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ON BEHALF OF THE  
NATIONAL MULTI HOUSING COUNCIL  
AND THE  
NATIONAL APARTMENT ASSOCIATION  
BEFORE THE  
INSURANCE, HOUSING AND COMMUNITY OPPORTUNITY  
SUBCOMMITTEE  
OF THE  
HOUSE COMMITTEE ON FINANCIAL SERVICES  
FOR THE HEARING ON  
“THE FUTURE ROLE OF FHA AND GINNIE MAE IN THE SINGLE-  
FAMILY AND MULTIFAMILY MORTGAGE MARKETS”

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Chairwoman Biggert and Ranking Member Gutierrez, on behalf of this nation's 17 million households who call an apartment their home, the National Multi Housing Council (NMHC) and the National Apartment Association (NAA) would like to thank you for the opportunity to testify today on the future role of the Federal Housing Administration (FHA) and the Government National Mortgage Administration (GNMA) in multifamily mortgage markets.

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. The National Multi Housing Council represents the principal officers of the apartment industry's largest and most prominent firms. The National Apartment Association is the largest national federation of state and local apartment associations. NAA is a federation of 170 state and local affiliates comprised of more than 50,000 multifamily housing companies representing more than 5.9 million apartment homes.

We applaud your efforts to examine the role of FHA in America's housing market and ways to improve its ability to provide liquidity to key sectors of the rental housing market.

***GROWING DEMAND FOR RENTAL HOUSING AGAINST A  
BACKDROP OF A SUPPLY SHORTFALL***

Prior to addressing the role of FHA and GNMA multifamily finance programs now and in the future, it is worthwhile to take a moment and note the fundamental role multifamily housing plays in our nation's economy.

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. Married couples with children are now less than 22% of households and that number is falling.

By 2030, nearly three-quarters of our households will be childless. Seventy-eight million Echo Boomers are beginning to enter the housing market, primarily as renters. Seventy-eight million Baby Boomers are beginning to downsize, and many will choose the convenience of renting.

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 an investment. That awareness is freeing people up to choose the housing that best suits their lifestyle. For millions, that is an apartment.

Renting has many advantages. Convenience, walkable neighborhoods and mobility to pursue job opportunities are some of the reasons why renting is no longer something you do until you can buy a house.

Today, nearly 89 million Americans, almost one-third of all Americans, rent their home. There are 17.3 million apartments (properties with 5 or more units) in the U.S. that, taken together, provide a place to live for more than 14 percent of all households. In this decade, renters could make up 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.

Unfortunately, supply is beginning to fall short of demand. An estimated 300,000 units a year must be built to meet expected demand. Yet most forecasts suggest ground will be broken on fewer than half that many in 2011. In fact, new multifamily construction set an all-time post-1963 low in 2010 at 97,000 new starts. That level of construction is not even enough to replace the units lost every year to demolition, obsolescence and other losses.

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.

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.

The bursting of the housing bubble exposed serious flaws in our nation's housing finance system. As policymakers craft solutions to fix the single-family housing problems, they should be mindful not to do so at the expense of the much smaller and less understood, but vital, multifamily sector.

The government sponsored enterprises' (GSEs) multifamily programs were not part of the melt-down and are not broken. They have default rates of less than one percent—a tenth of those in the single-family sector—and they actually produce net revenue (profits) for the U.S. government. They pose no risk to the taxpayer.

Through careful underwriting, the GSEs' multifamily models have met the test. They have attracted enormous amounts of private capital; helped finance millions of units of market-rate workforce housing without federal appropriations; sustained liquidity in all economic climates; and ensured safety and soundness in their multifamily business. 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.

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.

## ***FEDERAL SUPPORT OF THE MULTIFAMILY CREDIT MARKET***

### **Multifamily Capital Markets Overview**

Historically, the apartment industry has enjoyed access to mortgage credit from a variety of capital sources, each with its own focus, strengths and limitations. Private market sources include commercial banks, which offer short-term, floating rate financing for smaller, local borrowers. Life insurance companies target higher-quality properties in select markets. Their capital allocations change with market conditions, and their loan terms do not typically extend beyond 10 years. The commercial mortgage-backed securities (CMBS) market became a material source of capital for the industry in the mid-1990s but has been shut down since 2008, and it is unlikely to return to its pre-bubble levels of lending.

Even in healthy economic times, these capital sources have been insufficient to meet the full needs of the apartment sector, most notably the affordable and workforce housing sectors and rental housing in smaller markets.

To fill that gap, the federal government supports the multifamily housing finance market through three primary entities: the GSEs Fannie Mae and Freddie Mac; the Federal Housing Administration (FHA); and Ginnie Mae (GNMA). Each of these plays an important but different role in ensuring the availability of mortgage finance to the rental industry.

The GSEs have served as the cornerstone of the multifamily housing finance system for decades, offering a broad range of mortgage products, including long-term debt for the entire range of apartment properties (market-rate workforce housing, subsidized, large properties, small properties, etc.) in all markets (primary, secondary and tertiary) at all times regardless of economic conditions.

FHA was created in 1934 to insure multifamily loans originated by FHA-approved lenders to increase the capital availability to the industry. It offers high-leverage, long-term mortgages to many markets underserved by private capital. It primarily targets construction lending, although it is also available for substantial rehabilitation and acquisition and refinancing.

GNMA was established in 1968 to help create a secondary market for both single-family and multifamily FHA-insured loans. GNMA guarantees investors the timely payment of principal and interest on mortgage-backed securities (MBS) comprised of federally insured or guaranteed loans, including FHA loans. The GNMA guaranty allows mortgage lenders to obtain a more favorable price for their mortgage loans in the secondary market. Lenders can then use the proceeds to make new mortgage loans available. Notably, GNMA securities are the only MBS backed by the full faith and credit guaranty of the United States government, which means that even in troubled economic times, such as those that continue to confront the nation, investments in GNMA MBS are safe for investors.

## **FHA/GNMA: An Alternative Debt Capital Source and Private Sector Backstop**

Since its inception in 1934, FHA has insured over 47,000 multifamily mortgages. It currently holds 13,000 multifamily mortgages in its portfolio (compared to 4.8 million single-family mortgages). While it accounts for just six percent of the total outstanding multifamily mortgage debt, it is a material and important source of capital for underserved segments of the rental market.

It is best known for offering construction loans to developers who lack access to bank and other private construction capital sources. It also serves borrowers with long-term investment goals as the only capital provider to offer 35-40-year loan terms. FHA lending is essential to borrowers in secondary markets, borrowers with smaller balance sheets, new development entities and non-profit firms, all of which are often overlooked by private capital providers.

FHA-insured debt has also been widely used by sponsors of targeted affordable housing and properties that receive federal, state and local subsidies, project-based Section 8 and proceeds from Low-Income Housing Tax Credits (LIHTCs).

FHA serves the multifamily market through three key programs.

- *Section 221(d)(3) and Section 221(d)(4) Mortgage Insurance Programs:* These programs are of the most importance to the conventional apartment industry. They insure mortgages for new construction or substantial rehabilitation of multifamily rental or cooperative housing for moderate-income families, the elderly and the handicapped. Section 221(d)(3) is used by nonprofit sponsors while Section 221(d)(4) is used by profit-motivated sponsors. Notably, the program enables GNMA to use mortgage-backed securities to provide liquidity support for long-term mortgages (up to 40 years), which leads to lower interest rates for borrowers.
- *Section 207/223(f) Program:* These mortgage insurance programs insure mortgage loans to facilitate the purchase or refinancing of existing multifamily rental housing that was originally financed with conventional or FHA-insured mortgages. Properties requiring substantial rehabilitation are ineligible for mortgage insurance under this program, though HUD permits the completion of non-critical repairs after endorsement for mortgage insurance. The Section 223(f) program enables GNMA to use mortgage-backed

securities to provide liquidity support for long-term mortgages (up to 35 years), which leads to lower interest rates for borrowers.

## **CAPACITY AND PROCEDURAL OBSTACLES CREATE HISTORIC BACKLOG AT FHA**

In normal capital markets, FHA/GNMA play a limited, but important, role in the rental housing sector. During the economic crisis, however, FHA became virtually the only source of apartment construction capital. Demand for FHA financing surged, increasing more than five-fold. Applications have increased from \$2 billion annually to \$10 billion, and HUD anticipates that demand for FHA multifamily mortgage insurance will remain high for the next several years.

FHA's lack of resources and recently implemented new processing procedures have created an enormous backlog of pending applications for new construction financing (through the 221(d)(3) and 221(d)(4) programs and refinancing for maturing mortgages through the 207/223(f) programs. As a result, FHA is struggling to meet this increased demand. Further exacerbating its capacity issues are efforts implemented over the past year to create stricter credit requirements through more stringent loan terms and expanded underwriting review. Additionally, FHA has recently revised its mortgage closing documents for the first time in 30 years. These changes mean that borrowers are subject to processing times that can exceed 18 months, and there are increasing questions over whether applications will move forward at all.

NMHC/NAA strongly support FHA's efforts to introduce sound credit and underwriting policies; however, these changes are disruptive to the critical housing needs of our nation's communities. Improvements cannot be undertaken at the cost of unnecessarily increasing government bureaucracy that results in a bottleneck of applications and the rejection of qualified development transactions. Multifamily rental developments financed through FHA create thousands of jobs and generate revenue for the federal government and communities; hence, delays at FHA miss an opportunity to contribute to the economic recovery. Moreover, the FHA multifamily program generates net revenues for the taxpayer—revenues that are forsaken when FHA is unable to process the applications in its pipeline.

Before examining the specific problems facing FHA in greater depth, we must note that HUD Secretary Donovan and his team are working diligently to resolve some of the issues we are raising today. In fact, NMHC/NAA, along with the National Association of Home Builders and

the Mortgage Bankers Association, meet with top HUD officials on a quarterly basis to drive continued progress. All that said, while some progress has been made, it remains incomplete. Congressional action and vigilance will be required to ensure all problems are swiftly and satisfactorily addressed.

### *Loan Processing Issues*

Increased demand for FHA financing has resulted in significantly longer loan processing times throughout the country. This is creating a significant hardship for apartment providers seeking to meet the nation's growing demand for rental housing.

In recent months, HUD has attempted to reallocate resources to high-demand offices and increase the amount of information offered to borrowers so they will better know their place in the pipeline. HUD has also clarified its application fee refund policies to enable would-be borrowers to withdraw their applications without material financial penalty when alternate financing is available.

Despite these efforts, applicants in many HUD field offices still have no idea how many projects are in the queue ahead of them or when HUD/FHA is likely to respond. We offer the following recommendations, which include some items HUD/FHA has already identified:

**1. Follow the Multifamily Accelerated Processing (MAP) Guide to ensure loans are processed efficiently.**

HUD insists that transactions can be expedited through its MAP program; however, field offices often deviate from the guide, creating confusion among borrowers and lenders over what is required to secure FHA-insured debt. A more consistent application of the MAP Guide will eliminate this confusion and help reduce FHA's review time.

**2. Seek a more efficient means to address credit concerns.**

As noted above, FHA has undertaken steps to strengthen the credit risk of its portfolio. However, some of these steps could be reworked in ways that would help expedite loan processing and still protect the agency. For instance, FHA has mandated that all loans over \$15 million be processed by a National Loan Committee instead of being evaluated by the field office. This is an unnecessary complication. For years, FHA has relied on its lender partners to conduct due diligence, and the results have produced an FHA mul-

tifamily portfolio with acceptable credit performance. Instead of essentially abandoning this process, FHA should only require centralized review of loan requests that exceed the program's loan terms and requirements.

**3. Establish a special underwriting team for large, atypical loans.**

While we agree that loans that exceed the general parameters of loans typically insured by FHA should be carefully examined, creating a special team to process them would relieve the clogs in the pipeline and expedite the processing of more standard transactions.

**4. Provide greater oversight over market assessment information.**

HUD should use both appraisal data *and* the information provided by the Economic Market Analysis Division (EMAD) when reviewing applications instead of relying solely on EMAD data, which often is not an accurate assessment of local market conditions.

*Resources*

While some of the processing backlogs are a result of procedural obstacles, the greatest source of the problem lies in the insufficient staffing and financial resources available to FHA to meet current and future demand.

Although NMHC/NAA recognize that budget constraints confronting Congress and the nation make it unlikely that additional funding can be secured for administering the FHA multifamily mortgage insurance programs, we believe that existing resources can be reallocated to help alleviate bottlenecks.

Most notably, HUD can establish field office monitoring teams to evaluate and improve the ability of each FHA office to process applications, relative to their market share and based on the timelines set forth in the MAP Guide. Appropriators in Congress should give HUD the discretion to reallocate capital and staffing resources to offices that are the most efficient. Until then, however, HUD should not stand on the lack of such flexibility as a reason for the backlog instead of finding alternative solutions within its authority. For example, high-performing offices could be exempted from having the National Loan Committee review certain types of transactions that are unlikely to result in taxpayer losses. Finally, personnel in offices that are experiencing high

volumes of applications could be supplemented by temporary duty assignments to help reduce backlogs.

### **FHA-RURAL REGULATORY IMPROVEMENT ACT OF 2011**

The Committee has asked us to comment on its discussion draft, the FHA-Rural Regulatory Reform Act of 2011. While the bill predominantly addresses issues specific to the single-family and rural housing programs, there are several issues we want to raise regarding the FHA multifamily programs.

- *Loan Limits:* The current FHA multifamily loan limits are not high enough for properties that require elevator construction. Increases to the base loan limits and cost factors enacted over the past eight years have helped in many parts of the country, but they have not helped in urban areas where high-rise elevator construction is common. As a result, there is a significant financing shortage in these areas, where demand for affordable and workforce housing is high.

To meet the growing demand for affordable rental housing in urban areas, we propose a 50 percent increase in the FHA multifamily loan limits for elevator buildings. Elevator buildings are significantly more expensive to build, yet the loan limits for elevator buildings in FHA's most popular program, the 221(d)(4), are just 10 percent higher than garden apartment loan limits—\$68,7000 for a two-bedroom in a high-rise versus \$62,026 for a garden apartment. In a high cost market, the maximum elevator limit is \$214,421 compared to a non-elevator limit of \$195,382.

Our proposal would increase the base loan limit for a two-bedroom unit in an elevator property from \$68,070 to \$93,039 (approximately a 37% increase). Adding the high-cost area factors to this base limit would allow FHA to insure loans in elevator structures of up to \$293,073 per unit. Such a change would make a material difference in the amount of rental housing constructed in urban markets.

Last year, the House passed bipartisan legislation to increase the FHA multifamily loan limits in high-rise elevator properties. We urge this Congress to address the demand for construction financing in our nation's cities by including those provisions in your forthcoming bill.

- *Capital Reserves.* We appreciate the Committee's efforts to improve the long-term viability of the FHA multifamily programs by implementing a risk-based capital reserve. We strongly support adequately capitalizing the General Insurance and Special Risk Insurance Fund (GI/SRI funds). However, the mortgage insurance premium for lower-risk loan programs should not be increased to subsidize higher-risk FHA insurance activities. Such transfer of risk-based capital could have a chilling impact on the multifamily programs if premiums are raised to subsidize losses in other loan categories.

### ***FHA IS NOT THE SOLUTION TO THE CRISIS CONFRONTING THE GSEs***

As this Committee and Congress examine ways to address the crisis confronting Fannie Mae and Freddie Mac, some have suggested that Fannie Mae and Freddie Mac's secondary mortgage programs be replaced by or merged with FHA. NMHC/NAA strongly oppose such efforts. Such a move would exacerbate liquidity issues facing the multifamily industry, which could reduce the availability of workforce housing and jeopardize the economic recovery.

There are many reasons for our opposition. Lawmakers should recognize that FHA serves a very different market than Fannie Mae and Freddie Mac. It provides capital to help develop and preserve rental housing where bank financing and other forms of capital are unavailable or in short supply. It should continue to perform this important mission, and an important element of housing finance reform should be to identify areas where it is appropriate for private capital and FHA to partner. But even such risk-sharing programs would not come close to meeting the apartment industry's broad capital needs.

Even if FHA served similar market segments to Fannie Mae and Freddie Mac, as our testimony suggests, FHA is woefully unprepared to assume greater responsibility. It is already failing to meet current multifamily program demand, and there is no expectation that the resources exist within the current budgetary framework to bring it to the level that it could replace the liquidity provided by Fannie Mae and Freddie Mac.

Beyond its general capacity issues, FHA also has insufficient capacity to effectively respond to the multiplicity of unique and often complex issues presented by income property underwriting.

This means that many viable deals that could lead to the construction of workforce housing might not be able to go forward simply because FHA would be incapable of structuring a deal.

FHA's limited and inflexible mortgage products do not fit the variety of needs of the market and market conditions. Again, this means that profitable deals Fannie Mae and Freddie Mac might be able to underwrite today would not go forward under a regime where FHA was the only government-backed market participant.

FHA also imposes arbitrary loan limits on its products that preclude credit in markets with significant land and development costs (i.e., high-cost markets). If FHA took over the activities of the GSEs, credit support could well be inadequate in urban markets nationwide, which would lead to reduced construction and very possibly a smaller number of units available to lower- and middle-income families.

It is also critical to note that FHA's mortgage documents are outdated and not considered to meet many market conventions and standards. Imposing these on the entire sector would expose the entire industry to significantly slow processing times currently being experienced by the small segment of FHA borrowers. It would also force multifamily firms to devote resources to the bureaucratic exercise of filling out forms instead of doing what they do best, namely constructing multifamily housing.

Finally, FHA has inadequate systems to oversee existing portfolios to manage credit risk and support prudent loan servicing. Whereas the GSE multifamily serious delinquency rates remain below one percent, moving operations to FHA could jeopardize this sterling record of success and unnecessarily leave American taxpayers open to billions of dollars in losses.

Instead of joining Fannie Mae and Freddie Mac with FHA, housing finance reform should seek to encourage partnership between private and FHA multifamily mortgage credit sources where appropriate. Although such areas may be limited, they should focus on the development and preservation of multifamily housing where bank and other forms of capital are unavailable or in short supply.

We believe there is a better solution than folding the GSEs' multifamily programs into FHA and that with more time and data from the Federal Housing Finance Agency (FHFA) we can develop

a proposal to serve both the taxpayer and the millions of Americans who rely on rental housing for their shelter.

***REFORM MUST PROTECT MULTIFAMILY PROGRAMS,  
DO NO HARM AND TAKE FACT-BASED APPROACH***

While NMHC/NAA oppose merging GSE activities with FHA, we do strongly support housing finance reform and recognize the necessity of addressing the problems confronting Fannie Mae and Freddie Mac. That said, because of the multifamily sector's importance to the economy and prospects for recovery, proposals to address single-family housing problems must not be enacted at the expense of the very different, but vital, multifamily sector. Accordingly, we urge Congress to observe two principles *before* moving forward with any legislation:

First, proposals should do no harm to a multifamily sector that was not responsible for the financial crisis and, at the same time, is critical to ensuring a robust supply of workforce housing that will help drive our nation's economic recovery. Over 20 percent of all American households now live in apartment homes. In addition, demand for apartments is forecast to grow rapidly: In this decade, renters could make up half of all new households—more than seven million new renter households in total. Thus, public policy should take special care not to harm the planned production of workforce housing.

Moreover, while many have called for the elimination of Fannie Mae and Freddie Mac, this could have devastating consequences to multifamily housing if not done in a thoughtful and deliberative manner. Nearly all of the multifamily funding provided by the existing GSEs helped create workforce housing. In fact, 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.

Looking forward, it is hard to imagine a scenario in which necessary levels of workforce housing could be constructed without some level of government credit support, particularly during times of economic difficulty. Without government credit support of multifamily mortgages or mortgage-backed securities to ensure a steady and sufficient source of capital going forward, the apartment industry will be unable to meet the nation's housing needs in all markets, and Americans will pay more for workforce housing.

Finally, it is also critical for Congress to note that in stark contrast to the GSEs' single-family programs, the agencies' multifamily programs did not contribute to the housing meltdown. The risk models and underwriting standards Fannie Mae and Freddie Mac have used to produce millions of units of affordable housing work. In fact, Fannie Mae and Freddie Mac have actually earned net revenues exceeding \$2 billion during conservatorship.

As a second principle, proposals to address Fannie Mae should only be enacted after the best available data has been made publicly available and analyzed. This will help Congress to avoid unintended consequences that could threaten the availability of workforce housing and ensure that future legislation reflects lessons that can be gleaned from Fannie Mae and Freddie Mac's activities prior to and following conservatorship.

We encourage House Financial Services Committee Chairman Bachus to request that the Government Accountability Office (GAO) conduct a study on the performance history of Fannie Mae and Freddie Mac's multifamily mortgage purchase activities since the enactment of the *Housing and Community Development Act of 1992* (P.L. 102-550).

NMHC/NAA believe that Congress should not move forward with comprehensive legislation addressing GSE multifamily mortgage activities until GAO obtains and analyzes data from the GSEs and FHFA that provides:

- An overview of the lending activities and multifamily housing mortgage products offered by the enterprises.
- Data regarding loan origination activities broken down by mortgage product, state and metropolitan area where the loans financed properties, the type of properties financed and the period of the loans (5-, 7-, 10-, 15-, 20-, 25- and 30-year mortgage terms) used for financing.
- An assessment of annual loan performance by product type based on debt coverage ratio and loan-to-value. This should also include an analysis of annual delinquency, default and foreclosure characteristics (in percentage and absolute numbers), and annual multifamily mortgage securitization activities.

- An examination of the credit standards and policy requirements the enterprises require for multifamily loans along with a comparison to other mortgage capital sources for both multifamily and single-family loans as available.
- Information about GSE multifamily loan loss reserves and their usage.
- An assessment of the enterprises' achievement of affordable housing goals, including multifamily contributions to corporate affordable housing goals and multifamily special affordable housing goals.
- An analysis of the enterprises' multifamily risk-sharing activities with the Department of Housing and Urban Development, the Federal Housing Administration, the Rural Housing Administration, and state and local housing finance agencies.

In closing, NMHC/NAA look forward to working with this Committee and the Congress to reform the nation's housing finance markets while ensuring that a robust supply of capital is available to provide for a sufficient supply of workforce housing that is so necessary to driving a sustained economic recovery.

Thank you again for the opportunity to testify this afternoon, and I stand ready to answer any questions you may have.