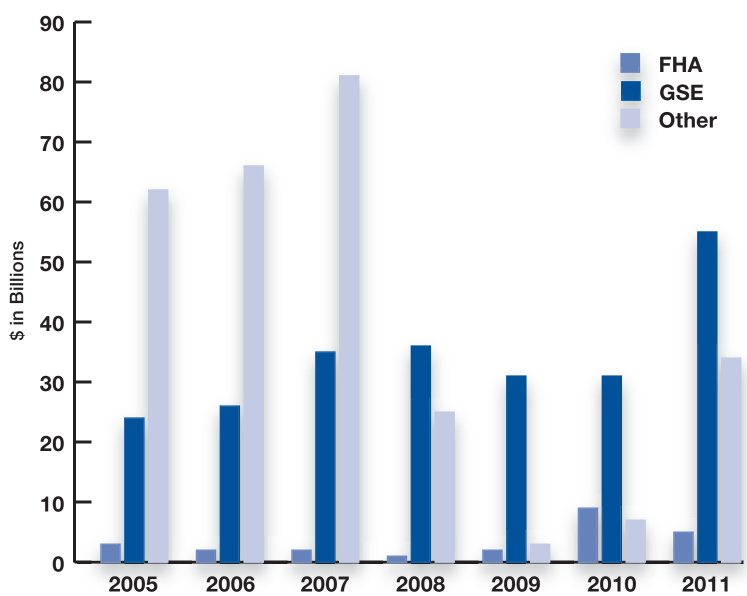
GSE Gains and Losses: Multifamily Programs Provide the Only Net Revenue (1Q 2008 through 3Q 2011)



Source: Capital changes between 1/1/2008 and 9/30/2011 are from the FHFA Conservator's Report on the Enterprises' Financial Performance, Third Quarter 2011, p 9. *Note: Numbers do not total due to rounding.*

GSEs' Share of Multifamily Mortgages Ebbs and Flows with Market Conditions, Serving as a Vital Backstop During Times of Crisis and Retreating in Strong Economic Times

Multifamily Mortgage Originations 2005–2010



Source(s): Information on private capital sources tabulated from the Mortgage Bankers Association's "Annual Report on Multifamily Lending." FHA data is provided by HUD, and GSE data is from their annual reports to FHFA. FHA and GSE data represent net new originations for the fiscal year for each and not total loan production. FHA data includes mortgage and refinance activity for conventional and LIHTC mortgage properties; health care, rural housing and construction lending are excluded. Originations by commercial banks, thrift institutions or other private debt capital providers are excluded.

The GSEs' multifamily programs have historically been well capitalized and have covered all losses through the loss reserves they collected. Even during conservatorship, the GSEs' multifamily programs have netted $7 billion in profit.

Through careful underwriting, the GSEs' multifamily models have met the test. They have attracted enormous amounts of private capital as a result of standardizing multifamily mortgage credit markets—from establishing strong due diligence requirements and documentation systems to industry-accepted risk-management standards.

They have created an effective risk-sharing partnership system that has helped finance millions of units of market-rate workforce housing without federal appropriations. They have spurred innovation in the marketplace to meet the wide range of borrower and property-type needs, as well as sustained liquidity in all economic climates. And they have done all of this while ensuring the safety and soundness of their multifamily lines of business and creating a mortgage credit standard.

As a result of the liquidity provided by the GSEs, the United States has the best and most stable rental housing sector in the world. They have counteracted the private sector's tendency to concentrate liquidity in certain geographic areas, as well as the ebb and flow of private capital from the multifamily sector based on broader economic conditions.

There are many reasons for the GSEs' strong apartment loan performance, including the following:

- 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.

We urge lawmakers to retain the successful elements of the GSEs' multifamily programs in a reformed housing finance system.

Key Principles of a Reformed Multifamily Housing Finance System

More than 17 million American households rely on the apartment sector to provide them with their homes, and without federal participation, vast swaths of the country would be left without sufficient liquidity to build, maintain or refinance those apartment homes. NMHC/NAA offer these key principles to guide multifamily housing finance reform.

1. Provide Access to Federal Credit Support

NMHC/NAA Position: *Given the market failure of the private sector to meet the apartment industry's broad capital needs, an explicit federal guarantee for multifamily-backed mortgage securities should be available in all markets at all times.*

Eliminating the federal guarantee would severely restrict private-investor appetite for multifamily-backed securities. Many investors, including sovereign wealth funds, investment funds and other institutional shareholders, purchase multifamily mortgage bonds precisely because they are implicitly backed by the federal government. They seek out these assets to diversify their portfolios and are willing to take lower returns because of the guarantee. Without it, they would likely move their money to Treasury and other high-grade corporate debt. They aren't likely to invest in higher-risk private-label multifamily bonds because of the higher risk.

> **Market Failure:** A private-only housing finance system results in an abundance of capital for high-end properties in top-tier markets, but leaves secondary and tertiary markets like Indianapolis, IN, or Topeka, KS, underserved.

Eliminating the guarantee would also force the apartment industry to rely on the private-label CMBS market as the primary secondary market execution. While the CMBS market is rebounding and will be an important capital source for multifamily, there are strong concerns that CMBS will not have the capacity to fully replace the GSEs or even provide the liquidity they did before the financial crisis. Increased regulatory oversight, including Dodd-Frank and risk-retention rules, combined with investor demand for higher quality assets and more transparency, will combine to produce lower volumes and higher prices for privately securitized debt. To the extent that these changes initiate a "flight to quality," it will leave mature apartment communities with fewer amenities (i.e., Class B and C properties) that relied more extensively on CMBS pre-crisis without sufficient capital.

Finally, eliminating the guarantee would fundamentally change the economics of apartment investment and create volatility that would negatively reverberate through the housing system. It would also encourage investors to exit the multifamily sector and increase the cost of equity that apartment owners seek to develop and maintain their properties. Furthermore, it would reduce the capital available to refinance the industry's maturing debt, and it could push more borrowers into FHA's multifamily insured loan program, which could require greater direct government investment at higher costs to the taxpayer. There are also serious concerns about FHA's capacity to absorb increased demand. When demand for FHA financing significantly increased after the financial collapse, loan processing timelines went from 60 days prior to the recession to 18 to 24 months.

2. Provide Broad Liquidity Support at All Times, Not Just "Stop-Gap" or Emergency

NMHC/NAA Position: *Any federal credit facility should be available to the entire apartment sector and not be restricted to specific housing types or specific renter populations.*

Narrowing any future credit source would remove a tremendously important source of capital to a large portion of our industry, namely market-rate developers who actually provide a large volume of unsubsidized workforce housing. Such a facility should also be available at all times to ensure constancy in the U.S. housing market throughout all business cycles. It would be impossible to turn on and off a government-backed facility without seriously jeopardizing capital flows.

3. Focus Mission on Liquidity, Not Mandates

NMHC/NAA Position: *The public mission of a federally supported secondary market for multifamily should be clearly defined and focused primarily on using a government backstop to provide liquidity and not for specific affordable housing mandates.*

> The industry supports a return to a system dominated by private capital; however, even in healthy economic times, private capital has not been able to meet the broad liquidity needs of the apartment industry.

Affordable housing mandates create conflicts within the secondary market, and some have claimed that affordable housing goals may have contributed to the housing crisis because of the distortions the mandates introduced into the GSEs' business practices. Instead of mandates, the new housing finance system should provide incentives to support the production and preservation of affordable multifamily housing. Absent incentives, the government should redirect the affordability mission to HUD/FHA and the Low-Income Housing Tax Credit program.

4. Restrict Federal Credit Support to the Security Level

NMHC/NAA Position: *The benefit of any federal guarantee should only accrue to the investors of multifamily mortgage-backed securities; it should not apply to the underlying multifamily mortgages or the entities issuing the securities.*

Providing a guarantee to the asset-backed security investor could be accomplished by either (1) modifying the current form of security or (2) making use of the Ginnie Mae guarantee. In the event of a borrower default, the losses would be incurred first by the parties that have retained first-loss risk, including risk-sharing originators/servicers and/or subordinate security investors. After that, the government guarantee would be used to pay the security investor; however, the security guarantor (i.e., the federal government) would look for reimbursement from the reformed/successor entity's risk-based capital reserves and from the mortgage originator if it had any retained risk. The reformed/successor issuing entity, in turn, would use the proceeds from the sale of the foreclosed property as reimbursement for the mortgage default. *(See Appendix I for a diagram outlining a possible government role in the mortgage origination process and the reimbursement process in the event of mortgage default.)*

5. Support Private Capital and Protect Taxpayers Through Effective Guarantee Structure and Pricing

NMHC/NAA Position: *Borrowers should pay for the guarantee in the form of an appropriately priced credit enhancement fee that actuarially insures taxpayers against future losses. Additionally, the fee should be priced to ensure that any advantage the GSEs historically have enjoyed over private mortgage capital is addressed and market participants not using government guarantees are not crowded out. Finally, if deemed necessary and appropriate, an insurance fund could be established from mortgage proceeds as an additional back stop against losses.*

Regardless of how the overall price paid to the government for the guarantee is established, the pricing should be (1) risk- and product-based as it is today; (2) reviewed, evaluated and reset on a scheduled basis; and (3) holistic and inclusive of the guarantee fee, risk-based capital, market-adjustment factors and other costs associated with the mortgage.[9]

6. Encourage Competition

NMHC/NAA Position: *Other entities should be allowed to obtain a federal charter to compete with the GSEs or their successors if they can meet mandated requirements, including robust levels of core capital and significant experience in mortgage underwriting.*

7. Empower a Strong Regulator

NMHC/NAA Position: *A strong and independent regulator with considerable expertise in multifamily lending is critical. To ensure sufficient financial resources and political independence, the regulator should be funded through industry assessments instead of congressional appropriations as is the case with the Federal Deposit Insurance Corporation, Federal Reserve and Office of the Comptroller of the Currency.*

The regulator of any restructured/successor entity would establish capital standards and other regulatory requirements to protect taxpayers. They would also work with other regulators and entities that establish and enforce risk-based capital standards for real estate lending. This includes prudential regulators, associations and other institutions that oversee and represent banks, insurance companies, the private securities markets (CMBS) and pension funds.

8. Impose Effective Capital Requirements

NMHC/NAA Position: *Effective capital reserve requirements, both for mortgages held in portfolio and those securitized, are vital to further protect taxpayers from future losses.*

In addition to capital requirements set by the new regulator, the reformed/successor entities would be required to comply with the systemic risk provisions in the Dodd-Frank Wall Street Reform and Consumer Protection Act (e.g., maintaining required capital levels and a "living will" for systemically significant institutions describing how they will be dissolved in the case of failure). They would also be required to maintain a minimum corporate credit rating as determined by their regulator. Finally, they would be prohibited from risk-mitigation activities that involve credit default swaps and other highly leveraged types of derivatives.

9. Retain Limited Portfolio Lending (Without a Federal Guarantee) While Expanding Securitization

NMHC/NAA Position: *Any restructured/successor entity should be able to retain restricted multifamily mortgage portfolios, although no government guarantee would apply to mortgages held in portfolio. Limited retained portfolios would be allowed for the following activities:*

1. Aggregate mortgages for the purpose of pooled securities execution;
2. Implement pilot mortgage programs and product modification testing;
3. Engage in targeted higher-risk transactions, including financing properties with rent-regulatory restrictions, off-campus student housing and senior and assisted living developments; and
4. Engage in pilot and other risk-sharing transactions for the purposes of workforce and affordable housing production with housing finance agencies, FHA and others.

We concur that a secondary market is critical to attract private capital to the multifamily sector. Already the GSEs' multifamily programs are shifting toward a securitization model. Since conservatorship, both Fannie Mae's and Freddie Mac's multifamily activities have, for the most part, relied on the sale of mortgage securities.[10] However, unlike single-family loans, multifamily loans are not easily "commoditized," and there are valid and necessary reasons to maintain some level of mortgages on the balance sheet of any entity.

To avoid a return to an over-reliance on portfolio lending, the following requirements should be applied to portfolio activities:

- No government guarantee of loans held in portfolio;
- Portfolio loans are subject to commercial bank mortgage risk-based capital standards; and
- Portfolio limits are to be established based both on absolute levels and as a percentage of guaranteed mortgage securities.

10. Reduce Existing Portfolios in a Responsible Manner

NMHC/NAA Position: *In the event that it is necessary and appropriate to establish GSE-successor entities (with or without new private capital), the current GSE multifamily portfolios should largely be transferred to the federal government to* *allow taxpayers to capture the portfolios' positive income stream and to eliminate any market advantage the GSE-successor entities would gain by retaining them on their balance sheets. However, any GSE-successor entities should be allowed to retain the minimum number of mortgages currently held in portfolio that are necessary to make them operationally viable. The GSE-successor entities should be charged with continuing to service the mortgages transferred to government control and would be paid a fee for doing so.*

To eliminate any capital advantage the newly privatized GSE-successor entities could have, the current multifamily portfolios should largely be transferred to the federal government except to the degree they are necessary to make the successor entities operationally viable. With such a transfer, the government would receive all the income from loan repayments, and the successor entities would be paid a fee for continuing to provide asset-management services for the transferred mortgages.

The two GSEs currently have combined portfolio mortgage holdings of approximately $300 billion, an amount that is forecast to continue to shrink both through natural attrition and the government-imposed liquidation of overall mortgage assets. (By contrast, the GSEs together hold more than $1.2 trillion in single-family mortgages in portfolio.) With default rates of less than one percent, the multifamily portfolios are expected to be profitable on an aggregate basis.[11] Under this proposed scenario, the government could realize revenue gains while the current portfolio continues to shrink.

A Separate Solution: The meaningful differences between the single-family and multifamily sectors require separate solutions for each. A solution that doesn't recognize the unique needs of the multifamily sector would have disastrous consequences for the nation's supply of workforce housing.

11. Create Certainty and Retain Existing Resources/ Capacity During the Transition

NMHC/NAA Position: *To avoid market disruption, it is important that policymakers clearly define the role of the government in a reformed system and the timeline for transition. Without that certainty, private capital providers (e.g., warehouse lenders and institutional investors) are likely to limit their exposure to the market, which could cause a serious capital shortfall to rental housing. In addition, during the transition years, we believe it is critical to retain many of the resources and capacity of the existing GSEs. The two firms have extensive personnel and technology expertise, as well as established third-party relationships with lenders, mortgage servicers, appraisers, engineers and other service providers, which are critical to a well-functioning secondary market.*

Private capital is returning to the market, but as has been the case historically, it is concentrating in a handful of cities and on trophy assets.

Key Differences Between Current/Past Status and a Reformed System

The key principles outlined by NMHC/NAA for a reformed multifamily housing finance system reflect meaningful differences between the current and historical GSE structure and a future one. The four main differences are:

1. **Government Guarantee at the Security Level Only.**
   NMHC/NAA's key principles would only apply the government guarantee to the unsubordinated mortgage security investor. The government claims for mortgage losses would inure to the successor entity, and the entity would compensate the government for any losses through reserves and shareholder capital. In the event of bankruptcy by the restructured/successor entity, the government would be the preferred creditor.

2. **Separately Account for Multifamily Activities.**
   Given the need for a unique multifamily solution and the fact that single-family and multifamily have different credit risk, mortgage purchase, aggregation and securitization, any reformed system must separately account for—and report on—its multifamily financing and securitization activities.

3. **Market Pricing.**
   The pricing of the federal guarantee must be done in such a way that it not only attracts mortgage-security investors, but also compensates the government for the value of the securities' insurance, funds needed risk-based capital reserves and does not crowd out private capital.

4. **Limited Retained Mortgage Portfolio.**
   The restructured/successor entities should be permitted to have a limited retained mortgage portfolio to support securitization activities and address overall mortgage credit risk. Mortgages retained in the portfolio after conservatorship would not be backed by the federal guarantee and would have higher capital reserve requirements than securitized mortgages. To prevent a return to a portfolio-based financing system, an overall portfolio cap would be imposed.

Conclusion

Steady, reliable and reasonably priced capital is essential to the apartment sector's ability to meet the nation's growing housing needs. While it is important for the nation to transition back to a housing finance system dominated by private capital, history suggests that a private-market only solution will provide insufficient capital to support the broad range of apartments needed throughout the entire U.S.

Given that market failure, there is an appropriate role for government to play in ensuring there is sufficient capital available to build, maintain and refinance housing for its citizens.

> A reformed housing finance system should retain the successful components of the existing multifamily programs in whatever succeeds them.

The existing GSEs provide a model for how that role can be served. Ultimately policymakers will need to determine if it makes sense to fundamentally change the structure of the GSEs (charter, capital, etc.) and keep them part of the system, albeit a smaller part, or wind them down completely. But lawmakers should be aware that whatever action they take, they must consider multifamily separately from single-family. Furthermore, policymakers are warned that winding down the GSEs without having a clear picture of what sources of capital can reasonably replace them is very risky and could easily result in severe disruptions to our housing system.

We look forward to working with both policymakers and stakeholders to further the debate and work toward a comprehensive and sustainable policy.

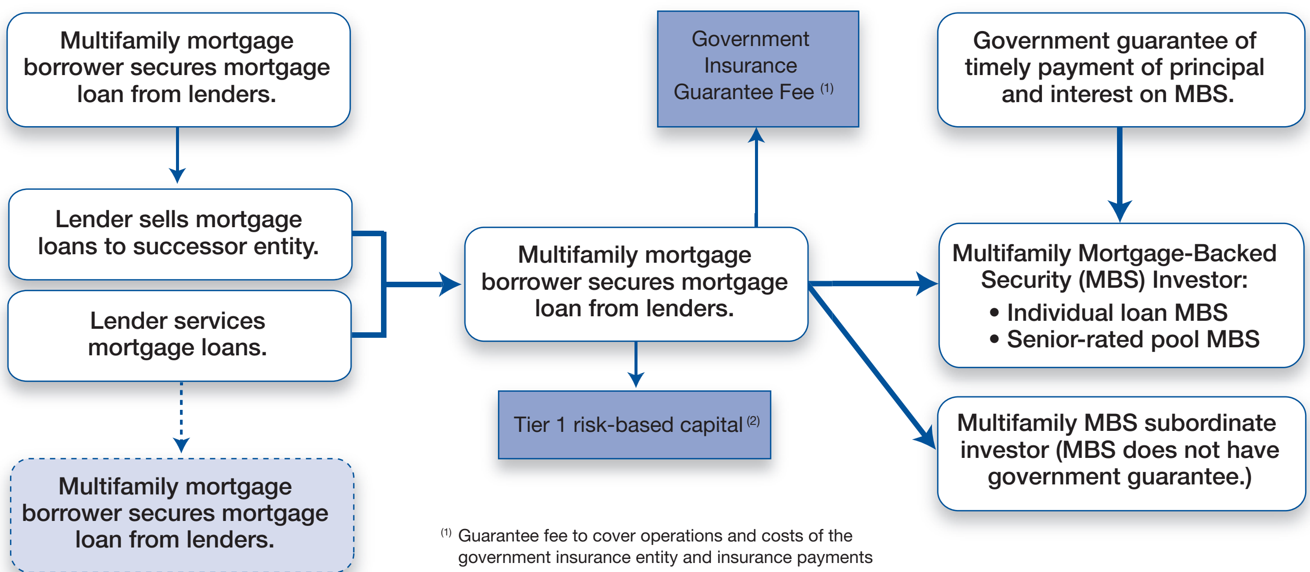
Appendix I

Proposed Successor Entity Mortgage Origination, Servicing and Securitization

The government should collect a guarantee fee on each mortgage-backed security issued by a GSE-successor entity and use those fees to pay security investors for defaults that occur in the normal course of business and to build reserves against significant losses due to structural or market failures.

As is outlined in this diagram, in the case that a GSE-successor entity experiences a loss during the normal course of business (i.e., a loss with regard to a limited number of loans), the government guarantee would compensate security investors for losses. The GSE-successor entity would then repay the government insurer for the outlay

Proposed Successor Entity Mortgage Origination, Servicing and Securitization



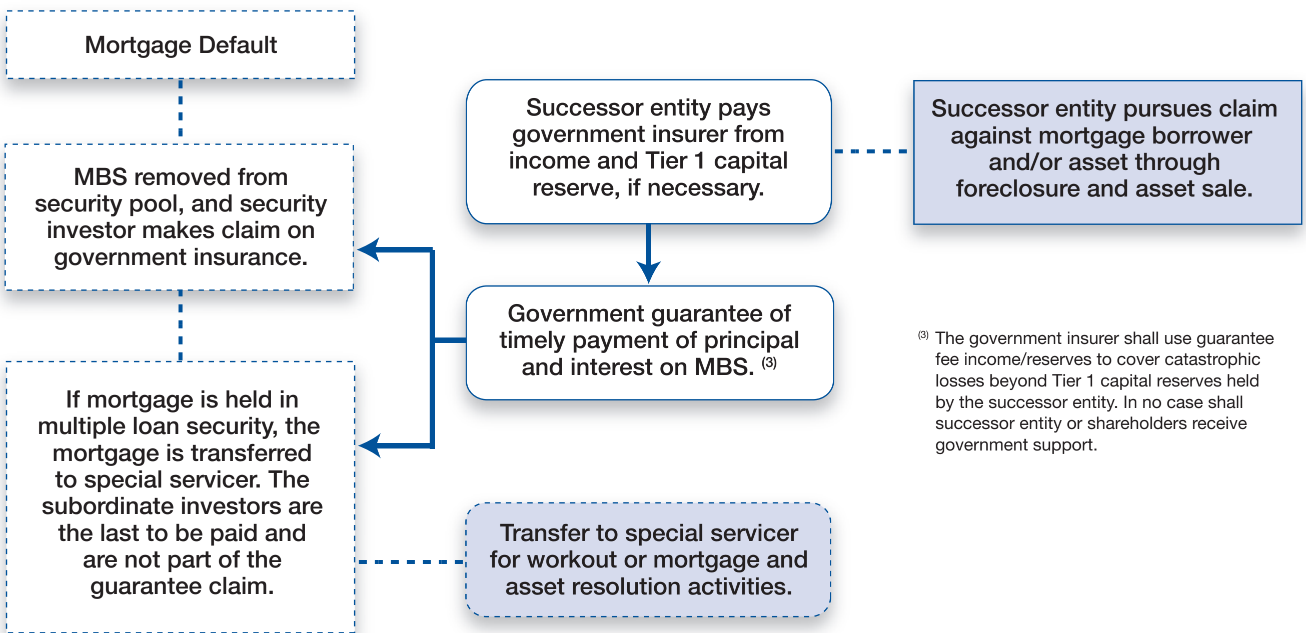
(1) Guarantee fee to cover operations and costs of the government insurance entity and insurance payments

(2) Tier 1 risk-based capital shall be used to cover mortgage default, foreclosure and associated costs necessary to reimburse the government insurer.

by looking to income and, if necessary, Tier 1 risk-based capital. Finally, the GSE-successor entity would then seek to recover its repayment by pursuing claims against the mortgage borrower or selling the underlying assets.

In the event of a failure of a GSE-successor entity, the government insurer would compensate security investors for losses. The government would seek reimbursement by seizing all capital held by the failed entity before tapping guarantee fees held in reserve. As the GSE-successor entity is wound down, the government would be entitled to any proceeds arising from the sale of mortgage real estate assets. Shareholders of the GSE-successor entity would fully lose their investment stake and be prohibited from receiving government compensation.

Mortgage Default, Guarantee Claim and Loss Mitigation Flow



(3) The government insurer shall use guarantee fee income/reserves to cover catastrophic losses beyond Tier 1 capital reserves held by the successor entity. In no case shall successor entity or shareholders receive government support.

NOTES

1. NMHC/NAA tabulations of data from the U.S. Census Bureau's 2011 Current Population Survey. *See: www.NMHC.org/goto/55508.*

2. NAA and NMHC (with data and research provided by Stephen J. Fuller), "The Makings of the Trillion Dollar Apartment Industry: How 35 Million Apartment Residents Drove a Trillion Dollar Contribution to the National Economy." February, 2013.

3. According to a report by the Office of Inspector General of the Federal Housing Finance Agency, the multifamily programs for the two Government-Sponsored Enterprises (GSE) created net profits of $7 billion through the third quarter of 2011. The assumption is additional net revenues have been earned since that time.

4. The estimate is based on NMHC/NAA tabulations of forecasts from the U.S. Census Bureau. The 2010 household formation rate of 37.8 percent was applied to the Census Bureau's high-immigration population projections from 2010 to 2020 to estimate the increase in number of households over the decade, namely 14.4 million *(see www.census.gov/population/www/projections/2009hnmsDownload.html for population projections)*. A 50-50 split between the number of new owner households and new renter households was assumed for the newly formed households. The number of newly formed renter households (7.2 million) was then added to the number of existing renter-occupied households in 2010 to estimate the total number of renter-occupied households in 2020.

5. Seven million new renter households in the decade breaks down to roughly 700,000 new renter households formed annually. Overall, about 43 percent of renters live in apartments. If the same rate applies to these additional renters, that would mean 300,000 additional apartments would be needed each year.

6. New privately owned housing units started in structures with five units or more, as reported by the U.S. Census Bureau. *See: www.census.gov/construction/nrc/pdf/startsan.pdf.*

7. "Commercial Real Estate Financing Loan Maturity Volumes as of December 31, 2011," Mortgage Bankers Association.

8. In the aftermath of the S&L crisis, depository institutions' net credit to multifamily borrowers fell by $39.4 billion, while the GSEs increased their multifamily mortgage credit by $8.9 billion. Similarly, beginning in 4Q 2007 through year-end 2011 (a time period encompassing the Great Recession and the implosion of the financial markets), depository institution multifamily mortgage credit dropped by $8.5 billion, and CMBS multifamily holdings plunged by $33.2 billion. During those same years, net multifamily credit extended by the GSEs rose by $106.1 billion. Data are NMHC/NAA tabulations of data from the Federal Reserve: *(www.federalreserve.gov/econresdata/releases/mortoutstand/current.htm)*.

9. Although NMHC/NAA take no position on how an actuarially fair guarantee fee should be set, one option would be to mandate that the regulator employ the rulemaking process and require the fee be reviewed no less than once per year. Under this scenario, the regulator could issue a proposed rule adjusting the guarantee fee based on an analysis of actuarial reports prepared by (1) the regulator; (2) the restructured/successor entities; and (3) an independent consultant retained by the regulator. The public would have an opportunity to comment on the proposed rule adjusting the guarantee fee before the regulator sets the final fee.

10. Fannie Mae issues mortgage-backed, pass-through securities backed by individual multifamily mortgages through their Delegated Underwriting and Servicing (DUS)-MBS lenders and program. They also issue pool-based securities of multifamily mortgages they aggregate through their GeMS and GeMS Mega securities offerings. Freddie Mac uses a pool-based securities execution similar to private-label commercial mortgage-backed securities through its Commercial Mortgage Execution (CME) facility. Unlike the Fannie Mae execution, Freddie Mac directs a small portion of the cash flow to securities that do not have any guarantee of payment or performance and that are subordinate to the cash flow of the government-guaranteed securities. As such, the investors receive a higher interest rate return, but they are at risk of losing a portion or all of their principal and interest should there be a material mortgage default or failure.

11. According to Fannie Mae's First Quarter 2012 Form 10-Q, as of March 31, 2012, the serious delinquency rate for its multifamily guaranty program was 0.37 percent. Freddie Mac reported in its First Quarter 2012 Form 10-Q a total delinquency rate of 0.23 percent for its multifamily segment. *See: www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2012/q12012.pdf and www.freddiemac.com/investors/er/pdf/10q_1q12.pdf.*

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