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BEEKMAN ADVISORS

MULTIFAMILY FINANCE REFORM: MOVING TO A SOLUTION IN 2013

June 24, 2013

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Section 1: Proposal

Does Multifamily today meet the principles of reform?

Yes, it does because the two GSE multifamily platforms already have:

1. Diversity of lenders: size, public/private, regulated/non-regulated etc. Here are the stats on the Fannie Mae DUS and Freddie Mac Program Plus lenders:
   - 24 DUS Lenders and 23 Program Plus Lenders; 14 have both licenses (33 firms in total)
   - 19 are publicly-traded or owned by a publicly-traded firm; 14 are private
   - 26 lend nationally while 7 are regionally focused
   - 12 are regulated banks or insurance companies
   - Many additional correspondents and brokers throughout the country
2. Diversification by geography: most markets and small/large loans and through many cycles
3. Risk sharing by private capital on whole loan and/or security basis
4. Performance history: has beaten the broad market over many years and through several cycles
5. Been able to limit portfolio, remain profitable and still focus on affordability
6. Existing basic structure can readily conform to the framework of a catastrophic government wrap with private capital in a first-loss position
7. Ability to stand-alone and separate from single family

Why do we need to do something?

1. $250 billion in new loans could be added over the next five years by the current GSEs if nothing changes; with the associated default and maturity risk, as well as rising rents and interest rates, affecting performance

2. Reduce risk to taxpayer now and in the future- manage the current book with motivated partners and reduce the future government risk starting in 2014

3. Sets up a market test on whether private equity will finance multifamily secondary market entities

Section 2: Multifamily Transition

Multifamily Solution: This is specific and should be done in 2013

1. Create a transition entity for multifamily (TransitionCo MF) as a joint venture of Freddie Mac & Fannie Mae (perhaps similar JV structure to single securitization platform), with existing multifamily operating assets and human capital lent by Freddie Mac and Fannie Mae.

2. Starting January 1, 2014, new multifamily business is done in TransitionCo MF.

3. TransitionCo MF is capitalized at $1 billion - $0.5 billion each from Fannie Mae/Freddie Mac; these numbers are illustrative and the market will ratify this. The GSE capital injection should be interest-bearing (with an equity kicker) and with a sunset on return of capital. TransitionCo MF should be a bankruptcy – remote corp. to limit the risk to Fannie Mae/Freddie Mac (government) to their actual investment.
   - Secure separate warehouse lines from private banks (unguaranteed)
   - Make a payment to both GSE's of a Guarantee Fee for each security issued (say 10-15 bps) whether whole loan or pool
   - After 1 year of operation, consider:
     1. Raising private equity to provide additional capital – say $1 billion so TransitionCo MF can increase business volume as needed. Given monoline structure, this can be structured to minimize risk to the GSEs' investment.
     2. Moving the GSE's multifamily staff into TransitionCo MF and creating a stand-alone infrastructure
     3. Executing an asset management contract to manage Fannie Mae and Freddie Mac on-and-off book portfolio of $300 billion
        - Creates annuity stream for TransitionCo MF thereby making it more valuable
        - Could require skin in the game from TransitionCo MF's private capital to create an aligned partner for the future

4. When FMIC happens, we could have one MBS Issuer for Multifamily ready to be spun-out and to return capital to the taxpayer without disruption to the market!

Risk-Sharing Currently

- **Issuer-based**: Fannie Mae DUS Model with private sector DUS Lender counter-parties
- **Securities-based:** Freddie Mac CME Program K-Series originated by Program Plus Lenders
- DUS: two formulas, both loan-by-loan
  - 1/3 of loss borne by DUS lender; or
  - Top 5% loss and then 25% of remaining loss, capped at 20% of original loan balance, borne by DUS lender
- Freddie K-Series Securities (typical pool is $1 billion)
  - 15% first-loss bought by third-party B-piece buyer
- Both of these models can demonstrate that they:
  - Could withstand most capital markets events without catastrophic loss
  - Maintained underwriting standards during crisis
  - Out-performed broad market in losses and problem loans
  - Could adjust the amount of private sector capital to provide comparable protection ahead of the government wrap, consistent with having the same G-Fee for both
  - Permit flexibility and avoid lender concentration risks
- Comparison to Single-Family Reform (Corker-Warner draft)
  - 10% risk coverage by Issuer

Broad Policy Discussion Points

- Government Entity
  - A wholly-owned government corporation (FMIC) would function as a catastrophic guarantor, administrator of risk insurance fund, and regulator of secondary market entities. The government entity, which would be backed by the full faith and credit of the U.S., would not be subject to the federal appropriations process, but would be funded by guarantee fees paid by issuers, as well as other statutorily defined assessments.
  - FMIC would set standards by which secondary market entities would be eligible to issue government-backed securities. The pricing of the guarantee should encourage competition, be commercially reasonable, and be subject to calibration based on pre-determined criteria that considers market conditions.

Broad Policy Discussion Points

- Private Sector Issuers
  - Multiple, privately-capitalized secondary market entities would purchase mortgages and issue mortgage-backed securities that support the multifamily market. They would purchase catastrophic reinsurance from FMIC (the government guarantor) that wraps the MBS. The first of its kind would be TransitionCo MF.
  - These entities should be structured as mono-line businesses, with segregated assets and separate capital standards, which would facilitate capital adequacy determinations, regulatory oversight, and aggregation capabilities that would support structured risk-sharing transactions.
  - The secondary market entities would be required to be separately capitalized. Governance structures that enhance independence from any potential affiliated business lines should be considered.

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Broad Policy Discussion Points

- Execution Models
  - Flexibility in the structure of the government wrap on MBS is important to allow for multiple risk-sharing executions (at the mortgage and securitization levels) to manage credit risk, as well as to adapt to varying market conditions. In times of market disruption, the government guarantee should be structured so that it can be expanded. In all cases, private capital and the Issuer's capital should stand before the catastrophic insurance comes into play.

Broad Policy Discussion Points

- Affordability & Access
  - By its very nature, multifamily rental housing tends to be affordable with rents generally for those at or below area median income. Policy proposals contemplating affordability requirements on secondary market entities should take this into account.
  - Policymakers should mandate an affordability requirement. As an example, the government regulator could set standards requiring that the majority (e.g., a percentage) of units financed in a given year (or over a multiple year-period) are affordable to families at or below area median income. Or, use a standard such as 80% of median household income (MHI) for the financing of a majority of the units in a given period (using 30% of income for rent) - this has the benefit of aligning with bank CRA requirements. There is significant data available that shows that the current GSE multifamily businesses' largely served those with incomes under 80% MHI; however, their financing of luxury-end apartment complexes and buying of CMBS super-senior notes with multifamily-only collateral would be constrained in the future.
  - As an additional example, the regulator should encourage small rental housing lending (under 50 units and even 2-4 unit dwelling). This may propel the creation of a Co-op MBS Issuer owned by small community banks which becomes the Credit Enhancer and Asset Manager for that product.

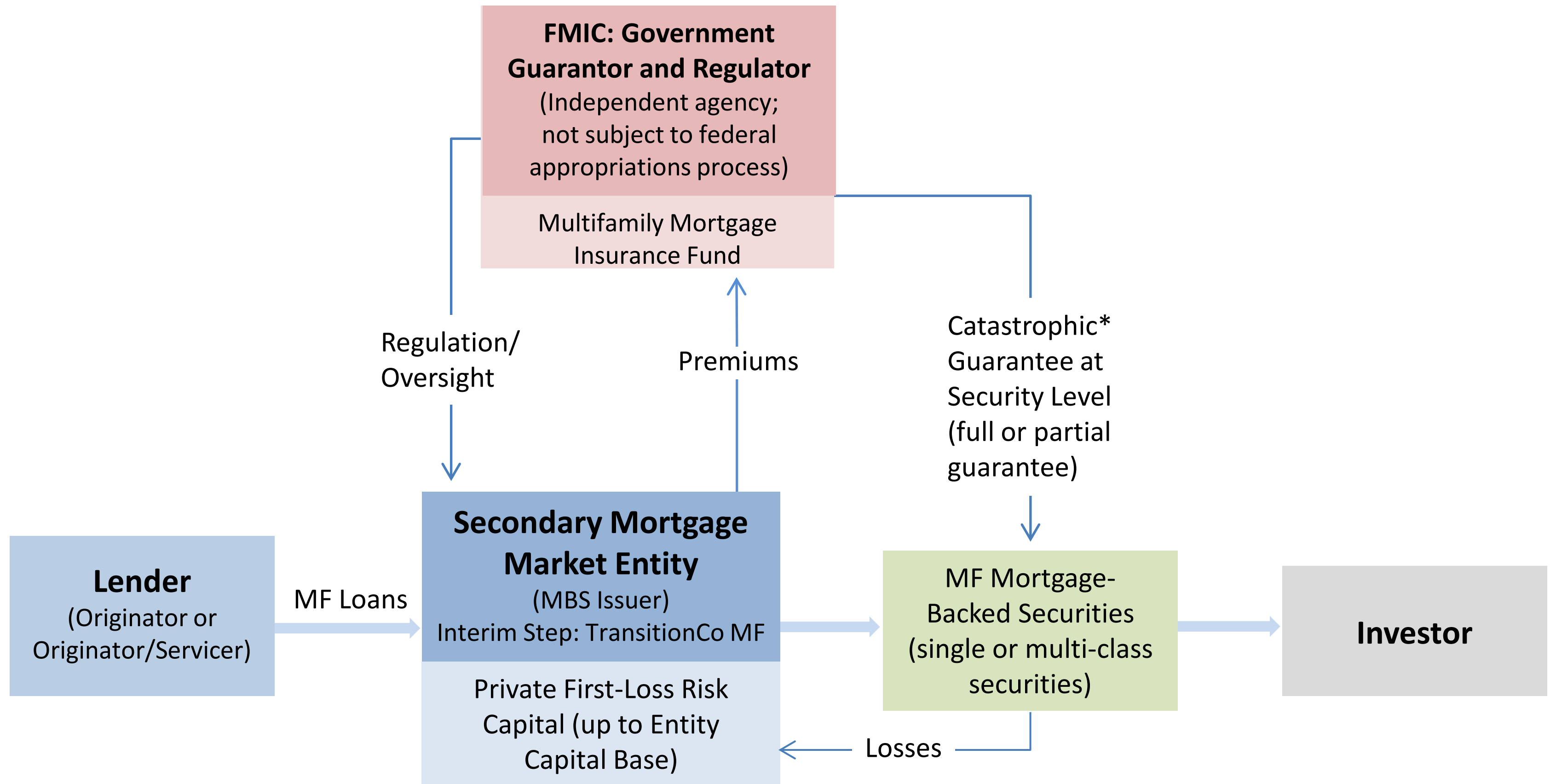
Broad Policy Discussion Points

- Capital Standards
  - Lenders' capital standards and risk retention, if applicable, would be a function of requirements imposed by the secondary market entities, applicable statutes/regulations (e.g., Dodd-Frank Act), and potentially the government guarantor through its regulation of issuers.

- Existing Multifamily Loan and Securities Portfolio – Protecting What We Already Have
  - As described in TransitionCo MF, the existing multifamily books of the GSEs (multifamily loans and securities) could be used to transition to the future state. These portfolios could be treated as legacy assets, and the new entities could manage the portfolios for a fee and could be required to have skin-in-the game to ensure alignment of interest. The big difference between multifamily and single family loans is that multifamily loan servicing requires constant contact with the borrower and loan review/asset management PLUS most loans have balloon maturity dates and require refinancing.

Chart Describing Multifamily Finance Future State:

Proposed Secondary Market MBS Issuers

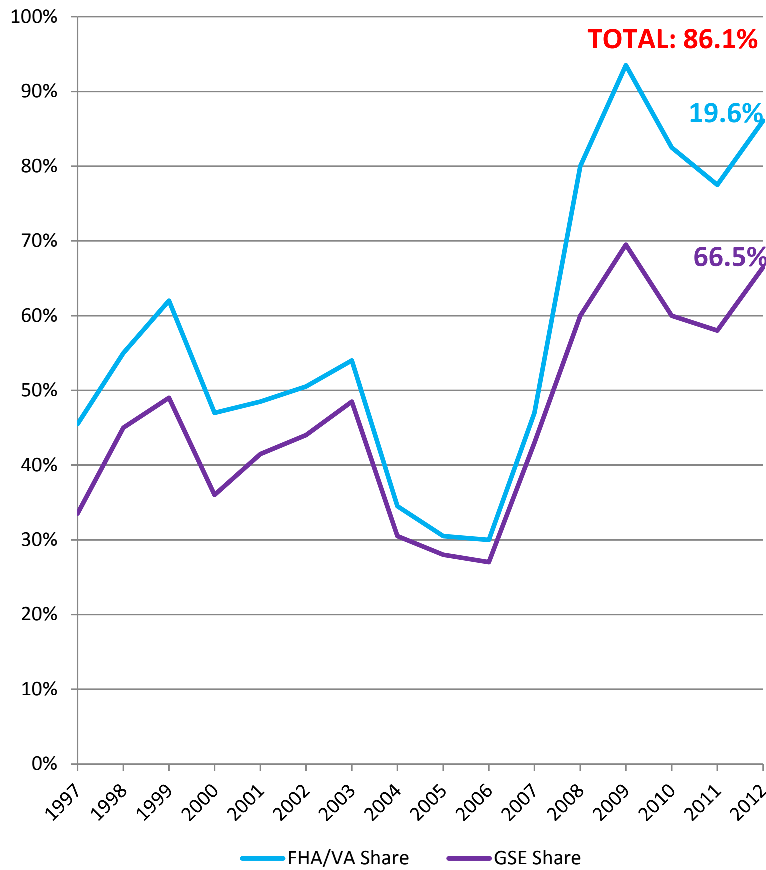


* Catastrophic Guarantee from FMIC kicks in only after Secondary Mortgage Market Entity has exhausted its capital base covering losses

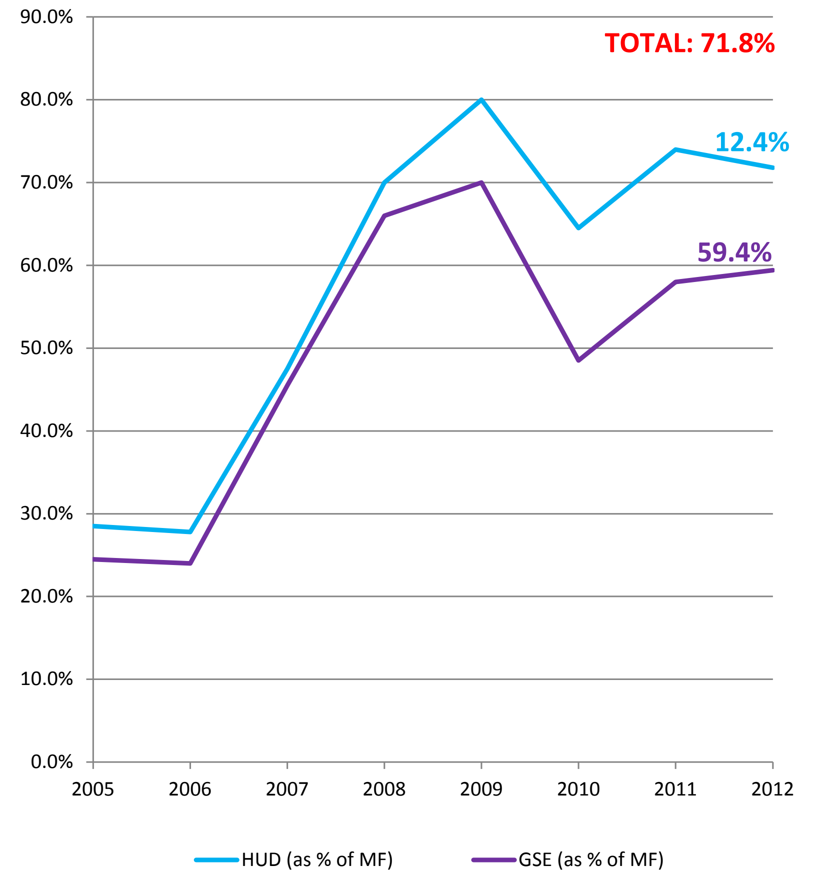
Section 3: Appendix

US Housing

Single Family & Multifamily Markets Dominated by Government



Source: Invesco presentation to Bipartisan Policy Center Housing Comissiong Forum



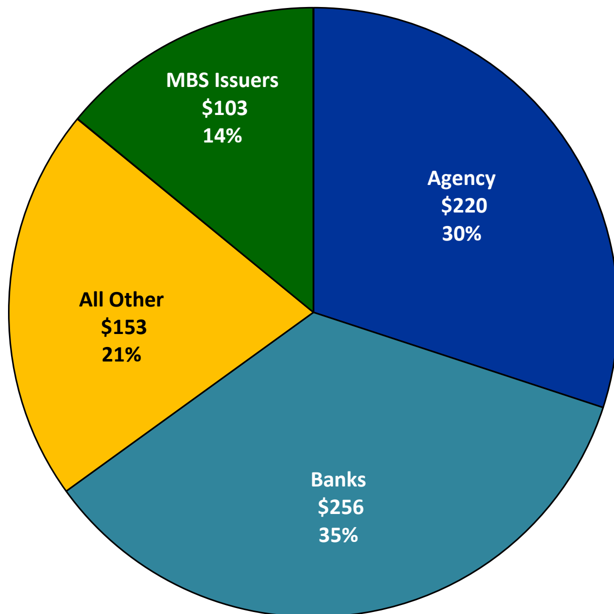
Source: Invesco presentation to Bipartisan Policy Center Housing Comissiong Forum

Multifamily Market

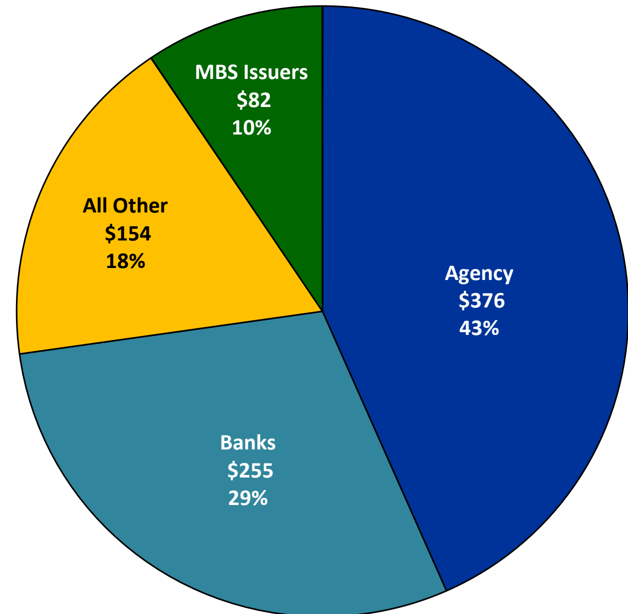
Growing Slowly (19%), but Agency is Growing Rapidly (71%) Since Start of Crisis

Multifamily

(in billions)



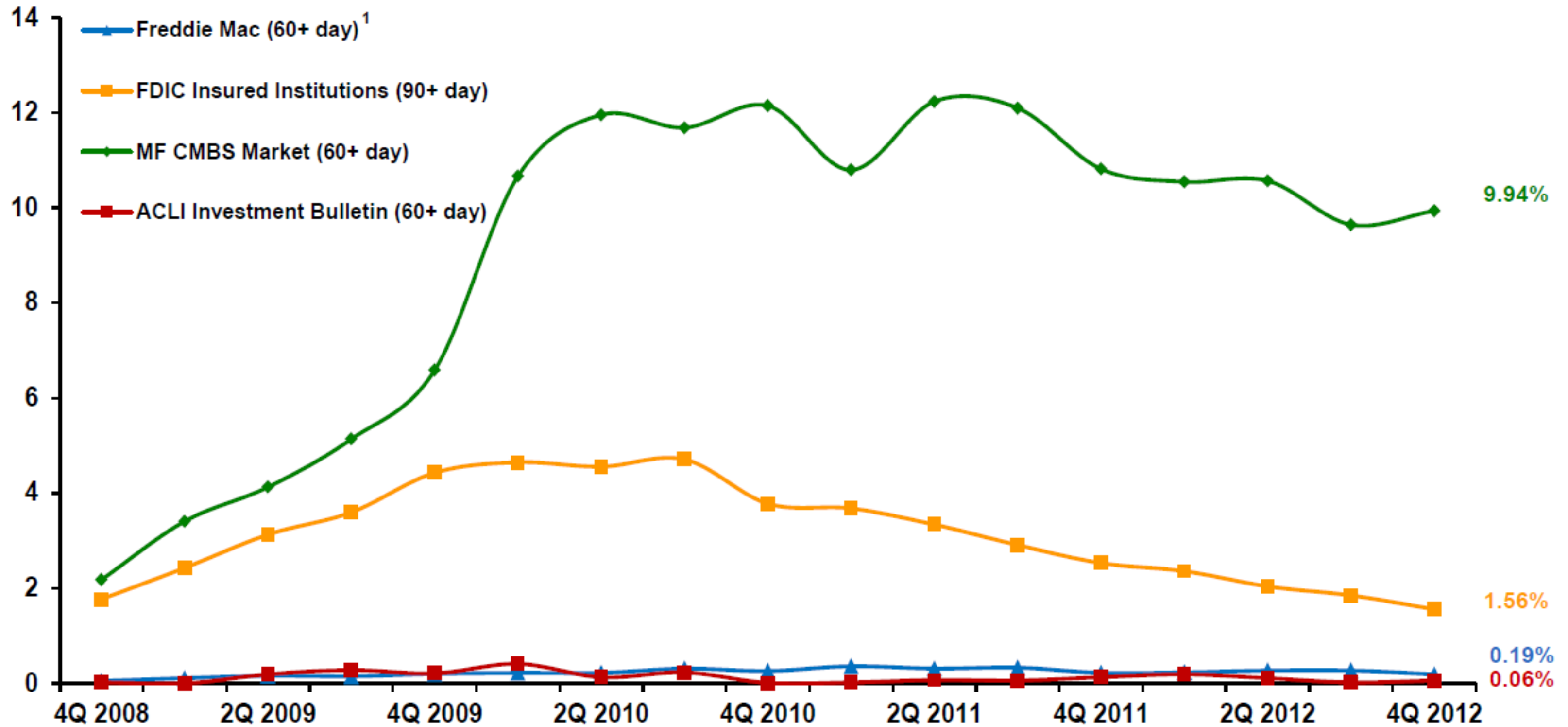
$731 Billion
as of December 31, 2006



$866 Billion
as of December 31, 2012

Source: Federal Reserve, Level Tables

Multifamily Market and Freddie Mac Delinquency Rates



[1] See "MD&A – RISK MANAGEMENT – Credit Risk – *Mortgage Credit Risk – Multifamily Mortgage Credit Risk*" in Freddie Mac's Form 10-K for the year ended December 31, 2012, for information about the company's reported multifamily delinquency rate. The multifamily delinquency rate at March 31, 2013 was 0.16%.

Source: Freddie Mac, FDIC Quarterly Banking Profile, TREPP (CMBS multifamily 60+ delinquency rate, excluding REOs), American Council of Life Insurers (ACLI). Non-Freddie Mac data is not yet available for the first quarter of 2013.

Data available on quarterly basis.

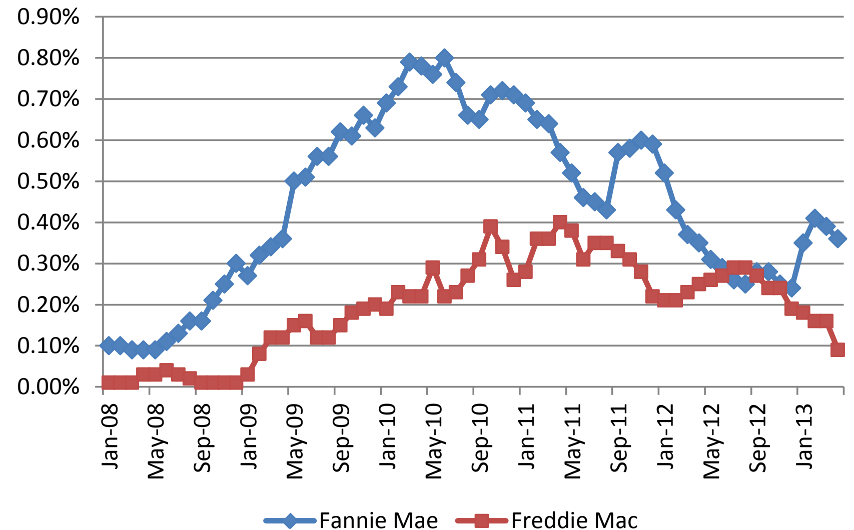
http://www.freddiemac.com/investors/er/pdf/supplement_1q13.pdf

Fannie Mae: Monthly Summary – Delinquency

TABLE 9. SERIOUS DELINQUENCY RATES

	Conventional Single-Family [8]			Multifamily
	Non-Credit Enhanced	Credit Enhanced	Total	Total [9]
April 2012	2.91%	8.17%	3.63%	0.35%
May 2012	2.87%	7.99%	3.57%	0.31%
June 2012	2.86%	7.88%	3.53%	0.29%
July 2012	2.84%	7.76%	3.50%	0.26%
August 2012	2.80%	7.56%	3.44%	0.25%
September 2012	2.77%	7.47%	3.41%	0.28%
October 2012	2.73%	7.31%	3.35%	0.28%
November 2012	2.70%	7.12%	3.30%	0.25%
December 2012	2.70%	7.09%	3.29%	0.24%
January 2013	2.60%	6.90%	3.18%	0.35%
February 2013	2.57%	6.71%	3.13%	0.41%
March 2013	2.49%	6.43%	3.02%	0.39%
April 2013	2.42%	6.17%	2.93%	0.36%

(9) Calculated based on the UPB of seriously delinquent multifamily loans owned by Fannie Mae or underlying Fannie Mae guaranteed securities, divided by the UPB of multifamily loans owned by Fannie Mae or underlying Fannie Mae guaranteed securities.



Source: Fannie Mae; Freddie Mac

http://www.fanniemae.com/resources/file/ir/pdf/monthly-summary/043013.pdf

Data available on monthly basis.

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Note: Organizational affiliations are for informational purposes only. Views are the authors alone.

Credit is given to the Mortgage Banker's Association and its work in the multifamily finance arena. The authors have liberally used it.

We also want to thank the Center for American Progress Mortgage Finance Working Group and the National Multi Housing Council for informing the views of the solution for multifamily finance.

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