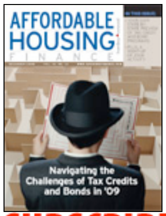

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Affordable Housing in the Next Generation of GSEs

By Jerry Ascierto

Fannie Mae and Freddie Mac have played a vital role in the affordable housing world, but the government-sponsored enterprises (GSEs) are an endangered species.

As Congress begins to remake our nation's housing finance system, one of the biggest issues is to what extent the next generation of housing finance agencies will play in the affordable housing arena.

All options, at this point, are on the table.

"I don't think anything is immune from being re-engineered," says Sheila Crowley, president of the Washington, D.C.-based National Low Income Housing Coalition (NLIHC). "The whole system, including the Federal Home Loan Banks and the FHA, is up for review at this point."

The right wing in Congress wants a fully private market, and to make affordable housing efforts the FHA's domain. The left wing wants the next generation of government-chartered entities to concentrate only on affordable housing, and remain largely in the government's control. But a hybrid system incorporating elements of both is much more likely.

In analyzing diverse proposals—from the Cato Institute, the

Center for American Progress, the Mortgage Bankers Association, and our industry's trade groups, the National Multi Housing Council (NMHC) and National Apartment Association—a way forward is beginning to emerge. Here are three general points of consensus that will likely survive the debate.

1. There will be multiple entities.
The housing finance system of tomorrow will include several new government-chartered entities, built on the ruins of the GSEs. These entities will all be private companies, capitalized with private equity. As such, the entities can fail like any other private company. But a regulator modeled on the FDIC will be able to put them into conservatorship if necessary.

Having several entities ensures that none of them are too big to fail, and it might bring more attention to underserved parts of the market, such as small properties. While Fannie Mae has a dedicated small loan program, Freddie Mac is less interested in anything that small. Yet a large portion of the nation's multifamily stock can't support millions of dollars in debt.

"No one at the national level, neither Fannie, Freddie nor the FHA, has been really able to address financing for smaller properties," says Buzz Roberts, a senior vice president for policy at the Local Initiatives Support Corp. "It's great if Fannie can go down to $1 million, but we need more than just one way to go. Competition encourages innovation, and better pricing."

The fledgling entities will be hungry to build up a market niche, Roberts says, and if an entity is a fraction of the size of Fannie Mae, small loans might look like a more attractive business line.

But having multifamily-specific entities is unlikely. "Capital markets like the brand comfort of the much larger market that is single family," says Sarah Rosen Wartell, executive vice president for the Washington, D.C.-based Center for American Progress. "So, if you take the rental market and put it in separate institutions, you actually may increase the cost of capital."

2. They will likely have a government guarantee.
These chartered mortgage issuers will likely have access to

an explicit government guarantee for the securities they issue, much like the Ginnie Mae structure of securitizing FHA-insured loans. And that guarantee will have a few strings attached to it, namely a public mission, and a price tag.

“More of the loans will be securitized and there will be some public mission tied to it,” predicts David Cardwell, vice president of capital markets for the Washington, D.C.-based National Multi Housing Council. “And I think that luxury properties will probably not be looking to the GSEs the way they are today. But how you define luxury is going to be the $64,000 question.”

The NLIHC naturally hopes to see deeper affordability goals than were previously imposed on the GSEs. The lowest income level the GSEs are now required to serve is 50 percent of the AMI, which the NLIHC says is a drop in the bucket. “That’s all well and good, but there’s no shortage of rental housing for people at 50 percent of AMI and above,” says Crowley. “The shortage is for 30 percent of AMI and below, and in some markets, between 30 and 50 percent.”

The government guarantee won’t be provided for free: the entities will pay for it in the form of fees or additional basis points built into the interest rate of each loan. Those fees will be collected in a reserve to protect against losses, and some portion of those fees might be diverted to support affordable housing initiatives.

The guarantee will help these entities provide countercyclical liquidity, to serve the market in good times and bad. When the rest of the market is healthy, the entities will see a reduced market share. And when the private market craters, the entities will scale up to pick up the slack. Importantly, the guarantee would also ensure a lower cost of capital in times of illiquidity.

“It’s possible, and almost very highly likely, that with industry support and public policy support, some kind of government guarantee for a preferred portion of the market will revive,” Wartell says.

3. They will have limited capacity.
These entities will focus on securitization first and foremost. They will have very limited portfolio capacity,

just enough to warehouse loans pre-securitization and to offer mortgages that don't have broad investor interest. As such, there may also be some level of government guarantee on the portfolio.

The GSEs have a wide range of products, not all of which can be securitized. This is particularly true in the affordable housing space, where tax-exempt bond credit enhancements, or forward commitments on tax-credit properties, are still portfolio executions.

"There should be some portfolio availability for highly-structured transactions, and specifically in the affordable multifamily sphere," says Michael Berman, chairman-elect of the Washington, D.C-based Mortgage Bankers Association and CEO of agency lender CWCapital. "But the total portfolio now is something like $1.5 trillion, and we don't even need a peppercorn compared to that."

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