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National Multi Housing Council®
Apartments: Smart Communities, Smarter Living

National Apartment Association

STATEMENT OF MARK J. PARRELL

ON BEHALF OF THE

NATIONAL MULTI HOUSING COUNCIL

AND THE

NATIONAL APARTMENT ASSOCIATION

BEFORE THE

SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

ON

PUBLIC PROPOSALS FOR THE FUTURE OF THE HOUSING FINANCE SYSTEM PART II

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Chairman Johnson, Ranking Member Shelby and distinguished Members of the Committee, my name is Mark Parrell, Executive Vice President and Chief Financial Officer of Equity Residential. Equity Residential (EQR) is an S&P 500 company focused on the acquisition, development and management of apartment properties in top U.S. growth markets. Equity Residential owns or has investments in more than 450 properties with 117,286 units in 17 states and the District of Columbia. I am testifying today on behalf of the National Multi Housing Council (NMHC) and its joint legislative partner, the National Apartment Association (NAA).

NMHC and NAA represent the nation's leading firms participating in the multifamily rental housing 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 the largest national federation of state and local apartment associations, with 170 state and local affiliates comprised of more than 50,000 multifamily housing companies representing more than 5.9 million apartment homes.

I appreciate the opportunity to be here today to present the industry's perspective on the role of the Government Sponsored Enterprises (GSE), specifically Fannie Mae and Freddie Mac, and how the multifamily market works and is different than the single-family market. I will also discuss the benefits derived from the GSEs' presence in the multifamily market and why we believe there will be a continued need for federal involvement even after they are phased out.

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

Currently, one-third of Americans rent their housing, and nearly 14 percent—17 million households—call an apartment their home. Americans are changing their housing preferences. Married couples with children represent less than 22% of households, and that number is falling. By 2030, nearly three-quarters of our households will be childless. Echo boomers are starting to enter the housing market, primarily as renters, and baby boomers are beginning to downsize, and many are choosing the convenience of renting. Rental housing offers them a maintenancefree lifestyle with amenities, social opportunities and often walkable neighborhoods. In this decade, renters could make up more than half of all new households—more than seven million new renter households. Because of these changes, University of Utah Professor Arthur C. Nelson predicts that half of all new homes built between 2005 and 2030 should be rental units.

Apartments are not just shelter. They are also an economic powerhouse. The aggregate value of this apartment stock is $2.2 trillion. Rental revenues from apartments total almost $120 billion annually, and management and operation of apartments are responsible for approximately 550,000 jobs. Moreover, the construction of apartment communities in the last five years has added an average of 210,000 new apartment homes per year, providing jobs to over 270,000 workers.

Finally, apartments also produce societal benefits; not only are they environmentally sustainable, resource- and energy-efficient, 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 encourage Congress to consider the unique needs of the apartment industry as you pursue reform options.

The bursting of the housing bubble exposed serious flaws in our nation's housing finance system. However, fixing the single-family housing finance system should not come at the expense of the much smaller and less understood, but vital, multifamily sector. The GSEs' multifamily programs did not contribute to the housing meltdown, and without adequate attention to this segment of the housing market we risk becoming collateral damage. We believe a fully functioning secondary market, backstopped by the federal government is absolutely critical to the multifamily sector and our industry's ability to continue to meet the nation's demand for market-rate, workforce and affordable housing.

I have been invited here today to talk about what works in the current GSE system of mortgage finance. Regardless of what you hear and read relative to the perceived evils of the GSEs and their contribution to the housing meltdown, when it comes to financing multifamily housing, quite a lot works. Let me be clear, I am not here to defend the GSEs or to suggest that they be continued in their current form. However, I would like to highlight for the Committee those elements of the system that worked well for multifamily lending and, most importantly, at no cost to the taxpayer. It is our hope that these elements of success can be incorporated into whatever you design 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 portfolio stands in stark contrast to that of the single-family business. In short, the multifamily programs were not part of the meltdown and are not broken.

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. They have outperformed CMBS, commercial banks and even FHA. In addition, since the federal government placed the GSEs in conservatorship, the multifamily portfolio has managed to net approximately $2 billion in profit for the federal government.

Not only are the GSEs' multifamily programs operating in a fiscally sound manner, they are 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 including conventional market rental housing, workforce rental housing and targeted affordable (e.g., Project-based Section 8, properties subsidized by state and local government 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.

Federal Credit Guarantee: Meeting the Needs When Private Capital Disappears

This most recent crisis underscores the need for a capital source that will be available in all economic climates. In the last two years, the GSEs have provided $94 billion in mortgage debt to the apartment industry when virtually every other source of capital left the market. They served a similar role during the 1997-1998 Russian financial crisis and in the post-9/11 recession of 2001.

Their 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. 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 its capital sources.

If not for the GSEs' multifamily programs, I would most likely be telling a different story today. It would be one of higher default and delinquency rates because owners would be unable to secure capital to refinance maturing, but otherwise performing, mortgages. The consequences for renters nationwide would have been severe. Multifamily may only represent 10 percent on average of the GSEs' mortgage debt, but the GSEs currently provide nearly 90 percent of multifamily mortgage capital.

Historically, the apartment industry enjoys access to mortgage capital from a variety of credit sources, each with its own focus, strengths and limitations. In addition to the GSEs, these sources include commercial banks, life insurance companies, CMBS and pension funds. Prior to the financial crisis, these combined capital sources provided the apartment sector with $100-$150 billion annually, reaching as high as $225 billion to develop, refinance, purchase, renovate and preserve apartment properties.

We are encouraged by the thawing in the private capital markets and support a return to a marketplace dominated by private capital. But even in healthy economic times, the private market has not been able or willing to meet the full capital needs of rental housing. The following highlights some of the capital sources, limitations and level of participation in the multifamily market:

- Banks are limited by capital requirements and have never been a source of long-term financing. They currently hold 31.2% of outstanding multifamily mortgage debt. Between 1990 and 2010, they provided 24% ($136.49 billion) of the total net increase in mortgage debt but have provided limited amounts of capital to the industry since the financial crisis.

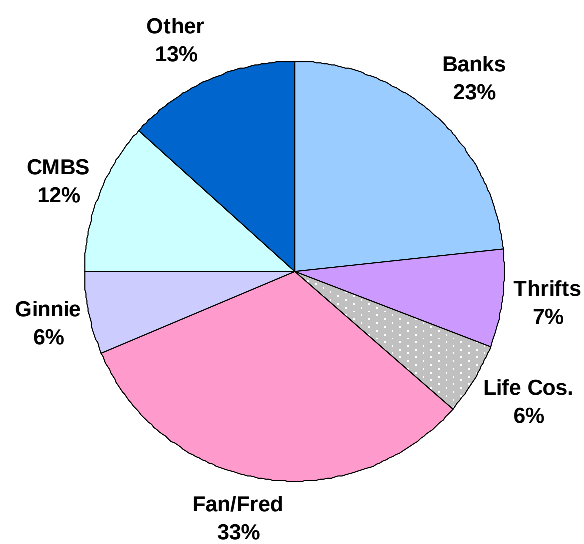
- Life insurance companies target very specific product, i.e., newer, luxury high-end properties. They tend to enter and leave the multifamily market based on their investment needs and economic conditions. They currently hold just 5.6% of outstanding multifamily mortgage debt. Between 1990 and 2010, they accounted for just 3% ($18.3 billion) of the net increase in multifamily mortgage debt.

- FHA has exceeded its capacity to meet the sector's capital demands and their capital targets construction lending. FHA/Ginnie Mae currently hold 14% of outstanding multifamily mortgage debt. From 1990 to 2010, they accounted for 10.7% ($59.6 billion) of the total net increase in mortgage debt.

- The private-label CMBS market is unlikely to return to the volume and market share it reached a few years ago. It peaked at 16.5% of the market ($17.6 billion a year) in the housing bubble years of 2005-2007. The CMBS market now holds 12.2% of the outstanding multifamily mortgage debt.

- While covered bonds might provide some additional liquidity to apartment borrowers, they are unlikely to provide the capacity, flexibility and pricing superiority necessary to adequately replace traditional sources of multifamily mortgage credit, including the GSEs.

Mortgage Debt Outstanding 2010 Q4: $841 Billion



Source: Federal Reserve Board.

Federal Credit Guarantee Creates Workforce Housing without Federal Appropriations

It is important to note that nearly ALL of the multifamily funding provided by the existing GSEs helped create workforce housing (not just the capital they provided to properties designated “affordable”). Fully 90 percent of the apartment units financed by Fannie Mae and Freddie Mac over the past 15 years—more than 10 million units—were affordable to families at or below the median income for their community. This includes an overwhelming number of market-rate apartments that were produced with no federal appropriations, and with virtually no risk to the taxpayer.

The ability to serve renters at or below area median income is dependent on the liquidity provided by the government-supported secondary multifamily mortgage market. It lowers the cost of capital to borrowers who provide workforce market-rate housing. Without this support, interest rates and debt service costs would rise, rents would increase to cover these costs and fewer renters would be able to enjoy the pricing at area median income levels.

Not only does the presence of a government-supported secondary multifamily mortgage market lower the cost of capital, it also works to leverage private capital to support affordable housing. We are convinced that removing the government guarantee of multifamily mortgages or mortgage-backed securities will put the supply of affordable housing at risk. Other capital sources will simply not fill the gap, and with a severe supply shortage already existing in many markets and steadily forecasted to worsen, vacancy rates will most certainly decrease and rents will rise. This most recent crisis underscores the need for a capital source that will be available in all markets, whether it is New York City, Sioux Falls, South Dakota or Birmingham, Alabama, and at all times.

Multifamily Loan Maturity Risk Depends on Active and Functioning Securitization and a Secondary Market

A federally backed secondary market is critical not only for the long-term health of the industry but also to help refinance the estimated $300-$400 billion in multifamily mortgages that will mature by 2015. 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.

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. As I mentioned earlier, without this source of liquidity during the most recent and prior financial crises, performing properties could have been pushed into foreclosure or bankruptcy when their loans matured. The disruption in the housing system in such a scenario would be potentially devastating to millions of renters and the economy as a whole.

Growing Importance of Rental Housing, Experts Forecast Supply Shortage

As noted previously, the U.S. is on the cusp of a fundamental change in our housing dynamics. Changing demographics and new economic realities are driving more people away from the typical suburban house and causing a surge in rental demand. Tomorrow's households want something different. They want more choice. They are more interested in urban living and less interested in owning. They want smaller spaces and more amenities. And increasingly, they want to rent, not own. Unfortunately, our housing policy has yet to adjust to these new realities.

Our society is changing in meaningful ways that are translating into new housing preferences. Beyond just changing demographics, there is also a much-needed change in consumer psychology underway that favors more long-term renters in the future. The housing crisis taught Americans that housing is shelter, not the "sure thing" investment once believed. That awareness is freeing people up to choose the housing that best suits their lifestyle. For millions, that is an apartment.

While there may be an oversupply of single-family housing, the nation could actually see a shortage of multifamily housing as early as 2012. The shortage is particularly acute in the area of workforce and affordable housing. The Harvard Joint Center for Housing Studies estimates a nationwide affordable housing shortfall of three million units. (Addendum II of my testimony provides further information on the inherent affordability of apartments.)

This context is particularly important in understanding why it is vital that as Congress looks to reform housing finance, it do nothing that would jeopardize the construction, financing and availability of multifamily housing. Without a functioning securitzation process and a backstop of government credit support for multifamily mortgages or mortgage-backed securities to ensure a steady and sufficient source of capital going forward, the apartment industry will not be able to meet the nation's housing needs and Americans will pay more for workforce housing.

I am attaching the NMHC/NAA Key Principles for Housing Finance Reform as Addendum I of my testimony.

National Housing Policy

In closing, I would like to take a moment to address our national housing policy more broadly. I feel it underscores the importance of explicitly considering the multifamily component in a re-structured secondary mortgage market.

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. We have seen the devastating effects of such a policy. If there is a silver lining in this situation, it is the opportunity we now have to learn from our mistakes and rethink our housing policy. Housing our diverse nation means having a vibrant rental market along with a functioning ownership market. It's time we adopt a balanced housing policy that doesn't measure success by the level of homeownership.

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

ADDENDUM I: KEY PRINCIPLES FOR HOUSING FINANCE REFORM

The apartment industry urges you to consider the following key points for inclusion in any reform measure:

1. **Do No Harm: Preserve Multifamily Lending Programs**

   The multifamily sector produces the vast majority of this nation's affordable, workforce housing. Therefore, there is an appropriate public mission for the government to provide an effective financing system to ensure the nation's housing needs are met. In addition, the multifamily sector, and more specifically the GSEs' multifamily programs, did not contribute to the housing meltdown. Therefore, as policymakers "fix" the problems in the single-family sector, they should not do so at the detriment of the multifamily industry.

2. **Protect the Taxpayer: Look to Proven Multifamily Models**

   The taxpayer is footing the bill for the breakdown of the single-family housing sector, and that should never happen again. The GSEs' multifamily programs can serve as a model for a reformed housing finance system. They have performed extraordinarily well and have less than a one-percent delinquency rate. Historically, they have been well capitalized, have covered all their losses through the loss reserves they collected and have earned a profit. Even during conservatorship, the GSEs' multifamily programs have earned net revenues of $2 billion.[1] Their success is the result of strong business models that use retained risk and stringent underwriting criteria.

   To protect the taxpayer going forward, these models should be carefully studied for a broader application within the larger housing finance system. Specifically, the government must ensure strong regulatory oversight. It should consider implementing some level of retained risk by mortgage originators and servicers and adequate capital standards to fund loan-loss reserves. These steps would preserve the strong mortgage loan performance and track record seen in the multifamily sector and protect the taxpayer.

3. **Federal Government Involvement Necessary and Should be Appropriately Priced**

   Even after we transition to a new housing finance system, there will be an ongoing need for an explicit federal government guarantee on multifamily mortgage securities and portfolio-held loans. Over the past 40 years, there have been numerous occasions when the private

[1] Source: GSE SEC filings. This does not include write downs of Low-Income Housing Tax Credit holdings that the firms have been prohibited from selling and liquidating.

sector has been unable or unwilling to finance multifamily loans. There is a legitimate concern that the private sector cannot be counted on, from both reliability and capacity standpoints, to consistently finance the majority of multifamily borrowers' needs. Hence, it is hard to envision a reformed housing finance system without some form of federal credit enhancement. However, that credit should be priced at an appropriate level that reflects the mortgage risk and the value of the government's credit enhancement, and in such a way that it complements, but does not unfairly compete with, private debt capital.

4. Liquidity Support Should be Broad and Available at All Times, Not Just "Stop-Gap" or Emergency

Any federal credit facility should be available to the entire apartment sector and not be restricted to specific housing types or specific renter populations. Narrowing any future credit source would remove a tremendously important source of capital to a large portion of our industry, namely market-rate developers who actually provide a large volume of unsubsidized workforce housing. Such a facility should also be available at all times to ensure constancy in the U.S. housing market throughout all business cycles. It would be impossible to turn on and off a government-backed facility without seriously jeopardizing capital flows.

5. Mission Should Focus on Liquidity, Not Mandates

The public mission of a federally supported secondary market should be clearly defined and focused primarily on using a government guarantee to provide liquidity and not specific affordable housing mandates. Such mandates create conflicts within the secondary market and are partially responsible for the housing crisis because of the distortions the mandates introduced into the GSEs' business practices. Instead of mandates, the new housing finance system should provide incentives to support the production and preservation of affordable multifamily housing. Absent incentives, the government should redirect the affordability mission to HUD/FHA and the Low-Income Housing Tax Credit program.

6. Retain Portfolio Lending While Expanding Securitization

Securitization must be used to attract private capital for multifamily mortgage capital. However, unlike single-family loans, multifamily loans are not easily "commoditized." Without the ability to hold some loans in portfolio, multifamily lending activities will be significantly curtailed. In addition, securitizing multifamily loans is not always the best way to manage credit risk. Portfolio capacity is also required to aggregate mortgages for a structured securities sale.

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

   To avoid market disruption, it is important that policymakers clearly define the role of the government 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, we believe it is critical to retain many of the resources and capacity of the existing GSEs. The two firms have extensive personnel and technology expertise as well as established third-party relationships with lenders, mortgage servicers, appraisers, engineers and other service providers that are critical to a well-functioning secondary market.

We appreciate the opportunity to present the views of the apartment industry and look forward to working with you to build a world-class housing finance system that meets the nation's changing housing needs while also protecting the taxpayers.

ADDENDUM II: THE INHERENT AFFORDABILITY OF APARTMENTS

Many areas of the country are suffering from a severe shortage of workforce and affordable housing. In February 2011, 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. "Worst case housing needs" are defined as low-income households who paid more than half their monthly income for rent, lived in severely substandard housing, or both. The increase in the extent of worst case housing needs represents the largest two-year jump since HUD began reporting this segment of the rental market in 1985.

A separate study by the Harvard University Joint Center for Housing Studies found that falling incomes and the Great Recession have pushed both the number and share of renters facing severe cost burdens (those spending more than 50 percent of income on rent and utilities) to all-time highs and that nearly half of all renters face at least moderate housing cost burdens.

The growing incidence of renter payment burdens reflects a growing shortage of affordable and workforce housing and underscores the importance of ensuring a continued capital flow to the rental housing industry because apartments are inherently affordable.

An NMHC/NAA-commissioned study by MPF Research examined 5.6 million apartment units (without direct federal subsidy) and found that 94% of the units surveyed were affordable to households earning 100% of area median income (AMI). Fully 85% were affordable to households earning 80% of AMI, and 60% were affordable to those earning 60% of AMI.

Multifamily Rental Housing Affordability

March 2011

Unit Affordability - US			
Units at 100% AMI	Number of Affordable Units	Total MPF Sample	Percentage of Sample
0 BR	135,859	150,871	90.0%
1 BR	2,213,497	2,348,549	94.2%
2 BR	2,457,294	2,614,979	94.0%
3BR	452,369	482,526	93.8%
4BR	26,600	37,415	71.1%
Total	**5,285,619**	**5,634,340**	**93.8%**

Unit Affordability - US			
Units at 80% AMI	Number of Affordable Units	Total MPF Sample	Percentage of Sample
0 BR	119,292	150,871	79.1%
1 BR	2,016,186	2,348,549	85.8%
2 BR	2,222,279	2,614,979	85.0%
3BR	400,913	482,526	83.1%
4BR	18,798	37,415	50.2%
Total	**4,777,468**	**5,634,340**	**84.8%**

Unit Affordability - US			
Units at 60% AMI	Number of Affordable Units	Total MPF Sample	Percentage of Sample
0 BR	91,671	150,871	60.8%
1 BR	1,416,485	2,348,549	60.3%
2 BR	1,553,158	2,614,979	59.4%
3BR	263,925	482,526	54.7%
4BR	12,650	37,415	33.8%
Total	**3,337,889**	**5,634,340**	**59.2%**

Source: MPF Research, March 2011.