



MORTGAGE BANKERS ASSOCIATION

Testimony of E.J. Burke

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and

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Before

**The U.S. Senate Committee on
Banking, Housing and Urban Affairs**

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

October 9, 2013

Introduction

Chairman Johnson, Ranking Member Crapo, and members of the Senate Banking Committee, thank you for the opportunity to testify on behalf of the Mortgage Bankers Association. My name is E.J. Burke, and I am Chairman-Elect of MBA, as well as Executive Vice President and Group Head of KeyBank Real Estate Capital. I oversee multiple commercial real estate lending platforms for KeyBank, NA in its commercial and multifamily real estate finance business, including construction & development lending, portfolio lending, community development lending, commercial mortgage-backed securitization, life company placement, FHA multifamily programs, and Fannie Mae & Freddie Mac multifamily lending. I have over 34 years of experience in banking and commercial real estate finance. KeyBank, NA is a \$91 Billion regional bank that is headquartered in Cleveland, Ohio. KeyBank, NA provides community banking services in 14 U.S. states and corporate banking services nationwide. KeyBank Real Estate Capital is a national commercial real estate lender and commercial loan servicer.

Today's hearing serves as a catalyst to underscore the importance of multifamily rental housing. With Fannie Mae and Freddie Mac having been in conservatorship for more than five years, it is imperative that policymakers define a long-term plan for the future role of the federal government in the mortgage market. This plan must fundamentally include their unique role in multifamily rental housing. I commend the Chairman and Ranking Member for your leadership toward this end. We look forward to working with the Committee to help shape a vibrant rental housing market that builds upon the foundation that exists today.

As this Committee considers the essential elements of the multifamily housing finance system, we believe that policy makers should focus on ensuring that capital continues to be available in all market cycles. With this in mind, the policy discussion on the role of private capital and that of the federal government, in our view, is not mutually exclusive in character. We believe that public policy can strike a durable balance that continues to attract and deploy private capital in the multifamily market, while establishing a focused government guarantee that enables liquidity and stability in all cycles — a role that only the government can fulfill. This, in turn, will protect taxpayers and strengthen the financing system for rental housing.

These goals can be accomplished by building upon the strong foundation that currently exists in multifamily finance — where there is greater and increasing diversification in capital sources for multifamily housing, where private capital bears significant risk in existing multifamily finance platforms, and where government-backed sources have experienced, even through the recent financial crisis, very strong credit performance.¹

¹ For example, both GSE multifamily businesses have been profitable and have been prudent in their lending practices, as reflected in their current credit performance with less than a 20 basis point delinquency rate.

My testimony begins with an overview of the multifamily housing market and capital sources, including the GSEs, that support this market.

I then discuss overarching policy principles that we believe should guide the future of multifamily housing finance.

Based on these principles, I recommend a system that would strengthen multifamily housing finance, while providing commentary on current legislative approaches.

I conclude my testimony by emphasizing the importance of ensuring a stable transition and careful stewardship of taxpayer assets, in order to provide greater flexibility for Congress as it frames the regime that will govern the housing finance market.

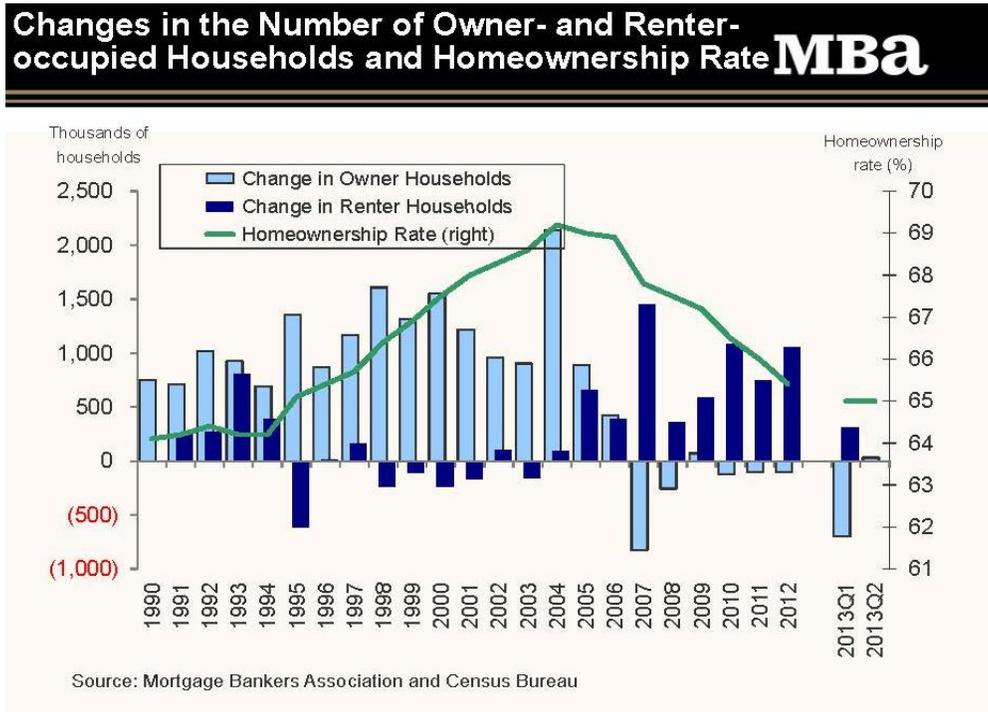
I. Overview of the Multifamily Housing Market

Importance of Multifamily Rental Housing

More than one in three American households rent their home, and more than 16 million of those households live in multifamily rental housing, a development with five or more units. The multifamily rental housing market is a critical component of our housing system — in size, reach and the households that it serves. Renters include workers who want to live near their jobs, young professionals, empty-nesters, retirees on a fixed income, families with children, students, and households who value the convenience and mobility that renting offers. The vast majority of multifamily rental housing provides homes for households earning modest incomes, with 93 percent of multifamily rental apartments having rents affordable to households earning at or below the area median income. Overall, renters' median household income is about half of that of homeowners.²

The share of households renting their homes has risen to 35 percent from a low of 31 percent in 2004. And since the end of 2006, the number of renter households has increased by five million, while the number of owner-occupied households has declined by 1.5 million.

² Joint Center for Housing Studies, Harvard University, *State of the Nation's Housing 2013*.



The number of renter households is expected to continue to increase substantially over the next decade. Harvard's Joint Center for Housing Studies "estimates that the number of renter households could increase by 360,000 - 470,000 annually between 2010 and 2020, in line with growth over the past decade."³ This growth in renter households will require substantial investment in multifamily housing.

The nature of financing multifamily rental housing differs from that in single-family lending in important ways. Among them, multifamily lending involves loans that have larger balances with more complex and heterogeneous properties, compared to single-family loans. Multifamily loans require a detailed underwriting process due to the fact that the repayment of the loan is dependent on the ongoing financial performance of the property, which is in turn dependent on the property's income streams, expenses, market conditions and outlook, and numerous other factors. As a result, careful underwriting is required to confirm a property's creditworthiness and the borrower's ability to successfully operate the apartment property. The origination, underwriting, securitization and investor reporting, and servicing expertise necessary to successfully finance multifamily rental properties is considerable.

The finance market that supports multifamily rental housing is substantial and includes a range of market participants. The total amount of multifamily mortgage debt outstanding is

³ Joint Center for Housing Studies, Harvard University, *State of the Nation's Housing 2011*.

approaching \$900 billion.⁴ Capital sources that finance the multifamily housing market include Fannie Mae and Freddie Mac, commercial banks, the Federal Housing Administration's (FHA) multifamily programs, life insurance companies, commercial mortgage-backed securities (CMBS) issuers, REITs, pension funds, state and local government agencies and others. While all sources play an integral role in supporting the multifamily market, each has its own focus, strength, and limitations.

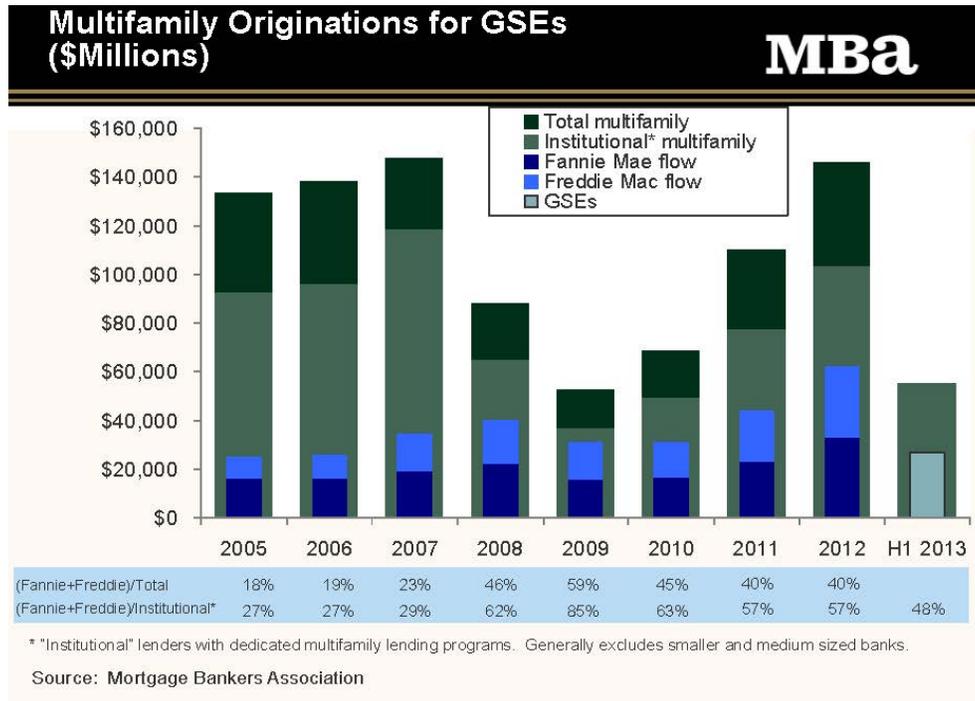
Importantly, when most private capital sources exited the multifamily finance market during the recent economic downturn, the GSEs and FHA continued to provide liquidity during this period of unprecedented market disruption.

The GSEs' Performance and Counter-cyclicality During Market Downturn

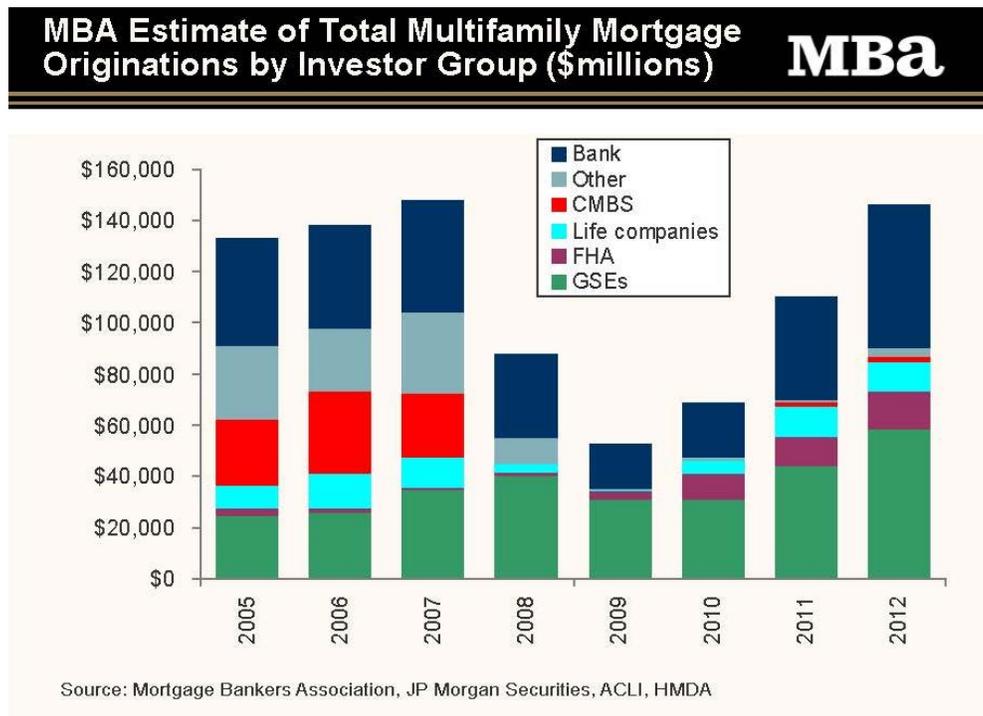
Let me turn to the role that Fannie Mae and Freddie Mac have recently played in the multifamily housing markets. The GSEs' role during the financial crisis demonstrates that they served a countercyclical role as providers of liquidity in the multifamily market when other sources pulled back. The GSEs' peak market share reached 59 percent of the total multifamily mortgage originations (and 85 percent of the institutional market⁵) in 2009. And since the crisis, their market share has trended downward — in 2012, 40 percent of the total multifamily market and 57 percent of the institutional market — even as overall multifamily origination volumes have increased.

⁴ MBA's *Quarterly Analysis of Commercial and Multifamily Mortgage Debt Outstanding*.

⁵ MBA defines the institutional market as the part of the market served by lenders with a platform dedicated to lending to commercial and multifamily property owners.



As the market has stabilized, other lending sources have increased market share, with non-GSE capital sources competing vigorously with Fannie Mae and Freddie Mac to finance multifamily properties.



In sum, the GSEs' multifamily businesses, their performance and role in the market are unique in many respects. As Acting FHFA Director Edward DeMarco observed in a speech earlier this year:

Unlike the single-family credit guarantee business, the Enterprises have a smaller market share and there are other providers of credit in the multifamily market Another difference from the single-family business is that each Enterprise's multifamily business has weathered the housing crisis and generated positive cash flow. In contrast to their common approach to their single-family businesses, Fannie Mae and Freddie Mac do not take the same approach to their multifamily businesses. Each approach also already embeds some type of risk sharing. For a significant portion of its business, Fannie Mae shares multifamily credit risk with loan originators through its delegated underwriting program. For a significant and increasing portion of its business, Freddie Mac shares multifamily credit risk with investors by issuing classes of securities backed by multifamily mortgages where the investor bears the credit risk.⁶

II. Policy Principles for Multifamily Housing Finance

Recognizing the unique attributes of the multifamily market, MBA recommends that policy makers support proposals that advance the following principles.

Our nation's multifamily housing finance system should rely on private capital. Private capital should be the primary source of financing for multifamily rental housing. Private capital has historically been brought to bear through the range of lending institutions that have supported multifamily finance, such as portfolio lenders and CMBS issuers, the GSEs' multifamily programs that require loss sharing with originators and with investors, and the capitalization of the GSEs themselves. We believe that government policies should maintain this reliance on private capital going forward.

Past experience shows that the federal government is the only entity that can ensure the availability of liquidity in all market cycles. The recent financial crisis and recession demonstrated that only the federal government can ensure liquidity through all market cycles, and, as demonstrated by the conservatorship of Fannie Mae and Freddie Mac, as well as programs like the Federal Reserve's asset purchases, the federal government will fill this role when necessary. Government policies should anticipate and prepare for this role.

⁶ FHFA's Conservatorship Priorities for 2013, Remarks Prepared for Delivery by Edward J. DeMarco, Acting Director, FHFA (March 4, 2013).

The government should ensure liquidity for multifamily mortgages through a carefully crafted guarantee on multifamily mortgage-backed securities. The federal government should provide a catastrophic backstop guarantee on mortgage-backed securities. The catastrophic backstop role would be similar to that of the U.S. government in a number of sectors and markets, including federal deposit insurance in the banking system. This government backstop should be available at the mortgage-backed securities level (rather than at the level of the issuer, as it is today with the GSEs) at all times to ensure liquidity in the multifamily finance market.

Taxpayers and the mortgage finance system itself should be protected through a strong regulatory framework and multiple layers of private capital. To protect taxpayers and the system itself, the government guarantee-related market should be subject to strong and independent regulatory oversight and risk-based capital requirements. Taxpayers also should be protected through multiple layers of private capital, including the equity in the multifamily property itself and the entity-level capital of the security-issuing institution and any risk sharing it may undertake. As noted above, a federal risk insurance fund should also be established, capitalized by risk-based premiums paid by participating firms. Only when all layers of capital are exhausted would a draw on the U.S. Treasury be authorized.

Policy makers should protect and preserve existing resources, as well as support greater transparency, during the transition to an overhauled housing finance system. Given the significant role of the GSEs in the multifamily market, their infrastructures, human capital, and resources should be carefully managed to avoid disruptions to the market, as well as to ensure an orderly transition to a new housing finance system. Prudent management of existing multifamily executions and mortgage portfolios is important due to its quality and positive cash flow generated — all of which are taxpayer assets.

III. Structural Recommendations for the Future of Multifamily Housing Finance

To implement these principles, MBA believes that a legislative solution should incorporate the following structural recommendations:

Establish A Government Guarantor. A wholly-owned government corporation should function as a catastrophic guarantor, administrator of a risk insurance fund, and regulator of secondary market entities. The government guarantor, which would be backed by the full faith and credit of the U.S., would not be subject to the federal appropriations process, but be funded by guarantee fees paid by issuers, as well as other statutorily-defined assessments.

The government corporation would, pursuant to statutory guidelines, approve private sector secondary market entities, as well as set standards by which secondary market entities would be eligible to issue government-backed securities. The pricing of the guarantee should encourage competition, be commercially reasonable, and be subject to calibration based on pre-determined criteria that considers market conditions.

Allow Multiple, Privately-Capitalized Issuers of Government-guaranteed Securities in the Secondary Multifamily Mortgage Market. Privately-capitalized secondary market entities would be eligible to purchase mortgages, aggregate (if applicable), and issue government-backed mortgage-backed securities that support the multifamily market. Regular and dependable security issuances would create the liquidity in the market to get attractive pricing and broad market participation by bond investors.

These issuers would be expressly permitted to purchase catastrophic reinsurance from the government guarantor to wrap the MBS. The government guarantee should be structured so that it can be expanded in times of market disruption. A mono-line structure, with segregated assets and separate capital standards, would facilitate capital adequacy determinations, regulatory oversight, and aggregation capabilities to support structured risk-sharing transactions. The government guarantor/regulator would be able to authorize the establishment of multiple such entities.

The secondary market entities should be required to be separately capitalized. Governance structures that enhance independence from potential affiliated business lines (if any) should be considered. We believe that these entities could be (but need not be) affiliated with single-family market entities. They would provide liquidity to the workforce rental housing market, including secondary and tertiary markets.

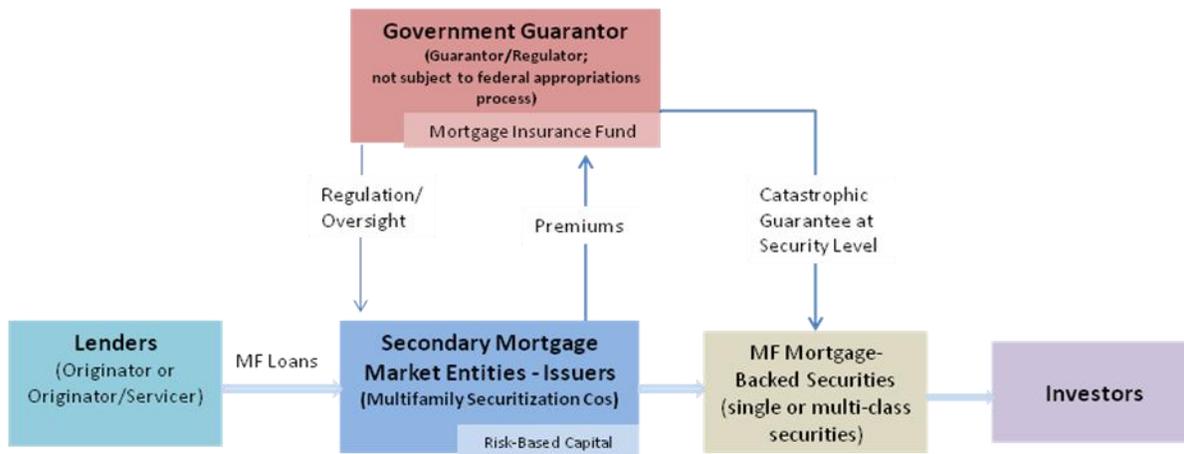
Preserve and Carry Over Execution Models. The GSEs' multifamily executions incorporate substantial private capital and risk sharing with other market participants, and have exhibited strong credit performance with current delinquency rates of less than 20 basis points. This and other flexibility in the structure of the government wrap on MBS is important to allow for multiple risk-sharing executions to manage credit risk. These businesses are valuable to U.S. taxpayers and should be transferred to new entities that would serve the multifamily housing finance market. Notably, in the multifamily space, we do not believe there is a need for utilization of a common securitization platform, private mortgage insurance, or other single-family-specific concepts at this time.

Consider Affordable Character of Multifamily Rental Housing. By its very nature, multifamily rental housing tends to be affordable, with 93 percent of multifamily units having rents affordable to households earning area median incomes or less. Policy proposals contemplating affordability requirements, if any, on secondary market entities should take this

into account. Any proposed approaches also should be reasonable and flexible, as well as balanced with regard to the need to attract private capital.

Summary Diagram. The following diagram summarizes our structural recommendations:

DIAGRAM OF RECOMMENDED MULTIFAMILY HOUSING FINANCE FUTURE STATE



Pending Legislative Proposals

MBA is encouraged by recent legislative activity that has revived the policy debate on the future of Fannie Mae and Freddie Mac. Senate and House members have introduced thoughtful proposals that would create a comprehensive framework for the future of housing finance. We commend these efforts. MBA views all such proposals through the lens of our guiding principles. In particular, the future system of multifamily finance should rely on private capital and protect taxpayers, while ensuring stable and continued liquidity in all economic cycles through a government backstop.

In the Senate, Senators Corker and Warner have introduced bipartisan legislation that would transform the housing finance system. To the extent that the Committee considers portions of this bill in its efforts to craft comprehensive GSE reform legislation, we offer several recommendations.

With regard to its treatment of multifamily housing finance, MBA strongly supports the bill's approach that provides an explicit government guarantee (through a Federal Mortgage Insurance Corporation (FMIC)) for multifamily loans. We also support the establishment of premiums paid into an FMIC-administered insurance fund, oversight by the FMIC as a strong regulator, and recognition of the value and retention of the GSEs' multifamily executions (*i.e.*, Delegated Underwriting & Servicing and Capital Markets Execution/K-Deals).

However, we would urge that the statutory language explicitly distinguish between the roles of the FMIC and multifamily private sector participants: The FMIC should retain the role of regulator, government guarantor and administrator of an insurance fund – but other roles should be transferred to private sector entities. Specifically, the bill should direct the FMIC to establish privately-capitalized secondary mortgage market entities to serve as issuers in the multifamily housing finance market. The current multifamily platforms of the two GSEs could be moved over into such new entities. Moving these businesses to the private sector (through a sale or public offering) — with continued access to a government guarantee — would likely return substantial capital to the U.S. Treasury.

These secondary market entities would purchase multifamily mortgages, aggregate loans, manage and distribute credit risk, credit enhance, and structure and issue government-backed MBS that support the multifamily market. In other words, the secondary market entities would have access to purchase catastrophic reinsurance from the government guarantor that wraps the MBS. We also believe that the FMIC should be authorized to approve several such companies in order to foster competition and innovation, setting forth criteria for the approval of these multifamily issuers. Governance guidelines and approval standards should be established as well.

Importance of FHA Multifamily and Healthcare Programs

While not the focus of today's hearing, I would like to emphasize the essential role that FHA plays in supporting the multifamily housing market. The Federal Housing Administration is a critical source of the long-term, fixed-rate debt needed to build and refinance affordable rental units for working families, seniors, and underserved populations. FHA's multifamily and healthcare loan programs are each designed to address a different loan type or segment of the market.⁷ FHA has played a strong, counter-cyclical role in this market as well. Its status as a government agency subject to the federal appropriations process, however, has presented inherent limitations in FHA's capacity, as we are witnessing today with commitment authority limitations and the recent federal government shutdown.

⁷ Some of the major FHA multifamily programs are: (1) new construction/substantial rehabilitation (NCSR); (2) section 223(f) for the purchase or refinancing of existing multifamily properties; and (3) section 223(a)(7) for the refinancing of loans that already have an FHA-insured mortgaged. FHA and its lender partners also provide financing programs to support healthcare and assisted-living facilities.

FHA provides an explicit federal government guarantee on multifamily and healthcare loans through a range of programs established by Congress. The guarantee is paid for through a mortgage insurance premium set by HUD and paid by the borrower. Not only have FHA multifamily and healthcare loans performed well with low default rates (as published by HUD in May 2013), but the programs generate significant revenue to the federal government in the form of a negative credit subsidy, generating positive cash flow to the U.S. Treasury. Diversification in business mix for FHA multifamily programs is essential and has contributed to their strong credit performance. Mortgage insurance premiums are deposited into FHA's GI/SRI fund, separate from the MMI fund that supports FHA's single-family programs. FHA serves a wide market that is sometimes bypassed by other capital sources. Many properties are in secondary or tertiary markets supported by niche borrowers and lenders, and this capital source supports a vital need in these areas.

Accordingly, MBA strongly recommends that Congress (1) reduce disruptions — at this time and on an ongoing basis — to the FHA multifamily and healthcare programs; (2) provide adequate FHA Commitment Authority for the full fiscal year to avoid costly and counter-productive stop and start problems; and (3) continue to encourage FHA to maintain a balance of affordable and market rate FHA multifamily financings.

IV. Transition and Stewardship of GSE Multifamily Resources

As the Committee is well aware, the GSEs are subject to FHFA's conservatorship and the Treasury Department's controlling interest pursuant to the preferred stock purchase agreement originally entered into in September 2008.⁸ With the GSEs controlled by the federal government, we urge policy makers to exercise stewardship with regard to the resources and assets of the GSEs' multifamily businesses — for purposes of ensuring a stable transition to the future system of multifamily housing finance.

While it is clear that the current state of the GSEs should not last indefinitely, policy makers should ensure the ongoing stewardship of valuable resources that support the multifamily market, utilizing them to transition to a stronger multifamily housing finance system. The resources of the GSEs, as taxpayer assets, should be preserved to support an orderly transition to a new mortgage finance system and ultimately to optimize potential returns to taxpayers.

⁸ The Treasury Department's August 2012 announcement on the most recent amendment to the agreement, requiring an expedited reduction in the GSEs' retained portfolios and an all income sweep of the GSEs' profits (but for specified capital reserve amounts), further underscores the integral tie between these entities and the federal government.

The talent, expertise and intellectual capital of their staff are valuable to the federal government, and the future deployment of these resources should be a core consideration in the transition to the future state of housing finance. Similarly, the multifamily market executions of the GSEs (each utilizes a distinct structure as its primary execution and attract private capital that assumes a substantial credit risk position) and their existing multifamily books of business are clearly taxpayer assets, and should be viewed in a manner that supports the pathway toward the future state of multifamily finance.

We also caution that the multifamily finance market and the role GSEs play should not be viewed as a potential thought experiment to test out scenarios. Blunt or dramatic changes imposed in conservatorship, for example, would be highly disruptive, risk the loss of significant talent, and reduce the value of taxpayer assets. Regulatory or legislative actions that could substantially jeopardize the viability and value of key resources within the GSEs' multifamily businesses should be avoided. While policymakers should continue to explore steps to facilitate the transition forward, the *do no harm* principle should equally govern.

Conclusion

Thank you for the opportunity to testify before you today. MBA remains committed to its key principle that a successful multifamily secondary market should rely primarily on private capital, while ensuring stable and continued liquidity in all economic cycles. We believe that this can be achieved in manner that protects taxpayers and builds upon the successes and strong foundation that exists today. We would be pleased to assist the Committee as it continues to engage in this critically important effort.