

**STATEMENT BY  
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**ON BEHALF OF THE  
NATIONAL MULTI HOUSING COUNCIL  
AND THE  
NATIONAL APARTMENT ASSOCIATION**

**BEFORE THE  
U.S. SENATE COMMITTEE ON BANKING, HOUSING, AND  
URBAN AFFAIRS**

**AT A  
HEARING ENTITLED  
“HOUSING FINANCE REFORM: ESSENTIAL ELEMENTS  
OF THE MULTIFAMILY HOUSING FINANCE SYSTEM”**

**OCTOBER 9, 2013**

Chairman Johnson, Ranking Member Crapo and distinguished Members of the Committee, the National Multi Housing Council (NMHC) and the National Apartment Association (NAA) would like to thank you for this opportunity to testify on housing finance reform and the multifamily perspective. We applaud your leadership in seeking to address the fatal flaws in our finance system that led to the fiscal crisis of 2008.

For more than 20 years, the National Multi Housing Council (NMHC) and the National Apartment Association (NAA) have partnered in a joint legislative program to provide a single voice for America's apartment industry. Our combined memberships are engaged in all aspects of the apartment industry, including ownership, development, management and finance. NMHC represents the principal officers of the apartment industry's largest and most prominent firms. NAA is a federation of more than 170 state and local affiliates comprised of 63,000 multifamily housing companies representing 6.8 million apartment homes throughout the United States and Canada.

My name is Thomas S. Bozzuto and I am the Chairman and CEO of The Bozzuto Group. The Bozzuto Group is a privately held, integrated real estate services organization. In our 25-year history, we have created quality homes and extraordinary communities – some 35,000 residences to date. Our more than 1,000 team members pride ourselves on providing outstanding service and consistent value for customers and partners.

I appreciate the opportunity to be here today to present the multifamily industry's perspective on the role of the Government Sponsored Enterprises (GSEs), Fannie Mae and Freddie Mac, and specifically how the meaningful differences between the multifamily market and single-family market require very different solutions in the context of housing finance reform. I will also discuss why we believe there will be a continued need for federal involvement in the multifamily sector even after Fannie Mae and Freddie Mac are phased out.

Before I do that, however, allow me to describe some key aspects of the apartment market and how changing demographics will demand a continued flow of capital into this sector if we are to meet the future housing needs.

The apartment sector is a competitive and robust industry that helps 35 million renters live in homes that are right for them. We help build vibrant communities by offering housing choice,

supporting local small businesses, creating millions of jobs and contributing to the fabric of communities across the country. And we are increasingly important.

More than a third of America rents, and that number is growing. Between 2007 and 2012, the number of renter households grew by almost five million.<sup>1</sup> In this decade, renters could make up half of all new households—upwards of seven million new renter households.<sup>2</sup> An estimated 300,000 to 400,000 units a year must be built to meet expected demand; yet just 158,000 apartments were delivered in 2012 – less than half of what is needed.

While some of this growth is clearly due to the challenging economic circumstances following the recession, the upward trend in renter households predates the fiscal crisis and is increasingly the result of Americans' changing housing preferences. In 1955, married couples with children made up 44 percent of all households. Today they constitute just 20 percent, and that number continues to fall. Among the fastest growing population segments in the next decade will be young adults in their 20s and empty nesters in their 50s—those most likely to seek options other than single-family houses.

In addition, almost 80 million Echo Boomers are beginning to enter the housing market, primarily as renters. Furthermore, many of their parents, the more than 77 million Baby Boomers, are beginning to downsize, and some will choose the convenience of renting.

All this increasing demand is good news because meeting it will create millions of jobs. Apartments are more than just shelter. They are also an economic powerhouse. The \$1.1 trillion industry oversees apartment stock valued at \$2.2 trillion. In 2011, the apartment industry and its residents supported 25.4 million jobs. Moreover, in 2011, new apartment construction alone produced \$14.8 billion in spending, supported 323,781 jobs and had a total economic contribution of \$42.5 billion. The same year, the operation of the nation's existing apartments accounted for \$67.9 billion, 2.3 million jobs and a total economic contribution of \$182.6 billion. Apartment resident spending in 2011 totaled \$421.5 billion, supporting 22.8 million jobs and a total economic contribution of \$885.2 billion. To put these numbers into perspective, **apartments and the people who live in them contribute, on average, more than \$3 billion a day to the economy.**

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<sup>1</sup> 2012 American Community Survey 1-Year Estimates, U.S. Census Bureau, "Tenure". 2007 American Community Survey 1-Year Estimates, U.S. Census Bureau, "Tenure".

<sup>2</sup> Based on Harvard University Joint Center for Housing Studies' forecast of 13.8 million new households by 2030. *The State of the Nation's Housing 2012*, The Joint Center for Housing Studies of Harvard University, Pg. 16. <http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/son2012.pdf>

Finally, apartments also produce societal benefits; not only are they environmentally sustainable, resource- and energy-efficient, but they also help create a mobile workforce that can relocate to pursue job opportunities.

I highlight these important changes in housing choice, supply and demand as well as the economic and social contributions apartments make to society to explain why it is so important for Congress to consider the unique needs of the apartment industry as it pursues mortgage finance reform options.

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

The Great Recession exposed serious flaws in our nation's residential home mortgage finance system. The apartment industry did not overbuild and for the most part did not overleverage during 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 mortgage financing and credit performance of their multifamily programs.

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 overabundance of capital for high-end properties in top-tier markets, but leaves secondary and tertiary markets like Westerly, RI, or Topeka, KS, underserved. The GSEs ensure that multifamily capital is 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.

Let me be clear, I am not here to defend the GSEs or to suggest that they be continued in their current form. Instead, I would like to highlight for the Committee those elements of the existing system that worked well for multifamily lending and, more importantly, at no cost to the taxpayer. It is our hope that these successful elements can be incorporated into whatever Congress designs to replace Fannie Mae and Freddie Mac.

## **Multifamily Performance: A Success Story**

It is hard to imagine a success story coming out of the worst housing crash in recent history, but the performance of the GSEs' multifamily businesses stands out. Overall loan performance remains strong with delinquency and default rates at less than one percent, a tenth of the size of the delinquency/default rates plaguing single-family. The GSEs' multifamily programs have also outperformed Commercial Mortgage-Backed Securities (CMBS), commercial banks and even FHA. In addition, since the federal government placed the GSEs in conservatorship, the multifamily programs have generated over \$10 billion in net profits for the federal government.

Not only are the GSEs' multifamily programs operating in a fiscally sound manner, but they are also doing so while offering a full range of mortgage products to meet the unique needs of the multifamily borrower and serve the broad array of property types. This includes conventional market rental housing, workforce rental housing and targeted affordable housing (e.g., project-based Section 8, state and local government subsidized and Low-Income Housing Tax Credit (LIHTC) properties).

The GSEs' multifamily programs adhere to a business model that includes prudent underwriting standards; sound credit policy; effective third-party assessment procedures; risk-sharing and retention strategies; effective loan portfolio management; and standardized mortgage documentation and execution. In short, the GSEs' multifamily models hit the mark. They have attracted enormous amounts of private capital; helped finance millions of units of market-rate workforce housing without direct federal appropriations; sustained liquidity in all economic climates; and ensured safety and soundness of their loans and securities. 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.

## **A One-Size-Fits-All Solution Will Not Work**

It is tempting to believe that a single solution will solve all that ails our housing finance system. Unfortunately, that simply is not the case. Multifamily finance and single-family finance operate differently. 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. It is, therefore, critical for Congress to pursue a separate solution for multifamily. Failure to do so puts the millions of Ameri-

cans who rely on the apartment industry for their housing and the \$862 billion multifamily debt market at risk.

Although I talked about rising demand and the need for new construction to meet it, preserving liquidity for multifamily is about more than just building new apartments. Unlike residential mortgages, which are typically for 30-year terms, most multifamily mortgages are for a period of seven to 10 years. This ongoing need to refinance apartment mortgages makes it imperative for the industry to have access to reliable and affordable capital at all times, in all markets and in all market conditions. In 2013 alone, an estimated \$100 billion in multifamily mortgages will need to be refinanced, many of which finance apartments that are not located in areas that attract private capital.

### **Private Capital is Necessary, but Not Sufficient**

We share your collective desire to return to a marketplace dominated by private capital. Even with the critical backstop provided by the GSEs, private capital has always been an integral part of the multifamily housing finance system. However, historically, private capital has been either unwilling or unable to meet the full range of the multifamily industry's capital needs, even during healthy economic times. There is no evidence to suggest that the situation is any different today.

Historically, the apartment industry has relied on a variety of capital sources to meet its liquidity needs. They include:

- Fannie Mae and Freddie Mac
- Commercial Banks and Thrifts
- Life Insurance Companies
- Federal Housing Administration
- Commercial Mortgage-Backed Securities / Conduits
- Pension Funds
- Private Mortgage Companies

Together, these capital sources have provided the apartment sector with \$100 billion to \$150 billion annually, reaching as high as \$225 billion last decade, to develop, refinance, purchase, renovate and preserve apartment properties. Each of these capital sources has its own focus, strengths and limitations.

Commercial banks and thrifts generally serve as a source of credit for smaller, local borrowers. They typically provide floating rate, short-term debt, and often their willingness to extend this credit is based on the availability of permanent take-out financing offered by the GSEs. They have resumed lending to multifamily after the crisis, but they are unlikely to return to their pre-crisis levels because of higher risk-based capital requirements.

Life insurance companies tend to restrict their lending to a handful of primary markets and to luxury 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 have generally provided 10 percent or less of the annual capital needed by the multifamily industry, but that number has gone as low as three percent.

The private-label CMBS market did not become a material source of capital to the apartment industry until the mid-1990s, peaking at 16.5 percent 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 and suffered high delinquency rates—reaching 17.4 percent in 2011. While CMBS is rebounding, regulatory changes imposed by financial regulatory reform legislation will mean that it will not return to its pre-bubble levels of lending.

Some have suggested that the Federal Housing Administration (FHA) could step in and fill the liquidity provided by Fannie Mae and Freddie Mac. This solution is unrealistic. FHA serves a very different market from Fannie Mae and Freddie Mac, focusing on construction lending and affordable rental properties not served by other sources of capital.

In all, however, FHA represents 9 percent of all outstanding multifamily mortgage debt, and even at that level has experienced serious capacity issues. When demand for FHA financing spiked during the credit crisis, FHA's backlog was so significant that borrowers reported loan applications languishing for 18 months or more.

Private capital has returned to the apartment sector, but 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. 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. The market failure the GSEs' multifamily programs

addressed was ensuring capital reached markets deemed too risky or otherwise undesirable by institutional capital. It is imperative that a reformed system continue to fill this important public policy need.

Finally, it must be noted that a December 2012 Freddie Mac report commissioned by the Federal Housing Finance Agency (FHFA) estimated the potential consequences to the apartment sector of eliminating the federal guarantee. According to that research, which was undertaken by Freddie Mac and independent third-party experts, interest rates would rise and debt financing capital would fall by 10 percent to 20 percent. That could result in a 27 percent drop in apartment supply, which could, in turn, cause rising rents nationwide and significant spikes in tertiary geographic markets.<sup>3</sup>

### **Federal Credit Guarantee: Meeting the Needs When Private Capital Disappears**

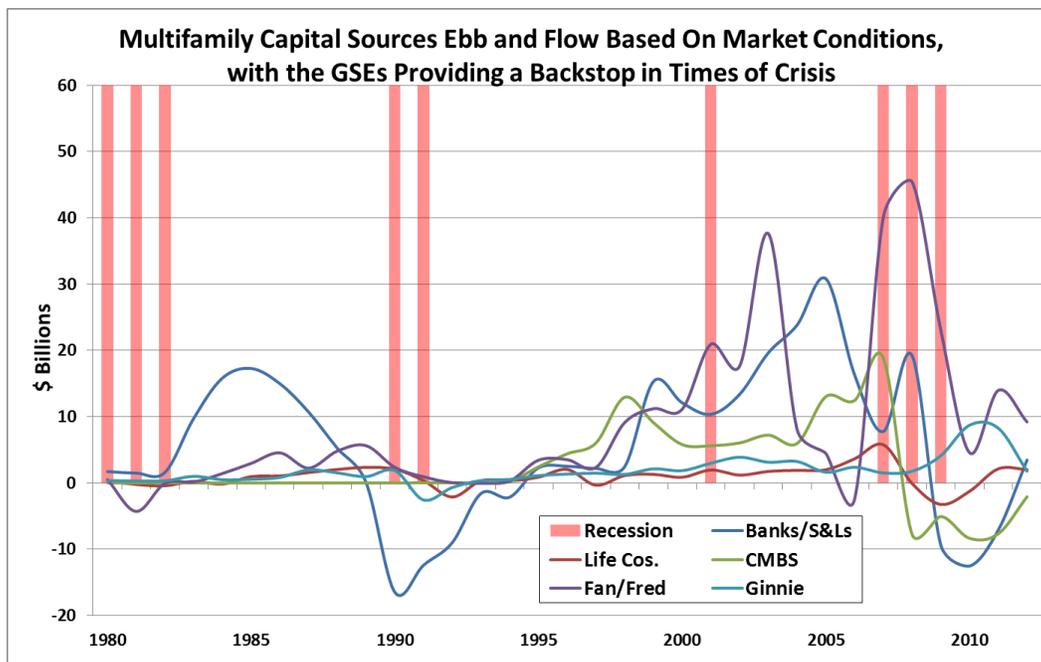
Fannie Mae and Freddie Mac have served as the cornerstone of the multifamily housing finance system, successfully attracting private capital to the sector. Unlike any other single source of capital, they offer long-term debt for the entire range of apartment properties (market-rate workforce housing and subsidized properties, large properties, small properties, etc.), and they are active in all markets (primary, secondary and tertiary) during all economic conditions.

As the chart below shows, the Enterprises' share of the multifamily mortgage market has varied considerably over time, increasing at times of market dislocation when other sources of capital are scarce and scaling back during times when private credit is widely available.

When credit markets have been impaired for reasons that have nothing to do with multifamily property operating performance, the federally backed secondary market has ensured the continued flow of capital to apartments. For example, when private capital left the housing finance market in 2008, the apartment industry relied almost exclusively on Fannie Mae, Freddie Mac and FHA / Ginnie Mae for capital.

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<sup>3</sup> Freddie Mac, *Report to the Federal Housing Finance Agency: Housing Finance Reform in the Multifamily Mortgage Market*, Pages 24-32. [http://www.fhfa.gov/webfiles/25161/FREReport\\_MF\\_MarketAnalysis.pdf](http://www.fhfa.gov/webfiles/25161/FREReport_MF_MarketAnalysis.pdf)



Source: Federal Reserve, Natl. Bureau of Economic Research; NMHC

Between 2008 and 2010, the GSEs provided \$94 billion in mortgage debt to the apartment industry. Without that critical backstop, thousands of otherwise performing multifamily mortgages would have gone into default because there were no private capital sources willing to refinancing maturing loans. This could have meant disruption to millions of renter households. The GSEs served a similar role during the 1997-1998 Russian financial crisis and in the post-9/11 recession of 2001.

Even now, with all players back in the market, Fannie Mae and Freddie Mac still provided 45 percent to 50 percent of multifamily mortgage debt in 2012. Again, this is not meant to suggest that Fannie Mae and Freddie Mac be allowed to continue. Rather it is to point out how large a chasm private capital would have to fill and to emphasize the public policy mission the existing system has served, ensuring liquidity and avoiding widespread adverse effects for the millions who rent.

### Principles of Reform

There is widespread agreement that Fannie Mae and Freddie Mac must be dissolved. A reformed housing finance system should, however, retain the successful components of the existing multifamily programs in whatever succeeds them. Accordingly, multifamily housing reform must:

**1. Provide Access to Federal Credit Support.**

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. A private-only housing finance system would result in an abundance of capital for high-end properties in top-tier markets but leave secondary and tertiary markets like Sioux Falls, SD, or Boise, ID, underserved.

**2. Provide Broad Liquidity Support at All Times, Not Just “Stop-Gap” or Emergency Financing.**

Any federal credit facility should be available to the entire apartment sector and not be restricted to specific housing types or renter populations. Moreover, it would be impossible to turn on and off a government-backed facility without seriously jeopardizing capital flows.

**3. Restrict Federal Credit Support to the Security Level.**

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.

**4. Support Private Capital and Protect Taxpayers through Effective Guarantee Structure and Pricing.**

Borrowers should pay for the guarantee in the form of an appropriately priced credit enhancement fee that 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.

**5. Encourage Competition.**

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 experiences in mortgage underwriting.

**6. Empower a Strong Regulator.**

A strong and independent regulator with 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, the Federal Reserve and Office of the Comptroller of the Currency.

**7. Impose Effective Capital Requirements.**

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

**8. Retain Limited Portfolio Lending (without a Federal Guarantee) While Expanding Securitization.**

Any restructured or successor entity should be able to retain limited multifamily mortgage portfolios, but no government guarantee should apply to mortgages held in portfolio. Limited retained portfolios would be allowed for the following activities: (1) aggregating mortgages for pooled securities executions; (2) implementing pilot mortgage programs and product modification testing; (3) engaging in targeted higher-risk transactions (e.g., financing properties with rent-regulatory restrictions, student housing and senior and assisted-living developments); and (4) engaging in pilot and risk-sharing transactions for affordable and workforce housing production. To avoid a return to an over-reliance on portfolio lending, portfolio loans would be subject to: (A) commercial bank mortgage risk-based capital standards; and (B) limits regarding absolute levels and percentage of guaranteed mortgage securities.

**9. Reduce Existing Portfolios in a Responsible Manner.**

As the GSEs are wound down, the current GSE multifamily portfolios should be largely 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.

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

To avoid market disruption, it is critical that policymakers clearly define the government's role 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, it is vital to retain many of the resources and capacity of the existing GSEs. The two firms have extensive personnel and technological 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.

#### **11. Focus on Liquidity, Not Mandates.**

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.

### **Essential Elements of a Reformed Multifamily Housing Finance System**

Putting the principles outlined above into legislative action could be accomplished in a number of ways. We have provided additional details in Appendix I. NMHC/NAA believe that Congress would be well served by including the following provisions in any housing finance reform legislation:

#### **1. Separate Title Addressing the Unique Needs of the Multifamily Sector**

As noted earlier, a one-size-fits-all solution will not work in housing finance reform. We strongly recommend that any reform measure include a separate multifamily title. This separate title should address not only what will replace the GSEs' multifamily programs, but also how the transition to that new system will be handled.

#### **2. Establish an Office of Multifamily Mortgage Oversight**

An Office of Multifamily Mortgage Oversight should be established to oversee and regulate all aspects of government-backed multifamily mortgage finance. In addition to serving as regulator, this Office should be charged with establishing and collecting fees paid by borrowers for government-backed mortgages.

#### **3. Transfer the Enterprises' Multifamily Activities to Successor Entities**

Having documented the need for an ongoing federal presence in multifamily finance, namely to serve properties and localities not well served by private capital, and having established the strong performance record of the existing GSEs' multifamily programs,

reform legislation should include a mechanism for explicitly transferring Fannie Mae and Freddie Mac's multifamily lines of business to successor entities. This transfer should be separate and apart from the GSEs' single-family business given the significant differences between the two. We recommend that the regulator oversee the complete privatization of Fannie Mae and Freddie Mac's multifamily lines of business beginning no later than one year after a new regulator is put into place. In addition to overseeing the transition of Fannie Mae and Freddie Mac's multifamily programs from government-sponsored enterprises to privately held entities, the regulator should evaluate whether there should be more than two private entities chartered to issue guaranteed mortgage-backed securities.

### **Focus on Liquidity Given the Innate Affordability of Multifamily**

Policymakers are understandably still struggling to determine the degree to which an ongoing federal role in the rental finance system should be connected with the pressing need to address the nation's affordable housing shortage. We begin by noting that multifamily housing is inherently affordable housing; fully 82 percent of existing apartments are affordable to households earning 80 percent of area median income, a common standard for measuring affordability. Therefore, the mere extension of a government role to ensure liquidity to the multifamily sector is, by definition, supporting affordable housing.

It is tempting to believe that more can be done to address affordability through housing finance reform, namely through imposing limitations on federal guarantees or other mandated benchmarks. We caution policymakers not to overreach, however, as such well-intended moves, if overly prescriptive, could have adverse consequences.

To begin with, one way the GSEs have been able to produce such a stellar performance record in multifamily is by being able to build a balanced book of business where lower-risk, higher-end properties enabled them to take on riskier, deeply targeted affordable housing properties, such as Section 8 and Low-Income Housing Tax Credit properties. Just as critical, the GSEs' multifamily programs have been able, through their broad platforms, to provide capital for projects located in markets that do not meet the credit or return standards required by many private capital debt providers.

Not only does a broad multifamily lending platform help the GSEs and successor entities manage risk, but it also ensures that there is a sufficient supply of liquidity in severe market down-

turns. For instance, in the most recent financial crisis, even firms and properties that would normally be well served by private capital found themselves with no options.

After 2008, the insurance companies, banks and other private capital debt providers exited the market leaving even higher-rent or luxury properties scrambling for debt capital to refinance maturing mortgages. Publicly traded apartment REITs were unable to issue bonds to finance their assets and had to seek funding from government programs. If the successor entities to Fannie Mae and Freddie Mac are more limited in what markets or properties they can serve, they will be unable to fill the critical public policy mission they have historically served. Failure to ensure sufficient liquidity for all types of apartments will have a spillover effect that could be disastrous for America's renters.

Nevertheless, we understand the need to tackle housing finance reform and affordability in the same debate. NMHC/NAA are reviewing the spectrum of options that could serve the nation's affordability needs without putting the broader multifamily market at risk. They include portfolio goals, explicit on-budget funding, loan limits and affordability-based-guarantee-fee pricing. NMHC/NAA look forward to working with Congress on developing workable solutions to this vital policy issue.

### **Comment on Federal Housing Finance Agency Action to Curtail Fannie Mae and Freddie Mac's Multifamily Activities**

Before closing, I would like to draw to the Committee's attention a letter that NMHC/NAA submitted to the Federal Housing Finance Agency (FHFA) regarding strategies it is considering as part of its 2014 Scorecard to reduce Fannie Mae and Freddie Mac's multifamily businesses. We appreciate that FHFA is seeking input before making this decision. However, placing caps on the GSEs' multifamily lending volume and reducing the diversity and availability of multifamily mortgage products as FHFA has proposed are not justified or necessary and will only lead to market uncertainty and instability. For this reason, we cannot support any further actions to restrict liquidity to the industry and residences we serve. Moreover, decisions made regarding the Enterprises' future activities are best left to Congress as opposed to their regulator. (Appendix II: NMHC/NAA Comment Letter: FHFA Letter to Limit Enterprises' Multifamily Activities).

Finally, I would like to take a moment to address the opportunity you have to rebalance our national housing policy through housing finance. 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. That had a devastating effect on our national economy, on local communities and for millions of households.

We now know that housing our diverse nation means having a vibrant rental market along with a functioning ownership market. How we as a nation tackle the housing finance reform effort that must be undertaken will, in large part, determine whether or not the country continues to have a strong rental sector. The stakes are too high to let the multifamily market become a collateral victim of the single-family housing crash.

I thank you for the opportunity to present the views of NMHC and NAA.

## Appendix I

### **Suggested Legislative Recommendations for a Multifamily Title in Housing Reform Legislation**

To implement the principles of reform NMHC/NAA recommend any legislation should include the elements outlined below. Because of the multifamily industry's unique needs and requirements, housing finance reform legislation should have a separate title governing the treatment of the sector. This will enable the government to wind down Fannie Mae and Freddie Mac's current multifamily activities and construct a new system enabling the apartment industry to access the capital necessary to meet the demand of America's renters.

#### **Specific Recommendations**

##### **1. Establish an Office of Multifamily Mortgage Oversight**

###### Purpose

- A new Office of Multifamily Mortgage Oversight would be charged with ensuring: (1) liquid capital is available in all markets at all times and for a wide range of multifamily property types; (2) transparency in the multifamily marketplace; and (3) access to federal mortgage credit to support a robust secondary multifamily mortgage and active multifamily mortgage backed securities.

The Office of Multifamily Mortgage Oversight would have the following duties:

- Market Regulator

*The Office of Multifamily Mortgage Oversight should be established as a separate unit within the entity ultimately charged with regulating the nation's government-backed housing finance programs. The Office of Multifamily Mortgage Oversight must have the capacity to evaluate the overall multifamily market, as well as expertise in multifamily mortgage underwriting, investment and securitization. This Director of the Office of Multifamily Mortgage Oversight should report to the chief executive and have dedicated research capacity and technical and capital markets expertise.*

- Establish Standard Form Structures, Contracts, Reporting, Data Repository Maintenance

*There should be a uniform repository established for multifamily mortgage origination data for properties with five or more units. Information collected and made available with appropriate disclosure to investors should include property characteristics, borrower type, principal amount, interest rate, term, amortization, maturity date and effective prepayment date.*

- Establish and Maintain Government Capital Through an Insurance or Reserve Fund Used Only to Pay Investors in Multifamily Securities

*A government guarantee of multifamily securities will exist exclusively to backstop, multifamily mortgage lending and securities activities.*

- Establish and Collect Fees in Exchange for Providing Insurance on Principal and Interest of Qualified Securities.

*The guarantee fee and other fees to support targeted housing activities shall be collected as a portion of the monthly mortgage payment in the form of an appropriately priced credit enhancement fee that insures taxpayers against future losses.*

- Authority to Protect Taxpayers in Unusual and Exigent Market

*The Office of Multifamily Mortgage Oversight may, upon determination that a material threat exists to the multifamily housing finance system, provide enhanced support to the market for a defined period.*

## **2. Transfer Enterprises' Multifamily Activities to Successor Entities**

Regardless of the transition of the single-family mortgage activities, a transition process tailored to the multifamily industry's needs is necessary because of the significant differences in capital sources and operations between single-family and multifamily mortgages. This different treatment is further justified by the long track record of strong credit performance in the Enterprises' multifamily programs. (See Overview of Multifamily Capital Sources in Appendix II).

The multifamily industry's ability to develop new properties, as well as to refinance the estimated \$100 billion a year in mortgages that mature, relies heavily on reliable and

stable access to credit and the existing origination and servicing expertise that is the result of the Enterprises' multifamily programs. Material disruptions in the debt capital markets will reverberate through local, regional and the national economies. To avoid triggering this consequence as Fannie Mae and Freddie Mac are wound down, the following actions are recommended to facilitate disposition of the Enterprises' multifamily portfolios and the transfer of their mortgage activities to successor entities.

- A. As fully described below, the multifamily activities of Fannie Mae and Freddie Mac should be privately capitalized. Furthermore, additional entities should be approved to benefit from a partial government security guarantee.
- B. Upon enactment of housing finance reform legislation, each Enterprise should be required to:
  - Establish separate accounting for multifamily activities.
  - Continue to reduce its multifamily portfolio and eliminate any portfolio activities other than those necessary to aggregate and facilitate securitization and address troubled mortgage assets.
- C. Upon enactment of housing finance reform legislation, each Enterprise should be required to set aside up to 75 percent of all net proceeds from multifamily mortgage activities into a separate account. These funds are to be used only to assist in the capitalization of the GSEs' multifamily units. Such proceeds should be exempt from the Treasury Stock Purchase Agreement and subsequent requirements for transfer of funds by the Enterprises.
- D. Each Enterprise should be asked to prepare a capitalization plan, including an asset management plan for existing multifamily mortgage and guaranteed mortgages. This plan shall be submitted to the regulator upon its certification.
- E. The regulator will approve or modify the capitalization plans and instruct the Enterprises to implement the capitalization and privatization of each multifamily unit within 12 months of certification. Any extension of the privatization activities will require approval of the regulator and may not exceed 36 months from the certification date.

F. Until such time as the multifamily activities are capitalized, the government must conduct activities to effectively oversee and support future multifamily secondary market financing. These activities include:

- Multifamily issuer, guarantor and associated entity oversight (servicer and special servicer);
- Guarantee fee administration and assessment;
- Credit policy and regulatory capital oversight;
- Product performance review and approval; and
- Loan performance, portfolio and security guarantee assessment and market analysis.

G. Upon successful capitalization, the new entity must repay, with interest at a rate determined by the Treasury Department, any dedicated revenues held by the government used to collateralize the privatization of the GSEs' multifamily mortgage activities. The repayment term may not exceed five years from initial capitalization.

H. Any revenues not used to capitalize the multifamily activities shall be returned to the Treasury.

I. All multifamily mortgage assets and guaranteed mortgages prior to privatization will transfer to the government.

J. The government will enter into an asset management agreement with the two approved successor entities to oversee the remaining multifamily portfolios and guaranteed mortgage assets at the time of regulator certification.

After successfully transitioning Fannie Mae and Freddie Mac from their status as government-sponsored enterprises to privately held entities, the government may act to expand the number of private entities to serve as approved issuers and or guarantors. Due to the need to retain a minimum share of the market, the government should approve entities on a limited basis until it determines the effectiveness and limitations of government credit and non-government credit to the multifamily market.