



Testimony of Terri Ludwig
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“Housing Finance Reform: Essential Elements of the Multifamily Housing Finance System”

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Chairman Johnson, Ranking Member Crapo and members of the committee, thank you for the opportunity to testify this morning. I am Terri Ludwig, president and CEO of Enterprise Community Partners.

Enterprise works with partners nationwide to build opportunity. We create and advocate for affordable homes in thriving communities linked to jobs, good schools, health care and transportation. We lend funds, finance development and manage and build affordable housing, while shaping new strategies, solutions and policy. Over more than 30 years, Enterprise has created 300,000 affordable homes across all 50 states, invested \$14 billion into communities and improved millions of lives.

One of Enterprise’s many business lines is mortgage debt financing with a focus on affordable multifamily rental housing in low-income communities. Last year we originated \$788 million in multifamily mortgages through our subsidiary, Bellwether Enterprise Real Estate Real Estate Capital, Inc., working with the Federal Housing Administration (FHA), Fannie Mae and Freddie Mac (the GSEs), private investors and other partners. We are an FHA Multifamily Accelerated Processing (MAP) lender and Ginnie Mae issuer, a Fannie Mae Special Affordable Delegated Lender, a Freddie Mac Program Plus Seller Servicer and Targeted Affordable Housing lender and a U.S. Department of Agriculture Section 538 lender. We also make loans through the FHA Section 232 program and operate a registered community development financial institution, Enterprise Community Loan Fund, which invested \$97 million into communities last year.

Before becoming president and CEO of Enterprise, I worked for more than 20 years in investment banking. My team and I used capital markets to efficiently invest in affordable housing and community development, often partnering with groups like Enterprise. This experience taught me that public-private partnerships are critical to bringing capital to working families in low-income neighborhoods. In countless communities across the country—rural, urban and suburban—the combination of public and private financing is effectively producing quality affordable housing.

Still, there is an urgent and growing need for decent and affordable rental housing. Enterprise is working with members of this committee and others in Congress on several issues to ensure that the needs of low-income renters are met, including housing finance reform, preserving and expanding the Low Income Housing Tax Credit (Housing Credit), ensuring adequate appropriations for critical housing and community development programs, authorizing much

needed reforms to rental assistance programs such as public housing and Housing Choice Vouchers, and finding new ways to preserve and improve the country's aging affordable housing stock. We look forward to continuing to work with you on these important issues as we work toward a day when every person in the U.S. has a quality and affordable home in a vibrant community.

We greatly appreciate the leadership of the chairman, the ranking member and members of this committee as you work to determine the future of Fannie Mae, Freddie Mac and the rest of the country's housing finance system. And we thank you for focusing today on an often-overlooked component of the reform effort: the multifamily mortgage market, which finances rental buildings with five or more units.

Above all else, we believe that any GSE reform plan must start with a simple goal: ensuring a liquid, stable and affordable housing market with appropriate support for both homeowners and renters, especially low income families.

In my testimony this morning, I will make the following points:

- **Multifamily housing is a key part of a well-functioning housing market.** Today more than one-third of the U.S. population rents, and that number is expected to grow in the coming years. And given who we expect these new renters to be—namely older or younger single-person households—multifamily will play an increasingly important role.
- **Fannie Mae and Freddie Mac play a critical role in multifamily housing finance today.** Among other things, Fannie and Freddie provide broad liquidity to the multifamily mortgage market, much-needed financing for affordable housing and a buffer from severe booms and busts in the rental market.
- **A limited, explicit government guarantee is essential to a well-functioning rental market.** According to a series of recent studies from the Federal Housing Finance Agency (FHFA), without a government guarantee on multifamily mortgages new construction of rental housing would plummet, average rents would rise significantly and the entire rental market would be more vulnerable to boom-and-bust cycles.¹ Low-income families would be disproportionately harmed, at a time when they already face an unprecedented affordable housing crisis.
- **Congress should pursue smart reforms to the multifamily market that preserve the business lines and other activities that work.** I will lay out a series of steps Congress should take to ensure a liquid, stable and affordable rental market, starting by spinning off Fannie's and Freddie's multifamily businesses and providing access to a limited, paid-for government guarantee.
- **Any future system of multifamily housing finance must have explicit provisions to support affordable housing, reach underserved segments of the market and**

promote long-term sustainability. I will lay out specific recommendations for each of these goals, which Congress should include in any housing finance reform legislation.

I'd like to start by providing a bit of context, including some background on the U.S. rental market and the government's essential role in it.

Background on the U.S. rental market, multifamily housing and the growing affordable housing crisis

More than 100 million people in the United States—about 35 percent of the population—rent their homes. In recent years more and more families have turned to the rental market, some because they are not ready for or not interested in homeownership, others because they have no other option. Over the past eight years, the percentage of renters in the U.S. has increased by four percentage points.²

On average, renters are younger, earn less income, are more likely to be people of color and live in smaller households compared to homeowners. Their median age is 40, compared to 54 for homeowners. The typical renter household earns just over \$31,000 per year, almost exactly half of the typical homeowner. Forty-seven percent are households of color, compared to 22 percent for homeowners. And 37 percent of renters are single-person households, compared to 23 percent for homeowners.³

Analysts predict a further shift toward rentals in the coming years. Part of this is due to the carry-over effects of the recent housing crisis, but the key driver is changing demographics. Harvard's Joint Center for Housing Studies projects an additional 3.6 million new households will become renters between 2010 and 2020, led mostly by an increase in younger, senior and minority households.⁴

These populations increasingly rely on multifamily housing as a source of stable, affordable rental housing. Today 40 percent of rental units in the U.S. are in multifamily buildings, but roughly 60 percent of single-person renters—often a sign of a younger or senior household—live in multifamily buildings. In addition, analysts at Harvard have found that younger renters “tend to favor multifamily housing in center city locations” linked to transit, jobs and other opportunities.⁵

Regardless of what type of housing America's renters live in, one thing is clear: they are facing an unprecedented affordable housing crisis. That's especially true for renters at the lower end of the income scale.

Housing costs for the typical renter rose by 6 percent between 2008 and 2011, while their income dropped more than 3 percent after adjusting for inflation, according to the Center for Housing Policy.⁶ While the number of very low-income renters has increased by 17 percent since 2007, the total number of affordable rental units has actually declined.⁷ As a result, of the 17.1 million very low-income renters in the U.S. today, 7.1 million spend more than half their income on rent, live in substandard conditions, or both, according to the Department of Housing and Urban Development.⁸

All told, 27 percent of renters—about 11 million families—are paying at least half of their monthly income on housing, a severe cost burden that often leaves families one paycheck away from losing their home. That’s an all-time high.⁹

Fannie Mae and Freddie Mac play a critical role in multifamily housing finance today

Today there is roughly \$875 billion in multifamily mortgage debt outstanding.¹⁰ Capital flows to the multifamily mortgage market from five main sources and several smaller ones:

- **Fannie Mae and Freddie Mac**, which account for 36 percent of multifamily debt outstanding. The GSEs serve a wide geography and a range of income levels and housing types, during both good and bad economic times.
- **Banks and thrifts insured by the Federal Deposit Insurance Corporation (FDIC)**, which account for 28 percent of multifamily debt outstanding. Banks and thrifts typically offer floating-rate, short-term debt, serving a broad range of lenders and communities. But their presence in the multifamily market has shrunk significantly since the start of the financial crisis.
- **The federal government**, which accounts for 10 percent of multifamily debt outstanding. This includes Ginnie Mae securities backed by mortgages insured by the Federal Housing Administration (FHA), the Department of Agriculture and other federal agencies. The FHA insures high-leverage loans with terms of up to 40 years and offers construction financing as part of the permanent loan.
- **Conduits for commercial mortgage-backed securities (CMBS)**, which account for 9 percent of multifamily debt outstanding. These are securities issued by financial institutions made up of multifamily, office, retail and other loans that are not backed by the federal government. The CMBS market was a leading source of capital during the recent housing bubble—peaking at 17 percent of the market in 2007—before it practically shut down during the crisis.
- **Life insurance companies**, which account for 6 percent of multifamily debt outstanding. Historically, life insurance companies have preferred to finance “Class A” multifamily assets, such as luxury apartment buildings in top-tier housing markets.
- **Other sources**, which account for the remaining 11 percent of multifamily debt outstanding. This includes state and local governments, private pension funds, Real Estate Investment Trusts and nonbank corporate businesses.

From their volume alone, it’s clear that Fannie and Freddie are a critical part of today’s multifamily market. By purchasing and securitizing a range of multifamily mortgages across geographies and lender types, Fannie and Freddie ensure that developers and owners have the capital they need to build, maintain and preserve rental housing. But increased liquidity is just one of many roles the GSEs play.

First, they promote stability and broad access to credit through flexible products. Fannie and Freddie tend to offer longer-terms and more fixed-rate loans than banks, thrifts and life insurance companies, which helps owners plan for future costs. Shorter-term, adjustable-rate mortgages, on the other hand, require frequent refinancing and recapitalization, which could discourage owners from holding onto a property over a long period.

Second, the GSEs promote strong underwriting, which mitigates systemic risk in the rental market. Fannie and Freddie multifamily deals are carefully underwritten and include a significant amount of risk sharing with purely private investors, which further limits taxpayer exposure to risk. For example, Freddie Mac's K-Series deals typically require private investors to cover the first 15 percent of losses without a guarantee, while Fannie Mae's mortgage-backed securities require its licensed lenders to cover the first five percent plus a significant portion of further losses.¹¹

As a result, GSE multifamily loans have experienced much lower delinquency rates than similar loans from private investors. According to the Mortgage Bankers Association, today only about 0.2 percent of Fannie- or Freddie-backed multifamily loans are delinquent by 60 or more days, compared to 2.1 percent for loans held by banks and thrifts and 7.8 percent for loans in commercial mortgage-backed securities.¹²

Third, they provide crucial countercyclical support to the market. As recently as 2007, Fannie and Freddie combined for less than 30 percent of multifamily loan originations, while private investors absorbed the rest of the market in their eagerness for mortgage debt. By 2009—the year after the housing market collapsed, taking the entire financial system with it—Fannie's and Freddie's share nearly tripled to 85 percent as investors were leery of putting their money into housing without a government guarantee.¹³ Without that support, financing for multifamily housing would have all but dried up, halting all new construction and making it extremely difficult for building owners to refinance maturing loans.

Finally, the GSEs are critical sources of financing for affordable rental housing. This includes both the apartments financed through GSE multifamily securities and the investments held in each company's portfolio. Over the years, Fannie and Freddie have developed working relationships with small community banks, state housing finance agencies and community development financial institutions across the country, allowing them to efficiently and profitably finance affordable housing in lower-income communities.

Last year, 67 percent of the rental units financed by Fannie or Freddie were affordable to families earning less than 80 percent of Area Median Income (AMI), commonly referred to as "low-income," while roughly 17 percent were affordable to families earning less than 50 percent of AMI, commonly referred to as "very low-income."¹⁴ While rent data are not available on units financed by banks, we know that private investors tend to prefer higher-end properties in top-tier markets.

A key to Fannie's and Freddie's ability to play this important role in the market is their access to an explicit guarantee from the federal government.

A limited, explicit government guarantee is a key part of a well-functioning rental market

After five years of conservatorship, we are pleased to see Congress making meaningful progress on housing finance reform. Regardless of what lawmakers decide to do with Fannie Mae and Freddie Mac, I urge you to preserve the aspects of the current system that have proven to work. This includes an explicit, limited guarantee on multifamily mortgages.

The government guarantee on multifamily mortgages makes the U.S. rental market more liquid, more stable and more affordable. These are four powerful reasons for maintaining it in any reform effort.

Eliminating the multifamily guarantee would have devastating consequences for the U.S. rental market, with low-income communities bearing the largest share of the burden. Earlier this year FHFA asked Fannie, Freddie and external consultants to assess what the market would look like without a government guarantee on multifamily mortgages.¹⁵ They found that:

- 1) Without a government backstop, the rental market would be subject to wild boom-and-bust cycles, leading to significantly less development during market downturns. According to Freddie Mac's estimates, this lack of stability would cause multifamily interest rates to increase by 150 basis points and multifamily property values to decrease by as much as 16 percent; and¹⁶
- 2) Rental housing would be much more difficult to find and much more expensive. If the government guarantee were to go away, new construction on multifamily housing would plummet by as much as 27 percent, while average rents would rise by as much as 2 percent.¹⁷ And since purely private investors would be less likely to finance lower-end developments in second- and third-tier markets, lower-income families would likely see even bigger increases in rent.

It's also important to note that Fannie's and Freddie's current multifamily businesses are quite profitable—as they have been throughout the housing crisis—and have steadily returned money back to the U.S. Treasury in recent quarters. According to 2012 financial reports, Fannie Mae's multifamily business reported a net income of \$1.5 billion last year,¹⁸ while Freddie Mac reported \$2.1 billion.¹⁹ Meanwhile, according to FHFA's own analysis, “there is little inherent value in (Fannie's and Freddie's) current multifamily businesses without the government guarantee.”²⁰

Our plan for multifamily housing finance reform

Last month, Enterprise co-authored a detailed plan for multifamily housing finance reform, along with members of the Mortgage Finance Working Group. The plan was initially drafted as a supplement to the bipartisan Housing Finance Reform and Taxpayer Protection Act of 2013 (S. 1217), which preserves a limited and paid-for government guarantee on qualifying multifamily securities. We propose:²¹

- Starting immediately, spin off Fannie’s and Freddie’s multifamily businesses into two self-contained subsidiaries of their respective corporations. The new entities would maintain the current multifamily products—namely the Fannie Mae DUS Program and the Freddie Mac CME Program K-Series—and contract with Fannie and Freddie to manage the existing multifamily assets.
- During a brief transition period, these entities would continue to purchase, securitize and insure qualifying multifamily mortgage-backed securities, with support from the U.S. Treasury as needed.
- When the public guarantor (the FMIC under S. 1217) is fully operational, the insurance function would be transferred to the federal government. From that point on, the new entities would have the option of purchasing FMIC insurance on the multifamily securities they issue, backed by the full faith and credit of the U.S. government. The FMIC maintains all multifamily guarantee fees in a separate insurance fund.
- Over time, the new entities would be required to raise private capital with the option of buying out the government’s interest. Meanwhile, other government-approved, privately-funded companies would have the option of purchasing FMIC insurance on the multifamily securities they issue. As soon as possible, the FMIC would establish a third issuer (beyond the two new entities) to ensure that smaller banks have access to the secondary market for multifamily mortgages.

By spinning off the GSEs’ multifamily businesses, Congress can ensure that the multifamily market continues to function smoothly through any transition period. By preserving Fannie’s and Freddie’s tried-and-true multifamily products, Congress can provide much-needed certainty to multifamily investors, ensuring that money keeps flowing into the rental market. And by setting a clear path forward for the companies’ multifamily businesses—which remain profitable—Congress can help Fannie and Freddie keep top talent, retain institutional memory and invest in the staff, systems and technology necessary to compete in a constantly evolving market.

In addition, by opening the government guarantee to other government-approved issuers down the line, Congress can promote competition in the market and protect taxpayers from “too-big-to-fail” bailouts. And by setting up a third approved issuer put in place to support smaller lenders, lawmakers can ensure that all communities have equitable access to the government guarantee.

Other important components of any future system of multifamily housing finance

There are other important issues that require attention in any multifamily reform legislation. These include:

Broad affordability mandate for issuers of FMIC-insured multifamily securities

A government guarantee on multifamily securities is remarkably valuable. So it makes sense for policymakers to target the benefits of that support to the renters who need it most—namely low- and moderate-income families.

We propose a broad affordability mandate for all issuers of FMIC-insured multifamily securities. For each issuer, not less than 60 percent of the rental units financed through FMIC-insured securities in a given year must be affordable to low income families making 80 percent of AMI or less. This requirement would be assessed at the time of origination based on a 30 percent affordability standard and would be reported to the FMIC at the end of each fiscal year.

Support for deeply affordable housing for lower-income families

During the past two decades, Fannie and Freddie have shown that investors can finance affordable housing in a way that's both responsible and profitable. For very low-income renters below 50 percent of AMI, however, it's very difficult to make those deals pencil out without outside subsidy to help cover operating costs.

Therefore, instead of mandating that a certain percentage of government-backed issuers serve very low-income families, we recommend levying an additional 5-10 basis point fee on all FMIC-insured multifamily securities to fund programs that provide housing to families earning 50 percent of AMI or less. Specifically, the proceeds from that fee would fund the National Housing Trust Fund, the Capital Magnet Fund and additional programs to support broad access to safe, affordable mortgage credit in low-income communities.

These funds have the potential to meaningfully expand the supply of affordable rental housing in the U.S.—through states for the Housing Trust Fund and through community development financial institutions and nonprofit housing developers for the Capital Magnet Fund. The Capital Magnet Fund is particularly effective at encouraging private investment in affordable housing; in the initial round of funding in 2010, recipients were able to leverage 15:1 with private capital sources.²² As originally envisioned, both funds should have received funding through assessments on the GSEs' ongoing business, but those obligations were suspended when Fannie and Freddie were put into conservatorship.

While we don't recommend placing a hard limit on the type of multifamily properties the FMIC can insure, there could be a benefit in discouraging higher-end properties from accessing the government guarantee. For example, if the majority of units in a multifamily property financed by a FMIC-backed security are unaffordable to families earning less than 150 percent of AMI, the FMIC could collect an additional fee to fund affordable housing programs.

Plans to reach underserved segments of the multifamily market

Private investors have historically done a poor job of serving the entire rental market on their own. Certain segments—namely low-income communities, rural and Native American communities, subsidized affordable multifamily housing and small multifamily housing—have been underserved by traditional capital markets, resulting in housing scarcity, disproportionately expensive rents and unacceptably poor conditions.

Fannie and Freddie are critical sources of capital for these underserved segments. For example, prior to 2008 Fannie Mae was a primary investor in several affordable housing developments in tribal lands financed with the Housing Credit. In fact, Fannie was one of the only private investors in this market at the time. Over the past two decades Enterprise has partnered with Fannie to build or preserve nearly 700 affordable homes on Native Lands.

We recommend addressing this problem through an annual strategic planning process. Each year, each approved issuer of FMIC-insured multifamily securities should work with the FMIC to create a plan for serving underserved market segments. At the end of each year, each issuer would report on their performance toward that plan. If the issuer does not comply or routinely misses their targets under this plan, the FMIC can apply financial penalties or revoke their approved-issuer status.

In addition, we recommend mandating that the FMIC establish at least one pilot program to test the securitization of small multifamily loans, which typically finance rental properties with between five and 50 units. These buildings are a critical source of affordable housing in many communities, but they are often difficult to execute profitably through traditional capital channels.

Encouraging investments in Low-Income Housing Tax Credits

For decades, Fannie Mae and Freddie Mac played a critical role in the Housing Credit market. Since its inception in the late 1980s, the Housing Credit has been America's main tool for building and preserving affordable homes, creating 2.6 million and counting. Each year the program finances roughly 90 percent of affordable homes created in the U.S., generating 140,000 jobs and \$1.5 billion in state and local tax revenues in the process.²³

Before the financial crisis, the GSEs provided roughly 40 percent of Housing Credit investments producing tens of thousands of affordable apartments each year, including in markets with little to no CRA-related investment. After the financial crisis began, Fannie and Freddie all but withdrew from the Housing Credit market. The market has since rebounded and is running smoothly today, but it lacks a stable entity to keep money flowing into Housing Credit deals during future economic downturns.

To further promote affordable housing, we believe that any future system of multifamily housing finance should include rules that encourage issuers of FMIC-backed securities to invest in Housing Credit deals. As one possible approach, the FMIC could count any affordable units financed through Housing Credit investments toward the issuer's annual affordability requirement described above.

Promoting energy efficiency and long-term sustainability in multifamily housing

There are tremendous economic benefits to investments in energy-efficient systems for multifamily buildings. That's especially true for the existing affordable housing stock, where we're seeing rising utility costs straining many owners.

For example, Enterprise recently extended a line of credit to owners of a large multifamily development in Brookline, Massachusetts. The owners made an upfront investment of just under a million dollars to install energy-efficient boilers, water pumps and controls. The retrofits brought a 25 percent reduction in energy usage in the first year, translating to \$170,000 in savings. The owners project that future savings will stay around that level, meaning they'll recoup their investment in less than six years.

And that doesn't even account for the broad social and environmental benefits of greener housing. For example, green homes have proven to improve a resident's asthma,²⁴ cardiovascular health, mental health and other major health issues.²⁵ Because low-income families have so much to gain from living in healthy, energy-efficient homes, we launched the Enterprise Green Communities initiative more than a decade ago, and today we're working to make green building the norm for our industry.

In recent years, Fannie Mae has been an important partner in that effort. Despite clear evidence of the long-term benefits of green investments, owners and developers often have difficulty securing financing to cover the upfront costs. Fannie is working to solve this problem through its Green Refinance Plus program, which helps owners of affordable multifamily housing access the capital they need to make economically justifiable energy and water retrofits. This also helps Fannie's bottom line: the lower operating costs in green multifamily properties tend to lower the risk of default.

The program is still in the pilot phase, but it has already helped several developers complete energy-efficiency retrofits that otherwise would not be possible. And perhaps most importantly, the program is taking steps toward creating a new industry standard by incorporating future energy savings into the underwriting and physical needs assessments for multifamily developments.

We believe that Congress should pursue similar programs that promote healthy, energy-efficient rental housing with any future replacement for Fannie and Freddie to.

Conclusions and next steps

Thank you again for tackling this important issue. The decisions made in Congress today on GSE reform will have a profound impact on the U.S. housing market and the broader economy, so it's important that we get the details right.

A liquid, stable and affordable market for multifamily mortgages is absolutely critical to a well-functioning housing market—and that depends on a limited, explicit guarantee. It's also important that any reform effort preserves other components of the existing system that have proven to work, including Fannie's and Freddie's existing multifamily products and underwriting standards and a clear requirement that investors who benefit from a government guarantee support affordable rental housing investments.

That said, housing finance reform on its own will not solve all of our nation's housing problems. We are facing a critical affordable housing crisis in this country, with more than a quarter of renters living one paycheck away from losing their homes, while rental demand is expected to rise exponentially in the coming years. So GSE reform must be part of a series of policy changes and investments to address the needs of low-income families and communities, including preserving and expanding the Housing Credit, reforming rental assistance programs and investing in proven housing and community development programs with adequate appropriations that help communities build capacity to meet their specific housing needs.

I look forward to working with you Chairman Johnson, Ranking Member Crapo, and other members of the committee on these and other critical reforms. I appreciate the opportunity to testify today and look forward to your questions.

ENDNOTES

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¹³ Federal Housing Finance Agency, Office of Inspector General. FHFA's Oversight of the Asset Quality of Multifamily Housing Loans Financed by Fannie Mae and Freddie Mac. FHFA OIG, February 2013.

¹⁴ Fannie Mae financed 559,000 multifamily units in 2012, 376,000 of which were affordable at 80 AMI or below and 109,000 of which were affordable at 50 AMI or below. Freddie Mac financed 435,000 multifamily units in 2012, 299,000 of which were affordable at 80 AMI or below and 60,000 of which were affordable at 50 AMI or below.

¹⁵ Federal Housing Finance Agency. News Release: FHFA Releases Fannie and Freddie Reports on Viability of Their Multifamily Business Without Government Guarantees. Attachment: 2012 Conservatorship Scorecard: The Enterprises' Reports on a Multifamily Future State Without a US Government Guarantee. FHFA, 3 May 2013.

¹⁶ Ibid.

¹⁷ Freddie Mac. Report to the Federal Housing Finance Agency: Housing Finance Reform in the Multifamily Mortgage Market. Freddie Mac, December 2012.

¹⁸ Fannie Mae. Form 10-K: Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. United States Securities and Exchange Commission, December 2012.

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