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July 21, 2010

**VIA ELECTRONIC FILING**

The Honorable Timothy F. Geithner  
Secretary  
United States Department of the Treasury  
1500 Pennsylvania Avenue NW  
Washington, DC 20220

The Honorable Shaun Donovan  
Secretary  
United States Department of Housing and Urban Development  
451 Seventh Street SW  
Washington, DC 20410

**Re:** Public Input on Reform of the Housing Finance System,  
eDocket Nos. TREAS-DO-2010-0001; HUD-2010-0029

Dear Secretaries Geithner and Donovan:

The Commercial Real Estate (CRE) Finance Council appreciates this opportunity to provide comments on reform of the nation's housing finance system.<sup>1</sup> The CRE Finance Council is the collective voice of the entire commercial real estate finance market, including financing for multifamily housing. Our members include all providers of debt capital, rating agencies, accounting firms, servicers, and other service providers.<sup>2</sup>

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<sup>1</sup> Notice and Request for Information, Public Input on Reform of the Housing Finance System, 75 Fed. Reg. 21146 (Apr. 22, 2010) (RFI).

<sup>2</sup> The CRE Finance Council was previously known as the Commercial Mortgage Securities Association (CMSA).

Because our membership consists of all constituencies across the entire market, the CRE Finance Council has been able to develop comprehensive responses to policy questions to promote increased market efficiency and investor confidence. For example, our members have, and will continue, to work closely with policymakers in Congress, the Administration, and financial regulators, providing practical advice on measures designed to restore liquidity and facilitate lending in the commercial mortgage market such as the Term Asset-Backed Securities Loan Facility. Our members have also testified multiple times at Congressional hearings on the state of the CRE market and on financial regulatory overhaul measures. The CRE Finance Council is also recognized as a leader in the development of standardized practices and in ensuring transparency, such as through our Investor Reporting Package, in the commercial real estate finance industry.

Thus, we have a distinct perspective on the tremendous challenges facing the \$3.5 trillion market for commercial real estate finance, particularly financing of multifamily housing, and the need to establish a more stable and sound housing finance system.

In recognition of the importance of having a stable and sound multifamily housing finance system, the CRE Finance Council established a Multifamily Housing Forum and a Government Sponsored Enterprise (GSE) Reform Task Force to focus on issues related to multifamily housing finance reform. The Multifamily Housing Forum is made up of affordable and market-rate housing lenders, and looks at the emergence of capital, the role of tax credits, single-family reforms affecting commercial lending, asset performance, and capital access for multifamily assets going forward. Our GSE Reform Task Force is comprised of a cross-section of members who work in and have an intimate knowledge of the secondary mortgage market as it relates multifamily mortgages, commercial mortgage-backed securities (CMBS), and multifamily housing. The Task Force has developed the views presented here on behalf of the CRE Finance Council's membership. Furthermore, our comments and observations will remain focused on one of our core competencies, the multifamily housing market.

## **OVERVIEW**

The future of housing finance is directly related to and a key driver of overall housing policy. In the wake of the recent financial crisis, policymakers now have a unique opportunity to examine, re-structure, and re-invigorate the housing finance system for the long term. The formulation of housing policy should, therefore, take into account not only the present day economic climate, but anticipate the impact of this policy throughout economic cycles, societal changes in housing preferences and needs, and changes in the capital markets environment.

With respect to multifamily housing finance policy, the government's objective should be geared toward providing a stable, counter-cyclical, and affordable source of capital for affordable, and market-rate rental multifamily housing, while effectively managing the risk to the taxpayer and without bias toward or against home ownership. Furthermore, the nation's housing finance policy should be separated from broader housing or social policy objectives.

Housing finance policy should also recognize that the multifamily sector of the market is separate and distinct from the single family sector in terms of risk profile, historic profitability,

credit losses, and stakeholders. This is demonstrated by the fact that over 99% of the multifamily mortgages in the GSEs' portfolios have continued to perform through the economic downturn. And given the recent decline in homeownership rates due to the recession, developing and maintaining quality and affordable rental housing is increasingly more integral to housing finance policy. It follows that government support should be increased rather than decreased, and should cover all types of multifamily rental housing.

As for the housing finance system itself, the CRE Finance Council believes that some form of continuing governmental support for multifamily housing finance is necessary. Eliminating such support would have a significant adverse effect on the economy both at the macro and micro level. The removal of government support could, for example, exacerbate the impact of economic downturns, hamper the revitalization of deteriorating rental properties, limit the supply of affordable housing, and both reduce the amount and increase the cost of capital available to support multifamily housing finance, which could lead to higher rents for residents. The current framework of governmental support for multifamily housing finance is, therefore, a functional model that has proven its value to multifamily housing and the general economy. But it needs improvement.

In our view, the key elements of reform will involve maintaining the public-private ownership model for current or future GSEs involved in multifamily housing finance, as this balance is critical to appropriately manage risk and to provide the scalable capital needed for the growing multifamily market, particularly in light of demographic trends and likely increased demand for rental units over the next decade. As the commercial mortgage market has shown over the past three years, without government support, the lack of available financing for multifamily housing would have dramatically increased multifamily foreclosures, displacement of tenants and deterioration of the nation's rental housing stock. Going forward, as the homeownership rate reaches equilibrium at lower levels than that experienced over the past decade, and demographic trends pointing to material growth of the renting population manifest, demand for a stable source of capital for multi-family housing stock will only increase.

A second key element is for these entities to focus on their core competency of credit risk management, and reduce or eliminate interest rate risk. Third, since the GSE platforms are intended to be counter-cyclical, they should not be structured such that they are obliged to use their balance sheets to be directly competitive with the capital markets during peak periods of the economic cycle. Instead, they should be encouraged to continue to develop new and different ways to partner with private industry so as to meet the needs of the market throughout the cycle while minimizing taxpayer exposure and maintaining credit/pricing discipline.

Issues surrounding housing finance policy are complicated, and the following discussion will address the high-level policy issues raised in the Request for Information and their impact on the future of multifamily housing finance.

### **1. How Should Federal Housing Finance Objectives Be Prioritized in the Context of the Broader Objectives of Housing Policy?**

The key issue with respect to housing finance policy versus overall housing objectives is that the two should be carried out via separate mechanisms. The government's multifamily

housing finance objective should be geared toward providing a stable, counter-cyclical, and affordable source of capital for affordable and market-rate rental multifamily housing, while effectively managing the risk to the taxpayer. Housing finance policy should not be employed to carry out broader social or housing policy objectives, such as promoting or discouraging homeownership. Such a framework contributes to distortions in the mortgage markets, as recent experience has shown.

As a general matter, the recent financial crisis provides policymakers with a unique opportunity to re-examine the housing finance system. We urge that any reforms flowing from this re-examination seek to foster the viability of the multifamily housing finance system for the long term, including the availability of capital for affordable rental units. These policies should avoid focusing solely on the current economic situation, and should ensure that they also anticipate their impact on the economic cycle, societal housing needs and preferences, and changes in the capital markets.

## **2. What Role Should The Federal Government Play in Supporting A Stable, Well-Functioning Housing Finance System and What Risks, if any, Should the Federal Government Bear in Meeting Its Housing Finance Objectives?**

The CRE Finance Council believes that some form of continuing government support for multifamily housing finance is necessary to promote a stable, well-functioning housing finance system. As mentioned, the CRE Finance Council's membership includes all constituencies concerned with finance for multifamily housing. Accordingly, our observations are focused on the entire multifamily housing market, which includes affordable and market-rate rental apartments; hospitals; assisted living; senior housing; and rural housing. Significantly, the homeownership rate has declined to 67.2%, 1.8 percentage points below its peak of 69% in 2004.<sup>3</sup> While 1.8 percentage points may seem insignificant, keep in mind that generally, every 100 basis point decline in the homeownership rate yields an additional 1.1 million renters.<sup>4</sup> With these former home owners turning to the rental market, multifamily housing finance issues are highly relevant.

Adding to the demand for rental housing are macro demographic trends in the U.S. population, where age cohorts traditionally more likely to rent than own their home are growing. Maturing "echo boomers," coupled with the continuing influx of new immigrants, and citizens remaining single longer, will yield historically high numbers of households headed by young adults – conservatively estimated to be 86.5 million, outnumbering even the present number of baby boomers.<sup>5</sup> This new, younger generation will likely drive up demand for apartments over

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<sup>3</sup> See "Residential Vacancies and Homeownership in the First Quarter 2010," U.S. Census Bureau (Apr. 26, 2010), at 5 (Table 4SA, Seasonally Adjusted Homeownership Rates for the United States: 1985-2010).

<sup>4</sup> "Apartments at the Turning Point, Poised to Lead Recovery," Real Estate Research Report, Maximus Advisors (Apr. 7, 2010) at 1 ("Maximus Report").

<sup>5</sup> "The State of the Nation's Housing 2010," Joint Center for Housing Studies of Harvard University, at 16 ("2010 Harvard Housing Study").

the next 15 years. Indeed, studies have shown that the number of renter households has already been pushed up nearly 10% – 3.4 million households – by the stress in homeowner markets from 2004 to 2009.<sup>6</sup> At the same time, the massive and retiring baby boom generation will drive up the demand for both assisted living and senior housing.

In terms of supply, starts of multifamily housing are at an historic low. Because the completion of projects already in the pipeline lags housing starts, the full effect of the near cessation of multifamily housing starts in 2009 has not yet been felt in the market. Thus, while the national rental vacancy rate rose last year due to the combination of new multifamily completions and an increase in existing single-family homes for rent, the high vacancy rate is not expected to last. Indeed, an industry analysis anticipates that the apartment vacancy rate is already at or near its cyclical peak and will start to decline this year, registering the effects of several factors, including: the recent lag in new construction; increased demand due to younger demographics; and an economy edging its way to a recovery. When the tight credit market for new multifamily housing is also factored in, this analysis concluded that starting in 2011-12, the nation will see its biggest net undersupply of rental apartment housing since at least 1980.<sup>7</sup>

This impending undersupply will be most keenly felt by low to moderate income families and older Americans seeking affordable rental housing. A Harvard study described the erosion of affordability already occurring over the last fifty years as “striking,” explaining that only 12% of renter households spent half or more of income on housing in 1960, a share that had doubled by 2008.<sup>8</sup> This stubborn trend stems from the fact that “the cost of supplying modest units even in less desirable neighborhoods exceeds the rents that large fractions of renter households are able to pay,”<sup>9</sup> and there are no signs that this trend will improve. In addition, as aging baby boomers intensify demand for senior housing, the stock that is built between now and roughly 2025 must serve succeeding generations of older Americans, since their numbers will start to dwindle and the generation immediately following baby boomers is much smaller.<sup>10</sup> But at the same time, federal support for subsidized senior housing has been very limited. Therefore, senior housing will also become a critical issue in the years to come.

Recently, the void left by private capital exiting the multifamily housing market was filled by the GSEs, which increased their multifamily activity, starting in 2007, to help ease the credit crisis. According to the Federal Housing Finance Agency (FHFA), the GSEs’ share of the

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<sup>6</sup> *Id.* at 25.

<sup>7</sup> Maximus Report at 10.

<sup>8</sup> 2010 Harvard Housing Study at 28.

<sup>9</sup> *Id.* at 31.

<sup>10</sup> *See id.* at 16.

multifamily housing market rose from 33% in 2006 to 41% in 2007, and 79% by 2008 as the private market essentially shut down.<sup>11</sup> For 2009, the GSEs' share stood at 85%.<sup>12</sup>

The GSEs' role with respect to affordable multifamily housing is even more important, evidenced by the fact that more than 90% of the multifamily units financed by the GSEs in 2008 were affordable to residents at or below area median income (AMI).<sup>13</sup> In fact, more than 48% of the GSE-financed multifamily units were affordable to residents earning just 60% of AMI.<sup>14</sup> These percentages were even higher before the economic crisis took hold and the GSEs tightened their credit standards. For example, in 2005 nearly 95% of the multifamily units financed by the GSEs were affordable to residents at or below AMI, and nearly 63% were affordable to residents earning 60% of AMI.<sup>15</sup>

Given these demographic and market trends, the nation greatly benefits from a viable and sustainable secondary market for multifamily loans over all market cycles – benefits which are virtually impossible to achieve without some level of government support. Chief among these benefits are:

- **Market Liquidity:** Government support provides liquidity to the market during difficult economic cycles and during stressful and uncertain economic periods when private capital is unavailable or is priced unfavorably. As an example, the GSEs made liquidity available in certain market sectors even when the CMBS market was completely frozen in 2008-2009. In contrast, if there was no debt capital in the multifamily market, defaults and foreclosures would displace renters, which can have a serious detrimental effect on individuals and families, particularly those with low income.

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<sup>11</sup> See Letter from Edward J. DeMarco, Acting Director, Federal Housing Finance Agency, to the Honorable Christopher J. Dodd and Honorable Richard C. Shelby, U.S. Senate Committee on Banking, Housing, and Urban Affairs, and the Honorable Barney Frank and Spencer Bachus, U.S. House of Representatives Committee on Financial Services (Feb. 2, 2010), at 2 (available at <http://www.fhfa.gov/webfiles/15393/Conservatorhsip%20Letter%202%202%2010.pdf>).

<sup>12</sup> See Commercial Real Estate/Multifamily Finance Quarterly Databook, Mortgage Bankers Association (First Quarter 2010).

<sup>13</sup> Percentage calculated from data in HUD Government Sponsored Enterprise 2008 Geographically Targeted Goal Dataset, available at <http://www.huduser.org/portal/datasets/gse.html#download>.

<sup>14</sup> *Id.*

<sup>15</sup> Percentage calculated from data in HUD Government Sponsored Enterprise 2005 Geographically Targeted Goal Dataset, available at <http://www.huduser.org/portal/datasets/gse.html#download>.

- **Credit and Interest Rate Support:** HUD insurance and government or GSE guarantees (especially during difficult markets like the present one) provide credit support and interest rate support for (a) the loans secured by multifamily housing facilities (including mixed use retail/multifamily), senior assisted-living facilities, hospitals, and nursing homes, and (b) the related securities.
- **Support of Financing for Rural, Senior, and Other Specialized Housing:** Even during better markets, where the private sector is generally providing the necessary market liquidity, support is focused on densely populated areas rather than the underserved. Support from HUD and the GSEs is needed in rural areas to provide not only new multifamily housing facilities (including mixed-use retail/multifamily), senior assisted living facilities, hospitals and nursing homes, but also to assist with renovation of such facilities and refinancing of related loans.
- **Support of Financing for Affordable Rental Housing:** Government support encourages the stable flow of capital to facilitate affordable rental housing. As a case in point, past GSE experience indicates that more than 90% of the multifamily units financed by the GSEs were affordable to residents at or below AMI, as previously mentioned. At the same time, circumstances are developing that may lead to an unprecedented shortage of affordable multifamily rental housing in the mid- and long-term. Between 2008 and 2009, multifamily housing starts plunged 62% to the lowest level on record, affecting multifamily housing of all types, not just affordable rental housing.<sup>16</sup> With the recent decline in home ownership leading many Americans to move to the rental market, the availability of affordable rental housing will become increasingly critical in the future.
- **Attracting Capital to Invest in Rental Housing Stock:** Government support facilitates the ability to attract the lowest cost of capital globally to invest in America's rental housing stock. Moreover, there is also a need to continue broad use of REMIC (Real Estate Mortgage Investment Conduit) eligible products such as Capital Markets Execution (CME) and CMBS.
- **Better Loan Performance:** Due diligence of government agencies during the loan commitment and origination process, on top of the diligence performed by the originator and sponsor of the loan, adds an additional level of scrutiny to the loan underwriting, resulting in often higher performing loans for those originated privately. In fact, as of May 2010, current delinquency rates for multifamily mortgages at Fannie Mae and Freddie Mac were 0.78% and 0.32% respectively.<sup>17</sup>

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<sup>16</sup> 2010 Harvard Housing Study at 6.

<sup>17</sup> See Fannie Mae Monthly Summary (May 2010), at 2 (Table 9) (available at <http://www.fanniemae.com/ir/monthly/index.jhtml?s=Monthly+Summary>); Freddie Mac Monthly Volume Summary (May 2010), at 2 (Table 6) (available at <http://www.freddiemac.com/investors/volsum/>).

Clearly, the GSEs are a critical source of capital for the multifamily market, especially with regard to affordable multifamily housing. Because GSEs are such an important source of capital for multifamily overall, and because of the public interest in the availability of affordable housing, government support of multifamily housing should continue.

All of this is not to say, however, that the current system does not need improvement, nor that the private market should be ignored. See our response to RFI Question 4.

The RFI specifically asks about public versus private roles.<sup>18</sup> Although we believe government support should be maintained, the CRE Finance Council emphasizes that private sector involvement is just as, if not more important. The GSEs must maintain some form of private or quasi-private ownership. These businesses are large, sophisticated and complex. In order to appropriately manage risk, public/private sector balance and discipline is critical. Among the benefits of private sector participation, the private sector does the following:

- Provides GSEs the ability to lay off interest rate risk and minimize whole loan balance sheet exposure by selling government backed securities;
- Helps maintain GSE pricing and credit discipline through secondary market executions;
- Provides opportunities to sell off portions of credit risk not consistent with preferred GSE risk profile (e.g., Freddie Mac B-pieces in CME program);
- Shares risk with origination partners (e.g., Fannie Mae DUS program, Freddie Mac mezzanine program); and,
- Enhances the ability to attract and retain high quality, sophisticated management through private sector ownership.

### **3. Should the Government Approach Differ Across Different Segments of the Market?**

The multifamily housing finance market is separate and distinct from the single family market in terms of risk profile, historic profitability, credit losses, and stakeholders. It is also unique in that it primarily serves the needs of low- and moderate-income families. Given the recent decline in homeownership rates and demand trends described above, multifamily housing will likely be in even greater demand.

While the capital markets and balance sheet lenders have approached the multifamily market gingerly at times, the GSEs have proven adept at prudently and profitably underwriting the risks of this segment, and presently have an approximate 85% share of the market. It follows that GSE support is especially necessary for multifamily housing to provide a reliable and consistent source of capital for a safe and affordable rental housing stock. And GSE support for

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<sup>18</sup> 75 Fed. Reg. at 21147.

the multifamily segment certainly should not be reduced at a time when they hold such a significant share of the market.

In sum, the CRE Finance Council believes that the government's housing finance policies should be developed in recognition of the uniqueness of multifamily market and the importance of the role GSEs already play in this market.

#### **4. How Should The Current Organization of the Housing Finance System Be Improved?**

The current overall framework of governmental support for multifamily housing finance is a functional model that has proven its value to multifamily housing and the general economy especially over the past three years. Without this support, the multifamily housing market likely would have suffered even more severe displacement of homeowners and tenants, and diminution in property values.

At the same time, however, the CRE Finance Council believes that certain elements of these programs contributed to the current situation in the housing market and these deficiencies should be corrected so as to provide greater market stability, reduce taxpayer exposure, and encourage broader capital markets participation in housing finance. The following are examples of important improvements which should be made to the GSE structure and programs:

- Complement Private Sector, Encourage Public-Private Partnerships. The GSE platforms are intended to be counter-cyclical and should not be structured such that they are obliged to use their balance sheets to be directly competitive with the capital markets during peak periods of the cycle. Instead, the GSEs should be encouraged to continue to develop new and different ways to partner with private industry so as to meet the needs of the market throughout the cycle while minimizing taxpayer exposure and maintaining credit and pricing discipline.
- Stick to Core Business. One of the most important improvements that should be made is to reduce or eliminate GSE interest rate risk. The GSEs were involved in several activities and other investments aside from mortgage securitization, which put them in the position of having to manage the interest rate risk associated with an \$800 billion mortgage portfolio, holding massive non-mortgage portfolios, and purchasing tax credit investments.<sup>19</sup> The interest rate risk taken on by the GSEs had the potential to compromise the GSEs' credit guarantees. To avoid repetition of this situation in the future, the GSEs must focus going forward on their core competency of credit risk management and transition away from portfolio activity. Their current portfolios must also be carefully balanced with market risks and wound down to acceptable levels.
- Focus on Underserved Markets. We note that HUD and the GSEs should, of course, have sufficient flexibility to increase market participation when the private sector is

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<sup>19</sup> Fannie Mae and Freddie Mac each has an approximately \$800 billion portfolio.

not able to satisfy needs, but they must be required to change focus and reduce size or redirect efforts when the private market sector is again able to satisfy financing needs. One way to do this would be to expand involvement in underserved markets and areas, such as rural areas, certain geographic regions, and segments such as housing for seniors, which often do not get the support enjoyed by larger communities, but which have significant needs even in liquid markets.

- Focus on Rehabilitation. In light of the present movement of households toward the rental market, policymakers should also be aware that the rehabilitation and renovation of existing multifamily housing facilities, senior assisted-living facilities (and also hospitals and nursing homes), is often neglected in favor of new projects. Additional encouragement through tax credits and HUD and GSEs' credit support or supplement programs will ensure that these types of properties and facilities are properly maintained and upgraded as new living and environmental standards, energy-saving technologies, and technological or structural solutions are developed.
- Ensure REMIC Eligibility. Finally, we note that a guarantee of REMIC eligibility of all government insured or guaranteed loans or securities would reduce costs to the borrower and also to government reimbursement programs. Also, if a multifamily loan qualifies as REMIC eligible or is exempt, the loan will qualify for lower interest rates as sponsors and lenders have assurance that the loan may be included in a securitization vehicle. The qualification process should be simplified to provide better assurance especially for hospital and nursing home loans that they qualify and do not potentially trip over the current 80 (real property) – 20 (equipment) REMIC eligibility rules. All loans that are insured by the federal government or securities guaranteed by the federal government or a GSE should be deemed to be “significantly secured by real property” and thus REMIC eligible. This will likely result in an at least 100 basis point reduction in interest rates, resulting in lower government reimbursement of expenses and more efficient execution for lenders and sponsors.

In sum, the CRE Finance Council believes that the foregoing suggested reforms, in addition to maintaining government support and public/private sector balance, will best position our multifamily housing finance system to be stable and viable over all types of economic cycles, while providing an appropriate level of support for all of the various types of housing and facilities that Americans need now and in the future.

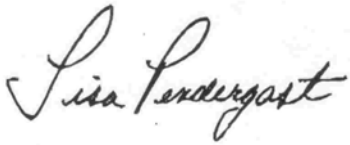
## **5. How Should the Housing Finance System Support Sound Market Practices?**

As mentioned, we believe that the present government involvement in due diligence during the loan commitment and origination process supplements that performed by the originator and sponsor, and that this additional level of scrutiny to loan underwriting may contribute to higher performing loans for those secured by multifamily housing facilities, senior assisted living facilities, hospitals, and nursing homes. The housing finance system can support sound market practices by continuing to encourage disciplined underwriting guidelines and practices, and encouraging standardization of those guidelines and practices across all industry participants. Standardization will lower the cost of capital directionally, and also benefits residents, communities and investors.

## CONCLUSION

The CRE Finance Council appreciates this opportunity to provide its views on reform of the housing finance system. We recognize that this inquiry is an initial step in what promises to be a deliberate process of examining the current system and developing improvements. We urge that policymakers keep in mind the unique and significant concerns of the multifamily housing finance market as distinct from single family housing, and we look forward to continuing discussion of these issues.

Sincerely,



Lisa Pendergast  
Managing Director  
Jeffries & Company; and  
President  
CRE Finance Council



Dottie Cunningham  
Chief Executive Officer  
CRE Finance Council