NMHC/NAA Multifamily Analysis: Bipartisan Johnson-Crapo Legislation

Background

Senate Banking Committee Chairman Tim Johnson, D-S.D., and Ranking Member Mike Crapo, R-Idaho, released draft legislation to reform America’s housing finance system on March 16. The legislation builds on the bill (S. 1217) introduced last summer by Senators Bob Corker, R-Tenn., and Mark Warner, D-Va., as well as a bipartisan group of eight co-sponsors.

However, the multifamily activities at Fannie Mae and Freddie Mac, and the broader industry, were largely passed over in the Corker-Warner bill, with senators and staff acknowledging that while the businesses performed well prior to and through the crisis, there was not consensus on how to proceed with their treatment at the time the bill was released.

In transitioning Fannie Mae and Freddie Mac away from their current conservatorship and status as Government-Sponsored Enterprises (GSEs), the Johnson-Crapo legislation recognizes the meaningful differences between multifamily and single-family and retains many of the successful components of the multifamily programs currently operating at Fannie Mae and Freddie Mac. The bill engages reform of the multifamily industry in earnest, with changes to the GSEs, their regulator, securities eligible for a government guarantee, affordability requirements and transparency for multifamily finance.

NMHC/NAA were pleased to work with members of the Senate Banking Committee to produce a bill that will help ensure that the $1 trillion apartment industry can meet the needs of the 35 million renters who now call an apartment home.

Key overall elements in the Johnson-Crapo bill include:

- **Preserving** a government guarantee for multifamily mortgages;
- **Maintaining** the current network of multifamily lenders and servicers;
- **Retaining** the current private-capital risk sharing mechanisms;
- **Establishing** a separate office of multifamily housing within the new Federal Mortgage Insurance Corporation (FMIC) that will regulate the industry;
- **Encouraging** more opportunities for private capital debt providers to serve the apartment sector; and
- **Addressing** the shortage of affordable housing through key provisions.

Johnson-Crapo announced a markup for the bill on April 29 at which time the Senate Banking Committee would amend and vote on passage of the measure. Some are currently questioning whether or not the vote will take place as they work to secure the number of votes needed.
Summary of Johnson-Crapo

New FMIC Entity

The Johnson-Crapo legislation modifies the market structure and government’s role in mortgage finance for both single-family and multifamily. A new regulator/insurance fund steward similar to the Federal Deposit Insurance Corporation (FDIC) would be established, known as the FMIC, for mortgage-backed securities that qualify for a government guarantee.

While private-sector participants will be responsible for originating, aggregating and securitizing loans, the FMIC will guarantee a portion of the credit risk on securities comprised of loans meeting FMIC standards.

Single-Family and Multifamily Distinctions

Johnson-Crapo also draws clear distinctions between single-family and multifamily in the treatment of current business activities for the GSEs:

- **Single-family** would be largely divested, or integrated, into a newly created Securitization Platform; and

- **Multifamily** operations would be separated into two wholly-owned subsidiaries with the goal of recapitalizing them as stand-alone companies within ten years of enactment.

These reconstructed companies would maintain their current processes and lender networks, however, they would not have special government status similar to the current model. They would instead be able to issue securities with a government guarantee on some portion of the credit risk, without receiving any governmental protection at the entity level.

Key Multifamily Provisions

**Full Faith and Credit of the Federal Government:** The draft establishes a federal guarantee for approved securities for single-family and multifamily.

**Establishment of a Multifamily Office within FMIC:** Within the FMIC, the successor to Federal Housing Finance Agency (FHFA), the draft creates an Office of Multifamily Housing responsible for establishing standards for covered securities, eligibility criteria for loans, and enforcement of multifamily guarantor regulations.

**Establishment of FMIC Board of Directors and Advisory Committee:** The draft creates a five-person board of directors similar to the Securities and Exchange Commission or FDIC and a nine person Advisory Committee to provide guidance and expertise on FMIC activities. Two of the seats on the Advisory Committee are required to have a background in multifamily, with one of those specifically reserved for affordable rental housing.

**Multifamily Title, including Fannie, Freddie Transition and Future Structure:** The draft dedicates Title VII to the transition, structure and regulation of the secondary market for multifamily mortgages. Characteristics of eligible loans, capital standards for guarantors (the first loss position in covered securities), reporting requirements, and fee descriptions for the federal guarantee and affordable housing activities are detailed in the multifamily title.
**Orderly Transition of Multifamily Operations:** The draft requires both Fannie Mae and Freddie Mac to develop a plan for separating their multifamily businesses into subsidiaries within 180 days of enactment and to execute this plan within one year. The transition to a subsidiary would serve as a staging point for the “sale, transfer, or disposition” of the businesses once they are determined to be viable and a capitalization method is agreed to. Upon transfer, the successor entities would act as approved issuer/guarantors for multifamily securities. FHFA would be responsible for oversight and approval of the transition process for multifamily.

The legislation preserves the multifamily lending networks and the multifamily mortgage activities of Fannie Mae and Freddie Mac in whatever disposition/capitalization method is chosen by FHFA. The bill specifically calls for the preservation of the Fannie Mae lender-based risk-sharing program utilized by its delegated underwriting and servicing (DUS™) lenders, and the Freddie Mac Program Plus and K-Series senior-subordinate securitization platform.

**Limited but Meaningful Affordable Housing Requirements:** The draft requires that all multifamily guarantors, the issuers and first loss position holders of covered securities, meet a minimum annual threshold for all rental units included in covered securities. Specifically, at least 60 percent of the units must be affordable at 80 percent of Area Median Income. This requirement applies to the total annual issuance of a guarantor, not to individual securities or loans. This requirement will continue to focus multifamily secondary debt providers on extending their activities to all markets and submarkets, as well as to continuing to meet the needs of the underserved.

**Elements of Covered Multifamily Securities**

Multifamily issuer/guarantors, including the successor entities to Fannie Mae and Freddie Mac Multifamily, will be required to:

- **Take or facilitate a 10 percent first loss position with private capital providers,** referred to as “guarantors” in the draft (notably, current risk-sharing methods employed at Fannie Mae and Freddie Mac will count toward meeting the 10 percent threshold);

- **Pay fees similar to the current guarantee fee on mortgages to a Mutual Insurance Fund** that will function as a catastrophic loss provider for covered securities; and

- **Pay a 10 basis point fee placed on each covered security to promote affordable housing** through the financing of a dedicated National Housing Trust Fund (supports development and preservation of affordable rental housing), a Market Access Fund (serves ownership and rental housing needs of low-income households through grants, loans, and credit enhancement), and a Capital Magnet Fund (provides grants to CDFIs for affordable housing loans and co-investment).
**Definition of Eligible Multifamily Loan**

Johnson-Crapo defines an eligible multifamily loan as a commercial real estate loan secured by a property with five or more residential units – or, if it is part of a demonstration or pilot program, two or more residential units.

The underwriting criteria would be established by FMIC and would include:

- A maximum loan-to-value ratio;
- A minimum debt service coverage ratio;
- Considerations for special uses of a property, such as nonresidential uses, seniors housing, manufactured housing and affordability restrictions; and
- A loan term of not less than five years and not more than 40 years.

**Proposed Entities in Johnson-Crapo Structure**

**Approved Aggregator:** Private-market participants approved by the FMIC to aggregate qualified mortgages for the purposes of securitization.

**Approved Multifamily Guarantor:** Private-market participants approved by FMIC to issue and guarantee a portion of credit risk on covered securities.

**Covered Security:** A security meeting all requirements for the government credit guarantee, including loan composition and guarantor solvency.

**Federal Mortgage Insurance Corporation (FMIC):** New regulator with jurisdiction over covered securities and variety of market participants. The FMIC will replace FHFA and have expanded authority over the MBS assembly line for covered securities.

**Background on GSE Reform Hearings**

Seeking to build a hearing record for future legislation the Senate Banking Committee held a series of hearings last fall to examine discrete elements of GSE reform. The hearing topics included:

- Private Label Mortgage Backed Securities, October 1st
- Multifamily Housing Finance, October 9th
- Consumer Protection in Housing Finance, October 29th
- Role of a Government Guarantee in Housing Finance, October 31st
- Small Lender and Small Loan Issues, November 5th
- Affordable Housing Options and Access, November 7th
- Powers and Structure of a Housing Finance Regulator, November 21st

The testimony provided in the hearings and feedback from numerous stakeholders informed deliberations between the Johnson and Crapo staffs throughout the fall. While the Senators repeatedly delayed release of the bill through late 2013 and early 2014, they did so to preserve the bipartisan support so critical to legislation in Congress.
**NMHC/NAA Outreach**

NMHC/NAA has to date met with Banking Committee members’ staff, individual Senate offices, and Administration officials from Treasury, HUD, and the National Economic Council since the bill’s release, and will continue to convey the importance of avoiding disruptions or restriction of capital to the multifamily market.

**Johnson-Crapo GSE Bill Details**

Related Links:
- [Bill text (442 pages)](#)
- [Section-by-section overview](#)

**Quick Reference: Multifamily Provisions**

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