

**Written Testimony of**

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Before the  
Senate Committee on Banking, Housing, and Urban Affairs

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

October 9, 2013  
10:00 a.m.  
538 Dirksen Senate Office Building

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Chairman Johnson, Ranking Member Crapo, Members of the Committee:

Good morning. Thank you for inviting me to testify at this hearing on Housing Finance Reform. My name is Shekar Narasimhan, and I am Managing Partner of Beekman Advisors, which provides consulting services to various commercial real estate and financial services companies. I have spent the past 35 years in housing and finance, including four years building single-family homes in Eastern Kentucky. Later, when I was CEO of one of the first publicly-traded commercial mortgage finance companies, we developed loan products to serve the low-income housing tax credit market. My experience in running and operating a real estate financial services business as a partner with Fannie Mae, Freddie Mac and FHA is what brings me here today. Through all this, I developed a deep and abiding passion for affordable housing.

The multifamily businesses at the GSEs are not part of the problem in the housing finance system. In fact, they are part of the solution. Every major principle articulated by stakeholders with regard to what a new housing finance system should look like is in practice at the multifamily businesses of the GSEs:

- Alignment of interest between the borrower, lender/investor and issuer. Typically 20% borrower equity, lender or investor taking risk if loan defaults and issuer putting its capital and reputation on the line;
- Detailed underwriting of every loan. Significant property, borrower and financial reviews with quarterly monitoring after loan closes and annual inspection to ensure maintenance;
- Service of virtually every market segment with a menu of stable and responsible lending products. Consistently serving the multifamily market for working class and lower-income households-strong rationale for policy-makers to consider limited government support for multifamily finance;
- Participation of both small and large private lenders in the system with skin in the game. Both issuer- and security-based risk-sharing models are already in place;
- A lengthy track record of profitable operations, even through conservatorship (\$13.6 billion in profits over the last three years). Gives credence to the belief that private capital will be willing to capitalize these companies; and
- A footprint that responds appropriately to economic conditions. Market share ranging from 25% during a bull period for the capital markets to 70% at the height of the crisis.

I am here today to propose that the multifamily businesses at the GSEs should be used to demonstrate the path to the new housing finance system, by spinning them out as privately capitalized entities with government guarantees limited to only the securities they issue.

We all recognize change is needed as everyone agrees that five years of conservatorship is already too long. It has discouraged the best and brightest from remaining at the GSEs and has stifled creativity. Moreover, it has left secondary markets uncertain. This is not good given that the significantly larger rental population (41 million at last count) desperately needs a steady supply of new rental housing units to keep housing burdens manageable. This is especially true for renters earning less than 80% of area median income. This is the market the current GSE multifamily businesses have served yesterday and today with over 60% of the units they finance affordable to those at 80% of area median income or below.

Responsible change, however, should involve doing the least damage. The work done recently at the multifamily units of Fannie Mae and Freddie Mac (at the behest of their regulator, FHFA) supports our conclusions on how to make this shift. Continue the focus of the new entities on the middle of the market and that they meet reasonable standards. Allow multiple entities to become issuers, but do not allow one to become dominant. Regulate the resulting issuers and guarantors to ensure a level playing field and have the ability and motivation to serve the broad markets now and in the future. In short, we believe our proposed pathway, if followed, will result in the least disruption to the markets and maximize the return to the Treasury.

What I propose therefore is an immediate spinout of the multifamily operations of Fannie Mae and Freddie Mac. It can fit into the architecture of any bipartisan proposal that embodies the principles of private risk capital in front of a limited government guarantee and continued availability of multifamily financing at all times in all markets. Transition to this new multifamily state can occur within a two-three year period. First, create wholly-owned multifamily subsidiaries of the current GSEs that can operate autonomously with a contract to manage the multifamily assets of their parent companies. Then, as soon as the government guarantor is stood up, spin them out with a well-constructed regulatory framework that encourages private capital to invest in these entities for the long-term.

There is no reason to wait given rental demand and the profitable track record of these current businesses. This is laid out in the paper and subsequent proposal my two colleagues and I have written.

Thank you for the opportunity to make these remarks. I will enter our proposal and the supporting information into the record. Look forward to your questions and comments.

# **Multifamily Mortgage Finance Reform**

Background and Recommendations for Reform

Senate Banking Committee

October 9, 2013

THIS DOCUMENT DRAWS FROM THE WHITE PAPER; “MULTIFAMILY FINANCE REFORM: MOVING TO A SOLUTION IN 2013”. Dated June 24, 2013

White paper Co-Authors:

## **Raphael Bostic**

- Dr. Raphael Bostic is the Judith and John Bedrosian Chair in Governance and the Public Enterprise at the Sol Price School of Public Policy at the University of Southern California. He has recently returned to USC after serving for 3 years in the Obama Administration as the Assistant Secretary for Policy Development and Research at the U.S. Department of Housing and Urban Development.

## **Shekar Narasimhan**

- Shekar Narasimhan is the Managing Partner at Beekman Advisors. He also serves as Chairman of Papillon Capital, focused on sustainable infrastructure investing. Prior to Beekman Advisors, Shekar Narasimhan was Chairman & CEO of WMF Group, one of the largest multifamily GSE and FHA lenders which he sold in 2000 to Prudential Mortgage Capital Company.

## **Mark Willis**

- Mark Willis is a Resident Research Fellow at the Furman Center for Real Estate & Urban Policy at the New York University. Before joining the Center, Mark was a Visiting Scholar at the Ford Foundation, working on research related to community development and the financial services sector. Prior to his time at Ford, Mark spent 19 years at JPMorgan Chase, overseeing its community development programs

Note: Organizational affiliations are for informational purposes only. Views are the authors alone.

## **Importance of multifamily**

- Renters are an increasing share of the occupied housing stock.
  - Today 34% of households are renters, up from 31% in 2005.
  - As more people have moved from home ownership to rental, the overall rental vacancy rate has dropped for three years in a row to the lowest figure since 2001.
- Demand for multifamily is growing.
  - 40% of rental stock is in multifamily buildings (five or more units).
  - Multifamily renter occupied units increased by 5% from 15.2 million in 2005 to 16.0 million in 2011.
- Renters are facing a growing affordability crisis.
  - Renters earn, on average, about \$30,000/year, approximately 55% of what homeowners earn.
  - 27% of renters pay more than half their income on housing, twice the share of homeowners similarly burdened.

## **Multifamily financing differs from single-family financing**

- Multifamily properties are businesses.
- Typical size loan is \$6 million versus single family at \$100,000.
- Loans are individually underwritten by both lenders and investors.
- Underwriting involves analysis of rental income, expenses, property condition, etc.
- Typical “down payments” of 15-20 percent.
- Lenders perform annual inspections and quarterly financial reviews.

## **Role of Fannie and Freddie multifamily**

- Liquidity: Fannie and Freddie alone backed nearly 60% of multifamily mortgages in 2012.
- Broad Access to Credit: These two GSEs serve broad geography and diverse lenders, including banks and insurance companies.
- Flexible Products: Fannie and Freddie offer more longer-term and fixed-rate loans than banks.

- **Strong Underwriting:** The multifamily delinquency rate during the crisis peaked for the two GSEs at 0.7%, compared to 12% for commercial mortgage-backed securities and 4.4% for banks.
- **Countercyclical Support:** The GSEs' share of the multifamily mortgage market grew from 25% prior to the financial crisis to 70% in 2009.
- **Affordable:** Over 60% of rental units financed by Fannie and Freddie are affordable to those earning less than 80% of median income.

#### **Private Capital: Fannie Mae's DUS Model**

- 24 multifamily lenders nationwide are approved under Fannie's delegated underwriting and servicing (DUS) program.
- Lenders underwrite the loans themselves and put them into mortgage-backed securities that are guaranteed by Fannie.
- Two structures of risk-sharing with the lender:
  - Lender absorbs 1/3 of losses; Fannie the other 2/3.
  - Lender absorbs first 5% of the losses and then absorbs 25% of any additional losses up to an amount equal to 20% of the loan balance.
- Loan servicer required to pay principal and interest on loans that are delinquent for up to 90 days.

#### **Private Capital: Freddie Mac's K-Series**

- 23 multifamily lenders nationwide are approved under Freddie's "Program Plus" program
- Freddie Mac underwrites each loan submitted by approved lenders working directly with the borrower
- Private investors typically take the first 15% of losses on a pool of loans
- Two subordinate tranches that absorb first losses are a "B" piece and mezzanine debt

#### **Recommendations for multifamily reform**

- Government Guarantor (GG) provides and charges for an explicit government guarantee of timely payment of principal and interest on qualifying multifamily mortgage-backed securities.
- Two newly incorporated issuers (initially Fannie's and Freddie's multifamily businesses) continue current DUS and K-Series models.

- Framework allows for additional approved issuers that can either adopt the current Fannie or Freddie models or the structure allowed for single-family mortgages.
- GG sets up a co-op specifically to ensure that small lenders have access to financing.

### **Stages of Transition**

1. Fannie's and Freddie's multifamily operating units are spun off into self-contained subsidiaries of their respective corporations.
2. These subsidiaries operate autonomously (e.g., have their own lines of credit).
  - A. The subsidiaries contract to manage the multifamily assets of Fannie and Freddie respectively and receive a fee for doing so.
  - B. The subsidiaries pay Fannie and Freddie respectively for the right to issue securities based on their corporate guarantees of timely payment of principal and interest.
3. These entities are privatized as soon as feasible (no private owner can have more than a 19.9% ownership interest).
4. The entities buy the government guarantee from the GG once it is up and running.

### **Market Focus**

- For each approved issuer, at least 60% of the units financed each year by GG-backed multifamily securities must have rents affordable to tenants earning 80% of Area Median Income (AMI) assuming they spend no more than 30% of their income on housing (assessed at the time the loan is made).
- Any property financed by GG-backed multifamily security where the majority of the units have rents not affordable to renters earning less than 150% of AMI will trigger a 50 bps additional charge to be used for the National Housing Trust Fund, the Capital Magnet Fund and the Market Access Fund (Fund).
- An annual fee of 5-10 bps will be collected from all mortgage-backed securities that benefit from a government guarantee and used for the Fund.
- Approved issuers submit an annual plan for serving communities and market segments not well-served by private capital, including low-income communities, rural communities, subsidized affordable multifamily housing and small rental properties. They utilize the Market Access Fund to enable pilots and experimentation of products and processing changes to serve these markets.

# Appendix

## Stages of Transition

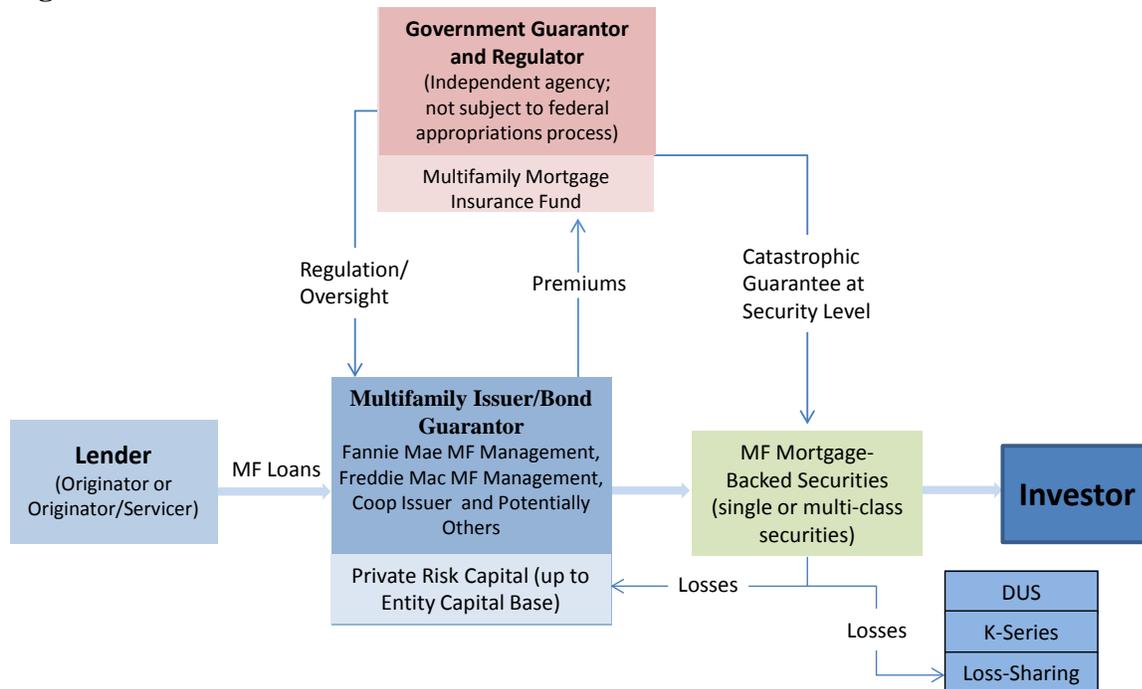
Figure 1:

	GSE multifamily operations spun off	Government Guarantor up and running	New multifamily issuers approved
<b>Bill Enacted</b>	<ul style="list-style-type: none"> <li>• New entities operate autonomously using parent Fannie or Freddie for guarantee</li> <li>• Entities continue to offer the DUS and K-Series models and contract to manage the multifamily assets of Fannie and Freddie</li> <li>• Entities are privatized as soon as feasible, with no private owner having more than a 19.9% interest</li> </ul>	<ul style="list-style-type: none"> <li>• Guarantee function is transferred to the Government Guarantor</li> <li>• Entities buy the government guarantee from the Government Guarantor</li> <li>• Government Guarantor holds all fees in a separate multifamily insurance fund</li> <li>• Government Guarantor regulates the entire secondary market for multifamily mortgages</li> </ul>	<ul style="list-style-type: none"> <li>• Government Guarantor sets up a co-op to ensure that small lenders have access to financing</li> <li>• Government Guarantor begins approving new issuers and their business models that can buy Government Guarantor insurance on their multifamily securities</li> </ul>
			<b>Bill Fully Implemented</b>

## Multifamily Finance Future State

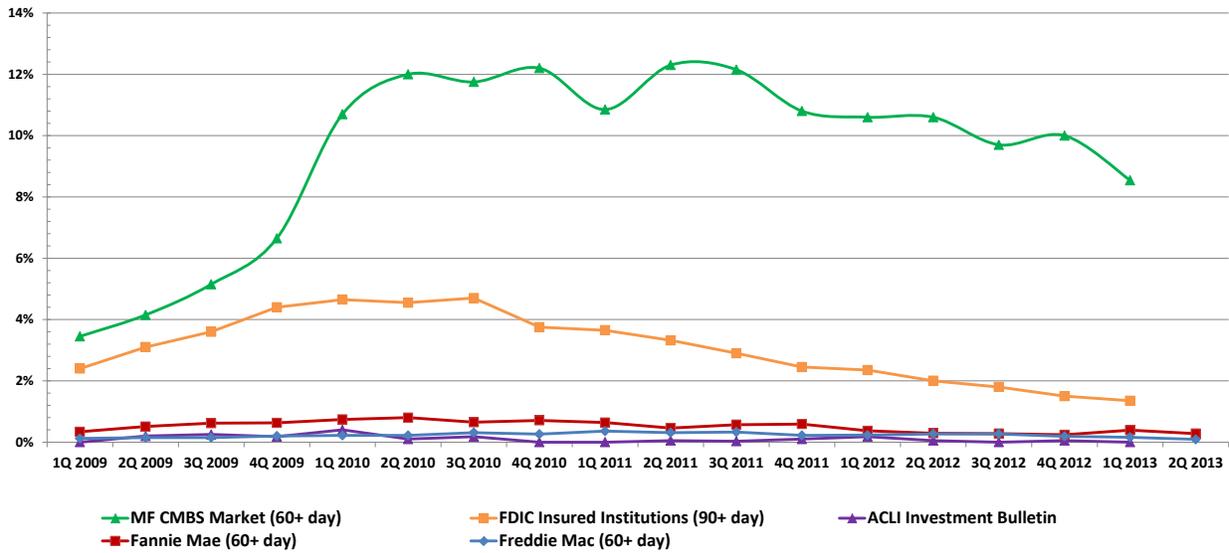
Catastrophic Guarantee from Government Guarantor kicks in only after Multifamily Issuer/Bond Guarantor Market Entity has used its capital base and all private parties have exhausted their risk-sharing obligations at the loan or security level

Figure 2:



## Multifamily Market Delinquency Rates

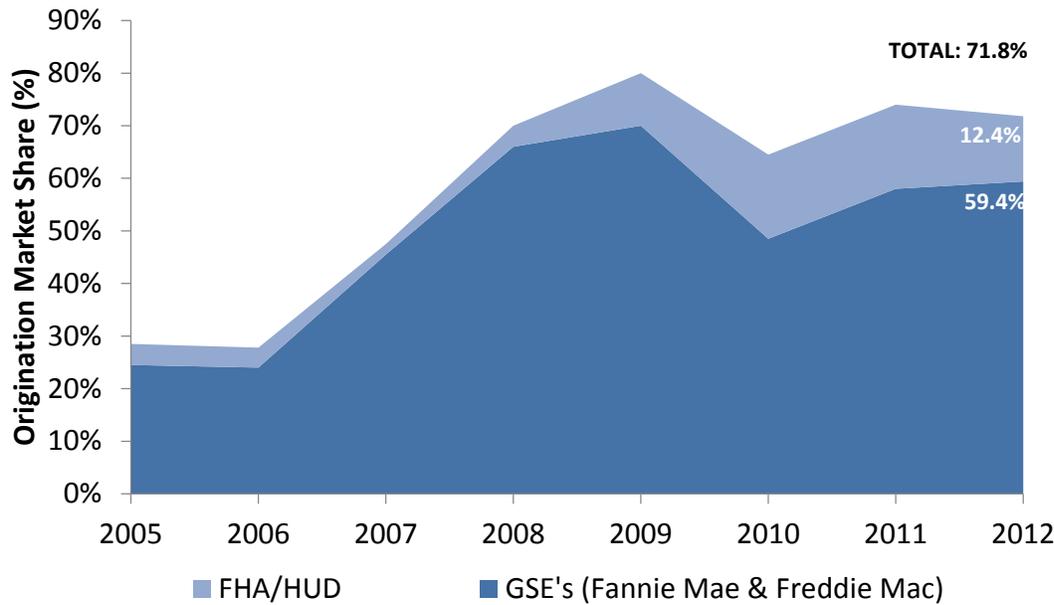
**Figure 3: GSEs have superior performance over Banks, CMBS, comparable to Life Cos**



Source: Freddie Mac, Fannie Mae, FDIC Quarterly Banking Profile, TREPP (CMBS multifamily 60+ delinquency rate, excluding REOs)

## Historical Multifamily Market Share

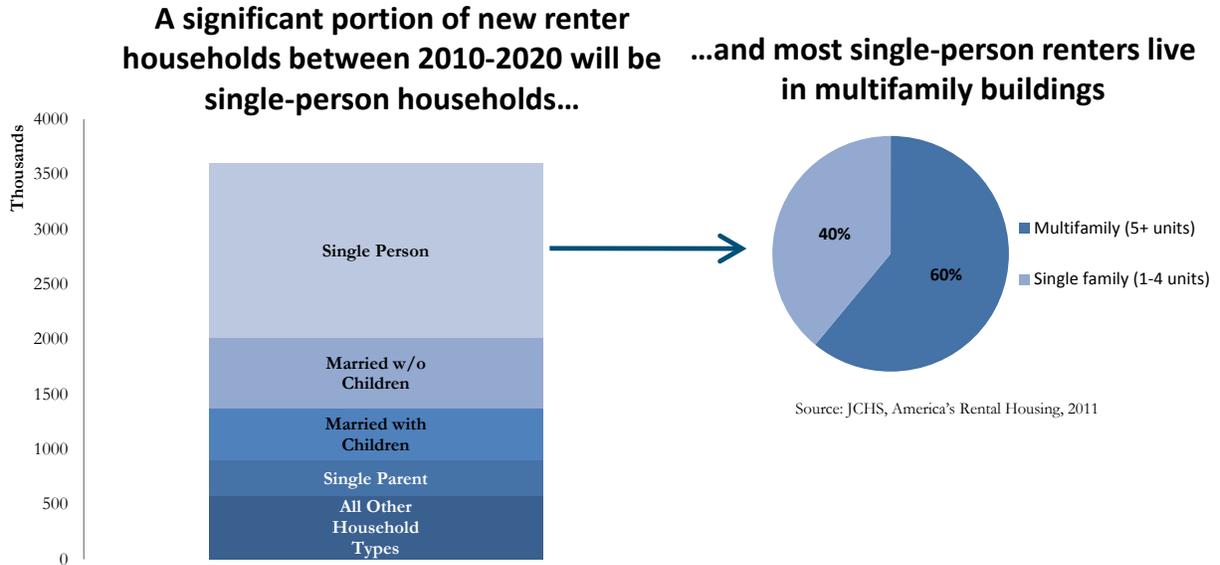
**Figure 4: Percentage Share of Total Multifamily Originations by Year**



Sources: Invesco presentation to Bipartisan Policy Center Housing Commission Forum; Fannie Mae, Freddie Mac and FHA public filings

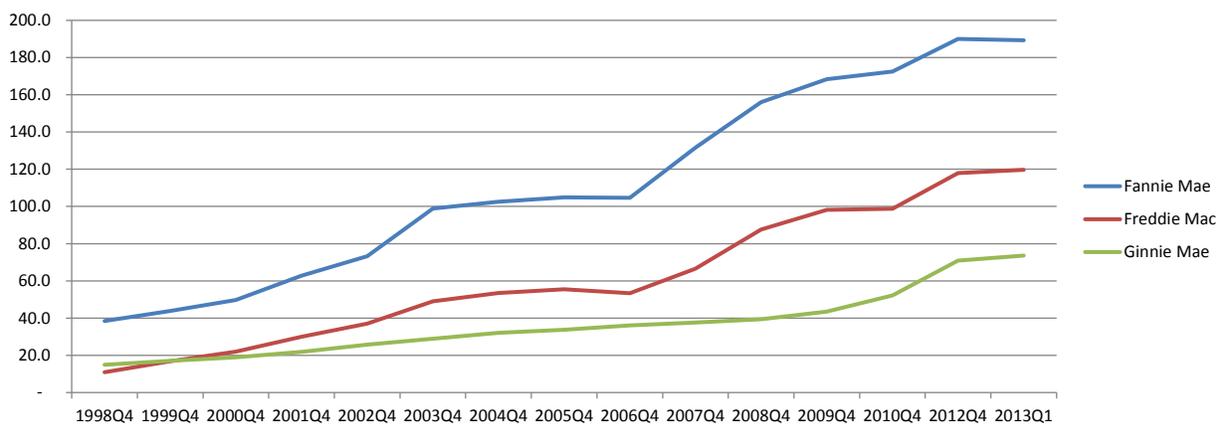
## Growth in Rental Demand Continues into Future

**Figure 5:**



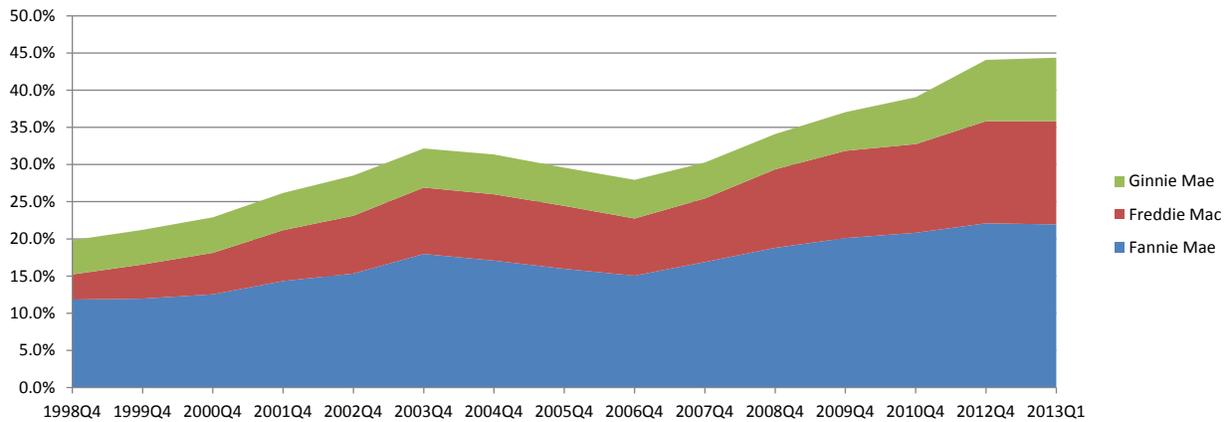
## Multifamily Mortgage Debt Outstanding

**Figure 6: GSE & Ginnie Mae Multifamily Mortgage Debt Outstanding (\$ billions)**



Source: Federal Reserve Flow of Funds

**Figure 7: GSE & Ginnie Mae Multifamily Mortgage Debt Market Share (% of total): Near 45% and growing**



Source: Federal Reserve Flow of Funds

**Roles of Key Market Players**

**Figure 8:**

Borrower	Lender	MBS Issuer/Bond Guarantor	Government Guarantor and Regulator	Investor
<ul style="list-style-type: none"> <li>• Select lender</li> <li>• Select product</li> <li>• Acquire loan</li> </ul>	<ul style="list-style-type: none"> <li>• Underwrite loan</li> <li>• Originate loan</li> <li>• Service loans</li> </ul>	<ul style="list-style-type: none"> <li>• Acquire loans</li> <li>• Structure securities</li> <li>• Credit enhance securities, including buying Government Guarantor insurance</li> <li>• Issue &amp; administer securities</li> <li>• Oversee risk-sharing partners (DUS Lenders, B-Piece buyers)</li> <li>• Disclosures</li> </ul>	<ul style="list-style-type: none"> <li>• Price the government guarantee</li> <li>• Collect G-fees and manage the multifamily insurance fund</li> <li>• Collect fees for the Affordable Housing Fund</li> <li>• Approval entities</li> <li>• Regulate the market for safety, soundness, access and affordability</li> </ul>	<ul style="list-style-type: none"> <li>• Purchase / sell securities with different risk characteristics</li> <li>• Access disclosures</li> </ul>