



Testimony of

Ethan Handelman

Vice President for Policy and Advocacy

National Housing Conference

Before the

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Banking, Housing, and Urban Affairs

Hearing on

“Housing Finance Reform: Essential Elements to Provide Affordable Options for Housing”

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My name is Ethan Handelman, and I am the Vice President for Policy and Advocacy at the National Housing Conference. I am grateful to the Committee for inviting me to testify, and I particularly thank the Chair, the Ranking Member, and the many other committee members who are working on housing finance reform in a constructive, bipartisan manner.

I appreciate your choice of “affordable options for housing” in the title of this hearing, as that should be a central goal of housing finance reform. The work of rebuilding the mortgage finance system cannot be only about making markets function—it must be about shelter. As the federal government creates new mechanisms for housing finance, deploys its full faith and credit, and encourages private entities to put capital to work, the social purpose of safe, decent, and affordable housing for all in America must guide those efforts. The new housing finance system you are working hard to create must find ways to harness the creativity and energy of the private sector to provide homes for people across this country: in cities, suburbs, and rural areas; in houses, apartments, and manufactured homes; for old and young, renters and owners, singles and families, of all backgrounds. To accomplish that, the housing finance system must by design serve as broadly as possible, and there must be mechanisms to fill in the remaining gaps.

About the National Housing Conference

The National Housing Conference (NHC) represents a diverse membership of housing stakeholders including tenant advocates, mortgage bankers, non-profit and for-profit home builders, property managers, policy practitioners, realtors, equity investors, and more, all of whom share a commitment to safe, decent and affordable housing for all in America. We are the nation’s oldest housing advocacy organization, dedicated to the affordable housing mission since our founding in 1931. As a nonpartisan, 501(c)3 nonprofit, we are an evidenced-based research and education resource working to advance housing policy at all levels of government in order to improve housing outcomes for all in this country.

The large and growing need for affordable housing

The reform of our nation’s housing finance system occurs in the context of a long trend of increasing housing need. For both homeowners and renters, the cost of housing outpaces income, often creating a severe burden. The annual Housing Landscape publication from NHC’s Center for Housing Policy documents the prevalence of severe housing cost burdens, meaning housing costs in excess of 50% of income, for working households. **More than one in four working renter households (26.4 percent) spent more than half of their income on housing costs in 2011**, an increase of more than three percentage points since 2008. Despite falling mortgage interest rates and home prices—a period when housing affordability for owners should have improved—rates of severe housing cost burden remained stable and high for working owners between 2008 and 2011. **Roughly one in five working owners experienced a severe housing cost burden** during this period.¹

¹ Center for Housing Policy, *Housing Landscape 2013*, May 2013, available at <http://www.nhc.org/media/files/Landscape2013.pdf>.

If we look beyond the subset of working households to all housing need, the picture is even worse. In 2011, **over 40 million households in this country were paying more than 30 percent of their income for housing, and 20.6 million were paying more than 50 percent.** Recent increases in cost burdens have been primarily among renters, with those of lowest income hit hardest. Yet, only one in four households eligible for housing assistance actually receives it.²

Looking to the future, we should expect the aging of the population and an Echo Boom with an increase in minority households to drive much housing need. Aging households will increase demand for modification of existing homes, smaller homes with supportive services, and better access to transportation. Rental housing demand will rise, driven by the more mobile Echo Boom and a larger proportion of minority and low-wealth household. Demand for starter homes and the need of low-wealth households for affordable home mortgages without overly restrictive down payment requirements will directly affect households' ability to achieve homeownership.³

Serving housing needs by encouraging private enterprise

The urgency of mortgage finance reform stems both from the growing housing needs of Americans and the need to restore a reliable source of mortgage capital in the wake of the 2008 financial crisis. We are still operating with what was thought to be a temporary conservatorship for Fannie Mae and Freddie Mac (the Government Sponsored Enterprises, or GSEs). Overall, the federal government continues to guarantee over 85 percent of new mortgages. Private capital has yet to return to sustainable pre-crisis levels. Finance for multifamily housing has fared somewhat better thanks in large part to the GSE's multifamily operations, but overall production of multifamily housing has only just returned to historically stable levels, leaving five years of pent-up demand to make up.

Mortgage finance reform must address both reliable capital flows and household need. A strong government presence in the secondary mortgage market can create the necessary stability and liquidity for private enterprise to provide home mortgages and finance rental housing effectively—in other words, to make the market function well. But we know that private enterprise does not serve all parts of the market well. Many rural areas, lower-income households, small rental properties, manufactured housing properties, subsidized rental housing, communities of color, and neighborhoods hit hard by waves of foreclosure lack adequate capital. Government's action must be about more than just market functioning. It should aim to unleash the energy of private enterprise to serve the shelter needs of all in America.

² Harvard Joint Center for Housing Studies, *State of the Nation's Housing 2013*, p. 5, available at: http://www.jchs.harvard.edu/research/state_nations_housing.

³ State of the Nation's Housing, p. 16. Also Bipartisan Policy Center Housing Commission, "Demographic Challenges and Opportunities for U.S. Housing Markets," March 2012, available at <http://bipartisanpolicy.org/sites/default/files/BPC%20Housing%20Demography.pdf>.

Enabling long-term financing with a federal guarantee

The critical first part must be a **federal guarantee that is explicit, paid-for, and protected by layers of risk-bearing capital**. The guarantee should be limited to securities, separate from the issuing entities or their debt. Absent that guarantee, there simply would not be enough private capital to make 30-year fixed-rate mortgages widely available. Nor would the To Be Announced (TBA) market function, which would make mortgages more expensive and deprive homeowners of the ability to lock an interest rate before closing.

The Federal Housing Administration (FHA), the U.S. Department of Agriculture (USDA), and Veterans Affairs (VA), are essential and at times play a critical counter-cyclical role, but they should remain focused on specific populations such as veterans, first-time homebuyers, and low-wealth households. We cannot rely on them to be the sole source for affordable, long-term mortgages.

Rather, we need to allow multiple, proven capital channels to serve housing needs. **Ensuring a mechanism by which housing finance agencies, credit unions, community banks, and other smaller lenders have access to securitization on an equitable footing** would provide additional means to finance affordable home loans and finance affordable rental housing.

Safe and sustainable low downpayment lending

Downpayment has an intuitive appeal from a regulatory standpoint, since it is a simple, bright line with a correlation to default rate. However, it is only one factor among many in a full underwriting analysis, and on its own is neither a necessary nor sufficient condition for a good loan. Using downpayment as a minimum threshold, moreover, powerfully disadvantages responsible low- and moderate-income homebuyers. **Eliminating the overly rigid 5% downpayment requirement** currently in S. 1217 is an important step toward broadening access to the most efficient source of mortgage capital.

A high downpayment threshold creates a powerful barrier to homeownership for low-wealth families, one that is uniquely difficult to overcome. A family can improve its credit performance over time or pay down non-mortgage debt, but saving up \$20,000 or \$40,000 (even more in high-cost markets) for a downpayment can take decades. Making the accumulation of wealth a requirement for access to affordable mortgage finance in effect excludes Americans who do not already have individual or family wealth. Not only is that fundamentally unfair, but it also **skews disproportionately against communities of color**.⁴

We know that **well-structured, low-downpayment loans to responsible borrowers perform well**. The best data on this come from the Center on Community Capital, which found that

⁴ Plan B, A Comprehensive Approach to Moving Housing, Households and the Economy Forward; April 4, 2011, by Lewis Ranieri, Ken Rosen, Andrea Lepcio and Buck Collins. Figure 14 shows that minority households in 2007 had median before tax family income of about \$37,000, compared to about \$52,000 for white families. Similarly, Figure 15 shows minority family net worth in 2007 of almost \$30,000, compared to more than \$170,000 for white families.

properly structured, low downpayment loans performed 3.5 to 3.99 times better than subprime loans to comparable borrowers, even during the height of the foreclosure crisis.⁵ The well-structured low-downpayment loans perform with comparable stability to prime loans. Data illustrate the converse, too: in the fourth quarter of 2010, the percent of prime fixed rate loans in foreclosure was 2.67%, the highest level in the history of the Mortgage Bankers Association National Delinquency Survey. The rate for prime adjustable rate loans was a whopping 10.22%.⁶ These data underscore that the housing crisis resulted from inherently risky mortgage features—exploding ARMs, no-doc loans, negative amortization—rather than loans with low downpayments.

We further know that **downpayment assistance programs provided by localities and approved nonprofits generate low-risk loans**. Indeed, buyers with assistance from affordable homeownership programs have default rates well below local market averages, even with very low or no downpayment from the buyer's own funds.⁷ Homeownership assistance programs use public resources efficiently to create long-term affordable housing, often making the loans safer than some unassisted transactions.

Serving all qualified borrowers

Discussions of **how to get the mortgage finance system to serve all qualified borrowers** often bog down in circular questions of whether the primary or secondary market should lead. The primary market lenders originate loans and so are the first gatekeepers of access to credit. However, their ability to lend is constrained by the liquidity supplied by the secondary market. Without a capital supply, the primary market cannot originate large volumes of loans. The secondary market, in contrast, focuses on efficiency, using high volumes of homogeneous loans to achieve economies of scale and attract capital. Packaging easily-standardized, lower-risk loans into securities has great benefits, but the business is necessarily constrained to work with the loans that the primary market originates. It therefore becomes difficult for either the primary market or the secondary market to cause the other to broaden its parameters for what loans to provide, since neither can act without the support of the other.

Government is uniquely placed to align the primary and secondary markets to serve as broadly as possible. A rebuilt housing finance system should include a strong regulatory agency with the necessary powers to supervise the market. The regulator could implement a requirement that secondary market participants who benefit from the stability, transparency, and liquidity created by the housing finance system serve the entire primary market. To the extent that the primary market is serving low-income areas, rural areas, communities of color,

⁵ Lei Ding, Roberto G. Quercia, Wei Li, Janneke Ratcliffe, "Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Property Score Models" Center for Community Capital Working Paper, May 17, 2010. Available at <http://www.ccc.unc.edu/documents/Risky.Disaggreg.5.17.10.pdf>.

⁶ The survey is available at <http://www.mortgagebankers.org/NewsandMedia/PressCenter/75706.htm>.

⁷ Urban Institute. *Balancing Affordability and Opportunity: An Evaluation of Affordable Homeownership Programs with Long-term Affordability Controls*, October 26 2010.

small rental properties, subsidized rental housing, manufactured housing, and other underserved market segments, the secondary market should also.

The Housing and Economic Recovery Act of 2008 (HERA) created a framework for measuring the secondary market's performance and evaluating it against the primary market. Home Mortgage Disclosure Act data provide a useful metric, among others. Similar mechanisms could be incorporated into the new legislation the committee is developing, for both single family and multifamily, provided there is a strong regulatory agency with the ability to gather market information and supervise participants.

Financing affordable multifamily housing

Renters make up more than one third of the country, and their median income is approximately half that of owners.⁸ Demand for rental housing is increasing, and multifamily properties are an important component of meeting that demand. Ensuring a steady supply of capital to multifamily housing, therefore, is a necessary part of ensuring that Americans can afford a range of housing options.

The Fannie Mae and Freddie Mac multifamily businesses are critical capital sources with a proven track record for the creation and preservation of affordable rental housing. The majority of Fannie Mae and Freddie Mac's multifamily business finances rental homes for families of modest means. In 2012, over 68% of units financed by Freddie Mac were affordable to households earning less than 80% of area median income (AMI), and 14% were affordable to those earning less than 50% of AMI. Fannie Mae's performance is comparable: 67% of the units financed in 2012 were affordable to households at 80% of AMI and 19% were affordable to those earning less than 50% of AMI.⁹

Production of so much affordable housing is in part due to the specialized products that Fannie Mae and Freddie Mac provide. They are able to provide longer-term debt than pension funds, banks, or conduit lenders typically offer.¹⁰ Having stable debt service costs is often essential to regulated affordable housing properties that must pledge long-term use restrictions, and it also critical to allowing properties to maintain lower rents even without a formal use restriction. Fannie Mae and Freddie Mac have also forged relationships with state housing finance agencies, community development financial institutions, and others financing affordable housing in ways that private capital sources simply will not fill in. A specific example is the advance commitments for permanent take-outs of bond-financed properties without which many bond-financed affordable housing properties could not come about.

⁸ State of the Nation's Housing 2013, p. 22.

⁹ Data compiled by the National Housing Trust from public sources including Fannie Mae and Freddie Mac quarterly statements and the 2012 FHFA Report to Congress.

¹⁰ Life companies offer some long-term debt, but they are a very small slice of the market and focus on only pristine, A-class properties.

The Fannie Mae and Freddie Mac multifamily businesses are proven and profitable, and they remained so even during the crisis. Both businesses have delinquency rates consistently under 1 percent, compared to 12.15 percent delinquency for commercial mortgage backed securities (CMBS) in 2010 and 9.65 percent for CMBS in 2012.¹¹

We recommend separating the multifamily businesses now, while still in conservatorship, to prepare for eventually privately capitalizing them as issuers of FMIC-insured multifamily mortgage-backed securities (MBS). FMIC should have a separate Office of Multifamily Finance to oversee the spun-off issuers as well as new issuers who are able to meet the same criteria for participation. All issuers of insured multifamily MBS should be obligated to meet a minimum affordability threshold at a portfolio level. More detail on our specific recommendations for improving treatment of multifamily appears in the proposal developed through the Mortgage Finance Working Group, presented in Attachment 1. Principles developed by NHC to guide mortgage finance reform for multifamily are presented in Attachment 2.

Filling in the market's gaps

The secondary mortgage market, despite its great efficiency, does not serve all those who need housing equally well. We therefore need specialized tools to fill in the gaps that are left. As currently proposed, S. 1217 includes a small fee on MBS to fund three complementary mechanisms for improving access and affordability:

- The **National Housing Trust Fund (NHTF)** directly serves the needs of extremely low-income renters using a combination of capital subsidy to create affordable rental homes and rental subsidy to enable those homes to serve extremely low-income households. Enacted in the Housing and Economic Recovery Act of 2008 (HERA), it still requires funding to begin allocating funds to the states for deployment. HUD is a natural fit to implement the NHTF, given its expertise in allocation of block grants and understanding of property finance and rental subsidy.
- The **Capital Magnet Fund (CMF)** supports financing for the preservation, rehabilitation or purchase of affordable housing for low-income communities and community service facilities such as day care centers, workforce development centers and health care clinics. It leverages other funds 10 to 1, and proved extremely effective in its first (and only) round of funding. CMF, also enacted in HERA, is capably managed by the Treasury's CDFI Fund and should continue there.
- The **Market Access Fund (MAF)** should be created to provide a way for government to share the risk of new product development and piloting, to help private enterprises develop more effective ways to direct capital to underserved households and communities. Through competitive research and development grants and temporary credit enhancement, MAF would seek to enable the private sector to more efficiently address unmet housing need. MAF would be best administered by FMIC, which would

¹¹ Freddie Mac, "Report to the Federal Housing Finance Agency: Housing Finance Reform in the Multifamily Mortgage Market," December 2012, p. 13.

have the necessary expertise and contact with secondary and primary market financing to evaluate product proposals and oversee credit enhancement.

To enable each of these complementary mechanisms, we therefore support the creation and funding of a multi-purpose fund that builds on Title IV of S. 1217 so that the new housing finance system can better serve a range of housing needs. We recommend assessing all mortgage backed securities (not just guaranteed securities) a 10 basis point annual user fee (i.e., a “strip”) that would be used to support the Market Access Fund, the National Housing Trust Fund, and the Capital Magnet Fund. We strongly suggest that percentage allocations to the three funds provided in Title IV be reconsidered to assure that the allocations more closely reflect the needs that each fund addresses.

All MBS, not just those with a guarantee, should pay the small fee to support these programs, for several reasons. Firstly, the entire market benefits from the stability and liquidity that the government creates through its guarantee and regulation. The jumbo market, for instance, benchmarks to the conventional guaranteed market and is modeled on processes developed by Fannie Mae and Freddie Mac. Secondly, having a fee on just the guaranteed market would distort incentives, unnecessarily steering securitization away from the government-backed channel and as a result requiring a higher fee. Thirdly, creating opportunities for wealth-building, stable rental housing, and stronger neighborhoods helps ensure more future homebuyers to keep the system running.

Others on the panel have already addressed the NHTF, but additional information on the CMF and the MAF may be helpful.

Capital Magnet Fund

The Capital Magnet Fund was created in HERA to supply capital to community development financial institutions (CDFIs) and nonprofit housing developers to finance affordable housing and related community development activities.¹² The CMF uniquely combines several features to empower nonprofits efficiently:

- **Competitive allocation** encourages efficiency by applicants and, if iterated in successive funding rounds, should lead to increasingly effective uses.
- A **leverage requirement** of 10:1 requires that grantees raise additional private capital to stretch government dollars further. Indeed, many grantees in the initial round report higher than required leverage ratios.
- **Enterprise-level capital** grants helps high-capacity nonprofits increase their scale and magnify their impact. For instance, grant funds deployed as loans can often be recycled as loans are paid off.

¹² This section relies heavily on material produced by the Housing Partnership Network and the Opportunity Finance Network.

- **Accountability for performance**, monitored by the Treasury Department’s CDFI Fund, ensures that program dollars are used well.

A few examples of CMF awards demonstrate the range and effectiveness of the program. Volunteers of America National Services used a CMF soft loan to fill the capital gap for Trailside Heights Apartments in Anchorage, Alaska, providing 446 affordable townhomes for families. Habitat for Humanity International used a CMF grant to create a loan fund to help finance affordable homes in California, Florida, and Tennessee. The Low Income Investment Fund used CMF dollars as credit enhancement for land acquisition funds to create 146 affordable apartments for seniors.

Although the CMF was created in HERA, it was never funded by the intended fee on the GSEs. It did, however, receive a single appropriation of \$80 million in 2010 (far below the originally intended funding level). That single initial allocation round received \$1 billion in applications from 230 organizations, of which nearly half scored into a highly-qualified pool. That level of demand and application quality strongly suggests that the CMF could allocate far more funds to great effect, particularly as the competitive dynamic encourages the applicant pool to grow and improve.

Market Access Fund

The Market Access Fund (MAF), if created, would enable participants in the new housing finance system such as lenders, issuers, and guarantors to safely and sustainably serve the broadest possible range of creditworthy borrowers and underserved markets.¹³ The MAF would accomplish this goal through competitively awarded grants and temporary credit enhancements that **help the private sector find ways to better reach the under-served**. Its resources would support a combination of product research and development and testing at a scale sufficient to enable commercial evaluation of new products and processes. In other words, the MAF breaks through the common impasse in which private businesses under-serve potentially profitable creditworthy borrowers because it is challenging to invest in specialized systems and products. With the MAF sharing the cost of that initial investment, we can identify ways to serve more housing needs in profitable ways.

Some examples help illustrate areas where the MAF could support useful innovation:

- **Energy efficiency and underwriting:** Household energy costs in this country are about \$230 billion annually and make up 15 percent of the total cost of homeownership for average families—even more for lower-income families. [Research](#) has found a clear association between home energy efficiency and loan performance, but more research is needed to quantify that link and incorporate it into the mortgage qualification process. Lenders in markets with high energy costs could test using energy savings to adjust their loan underwriting, supported by the MAF.

¹³ This section relies heavily on material produced by the Center for American Progress (CAP). The Market Access Fund concept was developed by the CAP’s Mortgage Finance Working Group, in which NHC participates.

- **Reserve funds and homeownership success:** To make a down payment and pay closing costs, low-wealth households often use the bulk of their savings to acquire a home. However, new homeowners with additional liquid reserves have lower default rates. Lenders could experiment with requiring smaller down payments from borrowers but instead having them contribute to a dedicated reserve fund; this way, they could see if participating borrowers experience lower default rates than similar borrowers who make somewhat higher down payments but have fewer reserves.
- **Affordable housing preservation:** Owners of affordable rental properties sometimes need to refinance their loans, but often find it difficult to do so at terms that will enable them to keep rents within reach. As a result, affordable units disappear from the market, yet replacing them is less efficient and more expensive than preserving them. One way to fix this problem is to make financing for affordable housing preservation available on better terms, but experiments in doing so will need to be proven before they will become broadly acceptable. MAF resources could help lenders experiment with new ways to serve this market.

Not every experiment will work, nor should we expect them all to. MAF funding will be by nature temporary, so that successful experiments can find a home in the private sector or with specialized lenders and failed experiments can end. Putting the MAF in the hands of an agency with direct understanding of primary and secondary mortgage markets is essential, so that it can measure results accurately and evaluate success or failure. In the framework of S. 1217, the FMIC is the logical fit.

The MAF is essential to supplement the housing finance system, but on its own, it cannot fill the overall need for the mortgage market to provide broad access and affordability. It is rather a way to discover and test new tools to better fulfill the goals of access and affordability.

Addressing housing need early to avoid emergency fixes

A large body of research documents the benefits of investments in affordable housing—from transitional housing for homeless individuals and families to rental housing complemented by case management and supportive services to programs supporting affordable homeownership for low- and moderate-income households. **Investments in housing early can result in future economic benefits and cost savings.**

Myriad studies document the benefits of stable and affordable housing to individual and family well-being, including health, educational opportunities, increased income, and wealth building. **Stable, affordable housing helps children’s school performance and health, improving outcomes for them and for society.** Recent research from Children’s Health Watch demonstrated that children living in overcrowded housing or in families that cannot consistently afford their rent are at increased risk of poor educational outcomes,

developmental delays and hospitalizations compared with other children.¹⁴ Stable and affordable housing is associated with fewer school disruptions, better academic performance, and greater school and community involvement by families.¹⁵ A substantial amount of research has been done to demonstrate the link between education outcomes and future economic prospects for children. In fact, there is little debate about the relationship between academic performance and future earnings (positive relationship), future receipt of public assistance (negative relationship), and future incarceration (negative relationship). As a result, these relationships suggest positive impacts on the economy through higher taxes paid on higher wages and lower use of publicly-funded services. Finally, a study by McKinsey & Company Consulting concluded that if the gap in test scores between poor and wealthy students could be closed, yearly gross domestic product would be trillions of dollars higher, or \$3 to \$5 billion dollars per day higher.¹⁶

Housing the homeless is perhaps the clearest example of cost-effective housing intervention.

Several researchers have found that there are higher rates of emergency room use and hospitalization for mental health and substance abuse problems, and longer in-patient hospital stays, for homeless adults compared with other very low-income individuals.¹⁷ A study of supportive housing in New York City found that homeless individuals who received supportive housing were less likely to be hospitalized or incarcerated than comparable homeless individuals who did not receive services. The authors found that the costs of the supportive housing were offset by the savings in health care, law enforcement, and other service utilization.¹⁸ Additional studies in Seattle, Los Angeles, and Maine reached similar conclusions about the cost effectiveness of investing in permanent supportive housing, specifically finding that for every dollar invested in programs offering long-term housing and services for homeless individuals, there is an average saving of two dollars in terms of other publicly-funded services.¹⁹ Additional research has shed light on the relative costs associated with housing

¹⁴ Children's Health Watch. 2012. Stable, Affordable Housing Supports Young Children's Health in Philadelphia. http://www.childrenshealthwatch.org/upload/resource/12_05_PAhousingbrief.pdf accessed 11/4/2013.

¹⁵ Brennan, Maya. 2011. The Impacts of Affordable Housing on Education: A Research Summary. Washington DC: Center for Housing Policy. http://www.nhc.org/media/files/Insights_HousingAndEducationBrief.pdf. Brennan, Maya and Jeffrey Lubell. 2007. Framing the Issues—The Positive Impacts of Affordable Housing on Education. Washington DC: Center for Housing Policy. http://www.nhc.org/media/documents/FramingIssues_Education1.pdf.

¹⁶ Hernandez, Javier C. 2009. Study Cites Dire Economic Impacts of Poor Schools. New York Times. http://www.nytimes.com/2009/04/23/nyregion/23klein.html?_r=0 accessed 11/4/2013.

¹⁷ Kushel, M. B., Perry, S., Bangsberg, D., Clark, R., & Moss, A. R. (2002). Emergency department use among the homeless and marginally housed: Results from a community-based study. *American Journal of Public Health*, 92, 778–784. Kuno, E., Rothbard, A. B., Averyt, J., & Culhane, D. (2000). Homelessness among persons with serious mental illness in an enhanced community-based mental health system. *Psychiatric Services*, 51, 1012–1016. Salit, S. A., Kuhn, E. M., Hartz, A. J., Vu, J. M., & Mosso, A. L. (1998). Hospitalization costs associated with homelessness in New York City. *The New England Journal of Medicine*, 338, 1734–1740.

¹⁸ Culhane, D. P., Metraux, S., & Hadley, T. (2002). Public service reductions associated with placement of homeless persons with severe mental illness in supportive housing. *Housing Policy Debate*, 13, 107–163.

¹⁹ Ludwig, Terri. 2013. To Curb Medicaid Spending Tomorrow, Invest in Housing Today. http://www.huffingtonpost.com/terri-ludwig/curb-medicaid-spending_b_4117001.html accessed 11/4/2013.

families in temporary shelters compared to providing families with rental subsidies. The analysis of homeless families in four U.S. jurisdictions found the average cost of housing a family in a shelter for one year was about four times the cost of providing a rental subsidy to that same family, suggesting that investment in rental subsidies was a much more cost effective way of meeting homeless families' needs.²⁰ In short, **making stable housing available to end and prevent homelessness is cost effective.**

Housing counseling is a second example of cost-effective preventative housing assistance. Studies have found that **housing counseling can prevent foreclosure in times of distress, reduce family housing costs, and reduce the likelihood of mortgage delinquency.**²¹ A nationwide study of the foreclosure mitigation counseling program found that borrowers who had missed a payment on their mortgage were 45 to 50 percent more likely to get up-to-date on payments if they received counseling. The same study found that households who received counseling had on average lower monthly payments and were 45 percent more likely to sustain their mortgage modifications.²² Furthermore, most studies of pre-purchase counseling find that it reduces mortgage delinquency. **Making housing counseling an integral part of mortgage finance** would build on the lessons learned during the foreclosure crisis, namely, that housing counseling improves outcomes for borrowers, lenders, and neighborhoods alike by helping more families sustain homeownership.

The foreclosure crisis also provides a cautionary example of the costs of failing to act early. Allowing waves of foreclosure to occur, particularly concentrated in vulnerable neighborhoods, triggered a vicious cycle of disinvestment that has proven expensive and difficult to break.²³ **Preventing foreclosures and avoiding long-term vacancy by acting earlier would have avoided costly neighborhood rebuilding, better maintained home values, and helped families avoid the pain and cost of displacement.**

Making housing finance about shelter

In closing, I urge you again to make shelter an explicit and central goal of housing finance reform. Realign the incentives of the myriad market participants so that the energy and creativity of the private sector makes affordable housing options available broadly, and use targeted programs to fill in the gaps for those harder to serve. I hope that this bipartisan effort will move our country closer to safe, decent, and affordable housing for all in America.

²⁰ Culhane, D. P., Metraux, S., Park, J. M., Schretzman, M., & Ventura, J. (in press). Testing a typology of family homelessness based on patterns of public shelter utilization in four US jurisdictions: Implications for policy and program planning. *Housing Policy Debate*.

²¹ Laura Williams, Center for Housing Policy, "The Role of Housing Counseling in Reducing Mortgage Delinquency and Foreclosure," 2011, fact sheet available at http://www.nhc.org/media/files/Role_of_Housing_Counseling_in_Preventing_Foreclosure.pdf

²² Mayer, Neil et al. 2010. National Foreclosure Mitigation Counseling Program Evaluation: Preliminary Analysis of Program Effects. Washington, DC: The Urban Institute.

²³ For an overview, see "Understand Why Foreclosures Matter" on the Center for Housing Policy's site [foreclosure-response.org](http://www.foreclosure-response.org/policy_guide/why_foreclosures_matter.html), at http://www.foreclosure-response.org/policy_guide/why_foreclosures_matter.html.

Thank you again for the opportunity to be here. I am glad to answer questions from the Committee.

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Attachments

1. Multifamily Housing Finance Reform Proposal for Corker-Warner from the Mortgage Finance Working Group
2. NHC Policy Statement: Government Support for the Financing of Multifamily Rental Housing

Multifamily Housing Finance Reform Proposal for Corker-Warner

Mortgage Finance Working Group
August 2013

We recommend incorporating the following provisions specifically related to multifamily housing finance into S.1217: Housing Finance Reform and Taxpayer Protection Act of 2013 (“the Act”). These recommendations are intended to replace Title VI of the Act.

- **Spin off the current multifamily operations at Fannie Mae and Freddie Mac into two private entities, initially owned by the federal government.**
 - Effective immediately, direct Fannie Mae and Freddie Mac to spin off their current multifamily operations into two independent private, bankruptcy-remote entities, including all assets, staff, systems and other resources necessary to be a self-supporting and separately functioning entity.
 - The new entities will ensure that any multifamily business continues to operate, as applicable, consistent with the Fannie Mae DUS Model and the Freddie Mac CME Program K-Series.
 - Treasury will ensure that the new entities have sufficient capital to carry out the operations of issuing securities, including the ability to obtain warehouse lines of credit.
 - These new entities remain under the supervision of FHFA, later to be transferred to the FMIC when it is fully operational.
 - The new entities will contract with Fannie Mae and Freddie Mac to manage the wind down of Fannie’s and Freddie’s existing multifamily portfolio.
 - When the FMIC is fully operational, transfer the guarantor function at both companies to the FMIC at no cost to the government. From that point on, the two entities will be able to purchase government insurance from the FMIC on qualifying multifamily securities.
 - When the FMIC is fully operational, require the two entities to raise capital from private sources with the option to buy out the government’s interest.

- **Establish a separate insurance fund within the FMIC for qualifying multifamily mortgage-backed securities.**
 - In exchange for a fee, the FMIC shall insure the payment of principal and interest on a covered multifamily security with respect to losses that may be incurred on such security.
 - Levels of risk sharing in the multifamily market must comply with Section 202 of the Act. The private risk-taking capital incorporated in the Fannie DUS Model and the Freddie CME Program K-Series already meet this requirement.
 - In times of market disruption, the terms under which the federal government offers its guarantee can be expanded with the written agreement of the Federal Reserve Chairman and the Secretary of the Treasury, in consultation with the HUD Secretary, per Section 205 of the Act.
 - The FMIC sets a fee for this insurance that covers risk to taxpayers and is subject to calibration based on pre-determined criteria that considers market conditions.
 - The FMIC holds all guarantee fees, minus operating costs, in a Multifamily Housing Insurance Fund, backed by the full faith and credit of the U.S. government. The Multifamily Housing

Insurance Fund must be separate from the single-family Mortgage Insurance Fund established under Section 203 of the Act.

- A covered multifamily security must be comprised of mortgages financing properties of five or more rental units with terms of 5-35 years. The FMIC shall establish at least one pilot program to test the securitization of rental properties with less than five units.
- The FMIC will establish uniform processes, contracts, documents, data disclosures, and other appropriate standardized rules, consistent with the provisions in Subtitle C of the Act for covered single-family securities.
- **Allow other private issuers of qualifying multifamily securities to purchase FMIC insurance, after approval from the FMIC.**
 - Require the FMIC to establish a third qualified multifamily issuer to develop, securitize, sell, and otherwise meet the multifamily issuing needs of credit unions, community and mid-size banks, and non-depository mortgage originators with respect to covered securities. The structure and limitations of this new entity will be similar to the “FMIC Mutual Securitization Company” established under Section 215 of the Act.
 - When the FMIC is fully operational, allow other private entities to issue qualifying multifamily mortgages with the option of purchasing FMIC insurance. Each new entity must be structured as a mono-line businesses, with segregated assets and separate capital standards.
 - All new issuers of covered multifamily securities must be approved by the FMIC through the process laid out in Section 213 of the Act. In addition, any new issuer must show:
 - Experience with multifamily housing finance, including financing of properties with fewer than 50 rental units and in a variety of markets and geographies;
 - Experience with subsidized affordable rental housing properties;
 - Ability to meet the portfolio affordability requirements; and
 - Ability to foster a liquid capital market for multifamily mortgages in a wide variety of markets and geographies.
- **Establish a minimum affordability threshold and other requirements for any issuer of FMIC-backed multifamily securities.**
 - For any issuer of covered multifamily securities, at least 60 percent of the total rental housing units financed in the entity’s overall FMIC-backed loan portfolio must at time of origination have been for units whose rents were affordable to households earning at or less than 80 percent of Area Median Income for the locale in which such units were located. For this purpose, “affordable” means the tenant pays no more than 30 percent of their monthly income on rent. The percent of total rental units should be calculated based on a rolling average of at least one year.
 - Annually, each issuer of covered multifamily securities will work with the FMIC to create a 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. At the end of each year, each issuer must report on their performance toward that plan.

- Each issuer of covered multifamily securities must, on an annual basis, demonstrate compliance with the above provisions to maintain FMIC approval for future issuances.
- **Require private entities to pay a fee on all FMIC-backed multifamily securities to fund the Housing Trust Fund and the Capital Magnet Fund.**
 - The FMIC charges and collects a fee of 5-10 basis points of the outstanding principal balance of eligible mortgages collateralizing covered multifamily securities, consistent with Section 401 of the Act, to fund the Housing Trust Fund, as described in Section 402 of the Act, and the Capital Magnet Fund, as described in Section 403 of the Act.
- **Establish the FMIC as regulator of the entire secondary multifamily mortgage market.**
 - Establish a separate Office for Multifamily Finance within the FMIC, run by a Deputy Director for Multifamily Finance, with the responsibility to manage the Multifamily Housing Insurance Fund and ensure that participants in the secondary multifamily mortgage market (both covered and purely private) abide by all applicable nondiscrimination and consumer protection laws and minimize risk to taxpayers.
 - The FMIC is responsible for approving and overseeing all private mortgage insurers, servicers, issuers and guarantors associated with covered multifamily securities, consistent with Subtitle B of the Act. The FMIC is authorized to suspend or revoke approved status and impose an appropriate civil money penalty of any approved entity that fails to comply with the rules of the FMIC, consistent with Subtitle B of the Act.
 - The FMIC is authorized to develop, publish and adopt additional standards or requirements as necessary to ensure the availability of affordable rental housing and the liquidity, stability, transparency and competition in the secondary multifamily mortgage market, consistent with Section 216 of the Act.
 - The FMIC will establish uniform processes, contracts, documents, data disclosures, and other appropriate standardized rules for covered multifamily securities, consistent with the provisions in Subtitle C of the Act for covered single-family securities.
 - Each fiscal year the FMIC produces a report on the state of the Multifamily Housing Insurance Fund and the covered lending activity from the prior year, including overall volume and rental units financed, affordability of those units, and activity directed to communities and market segments not well-served by private capital, including low-income communities, rural communities, subsidized affordable multifamily housing and small rental properties..
 - The FMIC is authorized to conduct research, create indices and publish reports on the state of the multifamily housing finance industry, comparable to the research being done for the single-family industry.

The following individuals drafted this document (affiliations listed for identification purposes only):

David Abromowitz, Center for American Progress

Michael Bodaken, National Housing Trust

Raphael Bostic, USC Bedrosian Center and Lusk Center for Real Estate

Julia Gordon, Center for American Progress
John Griffith, Enterprise Community Partners
Ethan Handelman, National Housing Conference
Andrew Jakobovics, Enterprise Community Partners
Shekar Narasimhan, Beekman Advisors
Mark Willis, NYU Furman Center for Real Estate and Urban Policy



NHC POLICY STATEMENT

GOVERNMENT SUPPORT FOR THE FINANCING OF MULTIFAMILY RENTAL HOUSING

Final, Sept. 28, 2010

The debate on the future of Fannie Mae and Freddie Mac (the “Government-Sponsored Enterprises” or “GSEs”) has focused primarily on the role of these entities in financing single-family homeownership. However, the GSEs have also played a major role in financing multifamily housing, including and especially multifamily rental housing.¹ Given the fundamental importance of multifamily rental housing in meeting Americans’ housing needs, any overhaul of the government’s role in the nation’s housing finance system must ensure the continued availability of capital to preserve and develop multifamily rental housing.

In September 2009, the National Housing Conference (NHC) set out a series of [ten principles](#)² that NHC believes should guide the debate on the future of the nation’s housing finance system and the government’ role in that system. The recommendations below build on those initial principles to specify specific guidelines for the future of government support for multifamily rental housing (defined here as rental developments with five or more units).³

- 1. Any restructuring of the nation’s housing finance system must ensure the ongoing availability of capital to preserve and develop multifamily rental housing.** Some 15 million U.S. households live in multifamily rental housing, defined as rental housing with five or more units. These households represent more than 13 percent of all U.S. households and nearly 43 percent of U.S. renters.⁴ Reliable capital sources are needed to enable the multifamily rental sector to continue to meet America’s housing needs.
- 2. Multifamily housing finance must be addressed squarely and directly.** While many of the proposed systems for providing government support for single-family lending could be adapted to meet the needs of the multifamily rental housing market, not all would work equally well. Multifamily finance must be addressed directly, rather than as an afterthought to the larger debate.

¹ While these principles focus specifically on multifamily rental housing, we note that many of the considerations applicable to financing multifamily rental housing also apply to financing multifamily condominiums and cooperatives.

² Available here: http://www.nhc.org/media/files/NHC_Housing_Finance_Policy_Principles_FINAL1.pdf.

³ These recommendations build on the findings of an analysis commissioned by NHC and prepared by Recap Real Estate Advisors. The analysis is based on interviews Recap conducted of a wide range of practitioners as well as their own experience in the multifamily sector.

⁴ 2009 American Housing Survey Table 1-1. U.S. Census Bureau. Access on August, 27, 2010 at <http://www.census.gov/hhes/www/housing/ahs/ahs09/ahs09.html>.

As the debate proceeds, it will be important to consider the differences between the single-family and multifamily markets. One key difference is the fact that the existing system for financing multifamily housing – particularly the lending supported by Fannie Mae and Freddie Mac – has performed much better than the system for financing single-family housing. As of 2009, the GSEs' current multifamily mortgage and Mortgage Backed Securities (MBS) portfolios had distress rates of less than 1%, compared to roughly 7% for multifamily Commercial Mortgage Backed Securities (CMBS) and roughly 11% for the single-family market as a whole.

The soundness of the GSEs' existing book of multifamily business opens up a range of policy options that merit consideration for more effectively meeting the nation's current multifamily housing needs. These options include relaxing the current constraints on multifamily lending under the conservatorship; introducing some elements of the proposed final solution – such as an explicit government guarantee wrap of securities backed by loans underwritten by the GSEs – now, before new entities are chartered; or even moving forward with a resolution of the multifamily finance system first, without waiting for the single-family foreclosure crisis to play out to more fully assess the extent of the GSEs' single-family losses.

- 3. Private capital is indispensable for funding multifamily rental housing, but private capital by itself – without government backing in some form, such as a federal guarantee – is not sufficient to reliably meet the full range of the nation's multifamily finance needs.** In particular, government backing is needed to ensure the ongoing availability of long-term fixed rate mortgages for multifamily housing as well as the availability of credit for multifamily lending during financial downturns. Long-term fixed-rate mortgages help to attract a wider range of investors, ensuring that more multifamily deals can get done and thus helping to boost the supply of multifamily rental housing. They also play an essential role in ensuring properties can comply with the requirements of the Low-Income Housing Tax Credit program over the full fifteen-year compliance period.

Government backing also provides essential countercyclical liquidity for multifamily lending. As the present financial downturn illustrates, private capital dries up quickly in the event of a financial crisis. Without government backing, financing will be largely unavailable during downturns to fund the preservation and creation of new multifamily rental housing as well as to ensure that existing properties can refinance to ensure their ongoing viability.

- 4. To fully meet the diverse range of multifamily housing needs and ensure a competitive marketplace exists to hold down costs and encourage the development of specialized expertise, it is important that government support for multifamily lending be provided through multiple channels.** The Federal Housing Administration has a critical role to play in supporting multifamily lending, particularly for more complicated and non-standard transactions. With more capacity and more flexibility, FHA could meet a broader range of the market's needs. At the same time, however, there are limits inherent in the government structure of FHA that suggest the continued need for GSEs – or successors to the GSEs – that have the authority to assign a government guarantee or other federal backing to multifamily loans and package those loans for sale to the secondary market. As nongovernmental entities, the GSEs can respond more quickly and efficiently to the financing needs of the multifamily rental housing sector and have a greater ability to rapidly scale up in the event a financial downturn causes other financing sources to exit the market.

5. **The most efficient and effective way to provide the additional government backing needed to ensure continued access to capital for multifamily rental housing is to provide for a government guarantee wrap of the Mortgage Backed Securities backed by one or more multifamily loans that the GSEs or their successors underwrite.** The guarantee wrap should ensure timely payment of principal and interest, including full payment at maturity, be explicit in its potential cost, be priced to allow transparency of government exposure, and be focused on public benefit.

To minimize risks to taxpayers, the GSEs or their successors should be required to maintain minimum capital levels and their lending standards and execution should be carefully overseen by federal regulators. Under this approach, any loan losses not recoverable from the project or lender would be covered first by the GSEs and then by the accumulated guarantee fees. Only if all these sources proved insufficient would taxpayers be responsible for losses.

6. **The government's principal interest is to guarantee loans for housing at rent levels affordable to low-, moderate-, and middle-income households throughout the United States.**
7. **Strong government regulation is necessary and desirable to ensure the safety and soundness of the multifamily financing activities of the GSEs or their successors, as well as to ensure they make multifamily credit available for underserved market segments, including small multifamily loans (5 to 50 units) and in rural, lower income and other underserved markets.** Regulation should help to target GSE involvement in areas where it is most needed without crowding out private capital.
8. **The GSEs or their successors have important roles to play in supporting the financing of affordable housing, including providing long-term fixed-rate financing for low-income housing tax credit properties. But regulators should be careful not to push them to reduce lending standards to unprofitable levels in order to meet arbitrary targets.** A better approach would be for the regulator to work collaboratively with the GSEs to identify opportunities to take advantage of their expertise and market channels to test new approaches that could ultimately be profitable, either on their own, or in conjunction with separately funded subsidy or credit enhancement by the government.

In addition, funding should be made available to subsidize affordable rental housing for very-low and extremely-low income households through such mechanisms as the National Housing Trust Fund and the Capital Magnet Fund.

9. **The GSEs or their successors will need a limited portfolio capacity for multifamily housing to support many of their core functions.** For example, they may need to season certain types of loans before packaging them for sale to the secondary markets. However, **the large majority of their multifamily business should be to package loans directly for sale to the capital markets.**
10. **It could take several years to transition to a new housing finance system. During this interim period, the existing GSE channels for supporting multifamily lending should be maintained to ensure the ongoing availability of credit for multifamily rental housing.**