NATIONAL HOUSING TRUST

Testimony of Michael Bodaken
President, National Housing Trust
September 29, 2010

House Committee on Financial Services

Hearing on the Future of Housing Finance

Chairman Frank and Ranking Member Bachus, and members of the Committee, thank you for inviting me to testify today. My name is Michael Bodaken, and I am President of the National Housing Trust.

The National Housing Trust is a 24 year old national nonprofit organization dedicated to the preservation and improvement of existing affordable rental housing. Through our work in real estate development and affordable housing finance, the Trust has helped save and improve more than 22,000 apartments in 41 states, leveraging more than $1 billion in investment for affordable housing. The majority of these apartments have HUD subsidized mortgages or project-based rental assistance contracts.

We engage regularly with FHA, Fannie Mae and Freddie Mac and the Federal Home Loan Banks both in our operations as a nonprofit developer and at the policy level.

Our primary interest in the future of the nation's housing finance system is that the system be fairly balanced between homeownership and rental housing, and that the system provides liquidity, counter cyclicality and flexibility to assure the ongoing finance of rental housing. As I explain below, rental housing is the current tenure of at least 1/3 of all Americans and provides shelter for about half of all low-income households.[1]

The Housing Finance System Must Serve Rental Housing as well as Homeownership

All too often in housing finance discussions, policymakers overlook the central role rental housing plays in so many peoples' lives. Nevertheless, the fact remains that one-third of our nation's families and seniors depend on quality rental housing. Further, we know that renters have, on average, greater housing needs than homeowners. According to the Joint Center on Housing Studies at Harvard University, over 40 million U.S. households spend more than 30% of their income on housing; of these 40 million, nearly half, 19 million, expend more than 50% of their income on housing. Renters comprise a disproportionate share of these cost burdened households, constituting over 45% of those who expend more than 50% of their income on housing (compared to 30% of our nation's homeowners).[2] This housing need disparity is geographically widespread. Nowhere in the U.S. is a household earning the minimum wage able to afford a HUD Fair Market priced apartment. Many in our nation's workforce, including, but

---

[1] The information presented below is based, in part, on material developed by the Multifamily Subcommittee of the Mortgage Finance Working Group facilitated by the Center for American Progress in which the Trust participates.

[2] State of the Nation's Housing, 2010, Joint Center for Housing Studies, p. 5.

not limited to, teachers, firefighters and municipal workers, are renters. Yet, in discussions of housing finance, these people-and their housing needs-tend to be sidelined.

Hence, the "Future of Housing Finance" in the United States must effectively take into account both homeownership and rental housing. As Shaun Donovan, Secretary of HUD, remarked at the recent White House Conference on the Future of Housing Finance:

> "[A robust housing finance system] means ensuring that financing is available for those who will build the rental housing that we need to provide choices for those families for whom homeownership may not be the best option."[3]

What Type of Housing Finance System Works Well for Rental Housing?

Similar to that which accommodates homeownership, the characteristics of an effective rental housing finance system include the following:

1. *A well functioning, liquid secondary mortgage market supported by a government guarantee executed by an institution that engages in prudent underwriting.*

If recent experience has taught us anything, it is that a federal backstop is necessary to maintain liquidity for the housing market. There is little disagreement that the size residential mortgage markets and their importance to Americans demand that the federal government play such a role. In discussions of the housing crisis, the conventional wisdom is that rental housing, like single family housing, suffered large delinquencies and foreclosures. While it's true that there has been an increase in delinquencies in and foreclosures in the multifamily market, a review of the experiences of various multifamily mortgage lenders and a comparison to the crisis in the single family market during the crisis is instructive.

While it is tempting to think of "housing" as one category in the economy, the recent housing crisis was fueled almost exclusively by a crisis in the single family homeownership market. Perhaps no statistic is more telling here than a comparison of the performance of Fannie Mae and Freddie Mac single family vs. multifamily loans:

- Fannie Mae and Freddie Mac's share of delinquent (60 days without payment) or foreclosed loans rose from approximately 3 to 11.5% between 2005 and 2009;

- During that same time frame, Fannie Mae and Freddie Mac's delinquent or foreclosed multifamily loans remained at less than 1%.

Perhaps more importantly, loans provided by the government sponsored enterprises (GSEs) clearly outperformed private lenders. The GSEs had significantly lower delinquency rates on the multifamily mortgages they hold compared to "private label" investors in multifamily MBS as well to commercial bank loans. Specifically, the delinquency rates experienced by Fannie and Freddie were 1/14th the default rate for private label multifamily MBS, and 1/11th that of the commercial banks (0.45 percent versus 6.5 percent and 5.0 percent, respectively) at the end of

[3] Prepared Remarks of Secretary Shaun Donovan at White House Housing Finance Conference, August 17, 2010.

2009.[4] Unlike their underwriting of single family loans, the GSE multifamily mortgage business was prudently underwritten, standardized and characterized by a wide portfolio diversification.[5]

2. *A government supported secondary market that provides counter cyclical liquidity to the system without interruption.*

The "Great Recession of 2008-2009" provided concrete proof of the value of counter-cyclicality, at least in the multifamily housing market.

As referenced above, the GSEs' multifamily loan experience, in contrast to single family and private label multifamily lending, was both positive and profitable.

Yet the GSE's lack of delinquencies in the multifamily mortgage market in 2008 and 2009 was not due to their absence from the market. Indeed, quite the opposite: it's not too much of a exaggeration to state that without the GSEs, the rental housing mortgage market would have frozen altogether in 2008 and 2009. According to both the GSEs and the National MultiHousnig Council, during the market retreat, the GSEs picked up the slack, purchasing over 84% of multifamily mortgages in 2009 for securitization.[6] Moreover, their loans were geographically widespread. A review by the Trust in the spring of 2010 indicated that both Fannie Mae and Freddie Mac made multifamily loans in almost every state in 2008 and 2009.

Whatever the future fate of the GSEs, this type of market counter cyclicality is entirely appropriate and necessary for the market to function in times of stress. While one hopes that we won't encounter such stress in the future, we would be wise to take into account institutions that can play this crucial role should another housing recession occur in the U.S.

3. *The majority of the activity of this government backed entity would issue mortgage backed securities that would carry an explicit government guarantee of timely payment. The majority of multifamily loans should serve households earning less than 80% of median income.*

According to the National Multi Housing Council, "90 percent of the apartment units financed by Fannie Mae or Freddie Mac over the past 15 years-more than 10 million units-were affordable to working families [whose income] was at or below their communities' AMI." [7]

Moreover, according to data gathered from both Fannie Mae and Freddie Mac, some 62% of their combined multifamily loans made between 2006 and 2009 were made for apartment complexes where rents were less than 80% of the local community's AMI. In some years, the percentages of loans made that benefitted households earning less than 80% reached over 80% of

---

[4] Housing Finance-What Should the New System Be Able to Do? Part 1: Government and Stakeholder Perspectives, 111th Congress, 2nd Session, March 23, 2010, Testimony of Robert E. Dewitt representing the National Multihousing Council and the National Apartment Assn. before the House Committee on Financial Services.
[5] Joint Center for Studies at Harvard University, "Meeting Multifamily Housing Finance Needs During and After the Credit Crisis: A Policy Brief," January, 2009.
[6] Jonathan Pollack, Global Head of Principal Trading, Deutsche Bank, "Discussion Materials for June 15, 2010 Panel on Multifamily Housing Capital Markets," PowerPoint Presentation, June 15, 2010, p. 4.
[7] DeWitt testimony, p.4

the units financed.[8] Notably both Fannie Mae and Freddie Mac indicated that, unlike their single family loans, their multifamily loans were profitable.

While recent experience proves that a federal guarantee or insurance of multifamily loans or loan pools (but not the institutions themselves) is necessary to provide the same liquidity in multifamily lending as exists in the single family market, there needs to be a public quid pro quo for these explicit guarantees. The Trust believes it is essential that the trade off for government backing of multifamily loans require a commitment by the issuer to agree to finance at least 50 or 60% of all loans for multifamily properties where rents were less than 80% of local AM-a standard that is consistent with the recent, past practice of the GSEs.

While the debate of the future of our housing finance system is being conducted, there is an emerging crisis in the commercial real estate market that bears on how future housing intermediaries could serve the affordable housing rental market. Thousands of commercially financed rental properties now are worth less than the debt that is owed on them. As foreclosures on homes and apartment buildings continue to unfold, a growing number of renters are competing for a limited supply of affordable housing. Many of these families will be seeking apartments at the lower end of the of the cost spectrum, where there is already a shortage of affordable rental housing for the poorest households. Although market conditions have resulted in lower housing costs for many middle-income households, increased demand for the most affordable housing is actually leading to higher rents and tighter credit screening in some markets.

These properties need to be refinanced, even as the recession forces rents downward and commercial credit is as tight as ever. There will increasingly be a need for fixed rate refinancing of these underwater properties into prudent loans that are supported by more realistic rents.
To the extent supportable debt is based on these new rents, and to the extent these new rents are affordable to those earning less than 80% of median income, the future housing intermediaries can and should provide financing for apartments that house a broad spectrum of households, many of whom earn less than 80% of median income.

Digging Deeper: Preserving Section 8 Subsidized Housing Is the Logical, Cost Effective First Step in Solving the Housing Needs for Very Low Income Renters. Low Income Housing Tax Credits Are Increasingly Being Used for Affordable Housing Preservation. Secondary Market Issuers that Provided a Government Guarantee for Multifamily Lending Need to be Involved in Saving Government Assisted Multifamily Housing.

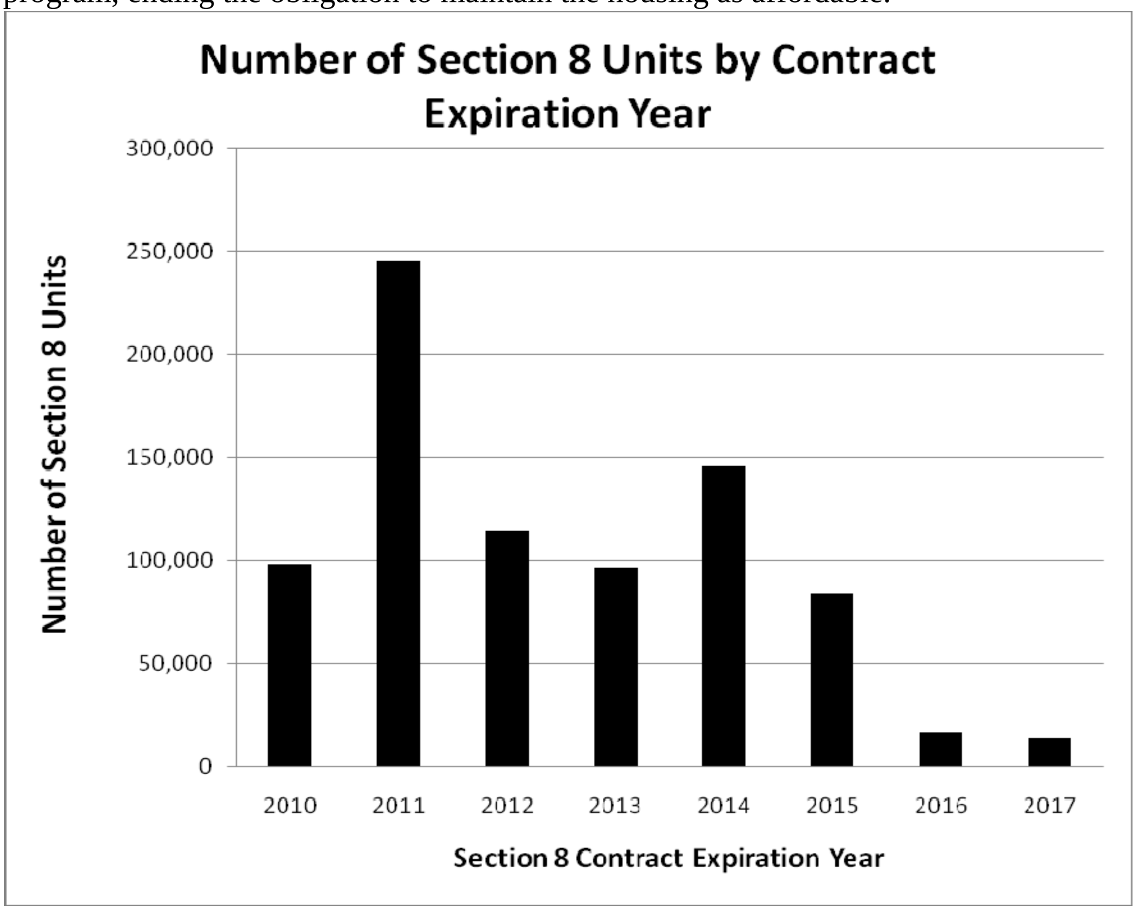
Having said that the secondary market institutions have a primary target of making at least 50-60% of their loans to rental housing with rents less than 80% of AMI, the Trust supports an additional targeting of lending for the preservation of HUD assisted housing that typically provides shelter to households earning less than 50% of median income, hereafter “very low income households.” The fact is that the challenge of providing affordable shelter to very low income Americans has proven difficult. The relatively high overall housing vacancy rate created by current economic conditions masks the critical mismatch between the nature of existing supply and unmet demand. An analysis conducted for HUD demonstrates that between 2005 and

[8] Data gathered from GSEs by National Housing Trust.

2007 the number of units affordable to households at or below 50% of area median income fell by 7%, *or a loss of over 1.5 million homes*, while the number of units affordable to households with incomes of over 100% of area median grew by 34%.[9]

For the Trust, the "duty to serve" of any future government sponsored housing finance intermediary starts with a survey of existing federally supported housing, an especially important resource of homes affordable to those with worst case housing needs at a time when housing affordability challenges are growing worse. Federally subsidized housing serves nearly every community in the nation.

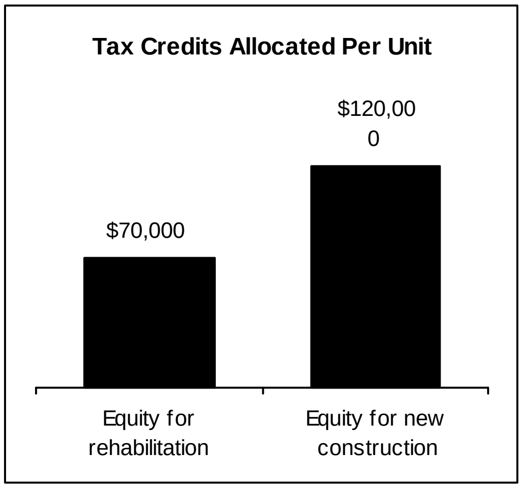
The largest of these programs, the project-based Section 8 rental assistance program, provides affordable apartments for more than 1.3 million extremely low income households. Of these 1.3 million apartments, 70%, or over 800,000 apartments, are governed by contracts that expire over the next 7 years. When a Section 8 contract expires, the owner can choose to opt out of the program, ending the obligation to maintain the housing as affordable.



Notably, federal government costs increase when an owner opt outs of a federal project-based rental assistance contract because the vouchers provided to protect eligible tenants from being displaced typically cost more—$1,000 more than the average project-based subsidy.

[9] Eggers, F.J. & Moumen, F. (2009, June). *American Housing Survey: Rental Housing Dynamics: 2005-2007*. Prepared for U.S. Department of Housing and Urban Development Office of Policy Development and Research. Bethesda, MD: Econometrica, Inc.

Further, the low income housing tax credit, the principal tool for affordable housing equity, is increasingly being used to preserve and improve existing rental housing. Over 40 states have an explicit preservation "incentive" in their housing tax credit Qualified Allocation Plans. In most states, the preservation of Section 8, HUD assisted housing is explicitly eligible for this incentive. In turn, these tax credits have attracted billions of dollars in private sector investment in the rehabilitation of federally subsidized housing. In a cost constrained environment, it's more efficient to preserve existing HUD assisted housing than to build new housing that serves very low income households. The preservation existing affordable housing is less expensive than constructing new housing as demonstrated in the following graph.[10]



Preserving existing, HUD assisted affordable housing provides an opportunity to reinvest in and improve our communities and protect the historic investment made by the federal government**.** If we do not preserve and improve the millions of apartments that have been produced through these successful public-private partnerships, we will permanently lose our nation's most affordable homes. This will represent a squandering of billions of taxpayer dollars. Safeguarding this housing presents an opportunity to reinvest in and improve our communities. Our future housing finance system must take into account this existing reality. [11]

Thus:

- Hundreds of thousands of privately owned, HUD subsidized apartments have contracts that expire over the next 7 years;
- State housing finance agencies are increasingly focused on the rehabilitation of existing housing; and
- FHA and HUD have a significant mission and financial stake in the maintenance of the nation's Section 8 inventory.

---

[10] Research by National Housing Trust.

[11] "Any changes in the housing finance system that fail to take into account the interdependence of housing policy goals and the needs of the capital markets and housing finance systems [into consideration] could easily derail the progress of critically important assisted housing programs, particularly rental housing programs." Remarks of Michael A. Stegman, Director of Policy and Housing, John D. and Catherine T. MacArthur Foundation, White House Conference on the Future of Housing Finance, August 17, 2010.

It is self evident that the future financing of government backed multifamily, Section 8 housing should be supported by the institution or institutions on which our nation's housing finance rests. The changes in the future housing finance system must take into account the interdependence of these privately owned properties, backed by FHA insurance and the properties dependence on HUD subsidies to operate.

Independently, the financing of preservation of affordable housing can produce a number of societal benefits. For example, we know that hundreds of thousands of these HUD subsidized apartments are located near mass transit. [12] The preservation of this housing not only serves very low income renters, but also maintains neighborhood diversity. Likewise, financial intermediaries could participate in mortgage financing that would reduce HUD's horrendous energy bill. Some have estimated that the retrofitting of the HUD stock would save HUD over $1 billion annually! [13]

Recommendations to Serve Very Low Income Households

The Trust proposes that the nation's future secondary market institutions have affirmative duties to:

- Provide reasonably priced forward commitments for rental housing serving very low income households;
- Consider their ability to act as guarantor or credit enhancer for low income housing tax credit transactions for very low income households, requiring an appropriate fee for that activity;
- Provide program related investments and lines of credit to creditworthy nonprofit and for profit intermediaries and developers who are preserving and improving multifamily housing affordable to very low income households;
- Provide flexible underwriting of affordable housing preservation transactions in underserved markets that balances the risk of the venture with the strength of the development team;
- Extend special financing for "green" affordable multifamily housing serving very low income households;
- Conduct outreach to state housing finance agencies and conduits on currently delinquent properties, especially if such properties can be "repurposed" to serve very low income households.

---

[12] Preserving Affordability and Access in Livable Communities Subsidized Housing Opportunities Near Transit and the 50+ Population,, National Housing Trust, Reconnecting America and AARP, April, 2009

[13] Scaling the Nationwide Retrofit of Affordable Multifamily Housing: Innovations and Policy Recommendations, Discussion Draft, September 27, 2010, p. 40.

Conclusion

Fixing the existing housing finance system is a complicated endeavor that requires careful analysis and a balance of taxpayer risk and the importance of housing to our national economy. As we design a future housing finance system, it's worth considering that one third of us rent and many of those who rent have significant housing burdens. Any successful future housing finance system must meet the challenges and take advantage of the opportunities in the U.S. rental housing market

Fortunately, we know that the performance of the government supported enterprises in multifamily housing was prudent, profitable and often served households earning less than 80% of median. Equally important, together with FHA, between 2008 and the present, the government supported enterprises provided the essential counter cyclicality for multifamily housing required when private lending dried up. These are good bases upon which to build the next generation of U.S. housing finance intermediaries.