

Multifamily Housing and the Secondary Market:  
Opportunities for Financing Affordable Housing

by  
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## **EXECUTIVE SUMMARY**

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The Federal Home Loan Bank (FHLB) of Seattle is investigating opportunities for improving access to capital for affordable multifamily housing. In support of this objective, this research examines whether access to the secondary market for affordable multifamily loans can benefit the FHLB of Seattle and the communities it serves.

The need for affordable housing in communities across the nation is extensive. Recent data shows that more than 14 million households pay more than 50 percent of their income for rent. At the same time, the available stock of housing with affordable rents is decreasing.<sup>1</sup> Multifamily rental housing is the predominant housing choice for those households who cannot afford homeownership. Further, demographic trends indicate that demand for multifamily housing is increasing among households of all incomes.<sup>2</sup> The problem of housing affordability and the growing demand for multifamily housing require innovative solutions.

In the last twenty years, the housing finance industry has become increasingly complex. The development of the secondary market for mortgage loans has grown from its roots in the Depression, and has been instrumental in providing liquidity in the single-family mortgage market. Yet, the development of the secondary market for multifamily mortgages has been more volatile. Multifamily housing loans involve more complex financing, increased risk factors, and higher dependence on local market conditions than single-family housing loans.<sup>3</sup>

This research examines these issues through investigating current secondary market programs, analyzing market demand for multifamily housing, and interviewing member banks of the FHLB of Seattle.

### ***FINDINGS***

The principal findings are threefold. First, current secondary mortgage market purchase programs are addressing a market need in providing capital for affordable multifamily housing. Further, there is demand for multifamily housing at the national level and in the FHLB of Seattle eight-state region. Lastly, member banks of the FHLB of Seattle are

interested in exploring opportunities to access the secondary market. These findings point to opportunities and barriers that exist in accessing the secondary market for affordable multifamily housing mortgages.

*OPPORTUNITIES*

Access to Capital  
Market Demand  
Strong Loan Performance  
Community Need  
Fee Income  
Customer Base

*BARRIERS*

Lack of Loan Standardization  
Challenge of Loan Pricing  
High Transaction Costs  
Lack of Knowledge  
Limited Loan Volume  
Lack of Credit Rating

These opportunities and barriers provide a framework for crafting solutions to expand access to the secondary market. The three principal strategies for the FHLB of Seattle to consider are: 1) lender education, 2) program development, and 3) investment in affordable multifamily securities. Based on these strategies, the following recommendations are made:

***RECOMMENDATIONS***

- **Engage in innovation.** The increased demand for multifamily housing and the growing need for affordable housing command innovative solutions that can grow from private-public partnerships.
- **Evaluate strategies.** The FHLB of Seattle has a range of options for expanding access to the secondary market for affordable multifamily housing, and each strategy requires further evaluation that addresses the financial complexity of the loan securitization process.
- **Involve stakeholders.** Each stage in the securitization process involves various stakeholders who both manage the transaction and benefit from the outcome. In evaluating the strategic approaches for accessing the secondary market, the involvement of these stakeholders, including developers, lenders and other programs, enriches the analysis.

## TABLE OF CONTENTS

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<b>EXECUTIVE SUMMARY</b>	i
<b>INTRODUCTION</b>	4
<i>PURPOSE</i>	5
<i>METHODOLOGY</i>	5
<i>DEFINITIONS OF TERMS AND CONCEPTS</i>	7
<b>DYNAMICS IN THE AFFORDABLE HOUSING MARKET</b>	10
<i>BRIEF HISTORY OF FEDERAL HOUSING POLICY</i>	10
<i>MULTIFAMILY HOUSING MARKET</i>	12
<i>AFFORDABLE HOUSING NEED</i>	15
<b>HOUSING FINANCE: GROWTH OF THE SECONDARY MARKET</b>	17
<i>DEVELOPMENT OF THE SECONDARY MARKET</i>	17
<i>DEVELOPMENT OF MORTGAGE-BACKED SECURITIES</i>	18
<i>AFFORDABLE MULTIFAMILY HOUSING IN THE SECONDARY MARKET</i>	20
<b>REGULATORY IMPACTS ON AFFORDABLE MULTIFAMILY HOUSING</b>	22
<i>COMMUNITY REINVESTMENT ACT</i>	22
<i>1986 TAX REFORM ACT</i>	24
<b>SECONDARY MORTGAGE MARKET PROGRAMS</b>	26
<i>GOVERNMENT-SPONSORED ENTERPRISES</i>	26
<i>FEDERAL HOME LOAN BANK</i>	28
<i>STATE HOUSING FINANCE AGENCIES</i>	30
<i>NON-PROFIT AND FOR-PROFIT PROGRAMS</i>	31
<b>MARKET ANALYSIS FOR MULTIFAMILY HOUSING</b>	37
<b>PERSPECTIVE FROM MEMBER BANKS</b>	48
<b>DISCUSSION: OPPORTUNITIES AND BARRIERS TO THE SECONDARY MARKET</b>	54
<b>STRATEGIES FOR THE FHLB OF SEATTLE</b>	65
<b>RECOMMENDATIONS</b>	70
<b>REFERENCES</b>	78
<b>APPENDICES</b>	85
<i>A: INTERVIEW PROTOCOL</i>	
<i>B: DEFINITION OF ACRONYMS</i>	

## TABLE OF FIGURES

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<i>Figure 1: Housing Tenure, 1997</i>	13
<i>Figure 2: Secondary Mortgage Market Loan Purchase Volumes, 2001</i>	35
<i>Figure 3: Population Trends in FHLB of Seattle Region</i>	39
<i>Figure 4: Housing Tenure in FHLB of Seattle Region</i>	39
<i>Figure 5: Employment Growth in FHLB of Seattle Region</i>	40
<i>Figure 6: Multifamily Units Authorized by Permit and Housing Starts, 1980 - 2001</i>	41
<i>Figure 7: Multifamily Units Authorized by Permit, Region Data, 1980 - 2000</i>	41
<i>Figure 8: Multifamily Units Authorized by Permit, State Data, 1997 - 2001</i>	42
<i>Figure 9: U.S. Rental Vacancy Rate, 1980 – 2001</i>	43
<i>Figure 10: Rental Vacancy for States in FHLB of Seattle Region</i>	43
<i>Figure 11: Multifamily Mortgage Originations, 1980 - 1997</i>	44
<i>Figure 12: Multifamily Mortgage Debt Outstanding, 1980 - 2000</i>	44
<i>Figure 13: Major Holders of Multifamily Debt , 1980, 1990, 2000</i>	45
<i>Figure 14: Securitized Multifamily Debt Outstanding, 1990 - 2001</i>	46
<i>Figure 15: Tax Credit Allocation in FHLB of Seattle Region</i>	47
<i>Figure 16: Units Developed with LIHTC Program in FHLB of Seattle Region</i>	47
<i>Figure 17: Bank Size by Total Assets</i>	48
<i>Figure 18: Interview Responses from Member Banks</i>	49
<i>Table 1: Resident Characteristics in Three Markets for Multifamily Rental Housing</i>	14
<i>Table 2: Percent of Total LIHTC Tax Credits Allocated by State</i>	47
<i>Table 3: Location of Member Banks Interviewed</i>	48
<i>Table 4: Opportunities and Barriers to the Secondary Market</i>	58
<i>Table 5: Possible Strategies for the FHLB of Seattle</i>	66

## INTRODUCTION

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Housing is both a basic human need and a market commodity.<sup>1</sup> As a necessity, housing should be available to all those in need of shelter. As a commodity, housing is bought and sold in markets impacted by a complex economic and political landscape. This dual nature generates a tension that emerges in debates over housing policy in this nation.

Not surprisingly, federal housing policy has historically fallen between these two extremes as an amalgam that addresses housing both as a necessity and a commodity. Yet, despite efforts to balance this tension, decent housing still remains unaffordable for more than 14 million households in this nation. Increasingly, both government and the private sector are addressing this lack of affordable housing by supporting programs that leverage private capital to develop housing for low-income households.

The Federal Home Loan Bank of Seattle (FHLB) is investigating opportunities to access private capital through the secondary market as a means to increase available funds for affordable multifamily housing. Specifically, the FHLB of Seattle is partnering with Community Reinvestment Fund (CRF), a non-profit organization that supports access to the secondary market for community and economic development by securitizing loans purchased from community financial institutions and lending consortia. Together, the FHLB of Seattle and CRF are researching the formation of an affordable multifamily housing loan pool that is rated by a national credit rating agency and sold to investors in the secondary market.

The securitization of loans, a financing structure that emerged in the 1970s, has increased efficiency in the real estate finance industry. By developing assets that meet the needs of investors, increased private capital is channeled to the housing market. This process encourages competition, providing borrowers both lower credit costs and increased choice in the market. Securitizing loans has also helped to manage risks that are inherent in the mortgage lending and investment industry.<sup>2</sup>

Securitization has become a tool that is widely implemented for single-family, multifamily and commercial real estate mortgages. Yet, the securitization process is not extensively utilized for affordable multifamily mortgages. The FHLB of Seattle is investigating what opportunities might exist to expand access to the secondary market for affordable multifamily housing.

### ***PURPOSE***

The purpose of this research is to investigate whether the securitization of affordable multifamily loans can benefit the FHLB of Seattle and the communities it serves.<sup>3</sup> An overview of affordable housing, including a brief history of federal housing policy, a snapshot of trends in multifamily housing, and a profile of the current need for affordable housing in the United States, provides a context for examining the development of the secondary market and the securitization process.

Building on this background, the research examines current dynamics in financing affordable multifamily housing. There is an overview of programs that provide access to the secondary market for affordable multifamily housing, and a market analysis illustrates the demand for multifamily housing through an analysis of recent data on demographic and employment trends, property data and mortgage data. The perspective of member banks in the FHLB of Seattle region illustrates the level of demand from lenders for access to the secondary market.

The research ends with a discussion of the opportunities and barriers in accessing the secondary market for affordable multifamily housing. This discussion leads to the development of strategies for the FHLB of Seattle to expand access to the secondary market for its member banks, and concludes with final recommendations.

### ***METHODOLOGY***

This research draws on data from a range of sources to provide a broad picture of the multifamily mortgage market. The three primary research methods include a literature review, market analysis of the multifamily housing market, and interviews. The goal of this approach is to merge trends in policy and program development with perspectives on the

implementation of these policies and programs. The literature review and market analysis create a framework for understanding the history of the secondary market and the trends that have impacted the growth of the securitization of mortgage loans. The interviews provide insight on the opportunities for improving access to the secondary market and the barriers that impede increased access.

- **Literature Review:** The purpose of the literature review is to document the evolution of affordable housing policy, outline the trends in multifamily housing, and highlight regulations that have directly impacted the financing of affordable housing in the current policy environment. While extensive research is available on affordable housing policy and multifamily housing finance, few sources investigate the intersection between affordable housing and private market financing. The goal of the literature review is to present the myriad of issues related to multifamily housing and the secondary market as a vehicle for understanding the complex dynamics of affordable housing finance.
- **Market Analysis:** The market analysis uses research and data on the multifamily housing market to highlight trends in the development and financing of multifamily housing. Data sources include the U.S. Census Bureau, U.S. Department of Housing and Urban Development (HUD), Federal Reserve Board, U.S. Bureau of Labor Statistics, National Council of State Housing Agencies and other various reports. The market analysis includes an overview of housing trends at both a national level and for the FHLB of Seattle eight-state region. The purpose of analyzing the demand for multifamily housing is to explore the need for expanding financing options for affordable multifamily housing.
- **Interviews:** Interviews were conducted with representatives from programs that provide access to the secondary market for affordable housing, as well as with member banks of the FHLB of Seattle. These two perspectives are essential for examining the implementation of programs that support access to the secondary market. The interviews were qualitative, using a semi-structured format with open-ended questions. All interviews were conducted by telephone and ranged from ten to fifty minutes in length. The selection of secondary market programs interviewed was gleaned from

research on the programs and contacts provided by the FHLB of Seattle. The selection of member banks interviewed was provided by the FHLB of Seattle. (Appendix A: Interview Protocol, including list of respondents and interview questions).

### ***DEFINITION OF TERMS AND CONCEPTS***

Terms and concepts in the housing industry are often used interchangeably. To address this issue, the following list provides definitions of terms and concepts used in this research. (Appendix B: Definition of Acronyms).

#### *MULTIFAMILY HOUSING/SINGLE-FAMILY HOUSING*

Multifamily housing is rental housing that includes five or more units. Single-family housing is owner-occupied housing with one to four units.

#### *AFFORDABLE HOUSING*

Affordable housing is defined using the standards most often cited in the research and used by most federal housing programs. Affordable housing is housing with rents that are no greater than 30 percent of the area median household income.<sup>4</sup>

#### *LOW-INCOME*

The definition for low-income is the definition used by the U.S. Department of Housing and Urban Development. A low-income household earns 80 percent of the area median income or below.<sup>5</sup>

#### *LIQUIDITY*

Liquidity is most often defined as the extent to which assets can be efficiently converted into cash. More telling definitions portray the level of liquidity “in terms of how much sellers stand to lose if they wish to sell immediately.”<sup>6</sup> The extent of liquidity of an asset can depend on the type of asset, the existing market for the asset and the quantity of the asset that is held.

### *SECONDARY MORTGAGE MARKET*

Real estate mortgages are financed through both primary and secondary mortgage markets. In the primary mortgage market, funds are provided to a borrower by a financial institution, typically a commercial bank, thrift or mortgage bank, to purchase real estate. In the secondary mortgage market, investors purchase those mortgage loans, either whole loans or pools of loans, that have been originated by financial institutions.<sup>7</sup>

Real estate markets are local systems where local financial institutions fund housing development to meet the needs of the community. The secondary market developed from the notion that, while mortgage lending is typically a local activity, mortgage finance should access a national market. In the secondary market, lenders sell loans that they originate to secondary market conduits or directly to investors. This system benefits the local lender by providing increased access to capital, which encourages recycling of capital within the housing finance system.<sup>8</sup>

Prior to the development of the secondary mortgage market, the volume of funds to finance mortgages depended on the capacity of the local market. Local banks provided the majority of mortgage loans, funding loans with the deposits held by the bank. In general, this system was viable and profitable for banking institutions. However, if interest rates were high, banks paid more interest on their deposits than was earned on the mortgages held in portfolio. The development of the secondary market mitigated these issues for local lenders, providing increased liquidity and allowing for increased lending in local communities.<sup>9</sup>

### *SECURITIZATION OF MORTGAGE LOANS*

The process of securitization, which emerged in the 1970s, evolved as an innovative solution to increase capital for mortgage lending. “Securitization can be defined as a process of packaging individual loans and other debt instruments, converting the package into a security or securities, and enhancing their credit status or rating to further their sale to third-party investors.”<sup>10</sup>

The purpose of the securitization process is to provide liquidity to the mortgage market. By pooling loans into securities, individual loans, which can often be difficult to sell, become

liquid assets that are marketable to investors. This structure differs from previous mortgage finance structures. In past, the collateral for mortgages was the general obligation of the issuing institution. In the securitization process, the collateral for the security is the pool of loans. Investors who purchase securities invest in a “share of the assets,” as opposed to the general obligation of the issuers’ debt.<sup>11</sup>

Securitization facilitates the movement of capital from investors to borrowers. The process begins with the loan origination by a financial institution for a borrower. Typically, the loan originator also services the loan by collecting payments and monitoring compliance to the loan terms. Second, the loan is sold to a purchasing entity that packages the loans and issues the security. The purchaser of the loan administers the payments to investors, based on the collection of loan payments from the loan originator or servicer. Generally, the purchaser of the loans is responsible for both pricing the security and marketing the investment to potential investors. The investor purchases the loan, and receives payments based on the loan terms. It is this demand from the investors that drives growth in the securitization of mortgage loans.<sup>12</sup>

This process also involves national credit rating agencies, like Standard and Poor’s, Moody’s, and Fitch. These agencies rate securities in order to provide investors with a benchmark for evaluating investments. These ratings allow investors to forgo some level of due diligence in reviewing the securities or the underlying loans that serve as collateral. Credit rating agencies rate securities based on the risk of default. Securities that receive the highest ratings are defined as investment grade securities, and many investors require this level of rating to invest.<sup>13</sup> In many cases, credit enhancements are required to garner a higher rating and ensure that investor is protected from loss. Credit enhancements can include a letter of credit from the financial institution, an insurance guarantee policy for the loans, or a reserve account to cover cash flows from the loan in the case of default.<sup>14</sup>

## **DYNAMICS IN THE AFFORDABLE HOUSING MARKET**

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### ***BRIEF HISTORY OF FEDERAL HOUSING POLICY***

In the housing market, a tension exists between providing housing for those in need of shelter and allowing the private market to operate based on the economic demand for housing. The history of federal housing policy illustrates the shift between these two objectives. More importantly, changes in federal policy demonstrate why private market tools, like the secondary market, are increasingly favored alternatives to direct government intervention.

Affordable housing policy has evolved into two stages.<sup>1</sup> First, from the Depression until 1973, the federal government promoted the production of housing, primarily through the development of public housing. Since 1973, when Nixon issued a moratorium on all federally subsidized housing, federal policy has advocated both the privatization of affordable housing production and the devolution of federal housing programs to state and local governments.<sup>2</sup>

The Housing Acts of 1937, 1949, and 1968 are federal legislative actions that emphasized housing production. The Housing Act of 1937 initiated the creation of public housing, owned and operated by the federal government. The purpose was to address the lack of affordable housing following the Depression, though only 40,000 units of public housing were constructed.<sup>3</sup> The Housing Act of 1949 mandated a “decent home and suitable living environment for every American family,” and authorized the creation of 810,000 public housing units over six years. Congress refused to appropriate necessary funds, and the objective was never achieved.<sup>4</sup> The Housing Act of 1968 aimed to revive the goals from the 1949 Act. In the 1968 Act, Congress established a goal to develop twenty-six million units of housing in ten years, including six million units constructed for low-income and moderate-income households. Though the Act was successful in implementing several subsidy programs, the accomplishment was fleeting.<sup>5</sup>

Following Nixon’s reelection in 1972, there was a decided shift in affordable housing policy. The Housing Act of 1968 had been successful in boosting housing production, but concerns

were raised that the housing policies implemented were ineffective. Key players in the housing industry, both in the public and private sector, found that current housing programs were too costly, produced poorly constructed units, and ignored the needs of central city communities and low-income households.<sup>6</sup> The political and economic landscape thwarted continued housing production as the cornerstone of federal housing policy.

In reaction to industry concerns, Nixon issued a moratorium of all federally subsidized programs in 1973, representing a complete departure from the intention of the Housing Act of 1968. Housing policy that emphasized the creation of additional housing supply was dropped in favor of policies that focused on housing demand. Three programs have dominated federal housing policy since the moratorium: housing vouchers, block grants, and tax credits.<sup>7</sup>

Housing vouchers, often called rent certificates, emerged in policy debates throughout the 1930s and 1940s. However, momentum for vouchers as an alternative to public housing did not surge until the 1970s. Vouchers, which have taken many names and forms over the years, allow low-income renters to choose housing options within the private market, based on criteria established by the program. Renters pay a fixed percent of their income to rent, and government pays the difference between the rent paid and a fair market rent, which is established by the federal government. Vouchers are considered an effective policy tool because they provide mobility and choice to low-income renters. Further, vouchers are often praised simply because they are not a production program, which have often been characterized by “the weighty baggage of blighting projects, excessive costs, social pathologies, bureaucratic bungling and outright scandal.”<sup>8</sup>

The block grant programs illustrate the continued devolution of housing programs to state and local governments. Block grant programs provide a funding mechanism that recognizes the inherent local nature of housing markets. The Community Development Block Grant (CDBG) program was enacted in 1974 and proved effective in allowing local communities more autonomy in funding decisions. The program, however, limited monies to housing rehabilitation, providing no funds for new construction. In 1990, the HOME Investment Partnerships program was created as a block grant that specifically focused on new housing

development. These programs effectively restored local control over the provision of affordable housing.<sup>9</sup>

Tax law has significant impact on housing markets, with developers, homeowners and investors benefiting from various tax regulations. In the 1980s, tax reform by Congress became a vehicle to “balance” housing production. In 1981, Congress reduced the depreciation schedules for multifamily construction, stimulating increased investment and construction. Multifamily housing construction nearly doubled by 1985, creating housing surpluses in many markets.<sup>10</sup>

In 1986, the Tax Reform Act balanced this surge in development by reversing the previous depreciation schedules, causing substantial reduction in construction and investment. To address the impact of this change on affordable housing, the 1986 Act provided tax incentives for investment in low-income and moderate-income multifamily housing production. The Low-Income Housing Tax Credit program (LIHTC) provides investors who contribute equity for the development of affordable housing with tax credits. Currently, this program is the primary financing tool for the development of affordable housing.<sup>11</sup>

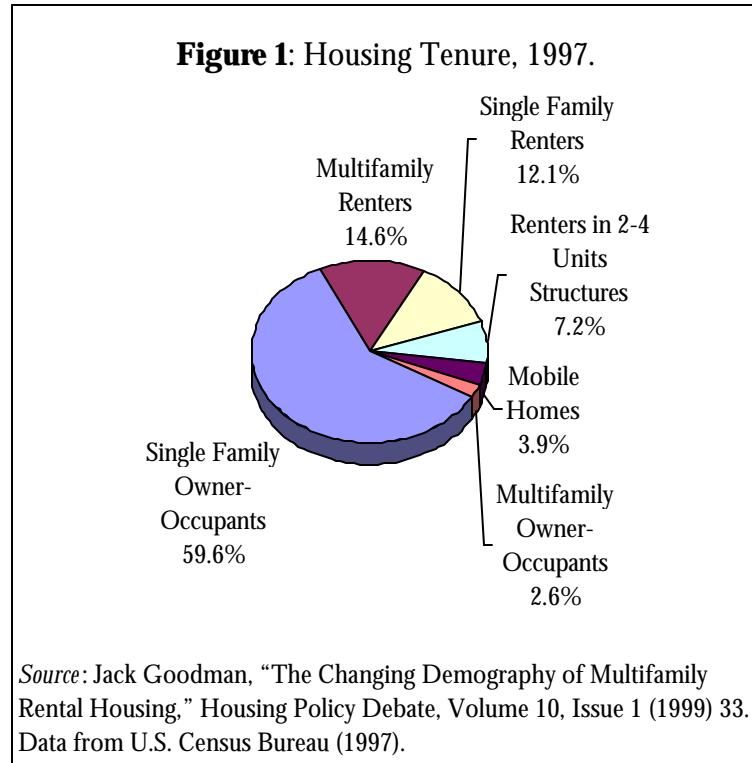
This overview of federal housing policy provides an important context. Current policy emphasizes programs that capitalize on demand for affordable housing and illustrate the devolution of housing programs to state and local governments. These trends are expected to continue, and highlight the importance of public and private partnerships to meet the needs of local markets, particularly for affordable multifamily housing.

### ***MULTIFAMILY HOUSING MARKET***

To assess how housing policy trends relate to affordable multifamily housing, it is important to define the market and its residents. Most available data describes housing markets by comparing homeowners and renters. For the purpose of defining the multifamily market, this comparison neglects the differences between those who own and those who rent multifamily housing. Recent research addresses this distinction, and provides a detailed analysis of the dynamics of the multifamily rental market.<sup>12</sup>

Historically, in a nation where homeownership represents the American dream, multifamily housing has been a small segment of the overall housing market. In 1997, 15 percent of all households rented in multifamily housing, while the rate for homeownership was more than 60 percent.<sup>13</sup> [Figure 1]

Although multifamily housing represents a significantly smaller segment of the housing market, nearly 50 percent of households in multifamily rental housing spend more than 30 percent of their household income for rent.<sup>14</sup> Therefore, multifamily housing is the primary housing choice for many low-income households.



Though a large percentage of low-income households live in multifamily housing, renters of multifamily housing represent a broad cross-section of the general population. Recent research characterized the multifamily rental housing market in three subgroups: "affordable housing market, middle market, and lifestyle market."<sup>15</sup> These definitions are useful for investigating trends in the multifamily housing market. The affordable market is defined as renters who spend more than 30 percent of their income to rent.<sup>16</sup> The lifestyle market is the segment of renters who rent by choice, usually desiring luxury amenities and earning higher incomes. The middle market includes the substantial number of renters who fall between the two markets.

While the data used to highlight the characteristics of these renter categories is somewhat dated, the analysis illustrates the nature of the multifamily housing market, particularly the affordable market (Table 1). Renters in the affordable market are generally older and are

more likely to have children in the household. They represent a more diverse population with a slightly higher percent of non-white or Hispanic residents. The average income of a renter in the affordable market is less than a quarter of the income of a renter in the lifestyle market.

<b>TABLE 1: Resident Characteristics in Three Markets for Multifamily Rental Housing</b>					
	Affordable Market		Middle Market	Lifestyle Market	All Apartment Households
	Total	Federally Assisted			
Percent of all multifamily rental households	49	19	37	14	100
Age of householder					
Median	41	44	33	38	37
Mean	47	49	38	42	43
% < 30	26	21	39	20	30
% > 65	23	31	8	10	16
Household Size					
Mean	2.1	2.3	2.2	1.4	2
% 1 person	50	43	31	65	46
% 4+ persons	17	19	14	0	5
% with 1+ children	35	50	31	0	29
Household Income (\$)					
Mean	11,795	10,944	42,752	62,382	29,603
Median	10,444	7,608	32,100	48,928	21,000
Race (%)					
White	66.7	59.1	74.2	79.7	72.7
African American	26.8	34.8	18.8	11.9	20.6
Other	6.5	6.1	7	8.4	6.7
Hispanic Origin (%)	23	14.6	11.4	8.1	14.9
Moved in the past year?					
% yes	30.1	21.8	38.7	31.3	33.4
U.S. resident less than 10 years?					
% yes	10.2	NA	8.6	6.9	8.9
<i>Source:</i> Jack Goodman, "The Changing Demography of Multifamily Rental Housing," Housing Policy Debate, Volume 10, Issue 1 (1999) 40.					

Nineteen percent of renters in the affordable market are utilizing federal assistance, either through public housing, the Section 8 program or other subsidized housing programs.<sup>17</sup> This figure does not include state and local housing assistance, such as the low-income housing tax credit program, but indicates that the role of federally assisted housing in the

multifamily housing market is significant. When compared with all households in the affordable market, renters who are assisted by federal programs are older and are more likely to have children. They have a slightly higher percentage of non-white residents. Further, renters receiving federal assistance are less mobile than other renters in the multifamily housing market. This lack of mobility is attributed to conditions of federal assistance that tie subsidies to specific locations.

Renters in the lifestyle market are typically single adults or married couples that do not have children, are established in their careers, and earn incomes that would allow them to purchase a home. In general, those in the lifestyle market rent based on personal choice rather than financial need. This market represents 14 percent of the total multifamily market, and has a higher percentage of smaller households and of white residents when compared to other renter categories.<sup>18</sup>

The middle market represents renters who are not included either in the affordable or lifestyle market. Renters in the middle market are younger and are more mobile than renters in the affordable or lifestyle markets. This market includes younger adults who are students or transitioning between jobs, single women who choose to live alone and families with children. Overall, the characteristics of this market fall between the affordable and lifestyle market.

The multifamily rental housing market is the housing choice for a diverse population in this nation. Yet, this analysis illustrates how important the multifamily market is for providing affordable housing. In many ways, defining this market “affordable” is deceiving due to the growing number of households who are still unable to afford decent housing.

### ***AFFORDABLE HOUSING NEEDS***

The lack of affordable housing is a challenge for a significant number of households in this nation, and these households face two substantial problems in securing affordable housing. First, low-income households face “severe cost burdens” in the housing market. Recent research indicates that more than two-thirds of low-income households who earn below 50 percent of the median income are paying more than 50 percent of their income to housing.

This group includes a disproportionately large share of minority, single-parent, and elderly households.<sup>19</sup>

Second, the housing stock available to low-income households is decreasing. The gap for unsubsidized housing affordable to low-income households is more than 3 million units, and the problem is apparent in central cities, suburbs, and non-metropolitan areas. As employment and population move from the central city to the suburbs, low-wage workers in need of housing near their employment face a deficit of more than one million affordable housing units in suburban communities. As rents continued to rise, the pressure on low-income households increases.<sup>20</sup>

For those low-income households that receive assistance through various federal programs, the outlook is similarly bleak. Though significant rehabilitation is occurring in many public housing communities, the number of available units has decreased. Many of the federal contracts for project-based affordable housing have been subject to renewal in the past several years. Owners of these units are choosing not to renew contracts and are increasing rents. Though the federal government has allocated more funding to increase the number of housing vouchers available, the demand for vouchers continues to significantly exceed supply. Further, renters often have difficulty using the vouchers because of the lack of units available that meet program requirements or because landlords are willing to accept housing vouchers.

For those in need of affordable housing, these trends represent significant barriers. When combined with changes in federal policy and the reliance of low-income households on multifamily housing, the question turns to solutions that can mitigate the growing affordability gap.

## **HOUSING FINANCE: GROWTH OF THE SECONDARY MARKET**

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To address the problem of housing affordability, it is critical to understand how affordable housing is financed. While a wide range of financing options exist, the secondary market has evolved into an effective tool for increasing capital available for housing. More importantly, the development of the secondary market and finance structures, like mortgage-backed securities, has altered how housing is financed. The true question is whether the affordable housing market can benefit from these changes.

### ***DEVELOPMENT OF THE SECONDARY MARKET***

During the Depression, the federal government became directly involved in the mortgage market for both single-family and multifamily mortgages to address significant losses in the mortgage lending. In 1933, nearly 50 percent of all national mortgage debt was in default, initiating significant government intervention.<sup>1</sup> The federal government created two agencies charged with distinct objectives to address the mortgage crisis.

In 1934, the Federal Housing Administration (FHA) introduced a mortgage insurance program for single-family loans and multifamily loans. Through this program, the FHA guaranteed mortgage loans for banking institutions, provided the loans met specific guidelines established by the agency. By guaranteeing loans, FHA program significantly reduced the risk associated with mortgage lending for financial institutions and restored confidence in the housing finance industry.<sup>2</sup>

In 1938, the Federal National Mortgage Association (FNMA), better known as Fannie Mae, was established with the explicit purpose of developing a secondary market for home mortgage loans. Originally, Congress intended that the secondary mortgage market would develop in the private sector, following the increased standardization of loans by the FHA. However, given the economic climate, no private sector enterprises took the initiative and Fannie Mae had to take the lead in facilitating the secondary market for mortgage loans.<sup>3</sup>

In the 1960s, as the baby boom generation began to move into the housing market, there was an increased demand for larger rental properties that required larger debt financing. To address this need, private financial institutions began selling individual multifamily loans to

large institutional investors, like insurance companies.<sup>4</sup> In reaction, several functions of Fannie Mae were transferred to other government agencies and, in 1968, though still a federally chartered entity, Fannie Mae became a private corporation. The charter specified that Fannie Mae focus solely on the facilitation of a secondary market for mortgage loans, emphasizing conventional loans.<sup>5</sup>

In 1970, the Federal Home Loan Mortgage Corporation (FHLMC), better known as Freddie Mac, was created. Similar to Fannie Mae, Freddie Mac is a federally chartered, private corporation. Specifically, Freddie Mac was chartered to purchase loans from thrifts. However, as the thrift industry declined, this focus shifted, and Freddie Mac now competes with Fannie Mae to buy and sell conventional loans.<sup>6</sup>

The role of these government-sponsored enterprises (GSE) in the development of the secondary market is significant. The economic justification for the large role that the GSEs play in the secondary market is that private individual institutions have no financial incentive to support the standardization and flow of information that is necessary for efficient movement of capital. “Although the overall market reaps substantial benefits from industry standards and information, no individual firm may have sufficient incentive to produce those standards and information if its production is costly and outweighs the benefits to the individual firm.”<sup>7</sup> Fannie Mae and Freddie Mac, as government-sponsored enterprises, support government intervention in the market to ensure that standards and information are available.

To date, Fannie Mae and Freddie Mac are credited with expanding the opportunities and increasing liquidity for primary lending institutions. Overall, this liquidity has encouraged efficiency in the mortgage market for both single-family and, to a lesser extent, multifamily housing loans.<sup>8</sup>

### ***DEVELOPMENT OF MORTGAGE-BACKED SECURITIES***

In 1968, the Government National Mortgage Association (GNMA), better known as Ginnie Mae, was created to assume responsibilities that had once been undertaken by Fannie Mae. Specifically, Ginnie Mae was charged with facilitating a secondary market for government-

insured loans.<sup>9</sup> In 1968, Ginnie Mae issued the first single-family FHA security, and in 1970, the first FHA multifamily loan pools. Though Ginnie Mae never dominated the market, it was the first example of a mortgage-backed security (MBS) for multifamily housing. Fannie Mae and Freddie Mac followed, issuing single-family securities and multifamily securities backed by FHA loans in 1970.<sup>10</sup>

In the 1980s, private financial institutions started to participate in the secondary market for multifamily housing. The first company to issue a private MBS backed by a commercial mortgage was Penn Mutual. The mortgage was not for rental housing, but it paved the way for the development of a rating system by Standard and Poor's for commercial MBS that were backed by office buildings and rental housing. Other rating agencies followed suit, developing rating systems for multifamily securities.<sup>11</sup>

The next step in the development of the secondary mortgage market was the creation of derivative products. In 1987, the first collateralized mortgage obligation (CMO) was issued. Cash flows were divided based on differing levels of maturity of the investment, allowing for the allocation of credit risk. By the 1990s, additional products had been developed to divide securities and sell them according to investor requirements.

The development of the securitization of multifamily mortgage loans was propelled by the market demand. Key players who facilitated the securitization process benefited from transaction fees. At the same time, the securitization process improved the efficiency of the multifamily mortgage market, providing increased liquidity and reduced credit risk.<sup>12</sup>

While the benefits gleaned from the secondary market drove increased investment, the evolution of the securitization process also experienced financial obstacles. In the 1980s, the downturns in the economic and real estate markets resulted in significant losses for both Fannie Mae and Freddie Mac. The experience of these two government-sponsored enterprises (GSE) highlights the potential risks in the development of the secondary market for multifamily housing.

### ***AFFORDABLE MULTIFAMILY HOUSING IN THE SECONDARY MARKET***

While Fannie Mae and Freddie Mac have a substantial role in the market for single-family mortgages, their role in multifamily housing has been nominal. In 1996, multifamily transactions represented approximately 3.2 percent of the total combined transactions for the GSEs.<sup>13</sup> Yet, despite this limited role, the GSEs have led the industry in providing access to the secondary market for affordable multifamily mortgages.

Though both GSEs are private corporations, they benefit from their association with the federal government. Specifically, they are not required to register with the Securities and Exchange Commission, are exempt from state and local taxes, and can request the U.S. Department of Treasury to purchase up to \$2.25 billion in securities to increase liquidity.<sup>14</sup> While these benefits have served both GSEs in developing strong market share, recent issues in financial accounting and auditing have spurred legislation in Congress that would require Fannie Mae and Freddie Mac to register with the Securities and Exchange Commission.<sup>15</sup>

Despite this potential change, the GSEs benefit from the perception that the federal government would support the institutions if they faced financial problems. As a balance to these advantages, the GSEs are mandated by Congress to support affordable housing. In 1995, the U.S. Department of Housing and Urban Development established rules to regulate the level of participation by both GSEs in the affordable housing market. From 2001 to 2003, a minimum of 50 percent of all units financed by the GSEs mortgage purchases are required to be for households earning no greater than the area median income as established by HUD.<sup>16</sup>

Given this significant charge to finance affordable housing, it is important to highlight the challenges that GSEs have experienced in the secondary market, particularly during the 1980s and early 1990s. The real estate recession that followed the 1986 Tax Reform Act substantially impacted the GSEs. The underwriting standards that were implemented by the GSEs for multifamily mortgages were considered too lenient given the economic conditions that followed the recession.<sup>17</sup> The experiences of the GSEs in the multifamily market increased the perception of the risk associated with multifamily lending.<sup>18</sup>

In 1990, 39 percent of Fannie Mae's total multifamily portfolio was considered "at risk" due to a lack of recourse to the lender or FHA insurance. At the same time, Freddie Mac had 88 percent of their multifamily portfolio in a cash mortgage purchase program that had neither recourse nor credit enhancement. Again, these loans were considered "at risk" because the GSEs faced significant loss in the case of default.<sup>19</sup> In 1988, Fannie Mae's delinquency rate peaked at 6 percent, and Freddie Mac's delinquency rate peaked at 3.8 percent in 1990.<sup>20</sup> At that time, while Freddie Mac had only 3 percent of holdings in multifamily mortgages, approximately 50 percent of its losses were in the multifamily market.<sup>21</sup>

In 1992, a study of multifamily rental housing highlighted four elements that must exist for growth to occur in the secondary market for affordable multifamily housing. Like the single-family mortgage market, multifamily mortgage loans need increased standardization. Second, improved credit quality is required, particularly for underwriting and credit enhancements. Third, investors need further education about the structures and risks associated with multifamily mortgage lending. Lastly, improved data collection is needed to analyze the performance and potential risk in multifamily lending and investment.<sup>22</sup>

The combination of the challenges that the GSEs have experienced and the barriers that still exist in the efficiency of the secondary market underscore the obstacles that inhibit expansion of the secondary market for affordable housing. While recent changes have addressed some of these concerns, there is still evidence that a lack of standardization and a lack of information are primary constraints in the market.<sup>23</sup>

## **REGULATORY IMPACTS ON AFFORDABLE MULTIFAMILY HOUSING**

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Several legislative actions have clearly impacted affordable housing and multifamily housing finance. In 1977, Congress passed the Community Reinvestment Act to address unfair lending in the housing finance industry. The legislation requires banks to invest in communities in which deposits are received, and mandates that lending activities be monitored to ensure compliance. In 1986, as part of the Tax Reform Act, the Low-Income Housing Tax Credit (LIHTC) was created, providing tax incentives for investors to provide equity financing for affordable housing.

Both these legislative measures regulate the multifamily housing market, and provide either requirements or incentives for increasing capital to affordable housing. The regulations are considerable factors in the growth of the secondary market, and impact how each industry player participates in the market.

### ***COMMUNITY REINVESTMENT ACT***

Passed in 1977, the Community Reinvestment Act (CRA) mandates all federally insured depository institutions to support the credit needs of the communities where deposits are received. The purpose is to ensure fair lending by financial institutions after practices of “redlining” considerably reduced lending in low-income and minority communities. When first implemented, CRA provided little direction on how to monitor compliance of financial institutions and afforded little enforcement capability to regulators. The performance measure was based on strategic plans outlined by financial institutions, and the only enforcement option for regulators was to deny applications for mergers for lack of compliance.<sup>1</sup>

In the 1980s and 1990s, CRA was amended to improved accountability standards for financial institutions. In 1989, the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) required public disclosure of the CRA evaluation and performance of each financial institution. Further, the Federal Reserve Board strengthened its position on enforcement of CRA. In 1995, regulators turned the focus of CRA evaluations to assessing actual performance rather than assessing strategic plans that institutions had developed for addressing CRA. Lastly, in 1999, regulations were added that

require financial institutions to have a “satisfactory” CRA rating prior to initiating the expansion of the institution’s financial activities, a significant mandate at a time when mergers in the financial industry were increasing.<sup>2</sup> These changes increased the accountability standards for financial institutions in meeting the goals of CRA.

The CRA regulations outline three performance tests to ensure compliance: lending, investment and services tests. The lending test examines a financial institution’s performance based on its record of “meeting the credit needs of its assessment area through its lending activities.”<sup>3</sup> The investment test evaluates performance based on “meeting credit needs through qualified investments.” Qualified investments are based on the following performance criteria: “dollar amount of qualified investments, innovativeness or complexity of qualified investments, responsiveness of qualified investments to credit and community development needs, and the degree to which the qualified investments are not routinely provided by private investors.”<sup>4</sup> Lastly, the service test evaluates a financial institution’s performance by investigating the “availability and effectiveness of a bank’s system for delivering retail banking services and the extent and innovativeness of its community development services.”<sup>5</sup>

This overview, while it simplifies the complexity of the CRA regulations, highlights the role that CRA plays in promoting investment in low-income communities. Financial institutions are held to standards to ensure that the credit needs of communities are served. The secondary market serves as a vehicle for financial institutions to meet CRA regulations, either through increased origination of loans that meet CRA or through investing in securities that are composed of affordable multifamily loans. The extent to which this outcome is possible depends on whether the origination or investment meets the performance tests outlined in CRA.

Conversely, it is important to note that recent research indicates that the development of the secondary market may reduce the effectiveness of CRA. The development of the secondary market, as well as other changes in the mortgage industry, has increased the gap between the location of the origination of loans and receipt of deposits. This shift potentially reduces the

impact of CRA and the investment by financial institutions in low-income and minority neighborhoods.<sup>6</sup>

### ***TAX REFORM ACT OF 1986: LOW INCOME HOUSING TAX CREDIT (LIHTC)***

The Low-Income Housing Tax Credit (LIHTC) program is the primary housing production program that the federal government currently funds. Understanding the program is central in investigating increased access to the secondary market for affordable housing because a significant portion of affordable housing incorporates this financing tool. Started in 1986, the program has been successful in the development of affordable, multifamily housing across the country. While the structure of the LIHTC is complex, the general concept is straightforward. Federal tax credits are provided for investors who are willing to provide equity for the development of affordable housing.

Primarily, the program is implemented by the state housing finance authorities. The role of these organizations is to review development proposals, monitor progress of the development and ensure compliance with federal program regulations.<sup>7</sup> As of 2002, each state receives \$1.75 per capita for the development of affordable housing with a minimum allocation of \$2 million.<sup>8</sup> Overall, the program has been effective in creating new units of affordable housing. Although, the exact number of new units provided is debated with estimates ranging from 500,000 to 900,000 units during the first ten years.<sup>9</sup> The program is praised for providing the flexibility to states and localities to provide various types of housing that serve diverse populations.<sup>10</sup>

Conversely, the program is criticized for being expensive and for providing subsidies to investors beyond what is necessary to finance the development.<sup>11</sup> After ten years, it was found that “while the tax credit program has become more efficient over time, with more of every federal tax credit dollar going to build housing, the overall program design can be expensive in terms of the total amount of subsidy required.”<sup>12</sup> In an analysis of 2,554 LIHTC developments, 68 percent of the total development costs were from government and private sources, with 66 percent of the costs from the available tax credits. Further, though most projects are financially sound, 16 percent of the developments had operating expenses that exceeded revenue.<sup>13</sup>

To examine how LIHTC may impact expansion of the secondary market for affordable housing, it is important to understand who the players in the industry are. Again, in the sample of 2,554 properties, approximately 40 percent of lenders were private banks. State governments provided 26 percent of the first mortgages, with local governments providing 19 percent and non-profits providing 9 percent.<sup>14</sup> Little data is available about the type of investors that participates in the tax-credit program. From 1986 to 1993, it is believed that the majority of tax credits were sold by brokers to individual investors. After 1993, when Congress made the program permanent, more corporate investors participated in the program, which is attributed to increase knowledge of the program and decreased perception of risk associated with investment in the program.<sup>15</sup>

As the primary vehicle for developing affordable housing, it is expected that any security composed of affordable multifamily loans will include loans supported by tax credits. Therefore, understanding the dynamics of this program proves crucial for examining the viability of affordable multifamily mortgages in the secondary market.

## **SECONDARY MORTGAGE MARKET PROGRAMS**

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Since the 1970s, the process of securitization has developed into a fundamental mechanism for financing the mortgage market, both single-family and multifamily mortgages. Yet, due to barriers in market efficiency, securitization and access to the secondary market have been limited for affordable housing mortgages. At the same time, the reduction in federal programs that address the need for affordable housing has fueled an increased demand for alternatives to financing for affordable housing.

The divergence between availability and need for financing has created an opportunity for new programs to expand access to the secondary market for affordable housing mortgages. While the GSEs still dominate the multifamily market, several new programs have been flourishing to meet the financing needs that have been underserved by the GSEs. These programs have developed as a vehicle for meeting the need of community and financial institutions in the regions that they serve.

Each program has developed to meet a unique segment of the affordable housing market that has been previously underserved. An overview of each program, as well as a discussion of issues impacting active participation in the secondary market, is informed by interviews with program representatives.

### ***GOVERNMENT-SPONSORED ENTERPRISES***

#### *FANNIE MAE*

In 1932, Fannie Mae was charged with developing a secondary market for mortgages. To that end, Fannie Mae has succeeded in providing a wide range of products and services for lenders, as well as promoting investment opportunities in the mortgage market. While Fannie Mae cannot directly finance the development of housing, it has created several programs that meet the needs of lenders who finance both market rate and affordable multifamily housing. Currently, Fannie Mae maintains a portfolio of more than \$82 billion.<sup>1</sup>

The largest multifamily program that Fannie Mae manages is the Delegated Underwriting and Servicing program (DUS), which supports both market rate and affordable housing. There are 26 approved lenders who are involved in the program, who have agreed to

originate multifamily loans to sell to Fannie Mae. Approved lenders share the risk of loss on a loan with Fannie Mae, and Fannie Mae enables lenders to originate, underwrite and service mortgages. Fannie Mae agrees to purchase these loans without extensive review if the loan meets established underwriting criteria.<sup>2</sup>

In addition to DUS, Fannie Mae provides several smaller programs, including a multifamily conduit, a program for smaller multifamily loans, and a program where lenders exchange multifamily loans for Fannie Mae mortgage-backed securities. Through its multifamily conduit, the Aggregation Facility, Fannie Mae purchases multifamily loans, non-recourse, for cash. To target smaller loans, the 3MaxExpress program was developed to purchase loans that are less than \$3 million. The underwriting process is streamlined, reducing transaction costs for the borrower. Lastly, Fannie Mae provides structured transactions, where lenders can sell multifamily loans in exchange for Fannie Mae guarantee MBS, providing lenders the opportunity to originate whole loans while holding diversified securities for investment.<sup>3</sup>

#### *FREDDIE MAC*

Like Fannie Mae, Freddie Mac has a history in facilitating secondary market for mortgages. The programs that Freddie Mac has established are similar to Fannie Mae in that they have developed a network of approved lenders, known as Program Plus®. Through its Program Plus lenders, Freddie Mac provides both conventional mortgage purchases, as well as programs that meet affordable housing needs.<sup>4</sup> Currently, there are 35 lenders in the Program Plus® program, and Freddie Mac finds that there is more interest from lenders than the program is able to support.

Again, like Fannie Mae, Freddie Mac has developed smaller programs to meet specific financing needs. Through its negotiated transactions and senior housing programs, Freddie Mac purchases loans from approved lenders. Freddie Mac retains the majority of the mortgage loans in its portfolio, securitizing a smaller portion of those purchases for sale to investors. Freddie Mac has the capacity to hold loans in its portfolio, and finds that multifamily business is profitable and supports the mission of the agency.<sup>5</sup>

One principal barrier that Freddie Mac experiences in creating access to the secondary market is the lack of knowledge that many lenders and borrowers have about capital markets. Selling loans in the secondary market requires a level of “sophistication” that often exceeds the capacity of lending institutions and its borrowers. Lenders need to construct deals that will be financially feasible in the secondary market, and often the constraints are too complex to easily negotiate. Further, affordable housing loans often include significant regulatory requirements, adding time and cost constraints to the efficient movement of capital.<sup>6</sup>

Overall, the majority of the business that Freddie Mac does in the secondary market provides financing for low and moderate-income households.<sup>7</sup> Through its ability to provide competitive pricing, its Program Plus® network capitalizes on the dominant role that Freddie Mac plays in the secondary market for affordable housing mortgage loans.

### ***FEDERAL HOME LOAN BANK SYSTEM***

The Federal Home Loan Bank system was created in 1932 as a vehicle for enhancing the credit needs of financial institutions that, in turn, support financing for mortgages. Since 1989 with the enactment of FIRREA, the FHLBank system expanded its mission to incorporate affordable housing and community development lending. The system includes twelve banks that serve different regions across the nation, each operating independently to meet credit needs in local communities.<sup>8</sup>

#### *FEDERAL HOME LOAN BANK OF ATLANTA (FHLBA)*

In 1997, FHLBA created a program to increase the stock of multifamily rental housing in its region. The Affordable Multifamily Participation Program (AMPP) is a partnership between the FHLBA and regional lending consortia. The goal of the program is to provide liquidity to consortia lenders in order to increase funds that the consortia can recycle in communities for new development.

FHLBA started this program with the Community Investment Corporation of North Carolina (CICNC). In 2000, FHLBA purchased \$2.9 million in loan participation from the 35 members of the consortia. Through the program, FHLBA purchases a maximum of an

80 percent participation in the multifamily loan, while the local bank maintains the servicing of the loan. FHLBA has found that more than half of the consortia members reinvested more funds back to CICNC than were originally sold to the FHLBA. This outcome is the goal of the AMPP program. The purpose is to have the purchase of multifamily loans by the FHLBA spur reinvestment by the consortia to the communities that need multifamily housing development. The success in working with CICNC encouraged three additional partnerships with the Alabama Multifamily Loan Consortium, the Georgia Affordable Housing Corporation, and the Neighborhood Lending Partners based in Tampa, Florida.<sup>9</sup>

The AMPP aims to meet needs that have been underserved in the past. For example, the Georgia Affordable Housing Corporation (GAHC) is a non-profit consortium of 36 banks that targets rural communities throughout Georgia. Historically, urban communities have had access to funding that rural communities struggled to tap. In 1998, the GAHC planned to buy participation in housing developments across the state, and the FHLBA will then purchase 75 percent of those participations. Again, this process provides the GAHC with additional funding to reinvest back into Georgia communities.<sup>10</sup>

For the FHLBA, the primary challenge with the AMPP was merely initiating a new program. It was the first program of its kind in the FHLBanks system, and FHLBA worked extensively with regulators to provide a product that would meet the needs of the community, as well as maintain the mission of FHLBA. In addressing concerns about AMPP, FHLBA emphasizes the partnership that occurs between the consortia and FHLBA. The limit on the FHLBA to purchase only an 80 percent participation interest helps to ensure a strong partnership between FHLBA and the lender for the long-term viability of the loan.<sup>11</sup>

The benefit to the FHLBA is that AMPP provides a needed service to its member banks, allowing them to increase capacity to meet community needs. In general, affordable housing loans have a strong performance over time, providing the bank with a sound investment.<sup>12</sup> For the participating consortia, the program addresses an unmet need. With an established outlet for selling loans, consortia have the opportunity to build networks within their communities to meet affordable housing needs.

Overall, FHLBA has found that the AMPP program has been an effective tool. To date, FHLBA has purchased 38 loans for more than \$24 million, providing more than 1,900 units of affordable housing. Further, FHLBA is currently exploring expansion of the program that would allow individual member banks, in addition to lending consortia, to participate in the program.

### ***STATE HOUSING FINANCE AGENCIES***

Each state has a housing finance agency that manages three federally authorized programs: mortgage revenue bonds, low income housing tax credits and the HOME Investment Partnership program. The goal of each of these programs is to target funding to the states for affordable housing.<sup>13</sup>

#### *ALASKA HOUSING FINANCE COMMISSION (AHFC)*

AHFC is a public corporation that works to meet the housing needs for Alaska communities. AHFC provides a range of programs, providing financing for single-family housing, multifamily housing and community facilities. To provide access to the capital for community development, AHFC created the Multifamily Loan Purchase Program (MLPP). The program was initiated in response to increased demand from the housing industry, which found that few lenders were underwriting multifamily mortgage loans in Alaska.<sup>14</sup>

In the program, AHFC works with approved lenders in Alaska to provide financing for multifamily housing. If a loan meets the underwriting criteria established by AHFC, the lender sells 100 percent of the loan to AHFC.<sup>15</sup> However, unlike other secondary market programs profiled, AHFC rarely purchases affordable multifamily loans through this program. AHFC administers direct lending programs, and has found that lenders utilize the direct lending programs for affordable housing rather than the purchase program.<sup>16</sup>

AHFC also differs from other programs in how mortgages are structured for investment. Rather than package loans into securities, mortgages are purchased and pooled as collateral for bonds that are issued by the agency. The bonds are secured by mortgage payments from the housing developments. For AHFC and other housing finance agencies, the bond rating

is supported by the pledge of general obligation debt rather than the credit of the underlying loan pool.

The key barrier that AHFC has experienced in the development of the program is educating borrowers and lenders about the program parameters. The AHFC only purchases loans that meet the underwriting criteria for the program and are originated by lenders who are approved to sell loans. Despite these challenges, the benefits of the program are significant. The program supports AHFC in its mission to increase housing opportunities for citizens of Alaska. Further, the program fills an underserved financing need in a market where limited financing options are available. The program ensures that underwriting is accomplished with sensitivity to the local market and its housing needs.<sup>17</sup>

### ***NON-PROFIT AND FOR-PROFIT ORGANIZATIONS***

As the federal, state and local government provide fewer resources for the development of affordable housing, smaller non-profit and for-profit programs have created innovative solutions that tap resources in the private market to meet community needs.

#### *COMMUNITY REINVESTMENT FUND (CRF)*

Community Reinvestment Fund was established in 1989. CRF is a non-profit organization with the mission to “provide new loan capital to community development lending organizations by purchasing their loans or structuring financial product to meet their loan capital needs.”<sup>18</sup> CRF fulfills this mission through three core services: purchasing development loans, servicing existing loans, and providing training and technical assistance for lenders. Since its inception, CRF has purchased more than 1,200 development loans totaling more than \$220 million, working with 88 organizations in 22 states and the District of Columbia.<sup>19</sup>

The core of the CRF mission started with purchasing economic and community development loans. Typically, loans are purchased from non-profit organizations and government agencies. In 1998, CRF expanded its mission to include affordable housing, and began working with non-profit lending consortia in several states.<sup>20</sup> The primary financing mechanism for CRF is to pool these loans and issue securities for purchase by institutional

investors. To date, CRF has issued 13 series of debt securities that are backed by purchased loans.<sup>21</sup>

CRF finds that the lack of standardization and the high transaction costs associated with purchasing loans have been the primary barriers to improving access to the secondary market.<sup>22</sup> Loans originated by community lenders are not uniform and the cost associated with underwriting smaller loans is often prohibitive. Further, lenders are challenged by pricing loans to meet investor demand in the market. Often, loans are only marketable to investors at a discount from the original cost, making the secondary market unfeasible for many community lenders.

The benefit that CRF provides to lenders is an alternative source of capital that allows lenders to meet the demand for affordable housing financing in their communities. Lending consortia raise capital from banks to fund development, however continued financial support is often difficult to maintain. Through selling mortgage loans to CRF, consortia are able to recycle capital in local communities. In addition, funds that many organizations can access through various federal and state programs have restrictions on their use. CRF finds that its program provides access to capital that complements these government monies, expanding financing alternatives for affordable housing.<sup>23</sup>

*COMMUNITY DEVELOPMENT TRUST, INC. (CDT)*

Community Development Trust, a for-profit organization, is a hybrid REIT that serves as a conduit for the securitization of loans. Established in 1999, CDT was one of the first REITs to target affordable multifamily housing, and evolved from the non-profit conduit Local Initiatives Asset Management Corporation (LIMAC). The goal of the organization is to increase capital for affordable housing and community development. CDT accomplishes this objective “by providing a secondary market for long term fixed rate mortgages and acquiring and preserving affordable housing.”<sup>24</sup>

With its Secondary Market Mortgage Program, CDT targets loans that do not meet traditional secondary market underwriting criteria. The loans that are purchased generally are not sold on the secondary market because the loans are too small, located in undesirable

communities or are not traditional multifamily developments.<sup>25</sup> CDT addresses this unmet need through purchasing long-term fixed rate permanent loans for affordable multifamily housing.

CDT raised \$32 million in initial equity, and used this equity to purchase loans from approved lenders. Like other programs, CDT only purchases loans from approved lenders, and currently has thirteen approved lending organizations. Once loans are packaged, CDT issues participation interests and sells senior participation to institutional investors. To date, the United Methodist church has been the primary investor, and the organization is exploring opportunities with other pension funds, insurance companies and GSEs to purchase senior participation in loan pools.<sup>26</sup>

The primary barrier for the CDT program is generating a volume of loans that are well diversified and will attract large institutional investors. Investors are interested in the product only if there is sufficient loan volume. In addition, there is a challenge in maintaining geographic diversity of the loans that are purchased. The diversity of the loan pool is a benefit for investors because if loans are originated in different states across the country, the investment faces fewer repercussions from regional economic shifts.<sup>27</sup>

The primary benefit that the CDT Secondary Mortgage Market Program provides is improved loan terms for borrowers. By creating access to the secondary market, borrowers have access to long-term financing that is otherwise unavailable. Overall, CDT has created a vehicle to provide liquidity for lenders who are interested in the development of affordable housing and meeting a need for both lenders and investors in the market.

*IMPACT COMMUNITY CAPITAL, LLC (IMPACT)*

Based in California, Impact Community Capital was developed as a vehicle for the insurance industry to voluntarily invest in local communities. In the late 1990s, the California legislature authored several regulations to mandate investment by insurance companies in local communities where premiums were collected from customers, similar to the Community Reinvestment Act regulations for the banking industry. To respond to this

legislative action, the insurance industry established a voluntary community investment program, known as COIN.<sup>28</sup>

Once established, however, the insurance companies that participated found that COIN was an ineffective vehicle for efficiently promoting community investment. The industry was negotiating a new investment arena, and found that some community projects were not appropriate investments for the industry. In 1999, Impact was established to address this concern. The organization is a for-profit enterprise, owned by ten insurance companies that provided initial capital.<sup>29</sup>

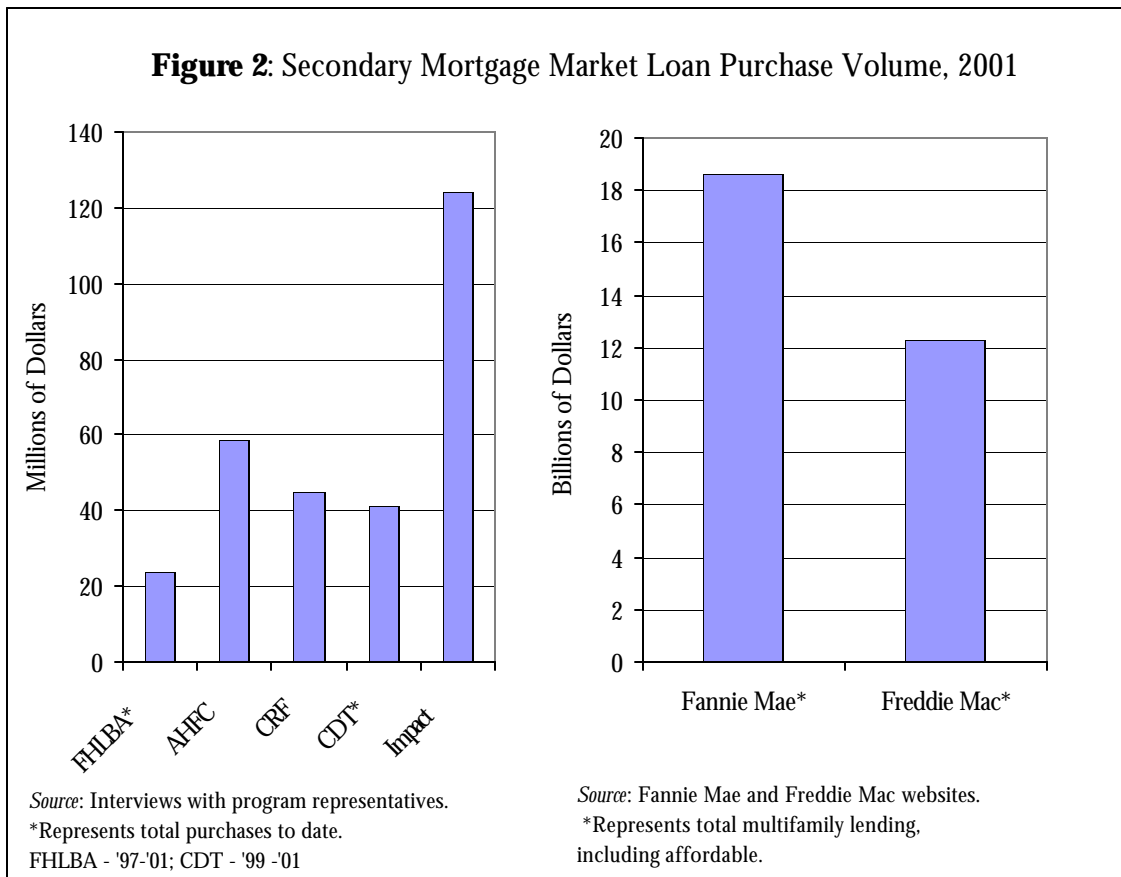
Impact purchases loans from financial institutions and non-profit community organizations. The underlying goal is to act as responsible investors for the insurance companies, using standards of safety and soundness, liquidity and return as the basis for investment.<sup>30</sup> Unlike other small non-profit and for-profit programs, the securities that are packaged by Impact are rated by national credit rating agencies. These ratings provide insurance companies with investment-grade securities for its portfolio.<sup>31</sup>

Impact cited three key barriers to efficiency in the secondary market that mirror current research and experiences of other secondary market programs. The lack of standardization in multifamily mortgage loans makes packaging loans into securities that can be rated difficult. Further, the transaction costs for getting loan pools “market ready” are extensive. To ensure that loan pools are acceptable to rating agencies and thus marketable to investors, Impact does extensive information gathering from lenders to ensure due diligence in underwriting the loan.

Lastly, the volume of loans needed for efficient transactions is often unattainable through lenders in the community. Impact relies on lenders that can sell an aggregate of loans for packaging into a security because it is more efficient than purchasing individual whole loans. In the future, Impact is looking toward structures that will allow the “warehousing” of loans. This structure would allow Impact to purchase smaller loans in order to create a larger pool of loans that is required by the rating agencies for effective securitization.<sup>32</sup>

Overall, Impact has found this investment framework beneficial to both the insurance industry and local communities. Impact is able to purchase loans from various states, creating a diversified investment vehicle that support the goals outlined by the insurance companies. Further, the program is able to fill an unmet need for affordable housing financing by purchasing loans that are not eligible in GSE multifamily programs.

Impact provides an innovative solution to provide for community investment by the insurance industry. As other states call for mandated investment by the insurance industry, the program demonstrates that alternatives exist to increased regulation. More importantly, Impact has capitalized on the investment by the insurance industry that has benefited multifamily housing development in California and other states.



These secondary mortgage market programs are addressing a market need for increased capital for affordable housing. While each of the programs meets this need differently and purchases varying volumes of loans, they experience similar opportunities and barriers to

efficiently providing capital (Figure 2). The insight about these opportunities and barriers is helpful for framing further discussion about the role of the secondary market in financing affordable multifamily housing.

## **MARKET ANALYSIS OF MULTIFAMILY HOUSING**

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The purpose of the market analysis is to depict trends in the development and financing of multifamily properties both at the national level and in the FHLB of Seattle eight-state region. The analysis includes a discussion of demographic and employment trends, as well as property and mortgage finance trends.

### ***DEMOGRAPHIC TRENDS***

The demand for housing is influenced by demographic trends in age, household composition, immigration, and household income. These factors impact the rate of household formation and the ability of households to afford their housing choice. An investigation of these trends, both at the national level and in the FHLB of Seattle region, highlights two key trends. First, nationally, there has been a decrease in the number of households renting single-family or multifamily dwellings. Second, research indicates that this trend will change over the next decade as demographic shifts fuel increased demand for multifamily rental housing.<sup>1</sup>

In 2001, the State of the Nation's Housing report stated that the strong economy in the late 1990s supported a steady increase in the number of homeowners, pulling demand away from rental housing. The housing preferences of the baby boom generation and economic and social trends that encourage more "doubling up" have led to a decrease in the number of households that opt for rental housing. At the same time, future trends, such as the move of the "echo boom," children of the baby boomers, into the housing market and the increase of elderly households and single-person households indicate an increased demand for rental housing.

The report found that rising rents forced more single households to "double up." In 1999, the number of people aged 25 to 36 years old who live with their parents remained significantly high, reducing demand from a cohort that typically chooses multifamily housing. Further, there are more households where three generations of one family live under the same roof.<sup>2</sup> These economic and social trends have a direct impact on the demand for rental housing.

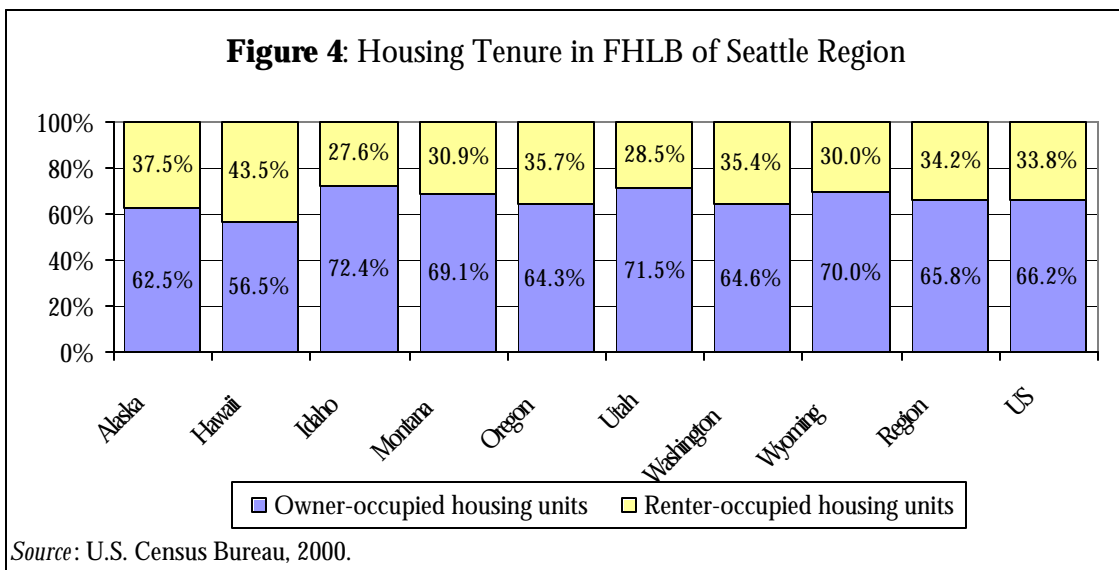
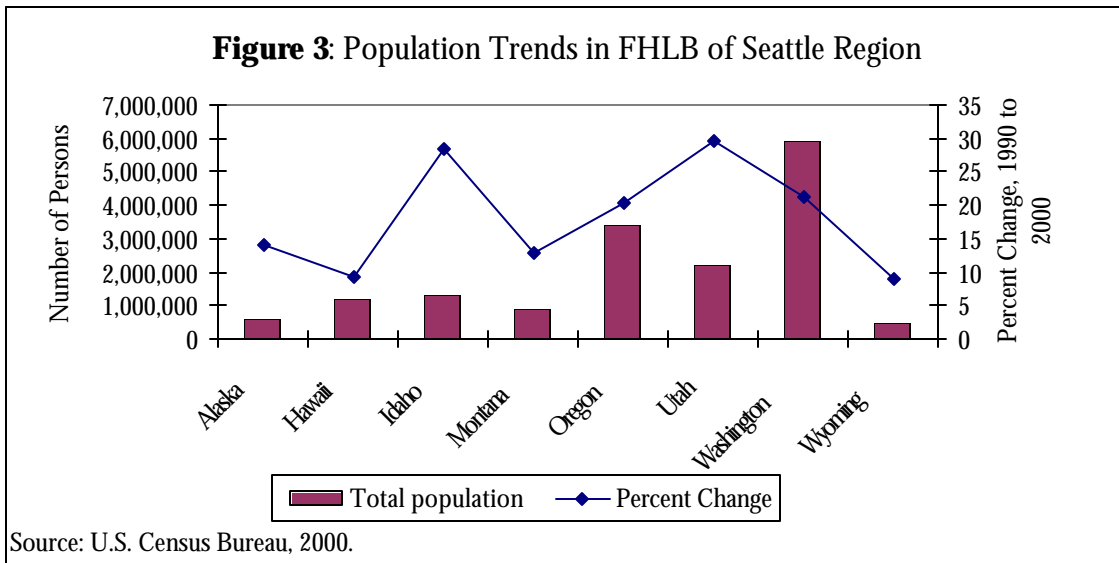
The “baby boom” generation has shaped the changing age and household formation trends for the last several decades. In the 1960s and 1970s, the demand for multifamily housing increased significantly as baby boomers began forming households and moving into the housing market. In the 1980s and 1990s, many baby boom households purchased homes, reducing the overall percentage of multifamily renters. From 1991 to 1998, total households increased by 8.7 percent, while the number of households who rented increased by only 2 percent over the same period.<sup>3</sup>

As the baby boomers age, their children, the “echo boom,” are expected to increase the demand for rental housing. It is predicted that this group will form more than 20 million households in the next decade. Other trends that will impact demand for multifamily housing include the increasing life span of older adults and the rising number of married couples without children and single-person households. With older adults living longer and healthier lives, heads of household who are 75 years of age and older is predicted to grow by 1.3 million over the next ten years. Single-person households are projected to be the second-fastest growing household type with more than 10 million new households by 2010.<sup>4</sup>

Immigration and the growth of minority populations also significantly impact the trends in household formation. Almost one-third of all household growth since 1995 has been from foreign-born households. Further, the age of minority populations is typically younger in comparison with the white population. Thus, in the next two decades, it is expected that Hispanic, Asian and black population growth will fuel more than 65 percent of all new household formation. These shifts will increasingly impact housing demand as the children of these households form their own households and move into the housing market.<sup>5</sup>

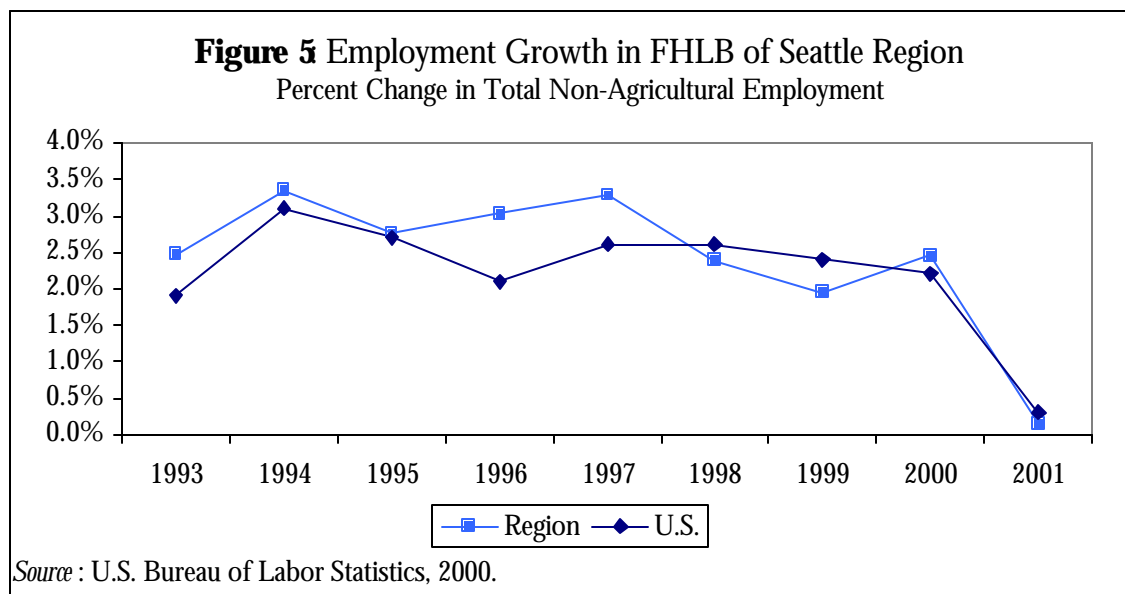
Additional research provides similar projections for multifamily rental housing.<sup>6</sup> This projection analyzed the annual percent growth of households by the age of the head of household and by household type from 1995 to 2010. Based on the assumption that the housing type selected by different age groups does not change, the projected growth of multifamily renters is similar to the expected growth of total households. While the projected annual growth in households was 1.1 percent from 2000 to 2010, the growth in multifamily renters was 1.1 annually from 2000 to 2005 and 1.2 percent from 2005 to 2010.<sup>7</sup>

In the FHLB of Seattle region, population growth has exceeded the national rate of population growth. Five states experienced a percent increase in population from 1990 to 2000 that exceeded the national increase of 13.2 percent during the same period. Washington State has the largest population in the region with a population that is nearly twelve times greater than Wyoming, which as the smallest population (Figure 3). Housing preference in the FHLB of Seattle region also reflects similar patterns in housing tenure when compared with the national average (Figure 4).



## **EMPLOYMENT TRENDS**

Despite the current economic downturn, it is expected that the demand for affordable housing remains substantial.<sup>8</sup> While the housing market has sustained the economy, employment trends for the nation and the FHLB of Seattle Region reflect the recent changes in the economy. National unemployment reached 6 percent in April 2002, compared with 4.5 percent in 2001.<sup>9</sup> Further, the growth of employment for both the nation and the region has slowed substantially in 2001 (Figure 5). The percent change in employment for the region mirrors national trends, indicating that a rebound in the national economy will positively impact the regional economy.



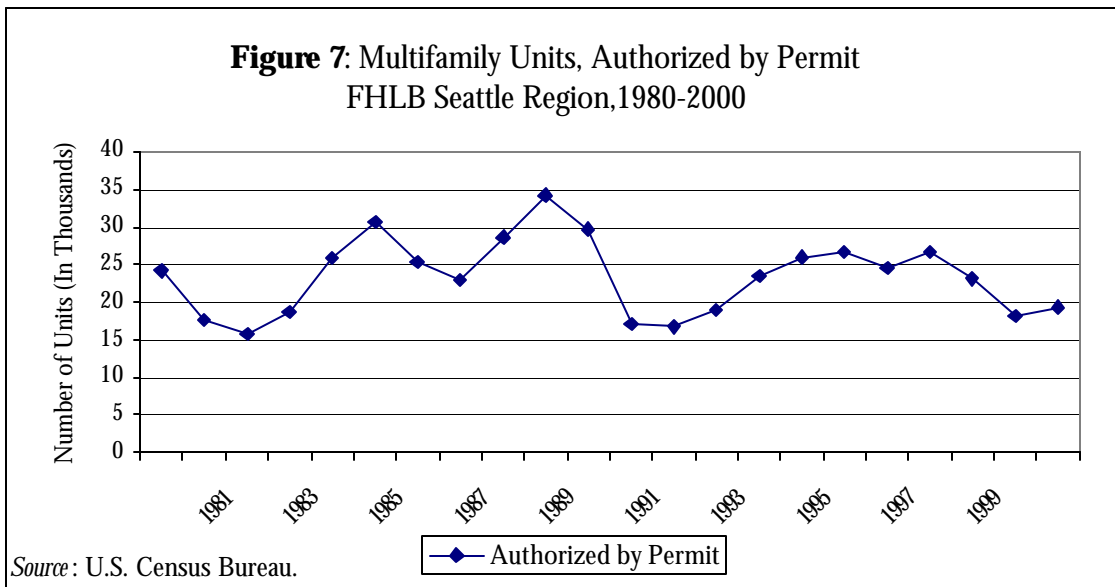
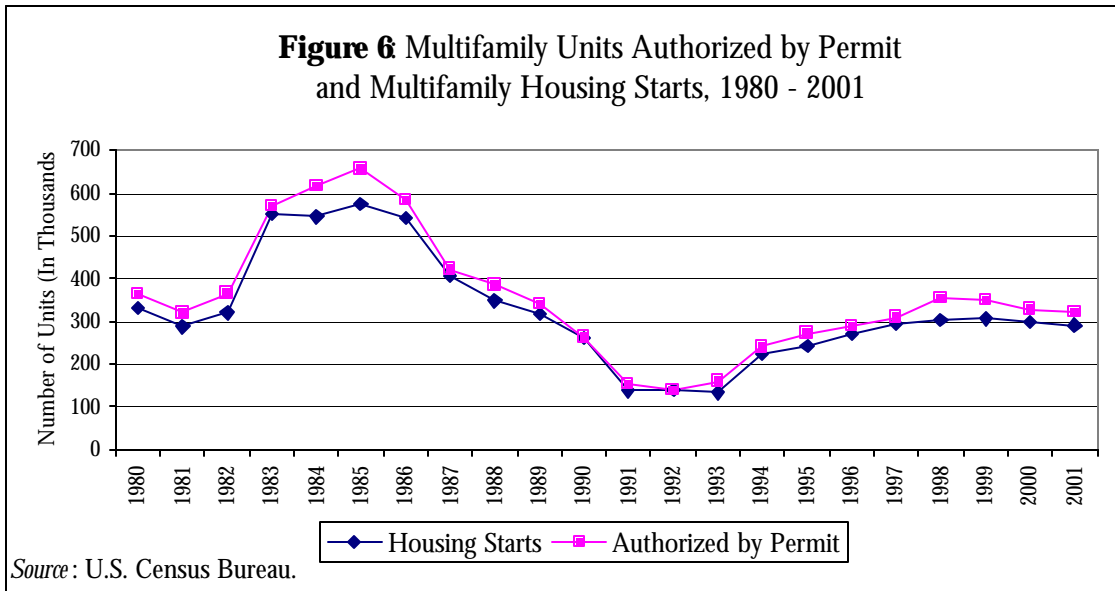
## **PROPERTY TRENDS**

The trends in housing construction complement current demographic and employment trends. Data on building permits, housing starts and vacancy rates illustrate changes that have occurred at the national level, as well as in the FHLB of Seattle region.

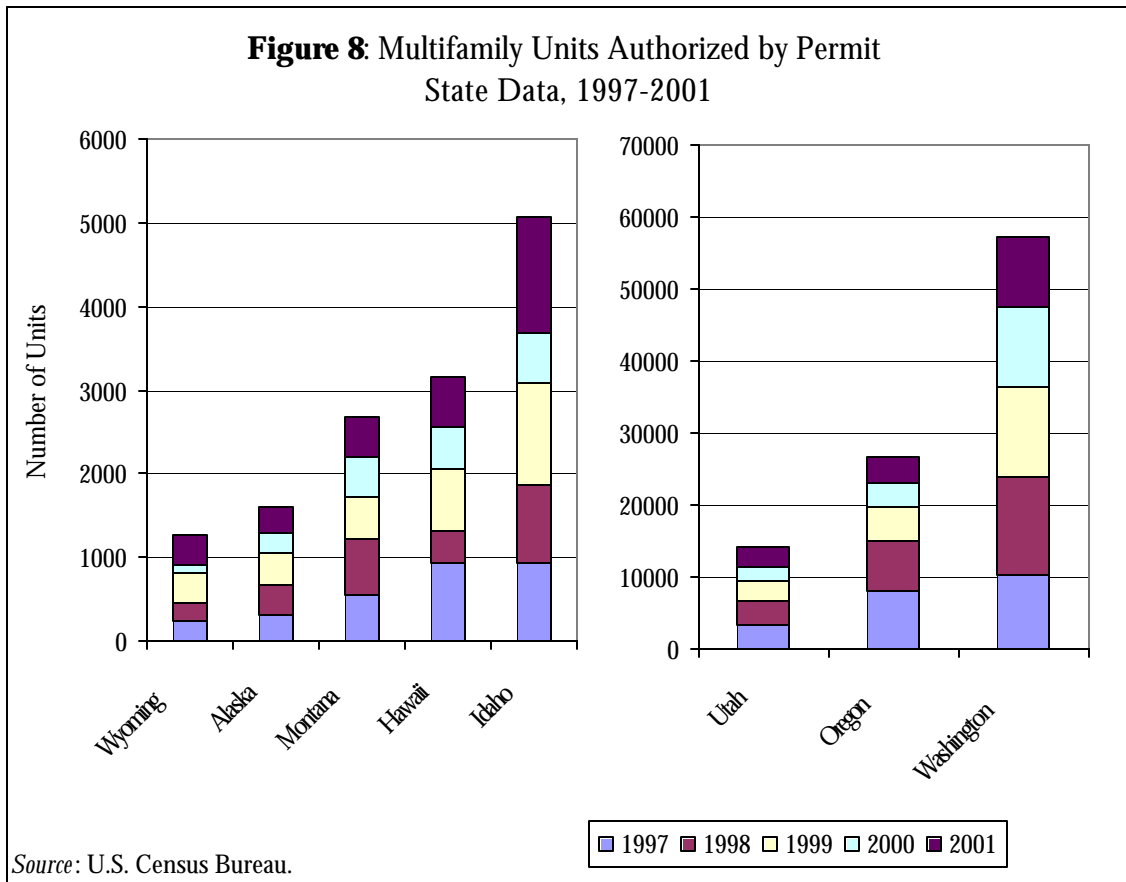
Historical data illustrate fluctuations in the issuance of building permits from 1980 to 1990. There was a rise in building permits issued in the early 1980s that was followed by a sharp drop beginning in 1986. This shift reflects the treatment of multifamily housing as an investment in the tax laws (Figure 6). The Tax Reform Act of 1986 significantly reduced the benefits to investors in multifamily housing through a change in the depreciation schedule.<sup>10</sup>

Since 1990, the level of building permits authorized has increased, remaining relatively constant over the last five years.

In the eight-state region that the FHLB of Seattle serves, the level of building permits fluctuated more widely in the 1980s and 1990s, declining in 1985 and again in 1989 (Figure 7). In the 1990s, the trend followed national trends, steadily increasing each year. However, in 1997, the region experienced a reduction in the number of multifamily building permits authorized. At the state level, Washington, Oregon and Utah have the highest number of

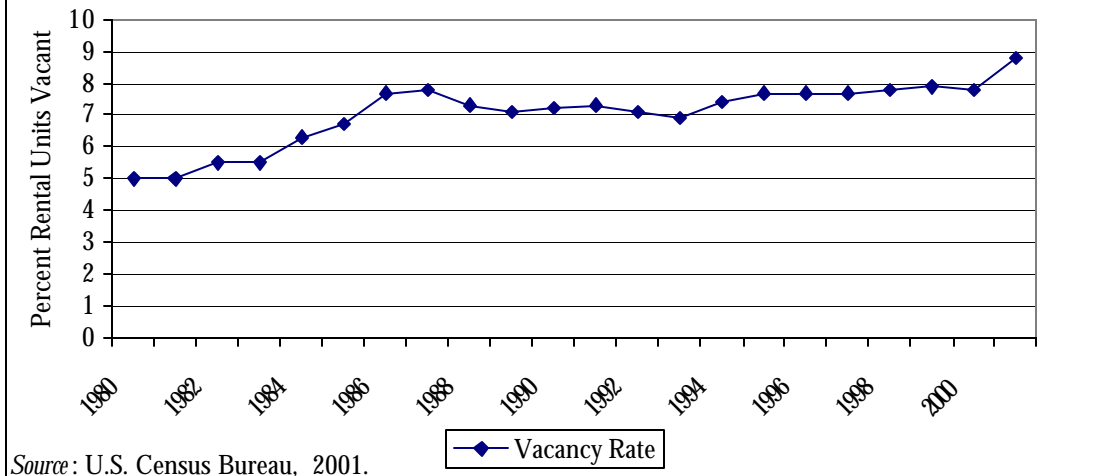


units authorized by permit, each with more than 10,000 units authorized from 1997 to 2000. Other states in the region range between 1000 and 5000 units over the same five-year period (Figure 8).

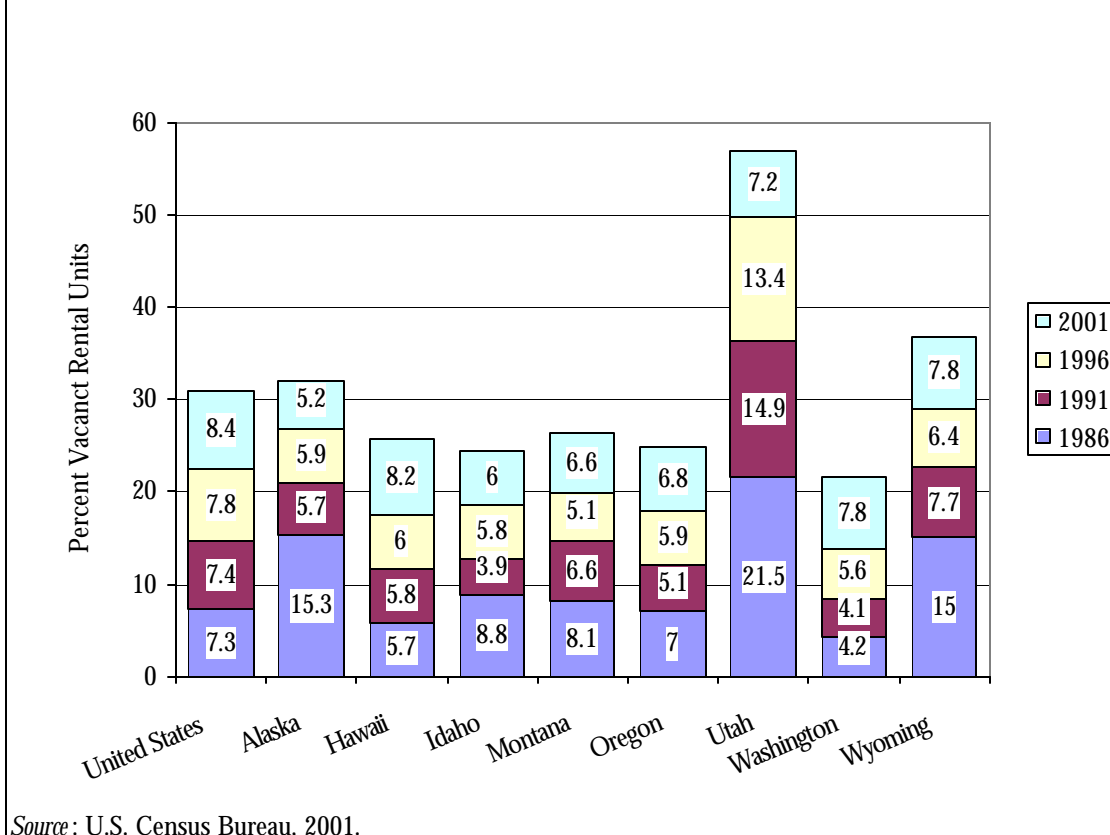


The vacancy rate for rental housing has increased steadily from 5 percent in 1980 to nearly 9 percent in 2001 (Figure 9).<sup>11</sup> There was a slight increase in the late 1980s followed by a slight decrease in the early 1990s. The state vacancy rates illustrate that most states in the FHLB of Seattle region have experienced similar rental vacancy rates over time, with the exception of Utah (Figure 10). For three out of the four years, Utah had a rental vacancy rate almost double other states in the region.

**Figure 9: U.S. Rental Vacancy Rate, Fourth Quarter  
1980-2001**

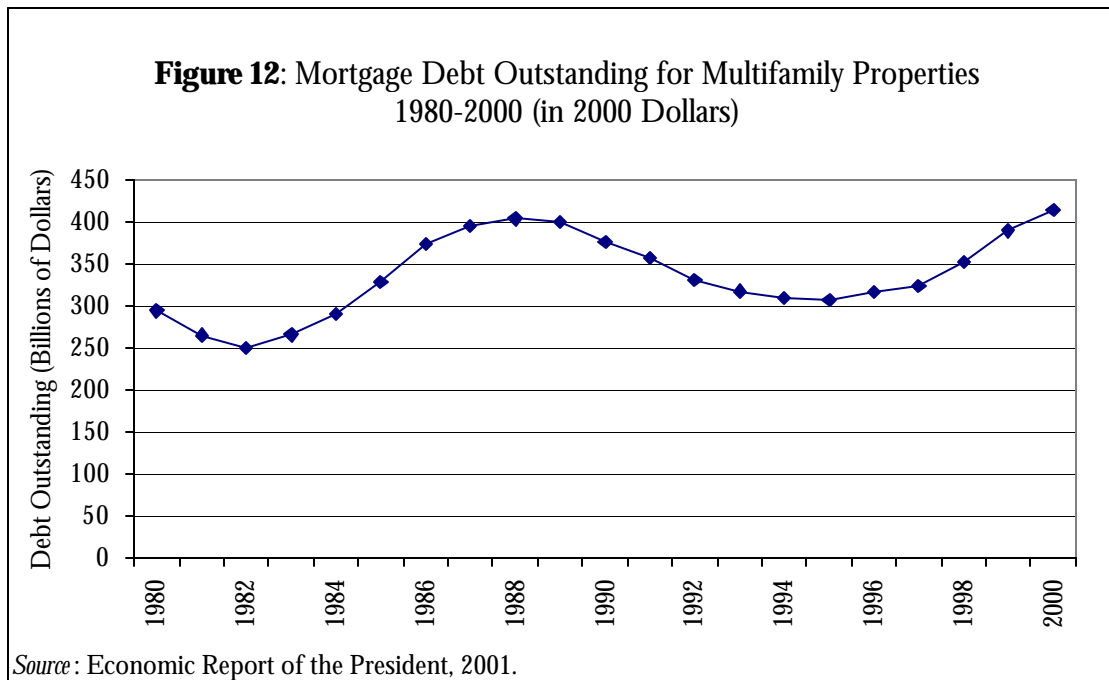
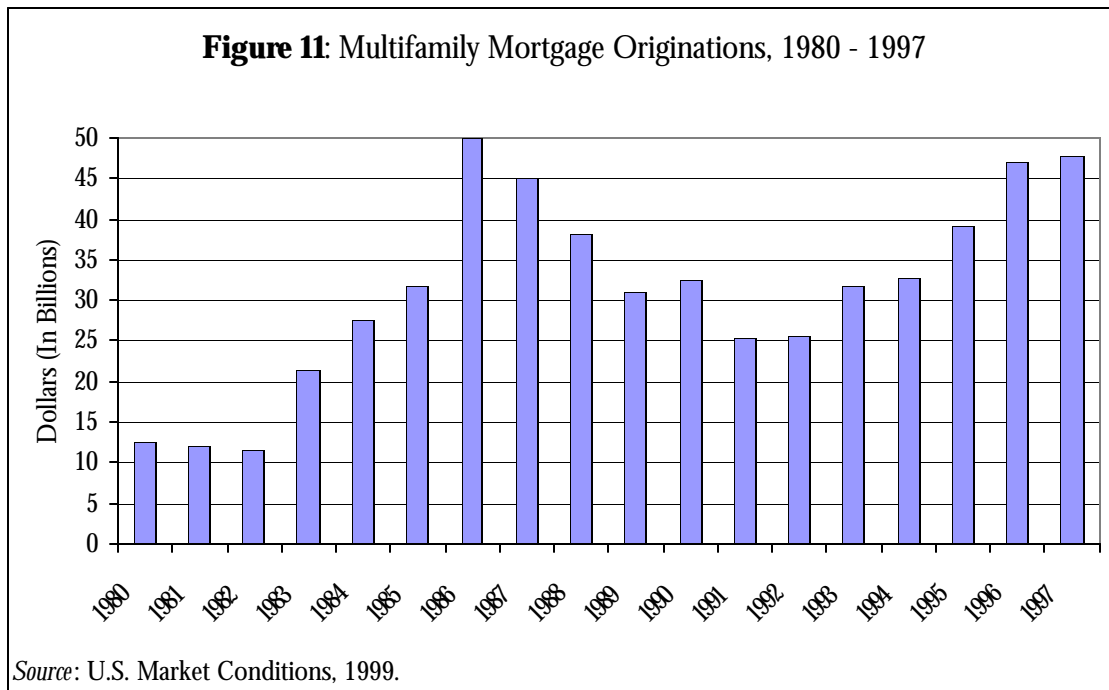


**Figure 10: Rental Vacancy Rate for States in FHLB Seattle Region  
1986, 1991, 1996, 2001**



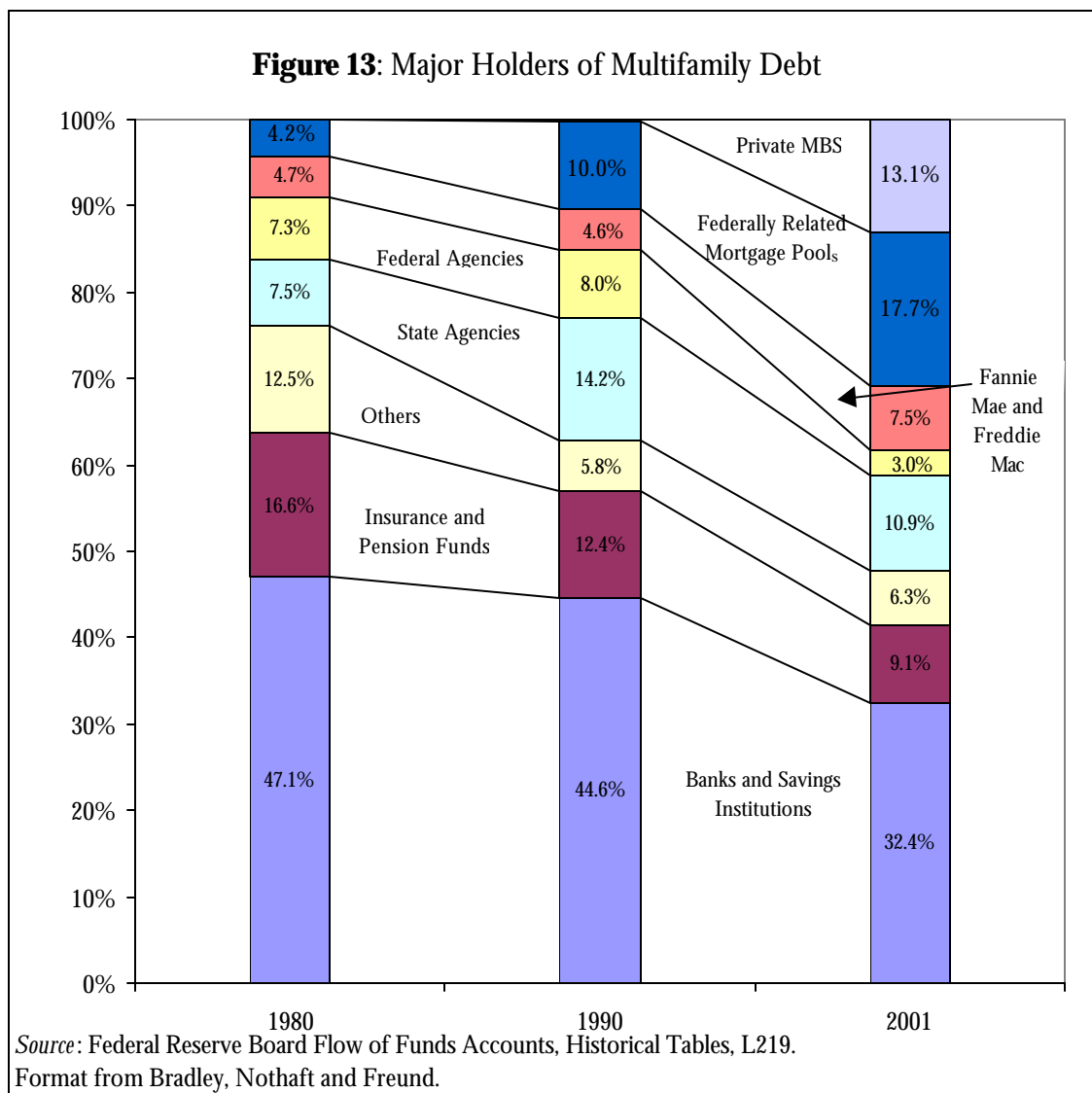
## FINANCE TRENDS

The volume of multifamily mortgages originated by lenders and level of outstanding mortgage debt on multifamily properties both highlight trends in the financing of multifamily properties (Figure 11 and 12). In 1986, the volume of multifamily mortgages originations reached a peak of \$50 billion. The origination volume declined steadily until



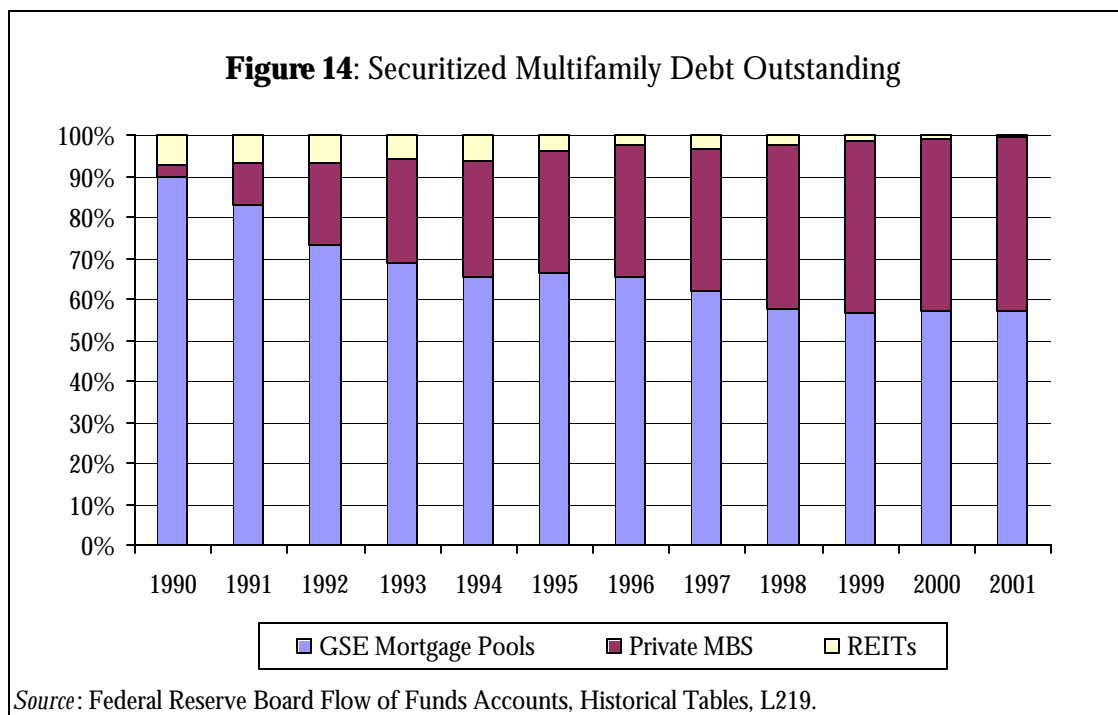
1992 and, by 1997, volume was approaching \$50 billion again. From 1982 to 1988, there was an increase in the level of multifamily mortgage debt. In the early 1990s, when construction levels decreased, the level of mortgage debt outstanding also declined. Levels increased again starting in 1997 and surpassed more than \$400 billion by 2000.

The changes in the major holders of multifamily debt reveal the shifts that have occurred in the mortgage finance industry (Figure 13). In 1980, banks, savings institutions, insurance companies and pension funds held more than 60 percent of outstanding multifamily debt. Federal and state agencies, a long with GSEs, held nearly 20 percent. By 2001, banks, savings

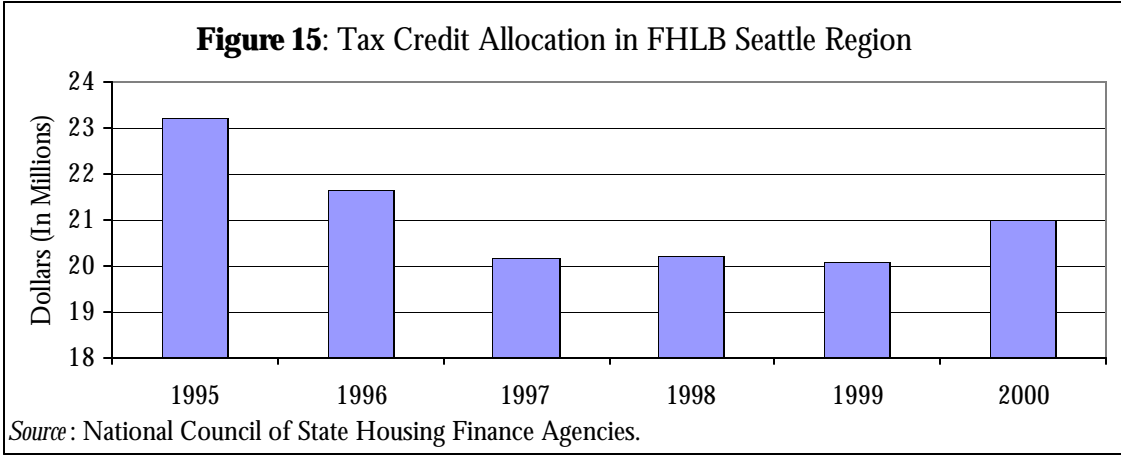


institutions, insurance companies and pension funds held only 40 percent of outstanding debt, and the government agencies and GSEs remained at 20 percent.

The outcome of changes in the mortgage industry has been the increase in private MBS and in federal mortgage pools. These players held less than 5 percent of outstanding multifamily debt in 1980. In 2001, the share is more than 30 percent. Though both these groups have significantly increased their holdings in multifamily, the share of private MBS has been increasing relative to the mortgage pools during the 1990s (Figure 14).



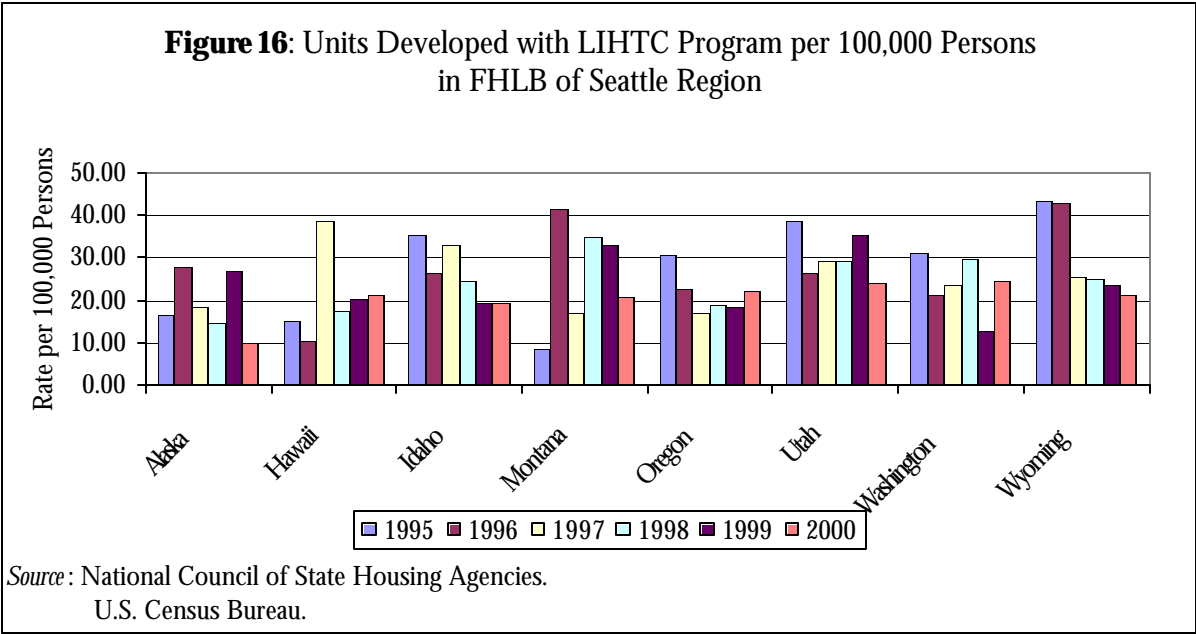
To examine financing trends for affordable housing, a useful benchmark is the current trends in the allocation and utilization of the Low-Income Housing Tax Credit program (LIHTC). From 1995 to 2000, the level of tax credit allocated by state finance agencies in the FHLB of Seattle region decreased (Figure 15). Yet, most states utilized the total number of credits available to them based on the per capita calculation. Since 1995, Montana has failed to use all the tax credits available, where Utah has used all credits available (Table 2). The effect of this allocation is the production of affordable housing units, and as expected given the per capita distribution of credits, similar proportion of units to total population have been developed in each state (Figure 16).



**Table 2: Percent of Total Tax Credits Used<sup>1</sup>**

	1995	1996	1997	1998	1999	2000
Alaska	100.0%	100.0%	100.0%	67.5%	100.0%	56.5%
Hawaii	100.0%	76.4%	99.6%	76.5%	100.0%	100.0%
Idaho	100.0%	100.0%	100.0%	80.6%	100.0%	92.5%
Montana	25.6%	80.4%	47.8%	96.8%	96.9%	99.5%
Oregon	100.0%	100.0%	100.0%	98.7%	99.8%	99.6%
Utah	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Washington	100.0%	100.0%	100.0%	100.0%	76.0%	100.0%
Wyoming	68.7%	100.0%	85.4%	71.8%	94.7%	100.0%
Region	94.2%	96.4%	96.8%	93.3%	91.6%	97.7%
US	97.3%	97.0%	98.9%	99.2%	98.8%	99.1%

<sup>1</sup>Total Credits equals total of per capita, returned, carryover and national pool credits.  
Source: National Council of State Housing Agencies.



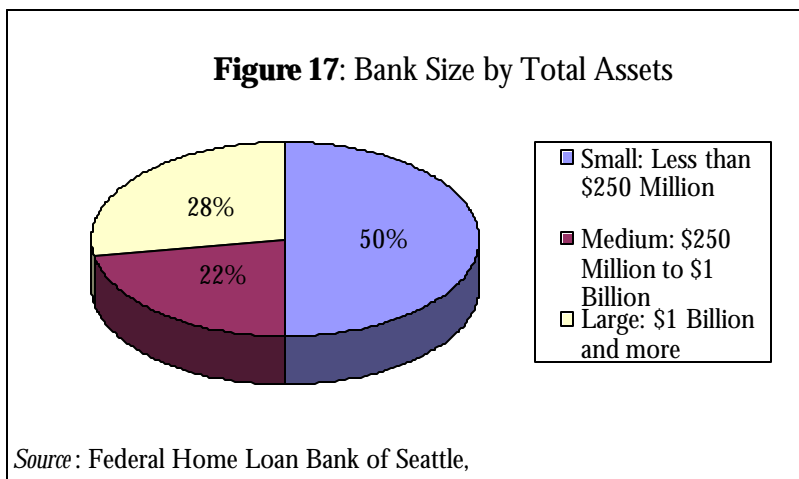
## MEMBER BANK PERSPECTIVE

The member banks in the FHLB of Seattle region work to serve community financial needs and to enhance bank profitability. To understand the lender perspective on the secondary market as a financing tool, eighteen member banks were interviewed about their experience and interest in accessing the secondary market for multifamily mortgages.<sup>1</sup> The purpose of these interviews was to determine the level of interest or need that member banks have to access capital for affordable multifamily housing. Interviews examined both the type of multifamily lending member banks are currently doing, as well as views on opportunities and barriers in accessing the secondary market for affordable multifamily loans.

The member banks interviewed were located throughout the FHLB of Seattle region with the largest representation from Washington State (Table 3). Each bank is categorized by an asset class, either small (less than \$250 million),

Alaska	2
Hawaii	2
Idaho	2
Montana	2
Oregon	3
Utah	1
Washington	5
Wyoming	1
<b>Total</b>	<b>18</b>

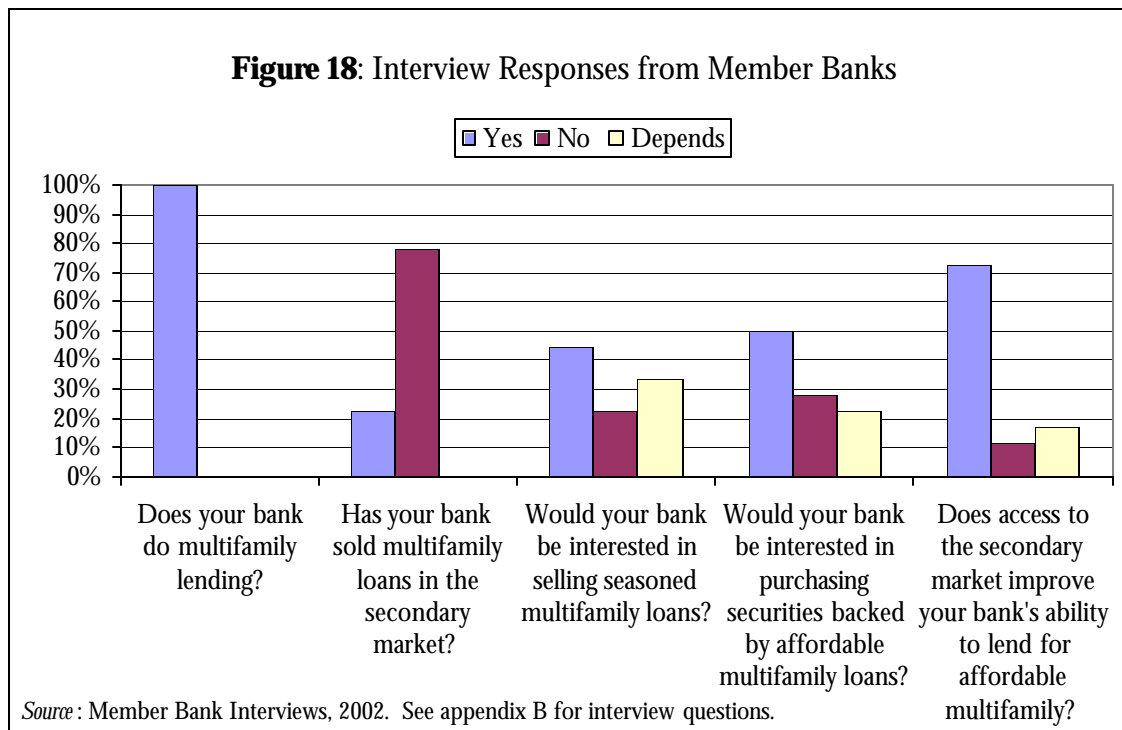
medium (\$250 million to \$1 billion) or large (more than \$1 billion), with half of all member banks interviewed categorized as small (Figure 17). The percent of total multifamily assets held by each bank ranged from a low of 0.3 percent to a high of 37.4 percent.



All of the member banks interviewed provide financing for multifamily properties, though the level of lending by each bank varies (Figure 18). Four banks mentioned that they have low loan volume in multifamily housing, lacking the

opportunity to lend on multifamily properties. Three banks stated that their legal lending limit is prohibitive to most multifamily lending, and either pursue limited multifamily lending or lend only in participation with other banks.

In the affordable housing market, seventeen of the banks indicated that they providing financing for affordable multifamily properties. Ten of these seventeen indicated that they either did limited affordable lending or participated with other lenders on affordable multifamily deals. Three banks stated that they worked with bank consortia to provide affordable multifamily financing.



Member banks cited that profitability, CRA regulations, and service of community need are the central reasons for both market-rate and affordable multifamily lending. More than half of the banks indicated that the multifamily lending was “good business,” and was generally profitable for the bank. Seven of the banks highlight CRA requirements as a motivation for lending on affordable multifamily deals, and six banks indicated that multifamily lending met a community need or was central to the banks’ mission. Other reasons for lending on

multifamily properties included generating fee income, building the banks' portfolio and investing in low-risk commercial property.

The level of experience and interest in the secondary market for multifamily loans varied for the member banks. More than 75 percent of the banks have never sold a multifamily loan in the secondary market; however, an equal percentage of the banks indicated a potential interest in selling loans in the secondary market. Of those banks who were interested in selling loans, more than 40 percent stated that they currently did not have loans to sell at this time but would consider the option if the secondary market were available. Seventy-two percent of the banks indicated that they might be interested in purchasing securities that were composed of affordable housing loans, though most banks stated that their interest would depend on the yield of the security or whether the security would meet CRA requirements.

The lack of experience in the secondary market coupled with the level of interest in accessing the secondary market for multifamily loans raises questions about the barriers to participation in the secondary market. There was a wide range of responses by member banks that typically reflected the level of experience that the bank had in the secondary mortgage market. For the five banks that had some experience in selling loans, the primary barrier was inefficiency of the market. Banks struggle with meeting underwriting guidelines or pricing the loans to meet the needs of the investors. Further, the banks indicate that building a network of investors was difficult. Three banks stated that their primary investors were other banks. Each investor has a different set of guidelines, and the timing of investment needs often does not match the banks' need to sell the loan. One bank sells loan to its state housing finance agency and finds that meeting the established guidelines and maintaining compliance can often be expensive.

Member banks that have not sold loans in the secondary market highlighted several barriers to entering the market. Four banks indicated that they have a low loan volume for multifamily properties and that the current goal of the bank was to build its own portfolio of multifamily loans. Similarly, three banks stated that the bank legal lending limit is prohibitive to participation in the secondary market. Several banks expressed an interest in selling loans,

but found that the bank lacked the knowledge and experienced staff to effectively use the secondary market to finance multifamily properties. Lastly, banks find that the underwriting and pricing of loans in the secondary market makes access to the market financially unfeasible.

Despite these barriers, each member bank cited benefits to accessing capital markets. More than half of the banks interviewed stated that the secondary market would increase liquidity for the bank and allow for increased multifamily lending. Four banks indicated that the secondary market potentially could provide access to long-term fixed rate financing, while three banks cited generating increased fee income as a primary benefit to the secondary market. Other benefits included increased access to a broader market and increased customer base through increased originations.

When member banks were questioned about specific drawbacks to accessing the market for their bank, the responses were similar to the general barriers to market entry. Five banks indicated that they were focused on building their own portfolio rather than selling multifamily loans. Also, the lack of knowledge about the secondary markets and the need to have trained staff limits active participation. Several banks had concerns about maintaining their customer base and losing loan servicing when selling in the secondary market. Lastly, the underwriting guidelines and the high transaction costs associated with meeting those guidelines prevent member banks from pursuing the sale of multifamily loans. The banks often cited the lack of standardization in multifamily lending and the market inefficiency that results as problematic for active participation in the market.

In addition to highlighting opportunities and barriers in accessing the secondary market, member banks discussed several other relevant themes. First, some member banks had explored opportunities with Fannie Mae or Freddie Mac for the secondary market. In most cases, the banks found that the GSEs were only interested in banks that can provide large loan volume, essentially shutting out smaller community banks. Though, one bank is currently exploring participation in the Fannie Mae 3MaxExpress program.

Several banks discussed the level of demand for affordable housing in their communities. In some cases, banks that serve small communities observed less demand for affordable housing. In other cases, the level of organization in the affordable housing community dictated the level of perceived demand for affordable housing by member banks. In one community, the main affordable housing developer had recently folded, and the bank did not find that there was a strong demand for the financing of affordable housing given the lack of organization within the community.

Two banks mentioned the role of the “safety and soundness” test for the bank. One bank clearly indicated that their primary goal was to ensure “safety and soundness” measures for the bank ahead of all other objectives. In the second case, the bank discussed the challenge of balancing the bank’s need to maintain safety and soundness while meeting the community need for affordable housing.

Nearly every bank mentioned the role of CRA in relation to affordable multifamily lending. For eleven banks, CRA requirements were not a motivation for participating in the secondary market because the banks have a satisfactory rating or higher. Six banks indicated that investment in securities would support their bank work toward meeting CRA requirements.

Two banks highlighted the role of regulatory constraints in the multifamily housing market. One bank indicated the importance of tax law in the treatment of multifamily investment. The other bank indicated that the regulatory environment of multifamily lending is often unnecessary and prohibitive for active participation, describing a “paper driven process” that reduced efficiency.

At the end of each interview, member banks were asked whether the secondary market could improve their ability to lend for affordable housing in the communities that they serve. Nearly 80 percent of the banks believed that access to the secondary market would improve financing for affordable housing, citing two primary reasons. First, as mentioned, the secondary market provides liquidity for banks interested in increasing lending for multifamily housing. Second, access to the secondary market satisfies an unmet need for affordable

housing financing. Many banks stated that the secondary market would provide increased investment opportunities for lenders. One bank mentioned that the decline of the thrift industry left a “vacuum” for affordable housing financing that could be filled if banks had increased avenues for lending and investment.

Several banks were unsure about the role of the secondary market in improving access to financing for affordable housing or believed that the secondary market would not be an effective tool. The primary issue was the pricing of loans in the secondary market. Concerns around standardization of loans, interest rates, and risk management were all highlighted. One bank felt that selling loans in the secondary market was ineffective for the bank’s community because the bank was not large enough to generate the necessary loan volume. Another bank commented that affordable housing was generally considered problematic, describing rental housing as low-end, poorly maintained units that often turn into “slums.”

Interviews with member banks of the FHLB of Seattle reveal important issues about utilizing the secondary market as a tool for financing affordable housing. Member banks raised fundamental issues that must be considered in developing strategies to increase access to capital for affordable housing through the secondary market. These insights provide a platform for discussing opportunities and barriers in the secondary market for affordable multifamily mortgages.

## **DISCUSSION: OPPORTUNITIES AND BARRIERS**

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The background on secondary mortgage market programs, the analysis of current housing market trends, and the perspective of member banks in the FHLB of Seattle region present a broad scope of issues about the secondary market as a vehicle to increase capital for affordable housing. The goal of this discussion is to integrate these findings as a means of illustrating the opportunities and barriers that exist in efficiently accessing the secondary market for affordable multifamily loans. This delineation of opportunities and barriers to the secondary market creates a framework for developing strategies for the FHLB of Seattle.

### ***PRINCIPAL FINDINGS***

The principal findings are threefold. Each of these findings indicates that opportunity exists in expanding access to the secondary market for affordable housing loans.

- **Secondary market programs are addressing a market need.** While each program outlined is meeting a different niche in the market and operating at different loan volume levels, these programs are flourishing. As a conduit to capital markets, programs are supporting the flow of funds to the affordable housing market. Each program operates under constraints on how to structure financing and price multifamily loans that are financially viable for investment.
- **Demand for multifamily housing is expected to grow.** The demand for multifamily housing is expected to continue both nationally and in the FHLB of Seattle region. Demographic trends indicate a growth in households who may prefer multifamily housing, and housing development and financing patterns illustrate potential growth in both market-rate and affordable multifamily housing.
- **Member banks are interested in secondary market programs.** Member banks of the FHLB of Seattle express a clear interest in opportunities to access the secondary market for multifamily loans. Though member banks raise concerns about barriers to active participation in the secondary market, most member banks interviewed believe that

access to the secondary market would enhance financing opportunities for affordable multifamily housing.

If the discussion ended with these principal findings, the inevitable conclusion advocates expanding opportunities to access the secondary market. However, prior to formulating recommendations, further examination is required addressing both the scope of the research and the analysis of the opportunities and barriers. First, the scope of research limits the extent of analysis that is feasible. The housing finance industry is a complex network that integrates intricate financial transactions managed by multiple entities and monitored by extensive regulations. The scope of the research centers on the need for affordable housing and refrains from exploring detailed components of the housing finance system.

Second, the analysis and, more specifically, the recommendations are impacted by findings from secondary market programs that are currently expanding opportunities for affordable housing finance and member banks that would employ these types of programs. There are clear opportunities for programs and member banks that engage in the secondary market. Yet, both the programs and banks face barriers to efficient participation in the secondary market, and these opportunities and barriers are vital for effectively examining potential recommendations.

### ***LIMITATIONS OF SCOPE***

Any compelling body of research requires a clearly defined question and scope of analysis. The question presented is how the securitization of affordable multifamily mortgage loans benefits the FHLB of Seattle and the communities that it serves. The scope is framed by the intersection of affordable housing policy and multifamily mortgage financing. The investigation of secondary market mortgage programs and market demand for affordable housing development and financing allows for an examination of opportunities and barriers in expanding access to the secondary market for affordable multifamily loans. Yet, this scope is limited in three ways.

- **The structure of financing is complex.** The secondary market promotes the flow of capital from investors to borrowers through a complex housing finance system.

Financial transactions occur between borrowers, lenders, secondary market conduits, and investors. For each transaction, a process exists for documenting and outlining the terms of the transaction. Often, these transactions incorporate various financing tools to ensure that the product meets the needs of the investor. The use of credit enhancements and the pricing of the loans for purchase and sale are integral components to ensure efficiency in market transactions.

In addition, the role of credit rating agencies, like Standard and Poor's, Moody's, and Fitch's, is central to structuring pools of loans for the secondary market. The rating by these agencies provide a standard by which investors can measure risk associated with any given investment. Each rating agency has different criteria for analyzing the credit rating for pools of affordable multifamily loans.

The process of originating a multifamily loan or creating a pool of loans that is creditworthy by the standards of the national credit agencies and institutional investors is a technical process, and these components are mentioned only briefly in this research. It is important to recognize that significant changes within these structures have clear impacts on the viability of the loan or security as a strong investment. Recognizing this limitation is critical in assessing the feasibility of recommendations.

- **Real estate markets are local systems.** The secondary market has shifted the financing of real estate from a local to a national scale. Yet, the development of real estate occurs in local communities and is impacted by the economic and political landscape of those communities. This fact is particularly salient in examining market demand data.

This research examined multifamily housing development and financing trends, using national data and aggregating data for the FHLB of Seattle region. Analyzing data at the local level affords an additional perspective on the demand for multifamily housing. The interviews conducted with member banks emphasize the role of the local community. For some banks, trends in the local area impacted the growth of multifamily housing. For one bank located near a resort community, demand for multifamily housing was

growing as working families are priced out of the local housing market. For another bank, the migration of households from rural communities to urban centers reduced the demand for multifamily housing in the communities that the bank served. These trends are a component of understanding the demand for multifamily housing, yet a detailed analysis of these local trends lies outside the scope of this research.

- **Data sources use varied definitions.** In compiling data for analysis, developing a benchmark for comparing data is inherently challenging. For example, many data sources use tenure, comparing owner-occupied units to rental units, to present housing trends; other sources break down tenure into single-family and multifamily structures. These variations present challenges in the clarity and flow of analysis.

For this research, the most significant issue is the differentiation between market-rate and affordable multifamily housing. While a clear definition for affordable multifamily housing is used, other data sources and organizations that were interviewed often maintain different perspectives on affordability. These differences are important in presenting recommendations because the nature of affordable multifamily loans is unique from market-rate multifamily loans.

### ***OPPORTUNITIES AND BARRIERS TO ACCESSING THE SECONDARY MARKET***

The process of selling multifamily loans in the secondary market involves three distinct transactions. First, a lender originates a loan for the development of multifamily housing. Once originated, the lender sells the loan to a financial institution or organization that purchases multifamily housing loans. Lastly, the purchaser finds an investor who is interested in multifamily debt as a long-term investment. The efficient movement of capital through each of these transactions is vital in order to use the secondary market effectively for financing affordable housing.

The lender and purchaser of the loan are essential in facilitating this flow of capital. The opportunities and barriers that they experience in these transactions provide a framework for investigating options in expanding access to the secondary market. Overall, both the

programs and the member banks emphasized similar issues in accessing the secondary market (Table 4). However, the opportunities and barriers impact programs and member banks differently depending on the role they perform in the transaction.

<b>Table 4: Opportunities and Barriers</b>	
<i>Opportunities</i>	<i>Barriers</i>
Capital	Loan Standardization
Market Demand	Loan Pricing
Community Service	Transaction Costs
Regulatory Requirements	Experience
Loan Performance	Volume
Income	Credit Ratings
Customer Base	

#### *OPPORTUNITIES*

The opportunities that exist in expanding access to the secondary market mirror the rationale for creating a secondary market for mortgage loans. The secondary market developed as a response to needed capital in the real estate market and as a vehicle to share lending risk when demographic and economic trends shifted. The opportunities that both programs and member banks expressed highlight how this need still exists and how the secondary market is a viable vehicle for providing capital.

- **Capital.** For lenders, access to capital and the potential for increased liquidity are the key benefits of the secondary market. By selling multifamily loans, lenders acquire additional capital that can be reinvested in the community. Typically, lenders prefer to provide short-term financing to borrowers. Multifamily mortgage loans require long-term financing, and face additional scrutiny for creditworthiness and risk. Multifamily lending can restrict funds that the lender could use for other lending opportunities. Therefore, increased access to capital from investors can help to facilitate liquidity for lenders.
- **Market demand.** Data on demographic shifts, housing construction and vacancy rates, and mortgage finance illustrate a demand for market-rate and affordable multifamily housing development, as well as for investment opportunities in multifamily real estate.<sup>1</sup> Further, there is an unmet demand in providing access to the secondary market for affordable housing loans. The intersection of these three components indicates that significant opportunity exists to participate in the secondary market for affordable multifamily loans.

For the property market, the increase of the elderly population and single-person households supports the increased production of multifamily housing. In the FHLB of Seattle region, the population increases over the last ten years have exceeded the population growth of the nation. This trend indicates that the region may experience growth in housing development that outpaces the rest of the nation.

The steady pace of housing starts and building permits authorized over the last five years point to continued growth in multifamily housing construction to meet population growth trends. Vacancy rates for rental housing have been constant from 1995 through 2000. These stable trends in both permits and vacancy rates indicate that the supply of housing is meeting the demand for market-rate multifamily housing. In 2001, a sharp increase in vacancy rate reflects the current economic downturn. While the housing market has been a significant economic boon during the current recession, it is difficult to predict how the trends in construction and vacancy will be effected in the next several years.

In the FHLB of Seattle region, the level of multifamily housing permits authorized has fluctuated over the last twenty years. There was a decrease in authorized permits in the late 1990s followed by a slight increase in 2000. The vacancy rate for most states in the region has been at the same level or below the national vacancy rate. In 2001, each state in the FHLB of Seattle region had a vacancy rate lower than the national rate. While these trends do not definitively indicate a growth in multifamily housing, they point to the steady pace of development of multifamily housing for the region.

In the affordable housing market, the demand for housing is significant. Two-thirds of low-income households are paying more than 50 percent of their household income for rent, and more than 3 million unsubsidized affordable units are needed to meet the national demand for affordable housing. The use of allocated funds through the LIHTC program further indicates the need for increased development and financing of affordable housing. For each state in the FHLB of Seattle region, more than 90 percent of allocated tax credit funds were used for the development of affordable housing. This

use of tax credits indicates that there is demand from developers and investors to include this source of equity financing for affordable housing. As the federal government reduces funding sources for the development of affordable housing and shifts responsibility to state and local governments, the LIHTC allocated funds are increasingly the only tool to finance affordable housing.

For the investment market, the changes in the holders of multifamily debt over the last twenty years highlight striking trends in the financing of multifamily housing. Commercial banks and savings and loan institutions have reduced holdings in multifamily housing debt, while private MBS and federally related mortgage pools have steadily increased their share in the last decade. This increased demand in multifamily housing as an investment opportunity has created opportunities for different agencies and programs to meet the need of investors. Further, several member banks indicated an interest in purchasing securities that are composed of affordable housing loans, highlighting an additional opportunity for marketing security investments.

Lastly, for secondary market mortgage market programs, there is an opportunity to address an unmet need in the housing finance industry. Many of the large institutions, like the GSEs, overlook a substantial segment of the market. The GSEs typically provide financing for large loans and for lenders who have the capacity to become approved lenders under various lending programs. The GSEs programs neglect the lenders who are financing smaller loans and who lack significant loan volume for the secondary market. Currently, the secondary market mortgage programs are working to meet this need for lending institutions that are interested in accessing the secondary market. The interest that has been generated in these programs illustrates a potential for growth within the industry.

- **Community service.** In interviews, both secondary market programs and many member banks highlight the importance of financing affordable housing as a means to meet community needs. For some institutions, meeting the needs of the community was primary in the mission of the organization. Expanding access to the secondary market provides an opportunity for lenders, programs and investors to meet this goal.

- **Regulatory requirements.** The primary regulation that lenders meet in financing affordable housing is CRA requirements. If lenders have the opportunity to originate more multifamily loans, there are increased opportunities to meet CRA goals. For many lenders, these CRA regulations motivate the type of loan origination that lenders do.
- **Loan performance.** The risk associated with multifamily loans, particularly affordable multifamily loans, is an important consideration in the secondary market. As mentioned, the experience of Fannie Mae and Freddie Mac raised concerns about feasible investment in multifamily mortgages. However, responses from programs and member banks indicate that multifamily loans, including affordable multifamily loans, are a strategic component of their financial portfolio. Further, research on the LIHTC program finds that mortgages on developments that use LIHTCs have low delinquency and default rates. This performance of affordable multifamily loans counters some perceptions of risk on affordable housing as an investment opportunity.
- **Income.** The primary reason that member banks listed for originating multifamily loans was that multifamily housing is a profitable investment for the bank. The banks are able to generate income through origination and closing fees, as well as fees for servicing over the life of the loan. In accessing the secondary market, lenders want to ensure that the ability to raise income from these transactions is not diminished. Depending on the pricing of the loans and the underwriting guidelines, the secondary market has the potential to increase the ability of lenders to generate fees by providing the capital to originate more loans.
- **Customer base.** Member banks were also concerned about the maintenance and development of its customer base. Accessing the secondary market may present additional opportunities to originate loans, expanding the current customer base. Some member banks indicated that it was important to maintain the servicing of the loan because of the connection with the customer, creating opportunities to provide other products and services. To be successful, opportunities to access the secondary market

need to recognize the relationships that lenders build to ensure the profitability and success of the lender.

For secondary market programs, the typical “customers” that sell loans are either approved lenders or lending consortia. Having established lenders or consortia provides the programs with a degree of control in managing the source of loan purchase. To date, utilizing approved lenders and working with consortia has been effective customer base for developing programs and facilitating secondary market transactions.

#### *BARRIERS*

- **Loan standardization.** The securitization process requires the standardization of mortgage loans. In the single-family mortgage market, the loan terms and documentation are similar for every loan that is originated, allowing for efficient pooling of the loans. This standardization streamlines the underwriting and credit rating process. The multifamily mortgage market has typically lacked any standardization in loan terms or documentation. The member banks and the secondary mortgage market programs highlighted this lack of standardization in the multifamily mortgage market.

Member banks that currently sell multifamily loans in the secondary market originate loans that meet underwriting guidelines established by secondary market purchase program. Those who plan to sell multifamily loans must be fastidious in meeting the underwriting criteria established by the purchaser. If not, lenders face holding the loan in its portfolio, which may not support the current bank investment standards. For member banks that have no experience selling in the secondary market, meeting these underwriting guidelines can often be difficult or financially prohibitive.

For programs that purchase loans, the lack of loan standardization raises significant challenges. In many cases, secondary market programs re-underwrite each loan that they purchase, and often require extensive research to ensure due diligence. This process is a costly and time intensive, but necessary, step to ensure that the loans are appropriate investments for either the purchase program or investor.

- **Loan pricing.** The level of interest in both selling and purchasing loans is typically based on how the loan is priced in the market. Both secondary market programs and member banks tempered their ability to capitalize on the benefits of the secondary market based on the capacity to achieve profit or provide for investor needs. The capacity to reach these objectives starts with how the loan is priced in the market.
- **Transaction costs.** The transaction costs for selling and buying loans for the secondary market impact the effectiveness of the tool for promoting affordable housing development. To meet underwriting guidelines, lenders incur costs for due diligence and third party reports. Often, it can be difficult for lenders to meet these requirements when originating loans, particularly for smaller banks and for banks that do not generate a significant volume of multifamily loans. For member banks that have sold loans in the secondary market, transaction costs make the secondary market inefficient as a means to generate income and meet the community needs for housing. For secondary market programs, the cost of purchasing loans and ensuring that loans are viable for sale can be prohibitive in expanding programs.
- **Experience.** Several member banks cited a lack of experience or knowledge of the secondary market as barrier. Generally, smaller banks do not have the experience or the staff resources to sell loans in the secondary market. This lack of experience hinders lenders from exploring how the securitization of loans could potentially increase access to capital for affordable housing. For secondary market purchase programs, the lack of experience or sophistication with capital markets by lenders requires more investment in education or support to ensure that loans are appropriate for sale in the secondary market.
- **Volume.** For some member banks, there are few opportunities in its service area to originate multifamily loans. Typically, these banks were located in smaller communities. This lack of loans to originate indicates some level of reduced demand for multifamily housing at the local level. If the loans are not available for the banks, access to the secondary market does not provide a benefit.

For secondary market programs, a primary challenge is developing a significant volume of loans to package into a security. Several programs are investigating options to “warehouse” loans until sufficient volume is generated. If the loan volume is not large enough, it is difficult for a program to make investment attractive to investors.

- **Credit rating.** Several secondary market mortgage programs have mortgage securities rated by one of the nationally accredited rating agencies, like Standard and Poor’s, Moody’s, or Fitch. The ratings by these agencies provide a standard by which investors can measure the risk associated with any given investment. For the programs that do rate their investments, the advantage is that investors have criteria on which to rate the security without analyzing each individual underlying loan. For programs that do not rate their securities, there is a greater need to “sell” investors on the strength of the investment. The rating agencies have been providing ratings for affordable multifamily loan pools for many years, but they have traditionally been for state housing finance agencies that are issuing bonds for the direct financing of multifamily housing. These newer programs are acting as a conduit between lenders and investors, and the rating agencies have begun to develop standards for rating the securitized pools.

## **STRATEGIES FOR THE FHLB OF SEATTLE**

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The FHLB of Seattle has a unique opportunity to affect change in the process of the securitization of affordable housing loans. As an agency with a mission to support affordable housing and the resources to provide a wide range of products, the FHLB of Seattle can potentially support the flow of capital at various levels in the process. The challenge is determining how the FHLB of Seattle can best facilitate the movement of capital to affordable housing through the securitization process.

The outline of opportunities and barriers experienced by programs and member banks illustrate where the FHLB of Seattle can leverage its resources to support the needs of member banks and the communities the banks serve. At each level of transaction, strategies can be implemented to capitalize on the opportunities in the secondary market and to address barriers to efficiency.

The discussion of these opportunities and barriers highlight three potential strategies that the FHLB of Seattle could implement. First, to support origination of multifamily mortgages that are viable investments in the secondary market, FHLB of Seattle could provide lender education to increase awareness of available secondary market programs and how these programs benefit banks in meeting lending goals. Second, the FHLB of Seattle could develop a secondary market purchase program, similar to the work of the FHLBA, which would expand opportunities for selling loans and for providing investment opportunities for member banks. Lastly, the FHLB of Seattle can purchase securities that are composed of affordable multifamily loans to support growth of the secondary market programs.

Each of these options capitalizes on the opportunities that programs and member banks highlighted. The strategies support the market demand for access to the secondary market, provide options for meeting the community needs, increase opportunities for lenders to generate income, and build a customer base. For each strategy, the question becomes what barriers does the strategy address and what implementation challenges might exist (Table 5).

<b>Table 5: Possible Strategies for FHLB of Seattle</b>		
<i>Strategy</i>	<i>Barriers Addressed</i>	<i>Implementation Issues</i>
<b>Lender Education</b>	Lack of knowledge Volume Loan standardization	Staff resources Level of support
<b>Program Development</b>	Transaction costs Loan Standardization Credit Rating	Staff resources Regulations Cost
<b>Investment</b>	Volume	Credit ratings

- **Lender education.** The lack of experience or sophistication with capital markets was cited by both programs and member banks as a barrier to participation in the secondary market. By supporting lender education, the FHLB of Seattle can support increased access to the secondary market.

Depending on how this strategy is developed, providing information and resources to lenders about the secondary market can address several barriers experienced by both lenders and secondary mortgage market programs. Primarily, it directly addresses the lack of familiarity that many smaller lenders have about the secondary market and its benefits for multifamily financing.

Several programs indicated that generating loan volume was a challenge in creating sufficient pools of multifamily loans for the secondary market. Educating lenders about secondary mortgage market programs can support the growth of those programs that are working to specifically address the needs for financing affordable housing. Further, this connection between lenders and programs is particularly beneficial for smaller lenders, which historically have struggled to effectively accessing the secondary market through Fannie Mae and Freddie Mac.

Lastly, working with lenders who are interested in selling loans in the secondary market creates the potential for improved loan standardization. To increase efficiency in the market, loan standardization is essential. If lenders understand the underwriting requirements of secondary mortgage market programs and how those requirements are

different from current multifamily loans, the flow of information, and eventually capital, between the borrower, lender, and purchaser is more effectively facilitated.

The successful implementation of this strategy requires further evaluation of the role that the FHLB of Seattle wants to take in the secondary market for affordable housing loans and the resources that are available to support that effort. If the FHLB of Seattle were to pursue a lender education program, the scope of the program and availability of FHLB staff resources needs to be considered. Currently, the FHLB of Seattle has partnered with Community Reinvestment Fund (CRF) to investigate the securing of a credit rating for loan pools that CRF is developing. The design of a pilot program that connects FHLB of Seattle member banks with CRF and includes an education component, which addresses the specific guidelines that are critical for selling loans in the secondary market, provides added value both to lenders and CRF. For the FHLB of Seattle, the development of this type of program requires an analysis of the level of involvement that the FHLB of Seattle deems most effective.

Lastly, many lenders were challenged by the lack of staff resources available to explore participation in the secondary market. This strategy involves examining the commitment of staff resources that the FHLB of Seattle is able to provide for member banks.

- **Program development.** Of the three strategies, the development of a multifamily mortgage purchase program involves the highest level of commitment by the FHLB of Seattle. FHLBanks that have explore this option, like the FHLBA, have found that the program meets the needs of lenders, yet requires investment of significant resources to maneuver through the regulatory landscape and other market barriers.

In developing a program, the FHLB of Seattle has the opportunity to mitigate high transaction costs and the lack of loan volume. In the case of FHLBA, the bank holds its participation interest in the loans in the Bank portfolio, as opposed to securitizing the loans for sale to investors. This process allows the bank to reduce the costs associated with packaging and rating the security, though costs for due diligence clearly remain.

Also, if the loans are held in portfolio, the bank does not need the volume of loans that programs that securitize loans for sale to investors require.

This strategy requires extensive resources from the FHLB of Seattle, in comparison to the other strategies. The development of a secondary mortgage market purchase program necessitates additional staff resources and start up costs. Further, the FHLB of Seattle operates within a system of government regulations, and any program development involves a thorough investigation of the potential regulatory barriers.

- **Investment in affordable multifamily securities.** The final strategy is one that the FHLB of Seattle is currently exploring. By investing in securities that are composed of affordable multifamily loans, the FHLB of Seattle facilitates the securitization process for the affordable multifamily loans. Many of the secondary market programs struggle in developing a strong base of investors. The FHLB of Seattle can fill the role of investor, directly supporting the movement of capital in the secondary market.

Investing in securities mitigates only a few of the barriers to the secondary market. Yet, this strategy faces the least challenges to implementation. As an investor in the market, the FHLB of Seattle generates increased demand for securities that are backed by affordable multifamily loans. While investing in affordable housing in this way supports the mission of the FHLB of Seattle, the security must meet certain internal investment guidelines in order to be purchased by the FHLB of Seattle.

In its partnership with CRF, the FHLB of Seattle is exploring this strategy as a way to support lending to affordable multifamily developments and its mission to provide affordable housing. Again, the challenge is creating investments that allow the FHLB of Seattle to purchase investments that meet internal investment requirements. The financing structure that CRF is investigating allows the FHLB of Seattle to purchase investments that are rated AA or higher by the national rating agencies. If this structure is successfully rated at that level, this strategy may offer the most straightforward approach to supporting the secondary market for affordable multifamily mortgages.

As mentioned, the development of strategies for the FHLB of Seattle is limited by the scope of this research. Yet, by investigating how the FHLB of Seattle can affect changes at different points in the securitization, there is a clear illustration of the wide range of possibilities that exist. The securitization process is relatively young in its development, and there are opportunities to further investigate how affordable housing development benefits from this financing structure.

## **RECOMMENDATIONS**

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The primary purpose of this research is to investigate how the FHLB of Seattle and the communities that it serves can benefit from the securitization of affordable multifamily loans. By examining current secondary market programs, analyzing market demand for multifamily housing, and interviewing member banks of the FHLB of Seattle, this research concludes that demand exists for multifamily housing and for the expansion of opportunities to access the secondary market. This demand is based on the belief that the securitization process creates access to capital and increased liquidity for lenders who are originating affordable multifamily loans. By supporting the flow of capital, there can be increased funding at the community level for affordable housing.

Yet, barriers impede this movement of capital in the secondary market. Both lenders and secondary mortgage market programs face obstacles in efficiently financing affordable multifamily housing loans. The fundamental goal is to develop strategies that address these barriers without further hindering the process. The strategies outlined in the previous section aim to support the FHLB of Seattle in exploring its role in the secondary market. Each strategy addresses the securitization process at a different point in the transaction. From origination to investment, the FHLB of Seattle has the opportunity to implement its mission and utilize its resources in the secondary market for affordable multifamily housing loans.

### ***RECOMMENDATIONS***

Underlying this discussion is a fundamental question about whether private market systems, like the secondary market, can be effective tools for accomplishing public policy goals. For the FHLBank system with a mission to support affordable housing, this type of private-public partnership is both possible and needed to address barriers to financing. Therefore, the FHLB of Seattle has the opportunity to take a leading role in expanding access to the secondary market for affordable housing loans. The recommendations for the FHLB of Seattle are:

- **Engage in innovation.** The utilization of the secondary market as a vehicle for expanding financing for affordable housing is in its infancy. None of the programs,

outside Fannie Mae and Freddie Mac, began purchasing affordable multifamily loans prior to 1997. Though there are barriers, the increased demand for multifamily housing and consistently growing need for affordable housing command innovative solutions that grow from private-public partnerships.

- **Evaluate strategies.** The FHLB of Seattle has a range of options for expanding access to the secondary market for affordable multifamily housing. However, for each strategy, the process of implementation is hindered by various constraints. Evaluating these strategies using criteria that incorporates the goals of the FHLB of Seattle and the financial and technical components of financing structures, can provide a more definitive course of action.
- **Involve stakeholders.** Each stage in the securitization process involves various stakeholders who manage the transaction and benefit from the outcome. In evaluating the strategic approaches to accessing the secondary market, the involvement of these stakeholders, including developers, lenders and other programs, enriches the analysis. The inclusion of these groups enhances the support that the FHLB of Seattle will receive in implementing a successful plan.

The evolution of the housing finance industry has created a unique occasion to investigate private-public partnerships between capital markets and affordable housing. The securitization process encourages the movement of capital between borrowers and investors who share the common goal of ensuring the provision of affordable housing. As the federal government continues its retrenchment in the direct provision of affordable housing, this type of innovation becomes increasingly important. In the end, housing remains both a human need and a market commodity, and it is the solutions that recognize this dynamic nature that thrive.

## END NOTES

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- <sup>2</sup> Jack Goodman, “The Changing Demography of Multifamily Rental Housing,” Housing Policy Debate, Volume 10, Issue 1 (1999) 41
- <sup>3</sup> U.S. Department of Housing and Urban Development, “Study of Multifamily Underwriting and GSEs’ Role in the Multifamily Market,” (Washington D.C.: U.S. Department of Housing and Urban Development, August 2001) 41.

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- <sup>2</sup> Leland C. Brendsel, “Securitization’s Role in Housing Finance: The Special Contributions of the Government-Sponsored Enterprises,” in A Primer on Securitization (Cambridge, Massachusetts: Massachusetts Institute of Technology Press, 1996) 22.
- <sup>3</sup> Federal Home Loan Bank of Seattle region includes Alaska, Hawaii, Idaho, Montana, Oregon, Utah, Washington, Wyoming and Pacific Islands of Guam and American Samoa. For the purpose of this research, the Pacific Islands of Guam and American Samoa are excluded from the analysis.
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- <sup>12</sup> Ibid, 5.
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<sup>3</sup> J. Paul Mitchell, "Historical Overview of Direct Federal Housing Assistance," in Federal Housing Policy and Programs: Past and Present (New Brunswick, New Jersey: Center for Urban Policy Research, 1985) 193.

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<sup>6</sup> Ibid, 499.

<sup>7</sup> Ibid, 502.

<sup>8</sup> Ibid, 505.

<sup>9</sup> Ibid, 510.

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<sup>12</sup> Goodman, 31.

<sup>13</sup> Ibid, 33.

<sup>14</sup> Ibid, 41.

<sup>15</sup> Ibid, 39.

<sup>16</sup> The benchmark rent for this standard is the Fair Market Rent that is set by the U.S. Department of Housing and Urban Development (HUD) for different regions across the county.

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## ***HOUSING FINANCE: GROWTH OF THE SECONDARY MARKET***

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<sup>3</sup> Office of Comptroller of the Currency, "CRA Regulations," [www.occ.treas.gov/fr/cfrparts/12CFR.htm](http://www.occ.treas.gov/fr/cfrparts/12CFR.htm). (Accessed May, 2002).

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<sup>4</sup> Joint Center for Housing Studies of Harvard University (2001), 10.

<sup>5</sup> Ibid, 11.

<sup>6</sup> This research differs from the State of the Nation's Housing report in that the analysis includes only multifamily renters, whereas the State of the Nation's Housing report includes both single-family and multifamily renters in its analysis.

<sup>7</sup> Goodman, 46.

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<sup>8</sup> Maria Siakavellas, "A/H Developers Stay on Track Despite Changing Industry," Multi-Housing News, Volume 37, Issue 3, (March 2002), 1.

<sup>9</sup> U.S. Bureau of Labor Statistics, "Labor Force Statistics," <http://data.bls.gov/>; accessed May 20, 2002.

<sup>10</sup> DiPasquale and Cummings (1992), 87.

<sup>11</sup> The vacancy rate data is for all rental housing, both single-family and multifamily.

### ***MEMBER BANK PERSPECTIVE***

<sup>1</sup> The response rate for the member bank interviews was 95 percent, with 18 out of 19 banks responding to the request for a phone interview. This high response rate is attributed to the introduction letter that was sent to contacts by the FHLB of Seattle by a Senior Vice President. Further, the FHLB of Seattle is viewed as an effective resource for member banks and most contacts were willing to share their experience.

### ***DISCUSSION: OPPORTUNITIES AND BARRIERS***

<sup>1</sup> Different data sources illustrate the demand for different segments of the market. The housing permit and vacancy rate data provides an overview of the entire multifamily market, whereas data on the LITHC specifically points to demand for financing of affordable multifamily housing.

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## **APPENDIX A: INTERVIEW PROTOCOL**

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The purpose of these interviews is to learn how member institutions feel about the opportunity to participate in a secondary market for multifamily loans. The primary emphasis is on how banks perceive the opportunity to sell their loans into the secondary market. There will also be questions about banks' interest in the investment opportunities of a secondary market. The interviews will be semi-structured with several open-ended questions.

### ***QUESTIONS FOR SECONDARY MARKET PROGRAMS***

- What was the motivation to provide your program?
- What are the barriers, if any, to active participation in the secondary market for multifamily lending?
- What are the benefits for financial institutions to participate in your program? What are the drawbacks?
- Who are the other key players in the industry, outside Fannie Mae and Freddie Mac?
- Who are your customers? For selling loans? For investment?
- How do you perceive demand for your program? From sellers? From buyers?
- What are the primary regulatory constraints that your program faces?
- Do you believe that access to the secondary market is creating additional opportunities for creating affordable housing?
- Any other thoughts that you would like to share about these issues?

### ***QUESTIONS FOR MEMBER BANKS***

- Does your bank do multifamily lending?
- What motivates your bank to participate in multifamily lending?
- Does your bank sell loans in a secondary market?
- What are the barriers, if any, to active participation in a secondary market?

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- What are the benefits to participating in a secondary market for your bank? What are the drawbacks?
  - Would you be interested in selling seasoned multifamily loans in a secondary market? Why or why not?
  - Would you be interested in purchasing a CRA-eligible security that is underwritten by affordable multifamily loans? Why or why not?
  - Do you believe that access to the secondary market will improve your bank's ability to do affordable housing loans in your community?
  - Any other thoughts that you would like to share about these issues?

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**APPENDIX B: DEFINITIONS OF ACRONYMS**

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AHFC	Alaska Housing Finance Corporation
AMPP	Affordable Multifamily Participation Program (FHLBA)
CDT	Community Development Trust, Inc.
CMBS	Commercial Mortgage-Backed Securities
CRA	Community Reinvestment Act
CRF	Community Reinvestment Fund
FHLBA	Federal Home Loan Bank of Atlanta
FIRREA	Financial Institutions Reform, Recovery and Enhancement Act, 1989
GSE	Government-Sponsored Enterprise
HUD	U.S. Department of Housing and Urban Development
LIHTC	Low-Income Housing Tax Credits
MBS	Mortgage-Backed Securities
MLPP	Mortgage Loan Purchase Program (AFHC)
REIT	Real Estate Investment Trust