

# Multifamily First

## Piloting a solution for the GSEs

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# Where are the battle lines drawn?

- The ideological fault line: no government role in mortgage finance other than FHA

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- Private entities that function as investment-grade counter-parties providing 100% credit-risk protection on loans securitized with a government wrap

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- *No constituency for pre-conservatorship model and a limited one for full government ownership*
  - *Very little chance that things remain the same*

***“Chains of habit are too light to be felt until they are too heavy to be broken.” Warren Buffet***

# The Joint Center for Housing Studies of Harvard University, April 2011

## ***The Need is Growing; Demand is Up***

- One in four renters, or 10.1 million households, spends more than half their income on rent and utilities. Another quarter of renters, 26.2%, spends 30%-50% of their income on rent and utilities.
- The U.S. Department of Housing and Urban Development (HUD) found that “worst case housing needs” grew by nearly 1.2 million households, or more than 20 percent, from 2007 to 2009 and by 42 percent since 2001.
- The number of people who rent shot up 8 percent nationally and 12 percent locally between 2007 and 2009, Census Bureau figures show. As demand surged, rents climbed 3 percent nationwide in 2010 . Expectations are now for 5-8% annual rent increases with little new supply till 2013.

# Availability/affordability is down

- Since the mid 1990s, more than 700,000 rentals with federal subsidies tied to them were lost from the subsidized housing stock (either through demolition, or owner decision to abandon subsidies and turn the units into market-rate rentals).
- Meanwhile, nearly 12% of low-cost market-rate rentals existing in 1999 were demolished or otherwise permanently lost from the housing stock by 2009.
- With a median age of 38 years, **the rental housing stock is older on average than it has ever been**, raising concerns about continued high losses of this valuable resource.

# Multifamily First: Why?

5 reasons why multifamily finance reform should come first

1. Multifamily demand is surging (demographics, no new construction for the last 24 months, foreclosures, increasing renters by choice)
2. Rents are rising, vacancies are decreasing and values are increasing
3. Affordable multifamily housing is diminishing
4. Balloon mortgages are the norm in commercial real estate and maturity defaults will increase without secondary market financing
5. New construction is needed in many markets nationwide

***“A problem cannot be solved by the thinking that created it”: Albert Einstein***

# The GSE Multifamily businesses

- Out-performed all other asset classes (single family, CMBS, banks, ABS) with losses of less than 1% over the last 10+ years
- Serves the broad market (small and large loans, large and small cities, small and large lenders) in good and bad times with market share ranging from 35-65% (56% in 2010)
- Have been consistently profitable and can exist with a limited government guarantee only on the loan pools
- Could attract private capital and be stand-alone rated companies.

# Could the GSE MF businesses be private?

Fannie and Freddie operate their MF business under different models

- Example, Freddie Mac's on-and off-book\* is \$100 billion and \$15 billion respectively and could be supported with a \$10 billion capital base (8-10% Tier 1 capital) and 10x leverage
- This compares to 0.45% Tier 1 capital and 40-80x leverage in the earlier incarnation
- This division made \$1 billion in 2010 and should have a run rate of \$900-\$1.1 billion per year thereby producing returns sufficient to attract private capital

*\*using public data only*

# Could the GSE MF businesses be private?

Function as investment-grade counter-party providing 100% credit-risk protection on loans securitized with a government wrap

- Example, Fannie Mae's on-and off-book is \$114 billion and \$76 billion respectively and could be supported with a \$15 billion capital base (8-10% Tier 1 capital) and 10x leverage
- This compares to 0.45% Tier 1 capital and 40-80x leverage in the earlier incarnation
- This division made \$1.1 billion in 2010 and should have a run rate of \$1.4-\$1.5 billion per year thereby also producing returns sufficient to attract private capital

*\*using public data only*



# A Few Statistics on the *other* Housing Market

- First, 58% of all rental housing in America is 1-4 units and therefore not called multifamily
- Second, the supply over-hang in that 1-4 market is astonishing:
  - 3.5-4.0 million homes are waiting to be sold (1.0-1.5 million more than normal levels)
  - 2 million homes are empty (may become for-sale when the markets stabilize)
  - 4.3 million households have missed at least 3 mortgage payments and are in serious danger of foreclosure
  - 6 million more homes are in danger of foreclosure

# A Few Out-of-the-Box Thoughts

- The US homeownership rate dropped from close to 70% in 2004 to 66% BUT if you exclude delinquent borrowers, it is actually close to 60%
- So, I would postulate three things:
  - We could become a 50% renter nation
  - Rental Housing Finance should cover all rental housing that has investor ownership so 2 units and above
  - To the usual renter demographics of 18-29 year-olds, empty nesters and new immigrants add foreclosed homeowners as the fastest – growing category. How sad!

# Now What?

*“Indecision and delays are the parents of failure”, George Canning*

- Talent is leaving. If it continues to deplete the GSE multifamily housing finance businesses, we will see an earlier wind-down with negative and unnecessary consequences to the taxpayer and the economy
- FHA is needed for multifamily new construction/sub rehab but cannot serve the broader market the GSEs currently do
- If Treasury could encourage a spin-out of the GSE multifamily businesses while retaining upside in stock and warrants, the taxpayer benefits and private capital re-enters
- This can be done using existing apparatus: FHFA as regulator and Ginnie Mae as the government wrap
- This could serve as a privatization model for the larger, more complicated single-family book/on-book that would remain