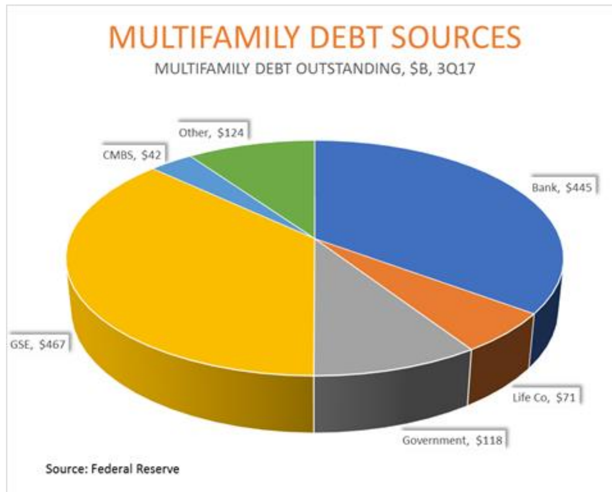
DEBT CAPITAL FLOWS TO THE MULTIFAMILY INDUSTRY

Historically, the apartment industry has relied on a variety of capital sources, each with its own focus, strengths and limitations, to meet its borrowing needs. These capital sources together have provided the apartment sector with over $150 billion annually on average – reaching approximately $280 billion in 2017 – to develop, refinance, purchase, renovate and preserve apartment properties.

Fannie Mae and Freddie Mac: A Critical Liquidity Backstop in All Markets and All Economic Cycles



- The Government Sponsored Enterprises (GSEs), Fannie Mae and Freddie Mac, serve an important role in the multifamily housing finance system, successfully attracting private capital to the sector who actively participate in taking first loss risk in all their loan purchases. Unlike any other single source of capital, they offer long-term debt for the entire range of apartment properties (market-rate workforce housing and subsidized properties, large properties, small properties, etc.) and are active in all markets (primary, secondary and tertiary).

- The GSEs' multifamily programs have served as a backstop to the industry, increasing at times of market dislocation when other capital sources leave the market, and decreasing as private capital returns. This was seen most recently during the 2008 financial crisis, when virtually all private capital left the market. Today, they currently hold 37%($467.3 billion) of the outstanding multifamily mortgage debt. Between 1990 and 2017, they accounted for 44% ($437.5 billion) of the net increase in mortgage debt.

Commercial Banks: Short-Term Financing for Smaller, Local Borrowers

- Commercial banks and thrifts generally serve as a source of credit for many borrowers to finance construction, acquisitions and ownership. They typically provide floating rate or short-term fixed rate debt, and often their willingness to extend this credit is based on the availability of permanent take-out financing offered by the GSEs.

- The banks currently hold 35%($445.1 billion) of outstanding multifamily mortgage debt. Between 1990 and 2017, they provided 32% ($317.7 billion) of the total net increase in mortgage debt. They provided limited amounts of capital to the industry during the financial crisis but have taken a much more active role in lending. Banks face constraints on maintaining the recent level of activity due to higher risk-based capital requirements, and new Basel accounting standards, which impose meaningful limits on the ability of banks to provide capital to commercial real estate. During 2017 the multifamily market saw meaningful pullback by depositories, especially in construction lending, due to regulatory and credit concerns.

Life Insurance Companies: Target High-Quality Properties, Capital Allocations Change with the Market

- Life insurance companies tend to restrict their lending to a handful of primary markets and to high-quality, newer construction apartment properties. They do not generally finance affordable apartments, and their loan terms typically do not extend beyond 10 years. Importantly, they enter and exit the multifamily market based on their investment needs and economic conditions. On average, they generally provide 10% or less of the annual capital needed by the multifamily industry, but that number has gone as low as 3%.

- They currently hold 6%($71.5 billion) of outstanding multifamily mortgage debt. Between 1990 and 2017, they accounted for 4% ($42.5 billion) of the net increase in multifamily mortgage debt.

FHA\GNMA: Reliable Capital Source but Limited Mortgage Products and Capacity Issues

- FHA offers high-leverage, long-term mortgages with 35-year terms and 80-83% loan-to-value ratio for the construction, substantial rehabilitation, and acquisition and refinancing of apartments. The loans FHA offers are frequently used for construction lending and the financing of affordable apartments. Ginnie Mae securitizes FHA loans and offers them with a full government guarantee.

- After the 2008 financial collapse, they became a vital source of construction capital and permanent financing for apartments, and now FHA/Ginnie Mae currently holds 8%($105.8 billion) of outstanding multifamily mortgage debt. Between 1990 and 2017, they accounted for 10.0% ($93.7 billion) of the total net increase in mortgage debt.

- Capacity issues, long processing times and statutory loan limit requirements prevent FHA from serving a larger share of the multifamily market.

CMBS/Conduits: Volatile Capital Source

- The CMBS market did not become a material source of capital to the apartment industry until the mid-1990s, peaking at 16.5% of the market, $17.6 billion a year, in the housing bubble years of 2005-2007.

- The CMBS market completely shut down after the 2008 crisis. Today, the CMBS market is showing some signs of recovery; however, regulatory changes imposed by financial regulatory reform legislation will mean that it will not return to its pre-bubble levels of lending.

- The CMBS market now holds 4%($42.5 billion) of the outstanding multifamily mortgage debt, however, it is no longer a major source of debt for the apartment industry and this share is expected to continue to shrink.

Source: Federal Reserve Report Mortgage Debt Outstanding