JOHNS HOPKINS UNIVERSITY
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A Policy Framework for the Multifamily Special Affordable Housing Goals for Fannie Mae and Freddie Mac

Thesis in Real Estate Investment Management

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This thesis discusses the statutory and regulatory history of the housing goals for Fannie Mae and Freddie Mac, their purchase of multifamily mortgages from 1993 to 2006 and the Multifamily Special Affordable Housing Goal Congress required the Federal Housing Finance Agency to establish when it enacted the Housing and Economic Recovery Act in July 2008.

Statement of Purpose

The purpose of this thesis is to develop a policy framework for establishing the Multifamily Special Affordable Housing Goal that was set forth in the Housing and Economic Recovery Act of 2008 (HERA). HERA requires the Director of the Federal Housing Finance Agency (FHFA) to "establish a single annual goal, by either unit or dollar volume, of purchases by each enterprise of mortgages on multifamily housing that finance dwelling units affordable to low-income families" for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), which are collectively known as the Enterprises.[1] This goal is designed to promote the availability of multifamily dwelling units that serve low-income families (families with earnings of 80 percent or less of area media income (AMI)) and very low-income families (families with earnings of 50 percent or less of AMI). The statute also requires FHFA to report on the Enterprises' purchases of mortgages secured by small multifamily properties (properties with 50 dwelling units or less or where the unpaid principal balances of the mortgages are $5,000,000 or less).[2]

This thesis examines the Enterprises' purchase activities related to low-income multifamily dwelling units, very low-income multifamily dwelling units and mortgages secured by small multifamily properties. The understanding gained from examining these areas was then used to develop a policy framework for establishing the Multifamily Special Affordable Housing Goal that could contribute to FHFA effort to produce regulations responsive to Congress'

[1] Housing and Economic Recovery Act of 2008, Section 1128 (b), Section 1333 (a)(1)
[2] Housing and Economic Recovery Act of 2008, Section 1128 (b), Section 1333 (a)(3)

objective to have the Enterprises finance more dwelling units for low-income and very low-income households.

Executive Summary

I. Introduction

The Federal Housing Finance Agency (FHFA) has been given the duty of establishing a Multifamily Special Affordable Housing Goal for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), which are collectively known as the Enterprises. The objective of this goal is to have the Enterprises finance dwelling units affordable to low-income and very low-income households, defined as households earning no greater than 80 percent of area median income or 50 percent of area median income, respectively. FHFA is also required to collect information from the Enterprises on their financing of small multifamily properties (those with 50 units or less), and FHFA has the authority to add requirements related to small multifamily properties and other areas to the Multifamily Special Affordable Housing Goal.

The Policy Framework for the Multifamily Special Affordable Housing Goal was written to potentially assist FHFA with its effort to perform its duty of establishing regulation for this housing goal. In addition to outlining a policy framework for the FHFA, this thesis provides the statutory and regulatory background of housing goals for the Enterprises, provides basic information of the affordability issues facing low-income and very low-income families and findings from analysis performed on the Enterprises' publically available multifamily mortgage purchase data.

II. Background

In July 2008, Congress enacted the Housing and Economic Recovery Act of 2008 (HERA) that created FHFA and requires FHFA to establish new housing goals for the

Enterprises, including a Multifamily Special Affordable Housing Goal. The new housing goals will replace the housing goals established by the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (FHEFSSA). Since 1995, the Department of Housing and Urban Development (HUD) has issued regulation establishing three housing goals for dwelling units financed by the Enterprises. HUD has collected mortgage purchase data and measured the Enterprises' housing goals performance:

- The Low- and Moderate Income Housing Goal for the purchase of mortgages for housing for low- and moderate income families;
- The Special Affordable Housing Goal for the purchase of mortgages for rental and owner-occupied housing affordable to low-income families in low-income areas and very low-income housing; and
- The Central Cities, Rural Areas and Other Underserved Areas Housing Goal (Underserved Housing Goal) for the purchase of mortgages for housing located in central cities, rural areas or other underserved areas.[3]

Table 1. The Enterprises Housing Goals from 1996 to 2008

Housing Goals	1996	1997-00	2001-04	2005	2006	2007	2008
Low- and Moderate-Income	40.0%	42.0%	50.0%	52.0%	53.0%	55.0%	56.0%
Geographically Targeted	21.0%	24.0%	31.0%	37.0%	38.0%	38.0%	39.0%
Special Affordable	12.0%	14.0%	20.0%	22.0%	23.0%	25.0%	27.0%
Special Affordable MF-Fannie Mae	$1.29 B	$1.29 B	$2.85 B	$5.49 B	$5.49 B	$5.49 B	$5.49 B
Special Affordable MF-Freddie Mac	$0.99 B	$0.99 B	$2.11 B	$3.92 B	$3.92 B	$3.92 B	$3.92 B

Source: 24 Code of Federal Regulation Part 81: The Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) Regulation; Original Final Rule, 12/1/1995, as amended on 10/31/2000 and as amended on 11/02/2004

[3] The Federal Housing Enterprises Financial Safety and Soundness Act of 1992, Section 1331-1334

HUD has set targets for these goals that have increased over time (Table 1).

HERA established three single family purchase money housing goals for the purchase of conventional, conforming, owner-occupied mortgages belonging to low-income families, families residing in low-income areas and very low-income families. These goals would be measured as a percentage of the total number of conventional, conforming, owner-occupied purchase-money mortgages purchased. A fourth single family housing goal was for the purchase of conventional and conforming used to refinance a mortgage for an owner-occupied single family dwelling unit where the families are low-income. This goal would be measured as a percentage of the total number of conventional, conforming, owner-occupied refinancing mortgages purchased.[4]

HERA established a Multifamily Special Affordable Housing Goal for the purchase of mortgages that finance multifamily dwelling units affordable to low-income families. The Director has the discretion to measure this housing goal by dwelling units financed by the mortgages purchased or the total dollar volume of the mortgages purchased. The Director is required to establish additional requirements for the purchase of multifamily mortgages used to finance dwelling units affordable to families earning very low-incomes. This Act defines a very low-income family to be a family with earnings of 50 percent or less of area median income while the Act of 1992 defined this term to be equal to or less than 60 percent of area median income. The Director is required to report on the number of mortgages financing small

[4] Housing and Economic Recovery Act of 2008, Section 1128 (b), Section 1332 (a)

multifamily properties, which may be defined either as those with 5 to 50 dwelling units or those with mortgages up to $5,000,000.[5]

III. Findings from Data Analysis

From 1993 to 2006, Fannie Mae purchased 71,650 mortgages that financed 5,606,180 dwelling units, and over 76 percent of these dwelling units were low-income. Freddie Mac purchased 48,087 mortgages that financed 4,788,399 dwelling units and more than 85 percent were secured by dwelling units affordable to low-income households. A substantial percentage of the difference in total dwelling units financed by the Enterprises can be explained by Freddie Mac's total number of dwelling units financed from 1993 to 1997.

The Enterprises financed 2,115,086 very low-income dwelling units from 1993 to 2006, which represent 20.3 percent of the multifamily dwelling units that they financed. Freddie Mac financed a higher percentage of very low-income dwelling units than Fannie Mae. While 16.3 percent of all dwelling units that Fannie Mae financed are affordable to very low-income households from 1993 to 2006, 25.1 percent of Freddie Mac's multifamily mortgage purchases fall into this category.

The Enterprises purchased a large number of mortgages associated with small multifamily properties; however the total number of dwelling units financed in large multifamily properties is far greater. From 1993 to 2006, Fannie Mae and Freddie Mac purchased 71,609 mortgages secured by small multifamily properties containing 1,185,302 dwelling units. During the same period, the Enterprises purchased 48,128 mortgages that financed 9,209,276 dwelling units in large multifamily properties.

[5] Housing and Economic Recovery Act of 2008, Section 1128 (b), Section 1333 (a)

Analysis of the Enterprises' purchase data reveals significant geographic concentration and very limited presence in rural areas. The Enterprises' mortgage purchases were concentrated in twenty states during the assessment period. Fannie Mae and Freddie Mac mortgage purchases were concentrated in California and other large states: 52.9 percent of Fannie Mae purchases and 44.2 percent of Freddie Mac purchases were in California from 1993 to 2006. Of the 119,737 mortgages purchased by the Enterprises during this period, 79.7 percent of the properties financed were located in ten states, and 91.5 percent were in the top 20. Fannie Mae purchased 1,299 multifamily mortgages secured by properties in non-metropolitan areas from 1993 to 2006. This represents 1.8 percent of all Fannie Mae purchased during this period. Freddie Mac's percentage was approximately 2.3 percent of all multifamily mortgage purchases associated with nonmetropolitan areas. In 2003, 16.8 percent of all renters lived in nonmetropolitan areas.[6]

IV. Policy Framework

FHFA should employ a multifaceted approach to establish the housing goals in order for the Multifamily Special Affordable Housing Goal to be effective. This approach should lead the Enterprises to finance low-income and very low-income dwelling units in a manner that serves the nation's credit needs. It also needs to channel funds into the most efficient forms of multifamily housing. The approach proposed in this thesis would lead the Enterprises to finance both low and very low-income dwelling units in both metropolitan and nonmetropolitan areas while encouraging them to consider issues of geographic diversity and financing small multifamily properties with dwelling units affordable to low-income and very low-income households:

[6] Joint Center for Housing Studies of Harvard University, America's Rental Housing: Homes For a Diverse Nation, 2006, Table A-6

- The Multifamily Special Affordable Housing Goal should be a dwelling unit percentage housing goal with a dollar volume component similar to the Special Affordable Housing Goal that included a Special Affordable Multifamily Purchase Subgoal;
- FHFA should establish a subgoal for financing low-income dwelling units located in nonmetropolitan areas that should be a dwelling unit percentage subgoal for low-income dwelling units that qualify under the housing goal;
- FHFA should require the Enterprises to submit annual reports on their small property financing activities and the geographic disbursement of the mortgages they purchase; and
- For the purposes of reporting on small multifamily properties, small multifamily property should be defined as those with 5 to 50 dwelling units.

Thesis in Real Estate Investment Management

I. Introduction

With the passage of the Housing and Economic Recovery Act of 2008 (HERA) that mandates establishment of a Multifamily Special Affordable Housing Goal, Congress has sent the message that the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) should improve their performance with respect to financing multifamily dwelling units affordable to low-income and very low-income families and households.[7] Studies have revealed a shortage of these dwelling units and the rents for low-income and very low-income families and households are high relative to their incomes.

HERA also created the Federal Housing Finance Agency (FHFA) and tasked it with issuing a regulation to establish the Multifamily Special Affordable Housing Goal. In order for it to complete this task, FHFA should identify the areas in which Fannie Mae and Freddie Mac, collectively known as the Enterprises, are underperforming. Once this is known, policy remedies should be incorporated into the regulation establishing the Multifamily Special Affordable Housing Goal.

Though recent events call into question whether the Enterprises will continue to exist in their present form, there remains support for the Enterprises, in whatever form they take, playing a significant role in the mortgage market for multifamily properties serving low-income families. On September 7, 2008, FHFA announced that the Boards of the Enterprises consented to being placed into conservatorship. On September 12, 2008, FHFA released a statement that included the following:

[7] Housing and Economic Recovery Act of 2008, Section 1128 (b), Section 1333 (a)

> "FHFA recognizes the importance of all aspects of the Enterprises' multifamily businesses—including the LIHTC (low-income housing tax credit) area and liquidity facilities for remarketed mortgage revenue bonds – for a healthy secondary market and housing affordability. In particular, support for multifamily housing finance is central to the Enterprises' public purpose."[8]

Because of this support, it is reasonable to conclude that goals for the Enterprises' low-income housing activities will continue to exist, and pursuing a better understanding of the impact of the previous housing goal regime is a productive endeavor.

Notwithstanding the support by the Enterprises' conservator, a belief persists that the housing goals are a major reason the Enterprises were placed in conservatorship. As will be discussed in more detail later, from 2004 to 2006, the Enterprises relied on multifamily dwelling units to meet their goals, and the majority of these dwelling units were affordable to low-income families. Unlike in the single-family markets, multifamily mortgage defaults remain relatively low. On September 10, 2008, the Mortgage Bankers Association reported that Fannie Mae had a 0.11 percent delinquency rate (60 days or more delinquent) based on its unpaid principal balance of their multifamily loans at the end of the second quarter. Freddie Mac's rate was 0.03 percent. Since these rates are significantly lower than those for banks and thrifts (1.18 percent) and commercial mortgage backed securities (0.53 percent), it appears that at least their multifamily mortgage purchases for the purposes of meeting the housing goals did not contribute to their demise.[9]

The claims that the housing goals were set aggressively and that the Enterprises invested in subprime and nontraditional mortgages to meet the housing goals are debatable. According to

[8] Federal Housing Finance Agency, FHFA Statement of Support for Multifamily Housing Finance Activities of the Enterprises while in Conservatorship, September 12, 2008

[9] Mortgage Bankers Association, MBA: Commercial/Multifamily Mortgage Delinquency Rates Up Slightly; Still Performing Well, September 10, 2008, http://www.mortgagebankers.org/NewsandMedia/PressCenter/64870.htm

a Congressional Budget Office report in 2005, the Enterprises financed a smaller proportion of mortgages for low- and moderate-income families than the market as a whole. HUD set the housing goals so that the Enterprise performance would match the market by the end of 2008.[10] Exceeding the market would be aggressive by most measures, not matching the market. Though it is possible that the large share of the market represented by subprime and nontraditional mortgages may have made it difficult to meet housing goals without purchasing them, it is also true that these loans and the mortgage-backed securities collateralized by them had higher yields. Without knowledge of the Enterprises' business objectives one cannot definitively say whether the Enterprises were purchasing these mortgages to meet the housing goals, boost profits or some combination of both. In fact, as a result of their yield, it is reasonable to believe that the Enterprises would have purchase these loans even if there were no housing goals.

This thesis is written from the perspective that establishing housing goals for the Enterprises is sound public policy and that the housing goals can be implemented in a manner that does not threaten the safety and soundness of the Enterprises. It is intended to assist FHFA with its task of establishing a Multifamily Special Affordable Housing Goal. HERA gives FHFA the option of establishing this housing goal based on dwelling units or a dollar volume; requires FHFA to establish additional requirements for financing dwelling units affordable to very low-income families; and provides FHFA with the option of establishing additional requirements for the financing of small multifamily properties that serve low-income families (HERA gives FHFA the discretion to define small multifamily property as those with 5 to 50

[10] Congressional Budget Office, Aligning the Costs and Benefits o the Housing Government-Sponsored Enterprises, April 21, 2005, http://www.cbo.gov/doc.cfm?index=6303&type=0

dwelling units or those where the mortgages the mortgage purchased has a unpaid principal balance up to $5,000,000).[11] Data analysis was performed to determine the Enterprises' historic performance in each of these areas and the policy issues associated with each are discussed.

HERA allows FHFA to take into consideration other factors, including "the national multifamily mortgage credit needs and the ability of the enterprise to provide additional liquidity and stability for the multifamily mortgage market."[12] While performing the above mentioned data analysis, it was discovered that the Enterprises' purchases were geographically concentrated. Given that Congress allows FHFA to take this issue into consideration, this thesis also includes a discussion of the geographic dispersal of the Enterprises' mortgage purchases.

Before discussing these four policy issues associated with establishing the Multifamily Special Affordable Housing Goal, background information will be provided on the statute and regulations that influence the Enterprises' multifamily mortgage purchases from 1993 to 2006. A brief discussion of the shortage of affordable housing and rents is also included in the background.

[11] Housing and Economic Recovery Act of 2008, Section 1128(b), Section 1333(a)
[12] Housing and Economic Recovery Act of 2008, Section 1128(b), Section 1333(a)(4)

II. Background

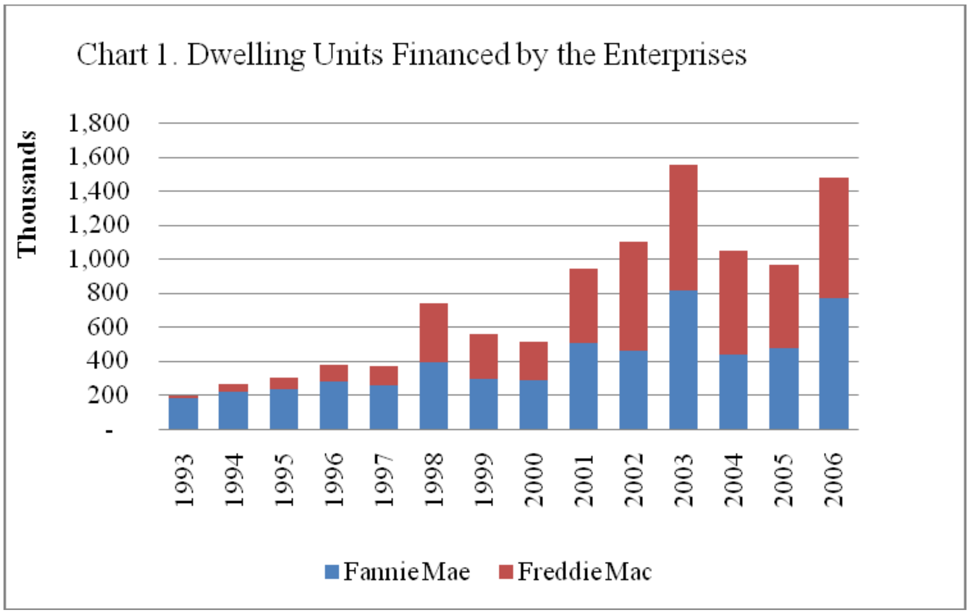
There are two federal statutes that are relevant to this thesis. One established the original housing goals for the Enterprises to finance low-income dwelling units, and the second established new housing goals requirements, including the Multifamily Special Affordable Housing Goal. Between the passage of these Acts, HUD published three regulations setting targets and establishing rules for the housing goals. Having information on these Acts and regulations is important to understanding how FHFA should proceed in establishing the Multifamily Special Affordable Housing Goal.

With the passage of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (FHEFSSA), the federal government mandated that the Enterprises' support the financing of dwelling units affordable to low-income families. And since 1993, the Department of Housing and Urban Development (HUD) has issued rules establishing three housing goals governing the Enterprises' activities related to them, collecting mortgage purchase data and measuring the Enterprises' housing goal performance:

- The Low- and Moderate Income Housing Goal for the purchase of mortgages for housing for low- and moderate income families;
- The Special Affordable Housing Goal for the purchase of mortgages for rental and owner-occupied housing affordable to low-income families in low-income areas and very low-income housing; and

- The Central Cities, Rural Areas and Other Underserved Areas Housing Goal (Underserved Housing Goal) for the purchase of mortgages for housing located in central cities, rural areas or other underserved areas.[13]

The statute defined moderate-income as not exceeding the area median income, low-income as not exceeding 80 percent of area median income, and very low-income as not exceeding 60 percent of area median income.[14] HUD has used its regulatory authority to establish home purchase subgoals for the each of the three housing goals.[15]



The Enterprises' purchase activity contributed to the financing of millions of dwelling units (Chart 1). From 1993 to 2006, the Enterprises purchased nearly 120,000 multifamily mortgages that financed the purchase, refinance, construction and rehabilitation of over ten

[13] The Federal Housing Enterprises Financial Safety and Soundness Act of 1992, Section 1331-1334
[14] The Federal Housing Enterprises Financial Safety and Soundness Act of 1992, Section 1331-1334
[15] Federal Register, Regulation of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), November 2, 2004, 24 CFR 81.12 (c), 81.13 (c) and 81.14 (c)

million dwelling units. Over 80 percent of these dwelling units were for low-income households and more than 20 percent for very low-income households (Appendix A-Table 1).

In July 2008, Congress passed and President Bush signed HERA. HERA repealed the previous housing goals and replaced them with four Single Family Housing Goals and one Multifamily Special Affordable Housing Goal. The Act will have a significant impact on the number of multifamily dwelling units affordable to low-income families the Enterprises will finance with their mortgage purchases and credit enhancement activities for years to come.

A. Statutory and Regulatory Background

1. The Federal Housing Enterprises Financial Safety and Soundness Act of 1992

Congress created the Enterprises in part to promote the secondary mortgage market that would finance dwelling units affordable to low-income and very low-income households, and until October 28, 1992, this purpose was implicit. With the passage of FHEFSSA, Congress amended the Federal National Mortgage Association Chart Act of 1934 and the Federal Home Loan Mortgage Corporation Act of 1970 that created Fannie Mae and Freddie Mac, respectively. Two of the Enterprises' purposes were amended with parenthetical statements that directly address their service to low-income households, families, and underserved communities. The Enterprises were established for the following purposes:

(1) To provide stability in the secondary market for residential mortgages;

(2) To respond appropriately to the private capital market;

(3) To provide ongoing assistance to the secondary market for residential mortgages (including activities related to mortgages on low-and moderate-income families involving a reasonable economic return that may be less than the return earned on

other activities) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing; and

(4) To promote access to mortgage credit throughout the Nation (including central cities, rural areas, and underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing.

Since the passage of the Federal Housing Enterprises Financial Safety and Soundness Act (FHEFSSA) of 1992, the federal government has explicitly directed the Enterprises to be active participants in the mortgage market for multifamily housing for low-income households. This Act required the Secretary of HUD to establish a Special Affordable Housing Goal "designed to adjust the purchase of each enterprise of mortgages on rental and owner-occupied housing to meet the then-existing unaddressed needs of, and affordable to, low-income families in low-income areas and very low-income families."[16] Low-income families or households being those earning not in excess of 80 percent of area median income, and very low-income households being those earning 60 percent or less of area median income. This requirement corresponds to the requirements of the Low-Income Housing Tax Credit program.[17] The Act also required that HUD consider the "ability of the enterprise to lead the industry in making mortgage credit available to low-income and very low-income families" when establishing these goals.[18]

FHEFSSA required Fannie Mae to purchase $1.0 billion and Freddie Mac to buy $0.75 billion in mortgages on multifamily housings to meet the Special Affordable Multifamily

[16] Federal Housing Enterprises Financial Safety and Soundness Act of 1992: Section 1333 (a)(1)
[17] Novogradac & Company LLP, Low-Income Housing Tax Credit Handbood, May 2005, page 325
[18] Federal Housing Enterprises Financial Safety and Soundness Act of 1992: Section 1333 (a)(2)(D)

Purchase Subgoal during a two-year period starting on January 1, 1993. Of all the mortgages purchased, 45 percent were required to be affordable to low-income families and 55 percent had to have one of the following characteristics: (1) at least 20 percent of the dwelling units had to be affordable to families with income that did not exceed 50 percent of AMI or (2) at least 40 percent of dwelling units had to be affordable to families with incomes 60 percent or less of their area median income.[19]

FHEFSSA allowed a dwelling unit to be counted under multiple housing goals. A mortgage that financed a dwelling unit received credit under the Special Affordable Housing Goal and the Low- and Moderate-Income Goal as well in most cases. Also, multifamily and single family dwelling units were counted under all the dwelling unit percentage goals.

2. <u>HUD Regulation of the Enterprises from 1993 to 2000</u>

On October 13, 1992, HUD established interim housing goals for the Enterprises for the two year period starting January 1, 1993. A second notice issued by HUD in November 1994 extended these goals to 1995.[20]

HUD established a minimum annual amount for the multifamily mortgage purchase subgoal under the Special Affordable Housing Goal when it issued Fannie Mae and Freddie Mac regulation on December 1, 1995. The regulation established a dollar value of multifamily mortgage purchase goal for the Enterprises. From 1996 to 1999, the Enterprises were required to purchase multifamily mortgages that dollar values were equal to at least 0.8 percent of the 1994

[19] Federal Housing Enterprises Financial Safety and Soundness Act of 1992: Section 1333 (d)
[20] Federal Register, "The Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) Regulation; Final Rule", December 1, 1995, page 61848, column 1, Interim Notices section

dollar value of such purchases.[21] Fannie Mae's dollar goal for 1996 to 1999 was $1.29 billion, Freddie Mac's goal was 0.99 billion.[22]

In addition to the regulatory requirement to purchase mortgages under the Special Affordable Housing Multifamily Purchase Subgoal, the Enterprises were also subject to dwelling unit percentage goals under the Low- and Moderate-Income Goal, the Underserved Areas Goal and the Special Affordable Housing Multifamily Goal. HUD exercised its statutory authority to allow multifamily dwelling units to be counted as eligible and qualifying dwelling units under these goals.[23]

Calculating the Enterprises' housing goals performance required HUD to count the number of dwelling units that qualify for the housing goals (numerator) and divide this number by the number of dwelling units financed by the Enterprises's purchase that are eligible to count towards the goals (denominator). HUD's regulation includes counting rules that defined eligible and qualifying dwelling units. Examples of ineligible purchases are non-conforming loans, equity investments in housing projects, and second homes.[24] Condominium and cooperative dwelling units are considered single-family dwelling units, so all the multifamily dwelling units are rental dwelling units.[25] Under the Low- and Moderate Income Housing Goal, a multifamily dwelling unit that is financed will receive credit if the known renter's income is at or less than

[21] Federal Register, "The Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) Regulation; Final Rule", December 1, 1995, page 61891, column 1
[22] HUD Prepares to Set New Housing Goals, Table 1. Overview of GSEs' Housing Goal Performance for 1993-1997 and Housing Goals for 1996-1999, http://www.huduser.org/Periodicals/ushmc/summer98/summary-2.html
[23] Federal Housing Enterprises Financial Safety and Soundness Act of 1992: Section 1331 (b)
[24] Federal Register, Regulation of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), November 2, 2004, 24 CFR 81.16
[25] Federal Register, Regulation of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), November 2, 2004, 24 CFR 81.15

the area median income or the rent amount of the dwelling unit does not exceed 30 percent of area median income. Under the Special Affordable Housing Goal, multifamily dwelling units affordable to low-income households only count under the goal if 20 percent of the property's dwelling units are affordable to households earning 50 percent or less of area median income or 40 percent are affordable to those households earning 60 percent or less of area median income. Under the Underserved Areas Housing Goal, a dwelling unit financed by a Enterprise's mortgage purchase will qualify for credit if the dwelling unit is located in a census tract with a median income below 120 percent of median income and has a minority population of 30 percent or greater or if the dwelling unit is located in an area with a median income at or below 90 percent of the area median income.

Table 1. The Enterprises' Housing Goals from 1996 to 2004

Housing Goals	1996	1997-2000	2001-2004
Low- and Moderate-Income	40.0%	42.0%	50.0%
Geographically Targeted	21.0%	24.0%	31.0%
Special Affordable	12.0%	14.0%	20.0%
Special Affordable MF-Fannie Mae	$1.29 Billion	$1.29 Billion	$2.85 Billion
Special Affordable MF-Freddie Mac	$0.99 Billion	$0.99 Billion	$2.11 Billion

Source: The Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) Regulation; Final Rule, 12/1/1995 and amended 10/31/2000

3. HUD Regulation of the Enterprise from 2001 to 2004

On October 31, 2000, HUD amended the regulation for the Enterprises' housing goals. The amendment increased all the goals by at least 19 percent and gave the Enterprises an incentive to invest in small multifamily properties and multi-unit single family properties (Table 1). Fannie Mae and Freddie Mac received bonus credit for the purchase of multifamily mortgages for properties with 5 to 50 dwelling units or single-family properties with two to four dwelling units from 2001 to 2003. The Enterprises were assigned double the weight for these dwelling units. In addition to these bonus points, Freddie Mac also received credit for 1.2 dwelling units for every qualifying one from properties with more than 50 units from 2001 to 2003.[26] Since HUD did not amend the regulation until November 2, 2004, the 2004 housing goals were the same as 2003.

4. HUD Regulation of the Enterprises from 2005 to Present

The version of the GSE regulation published in November 2, 2004 continued the upward trend of the housing goals. The housing goals established in the amended regulation were substantially higher than those established in 1996. The Low- and Moderate Income Goal increased by approximately 32.5 percent from 1996 to 2006. During the same period, the Geographically Targeted Goal rose by 81.0 percent and the Special Affordable Goal increased by 91.7 percent. Fannie Mae's Special Affordable Multifamily Purchase Subgoal requirement was more than four times the original dollar volume goal, while Freddie Mac's was nearly 400 percent of the 1996 amount (Table 2).

Table 2. The Enterprises Housing Goals from 2005 to 2008

Housing Goals	2005	2006	2007	2008
Low- and Moderate-Income	52.0%	53.0%	55.0%	56.0%
Geographically Targeted	37.0%	38.0%	38.0%	39.0%
Special Affordable	22.0%	23.0%	25.0%	27.0%
Special Affordable MF-Fannie Mae	$5.49 Billion	$5.49 Billion	$5.49 Billion	$5.49 Billion
Special Affordable MF-Freddie Mac	$3.92 Billion	$3.92 Billion	$3.92 Billion	$3.92 Billion

Source: The Secretary of HUD's Regulation Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac); Revised November 2, 2004

[26] The Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) Regulation; Final Rule as amended 10/31/2000, 24 CFR 81.16(10) & (11)

5. The Housing and Economic Recovery Act of 2008

On July 30, 2008, the Housing and Economic Recovery Act of 2008 amended the statutory language governing the housing goals. The Act created a new regulatory agency for Fannie Mae, Freddie Mac and the Federal Home Loan Banks. The Director of FHFA was given the duty of establishing new housing goals for Fannie Mae and Freddie Mac. Section 1128 of this Act established five housing goals for the Enterprises and eliminated the housing goals discussed above. Unlike the housing goals established under FHEFSSA, the goals are segmented and a mortgage purchase can only provide credit under one goal.

This Act established three single family purchase-money housing goals for the purchase of conventional, conforming loans, owner-occupied mortgages belonging to low-income families, families residing in low-income areas and very low-income families. These goals would be measured as a percentage of the total number of conventional, conforming, owner-occupied purchase money mortgages purchased. The fourth single family housing goal was for the purchase of conventional and conforming used to refinance a mortgage for an owner-occupied single family dwelling unit where the families are low-income. This goal would be measured as a percentage of the total number of conventional, conforming, owner-occupied refinancing mortgages purchased.[27]

This Act establishes a Multifamily Special Affordable Housing Goal for the purchase of mortgages that finance multifamily dwelling units affordable to low-income families. The Director has the discretion to measure this housing goal by dwelling units financed by the mortgages purchased or the total dollar volume of the mortgages purchased. The Director is

[27] Housing and Economic Recovery Act of 2008, Section 1128 (b), Section 1332 (a)

required to establish additional requirements for the purchase of multifamily mortgages used to finance dwelling units affordable to families earning very low-incomes. This Act defines a very low-income family to be a family with earnings of 50 percent or less of AMI while the Act of 1992 defined this term to be equal to or less than 60 percent of AMI. The Director is required to report on the number of mortgages financing smaller properties, which may be defined either as those with 5 to 50 dwelling units or those with mortgages up to $5,000,000.

While FHEFSSA gave the Secretary of HUD the discretion to determine the credit the Enterprises would receive from their purchase activities. HERA requires the Director to give full credit under the Multifamily Special Affordable Housing Goal for dwelling units in multifamily housing that would qualify otherwise for the goal that are financed by tax-exempt or taxable bonds issued by States or local housing finance agencies that are guaranteed by one of the Enterprises or purchased by Fannie Mae or Freddie Mac. The Director has the ability to give partial credit to investment grade bond purchases that do not create a new market or increase liquidity to an existing market.[28]

In the statutory language, Congress also expressed its desire to have Fannie Mae and Freddie Mac serve underserved markets. Section 1128 of HERA requires the Enterprises to support loan products that would help preserve affordable rental housing in federally subsidized multifamily projects.

[28] Housing and Economic Recovery Act of 2008, Section 1128 (b), Section 1333 (b)

B. Affordable Housing Shortage

The affordable housing shortage can be measured by the number of low-income households paying rents greater than 30 percent of their incomes. In a paper issued in May 2007, HUD estimated that in 2005 the nation had 27.4 million unassisted renter households, and 18.0 million renter households with incomes at or below 80 percent of area median income.[29] HUD has an affordability threshold that 30 percent or less of a household's gross income should be spent on rent. Using this threshold, HUD reported that 32.5 percent of low-income unassisted renter households had rent burdens in excess of 50 percent of household income, and another 27.8 percent of households had rents that accounted for 30 to 50 percent of their household income. More than 60.3 percent of the nation's low-income, unassisted renter households are living in dwelling units that are not affordable.[30]

The situation is more severe for very low-income renter households. Approximately, 11.8 million of the 16.1 million very low-income households pay rents in excess of 30 percent of their incomes. More than 4.5 million of these households receive direct or indirect assistance.[31] From these statistics, it is reasonable to conclude that almost 100 percent of very low-income renter households that do not receive assistance are rent burdened.

[29] Unassisted renter households are those that are not receiving any rental assistance from a government entity and are not living in government subsidized housing.
[30] Department of Housing and Urban Development, Affordable Housing Needs 2005: Report to Congress, May 2007, Table A-3
[31] Department of Housing and Urban Development, Affordable Housing Needs 2005: Report to Congress, May 2007, Table A-3

The number of households with rents greater than 30 percent of their income is trending upward. According to HUD, the number of households in this situation has increased by about 15 percent from 1993 to 2005.[32]

Studies indicate that the affordabiltiy of rental housing for very low-income households is an issue in most states. For instance, only eleven states have average rents low enough for very low-income households to afford. The national median income in 2007 was $50,233, so most households earning less than $25,116.50 would be considered very low-income households.[33] In metropolitan areas where the median income is less than the national median income, the upper bound of very low-income is lower as well. The National Low Income Housing Coalition (NLIHC) developed a national "Housing Wage," which is the wage one full-time worker must earn per hourto afford rent on a two-bedroom dwelling unit at fair market rent paying 30 percent of the household income for rent. In 2008, they calculated the national housing wage to be $17.32 or slightly over $36,000. The housing wage that would equate to the very-low income threshold for households is $12.02, and eleven states have housing wages lower than this.[34]

[32] Department of Housing and Urban Development, Affordable Housing Needs 2005: Report to Congress, May 2007, Table A-2a
[33] United State Census Bureau, Household Income Rises, Poverty Rate Unchanged, Number of Uninsured Down, August 26, 2008, http://www.census.gov/Press-Release/www/releases/archives/income_wealth/012528.html
[34] National Low Income Housing Coalition, Out of Reach 2007-2008, page 4 http://www.nlihc.org/oor/oor2008/introduction.pdf

III. HUD's GSE Public Use Database

This thesis is largely based on analysis of the multifamily mortgage data HUD has made publicly available. The analysis of The Enterprises' multifamily purchase data (1993 to 2006) and the review of their performance under the Special Affordable Housing Goal from 2002 to 2006 has led to insights that are reflected in the policy framework for the Multifamily Special Affordable Housing Goal. The primary objective of the data analysis was to examine the characteristics of the dwelling units affordable to low-income households and very low-income households financed by mortgages the Enterprises purchased. Attention was give to the location of the dwelling units, the size of the properties and the characteristics of the mortgages that financed these dwelling units.

HUD has made the Enterprises' multifamily mortgage purchase data available through its GSE Public Use Database. The database contains all of the Enterprises' multifamily mortgage purchases from 1993 to 2006. Though the data contains valuable information, HUD has also excluded data that could be used to identify individual properties and may be considered proprietary, such as the exact address of the property and the exact amount of the mortgage loan purchased.

To prevent users from identifying individual properties by matching data from these tables with known property data, HUD separated the database into two tables that do not share a unique identifier: the Census File and the National File. There are also separate files for each year. The Census Files contain income and minority data at the census tract level, and county, metropolitan area and state variables. This file also has the unpaid principal balance categories for the mortgages purchased. The Census Files do not have any dwelling unit level data. The

National Files have dwelling unit and property data. The files contain affordability and dwelling unit size by bedroom data. With the National Files' data, it is possible to perform dwelling unit analysis by census tract type (census tract income and minority percentage categories) analysis and property size (number of dwelling units) and the purpose of the loan.[35]

The data contained in the public use database and changes in the information contained in the database place limits on the type of analysis that can be performed and creates a need to give caveats about the data analysis. Several fields in the 1993 to 2003 data contain information from the 1990 decennial census, and starting in 2004, information from the 2000 decennial census was used. This impacts income and minority percentage fields in both files. It is understood that the further in time from the time the census was taken the less confidence one can have in the ratio data based on the decennial census, but no steps were taken to directly address this issue. HUD added and removed fields over time, so trend analysis for the entire period cannot be performed for several fields.

HUD regulation also requires the Enterprises to issue Annual Housing Activities Reports, and HUD has made the 2002 through 2006 reports available to the public. The reports contain aggregate unpaid principal balances (UPB) of their mortgage purchases and aggregate dwelling unit data that can be used to calculate the UPB per dwelling unit for their portfolio. From the tables, how multifamily dwelling units contributed to Enterprises' housing goal performance can be determined.

[35] Files are located at the following website: http://www.huduser.org/datasets/gse.html.

IV. Dollar Volume or Dwelling Unit Multifamily Special Affordable Housing Goal

HERA requires that the Multifamily Special Affordable Housing Goal be based on the number of dwelling units financed by the Enterprises' multifamily mortgage purchases or the dollar volume (sum of the unpaid principal balances of all the qualifying mortgages purchased). The Enterprises' historic low-income dwelling unit financing activities reveals much about how they may respond to aggressively set unit percentage housing goals. The Enterprises used dwelling units financed by their multifamily mortgage purchases to meet their housing goals. Multifamily dwelling units typically represented a disproportionate share of dwelling units that qualified under the Special Affordable Housing Goal. In 2006, multifamily dwelling units represented 16.4 percent of all dwelling units eligible under the Special Affordable Housing Goal, while multifamily dwelling units represented 34.2 percent of all the dwelling units that qualified for credit for Fannie Mae. The percentages for Freddie Mac that year are 17.0 percent and 42.3 percent. Similar overrepresentation of multifamily dwellings in the universe of qualifying dwelling units existed from 2002 to 2006. If dwelling units associated with single family mortgages were only counted, the Enterprises would have underperformed the target for this housing goal in recent years. They greatly exceed this target if only multifamily dwelling units were counted. From 2004 to 2006, the Enterprises' multifamily dwelling units that qualified for the Special Affordable Housing Goal as percentage of all eligible dwelling units was more than 250 percent of the target (Table 3).

Table 3. Percentage of Dwelling Units Qualifying for the Special Affordable Housing Goal					
	Fannie Mae			**Freddie Mac**	
Year	**Single Family**	**Multifamily**	**Target**	**Single Family**	**Multifamily**
2006	21.9%	58.1%	23.0%	18.5%	66.0%
2005	21.4%	59.4%	22.0%	17.7%	62.9%
2004	19.9%	53.7%	20.0%	18.1%	60.4%

Source: Enterprises' Annual Housing Activities Reports (AHAR) for 2004-2006; AHAR report data for 2002-2003 were not included because HUD gave the Enterprises bonus points during this period (see http://www.hud.gov/offices/hsg/gse/reportgse.cfm).

The Enterprises historically have met the Special Affordable Multifamily Purchase Subgoal easily. From 2002 to 2006, the dollar volume of Fannie Mae and Freddie Mac purchases that qualified for credit under the Special Affordable Multifamily Purchase Housing Goal ranged from 168 percent of the minimum required amount to 466 percent. As discussed above, the Enterprises use their multifamily mortgage purchases to meet the dwelling unit based goals. The Enterprises consistently exceeded the dollar volume multifamily mortgage purchase threshold to effectively offset their performance in single family dwelling units. Since this appears to be the case, it follows that the Enterprises' behavior associated with purchasing multifamily mortgages is not significantly impacted by the existence of the subgoal. As a result, the Enterprises' historic performance under this subgoal is not a good indicator of how they would perform under a challenging dollar volume housing goal in the absence of dwelling unit percentage housing goals (Table 4).

Table 4. The Enterprises' Special Affordable Multifamily Purchase Goal Performance (Mill.)						
Year	Fannie Mae	Goal	Percent	Freddie Mac	Goal	Percent
2006	$ 12,920.00	$ 5,490.00	235%	$ 14,013.00	$ 3,920.00	357%
2005	$ 9,221.00	$ 5,490.00	168%	$ 12,349.00	$ 3,920.00	315%
2004	$ 7,057.00	$ 2,850.00	248%	$ 9,832.00	$ 2,110.00	466%
2003	$ 11,058.00	$ 2,850.00	388%	$ 8,002.00	$ 2,110.00	379%
2002	$ 6,898.00	$ 2,850.00	242%	$ 5,105.00	$ 2,110.00	242%

Source: Enterprises' Annual Housing Activities Reports (AHAR) for 2002-2006 (see http://www.hud.gov/offices/hsg/gse/reportgse.cfm).

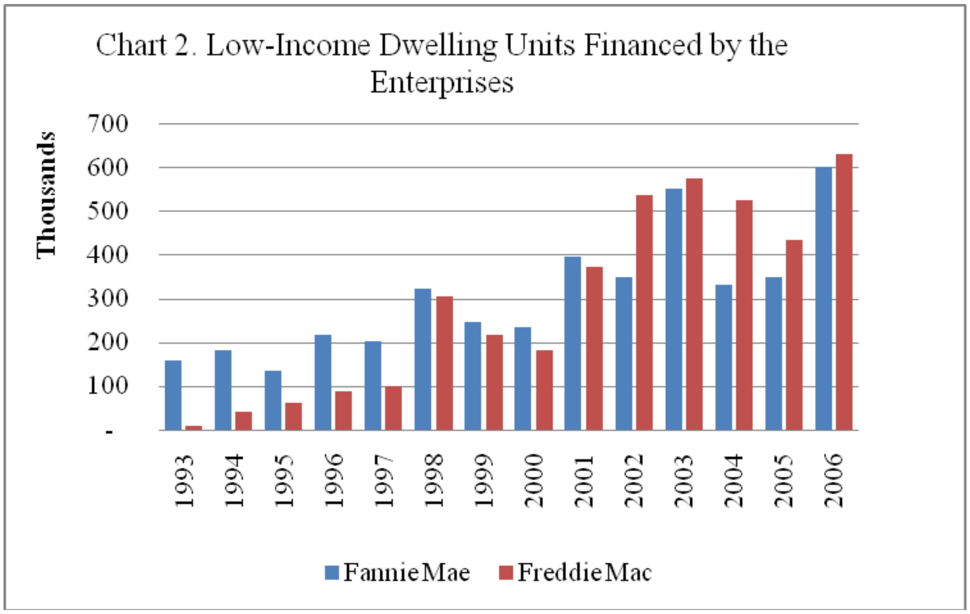
Because of this, it is best to rely on economic and financial theoretical analysis to assess how the Enterprises may respond to the volume based housing goal. Assuming that the Enterprises are cost minimizing firms, it can be assumed that they would seek the least expensive approach to achieve their housing goals. Many transaction costs are fixed, and therefore, purchasing mortgages with larger dollar volumes would reduce the transaction costs as a percentage of the total dollar volume purchased, and thus lowering the cost of complying with a dollar volume based housing goal. There are three basic approaches that the Enterprises could employ to reduce transaction costs as a percentage of total dollar volume purchased. Controlling for all other factors, properties with more dwelling units are more expensive then properties with fewer units, properties with higher per dwelling unit costs would have higher dollar volumes, and properties where the Enterprises' participation in the financing is a higher percentage of total financing would lead to greater dollar volumes.

Two of these three approaches would run counter to other potential policy objectives. The Enterprises would likely move away from purchasing small multifamily properties in the absence of additional regulatory requirements. The dollar volume housing goal approach would steer the Enterprises towards more expensive areas of the country where per dwelling unit costs are higher, which would increase the geographic concentration of their activities compared to dwelling unit percentage housing goals. This would also result in fewer dwelling units being served overall.

Increasing participation in the financing of multifamily properties in many cases should be consistent with Congress' policy objectives. Assuming that the Enterprises' debt financing costs less than equity or other debt financing, encouraging the Enterprises to participate more should lead to lower rents for low-income dwelling units served by the Enterprises. However, again fewer dwelling units may be served, which reduces the aggregate benefit of the approach to meeting a dollar based housing goal.

The Enterprises' historic purchase data reveals how they may respond to a unit percentage housing goal. From 1993 to 2006, Fannie Mae purchased 71,650 mortgages that financed 5,606,180 dwelling units, and over 76 percent of these dwelling units were low-income. Freddie Mac purchased 48,087 mortgages that financed 4,788,399 dwelling units and more than 85 percent were secured by dwelling units affordable to low-income households (Appendix A, Table 2). A substantial percentage of the difference in total dwelling units financed by the Enterprises can be explained by Freddie Mac's total number of dwelling units financed from 1993 to 1997. The size of the percentage of low-income dwelling units in their multifamily dwelling unit portfolios is such that the characteristics of this subset is typically consistent with the attributes of the entire universe.

Freddie Mac's presence in the low-income multifamily secondary mortgage market appears to be a direct result of the affordable housing goals. In 1993, the first year of the housing goals, Freddie Mac financed 9,784 low-income dwelling units, representing 90.6 percent of all of the dwelling units it financed that year. In 1997, Freddie Mac financed 99,679 of these dwelling units. In contrast, Fannie Mae financed 159,527 low-income dwelling units in 1993 and 200,968 of these dwelling units 1997, an increase of 26 percent. By 2002, Freddie Mac became the leader in financing low-income dwelling units. From 2002 to 2006, Freddie Mac financed 515,540 more than Fannie Mae (Appendix A, Table 1).

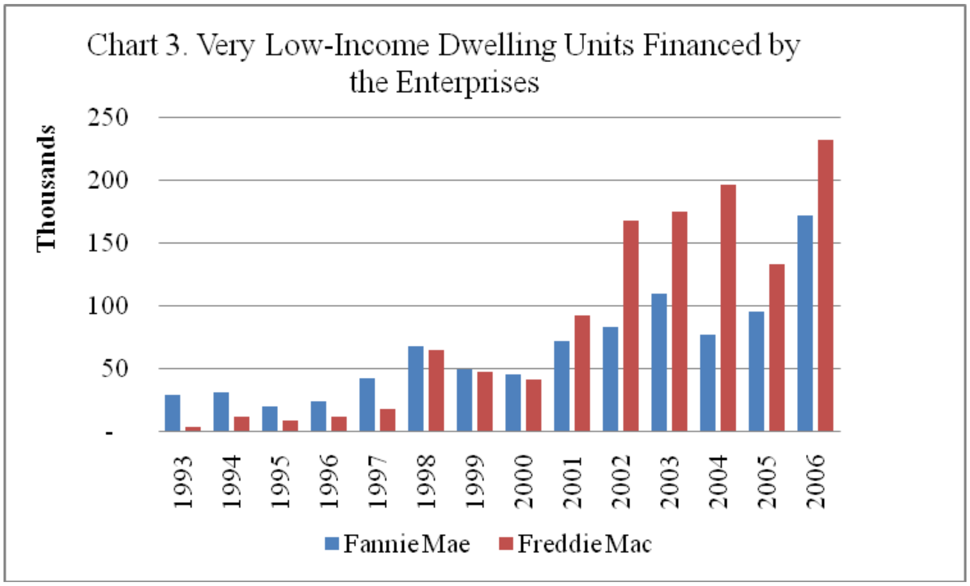


Another example of the impact of the dwelling unit percentage housing goals occurred from 2000 to 2003. In 2001, HUD increased the housing goals substantially and gave the Enterprises bonus points for the purchase of mortgage secured by small multifamily properties. Fannie Mae's financing of low-income dwelling units increased 134.5 percent from 2000 to 2003, and fell 39.8 percent from 2003 to 2004. Freddie Mac's activity increased 214.0 percent from 2000 to 2004 and then fell 8.5 percent in 2004.

Starting with the same theoretical basis of the cost minimization firm, the Enterprises would also try to take advantage of fixed transaction costs to meet a dwelling unit percentage housing goal. The Enterprises would like to purchase larger properties to minimize transaction costs, but purchasing more expensive dwelling units or increasing participation in financing on a per dwelling unit basis would not be the response. The Enterprises could respond in the opposite direction. They could seek to obtain lower cost dwelling units. This could lead the Enterprises to finance dwelling units in lower cost areas. The number of dwelling units financed by the Enterprises could also be lower as a result of these goals without some threshold.

V. Requirements for Financing Very Low-Income Dwelling Units

Congress mandated FHFA include requirements for the Enterprises to serve very low-income households with the Multifamily Special Affordable Housing Goal. The Enterprises financed 2,115,086 very low-income dwelling units from 1993 to 2006, which represent 20.3 percent of all the multifamily dwelling units they financed (Chart 3).



Freddie Mac financed a higher percentage of very low-income dwelling units than Fannie Mae. While 16.3 percent of all dwelling units Fannie Mae financed are affordable to very low-income households from 1993 to 2006, 25.1 percent of Freddie Mac's multifamily mortgage purchases fall into this category.

As discussed in the background, the 1992 Act required that 55 percent of the mortgages counting towards the Special Aforable Multifamily Purchase Subgoal be mortgages in which at least 20 percent of dwelling units are affordable to very low-income households or 40 percent of the dwelling units are affordable to households with income no greater than 60 percent of AMI. The Enterprises' financing of these dwelling units is likely linked to this requirement.

VI. The Enterprises Financing of Small Multifamily Properties

Whether including language in the regulation that would encourage or require the Enterprises to purchase mortgages on small multifamily properties is sound policy is an open question. Congress required FHFA to collect information on the Enterprises' financing of these properties and provides FHFA with the authority to establish housing goals regulation. Dwelling units contained in small multifamily properties are a significant percentage of total rental dwelling units, which would support the notion that FHFA should establishes rules related to them for the Enterprises. Although there was support for this among builders, the operating expenses of these properties are often higher than larger properties, and since higher operating costs translates into higher rents, it may make more sense to focus on more efficient multifamily housing.

In a February 2004 testimony, the National Association of Home Builders expressed their support for a bonus point program that encouraged the financing of small properties: "These units are key sources of affordable housing for large numbers of low- and moderate-income households, first-time homebuyers and minorities. One-third of the rented homes are in buildings with 5 to 50 units and minority renters are more likely to be the occupant than are white residents….. NAHB is a strong supporter of the bonus points system as a flexible means to provide incentives for the Enterprises to increase activity in targeted markets and we adamantly oppose HUD's decision to terminate the bonus points. The bonus points were an integral component of the current goals structure and they served their intended purpose as both Fannie Mae and Freddie Mac increased their purchases of bonus-related mortgages."[36]

Analysis of the Enterprises' purchase data revealed their level of activity in this market. Even though the Enterprises have purchased a large number of mortgages associated with small multifamily properties, the total number of dwelling units financed in large multifamily properties is far greater. From 1993 to 2006, Fannie Mae and Freddie Mac purchased 71,609 mortgages secured by small multifamily properties containing 1,185,302 dwelling units. During the same period, the Enterprises purchased 48,128 mortgages that financed 9,209,276 dwelling units in large multifamily properties. This demonstrates that the Enterprises' mortgage purchases were disproportionately associated with large multifamily properties.

A higher percentage of small multifamily dwelling units are located in low-income areas, but the vast majority of dwelling units affordable to very low-income households were in multifamily properties with more than 50 dwelling units from 1993 to 2006. More than 43 percent of all the small multifamily dwelling units are located in low-income areas compared to approximately one quarter of dwelling units in large multifamily properties.

Of the 2,115,086 dwelling units affordable to very low-income households securing mortgages purchased by the Enterprises, 91.1 percent of them are located in large multifamily properties; 187,455 of these dwelling units are located in small multifamily properties. The large multifamily properties also have a higher percentage of low-income and very low-income dwelling units compared to small multifamily financed by the Enterprises (Table 5).

[36] National Association of Home Builders, Testimony Of James R. Rayburn On Behalf Of the National Association of Home Builders Before the United States Senate Committee on Banking, Housing and Urban Affairs On Government-Sponsored Enterprises Regulatory Reform, February 2004, page 24

Table 5. Low-Income and Very Low-Income Dwelling Units Financed by Property Size (%)				
	Fannie Mae		**Freddie Mac**	
Income-Level	Small	Large	Small	Large
Low-Income	58.2%	78.9%	77.5%	85.8%
Very Low-Income	12.5%	16.9%	21.0%	25.5%

From 2002 to 2006, the unpaid principal balance per dwelling unit for Fannie Mae's mortgage purchases were higher for the dwelling units in small multifamily properties than the UPB per dwelling unit for low-income dwelling units in large multifamily properties. For Freddie Mac, that was the case in 2004 and 2006 (Table 6).

Table 6. Unpaid Principal Balance per Unit by Property Size				
	Fannie Mae		**Freddie Mac**	
Year	Small	Large	Small	Large
2006	$38,815	$47,200	$45,376	$42,393
2005	$33,820	$39,806	$43,911	$52,357
2004	$30,290	$37,688	$34,844	$34,006
2003	$29,790	$36,919	$27,712	$32,180
2002	$29,604	$31,848	$32,638	$41,513

Source Data: Enterprises' Annual Housing Activities Reports (AHAR) for 2002-2006.

The UPB per dwelling unit suggests that the units had non-traditional financing. If the average value of a multifamily dwelling unit was approximately $100,000 during this period, the amounts of financing the Enterprises provided would not be sufficient under a financing scenerio where the loan to value ratios was 80 percent. This is consistent with the fact that affordable dwelling units are typically financed with equity, debt and government and private subsidies.

Dwelling units in small multifamily properties represent a sizable percentage of affordable rental housing. A 2008 Harvard study indicates that when properties with four or less dwelling units are excluded that multifamily properties with 5 to 49 dwelling units represent 80.5 percent of unsubsidized and 67.7 percent of subsidized of all rental dwelling units in 2005. Most of the small multifamily properties that are privately owned were built at least 30 years ago and need to be renovated. A large percentage of these properties are also the ones that are affordable and accessible to low-income households. From 1995 to 2005, 445,000 dwelling units were demolished or became inhabitable. [37]

One of the potential financing sources for the construction or preservation of small multifamily properties is the low-income housing tax credit program, and tax credits awarded through this program were more likely to be used for larger properties than smaller properties according to a 2004 HUD report. HUD reported that the average LIHTC project had 42.1 dwelling units in the early 1990s but had 77.7 dwelling units in the early 2000s. HUD explained that the tax credit projects have been increasingly used with tax-exempt bonds that are typically associated with larger projects.[38] This appears to be an area where the Enterprises financing could help foster the construction or major rehabilitation of small multifamily properties by making available the debt that is needed to complement LIHTC generated equity.

One study revealed that small multifamily properties may have higher operating costs per dwelling unit than those with more than 200 dwelling units. That study, conducted by Jack Goodman in 2004, discussed his regression analysis which revealed that properties with 200 or more units have operating costs four to eight percent less than those than those with more than 200 units on a per unit per month basis. The study supports the notion that there are economies

[37] America's Rental Housing: The Key to a Balanced National Policy, Joint Center for Housing Studies of Harvard University

[38] Department of Housing and Urban Development, Updating the Low-Income Housing Tax Credit (LIHTC) Database Placed in Service Through 2002, December 2004, page 19, http://www.huduser.org/Publications/pdf/updtlihtc.pdf

of scale for multifamily properties, but does not explicitly establish that the properties with 50 units or less are less efficient than those with 51 to 199 units.[39]

Small multifamily properties are more likely to be owned by individuals and a 2001 survey of property managers and owners revealed that these properties may be more likely to experience problems. The survey showed that over 40 percent of properties with 10 to 49 dwelling units are owned by individuals and over 70 percent of dwelling units with 5 to 9 units are. Less than 10 percent of properties with 50 or more units are owned by individuals. Individual owners are typically perceived as less sophisticated owners when compared to firms and their properties may be less profitable as a result.[40] According to another study, for most individuals the rental business is a part-time activity, and most are not well diversified because of the small number of dwelling units they own. For the smallest multifamily properties, the survey revealed that only one in ten could afford third-party professional management.[41]

[39] Goodman, Jack, Determinants of Operating Costs of Multifamily Rental Housing, July 2004, Page 18
[40] Joint Center for Housing Studies of Harvard University, America's Rental Housing: Homes For a Diverse Nation, 2006, page 22
[41] Apgar, William, Enhancing Access to Capital for Smaller Unsubsidized Multifamily Rental Properties, March 2007, Page 13-14

VII. Geographic Analysis of Enterprises Multifamily Mortgage Purchases

HERA allows FHFA to take into consideration other factors when establishing the Multifamily Special Affordable Housing Goal. Geographic disbursement of the properties financed by the Enterprises should be one of these factors. The Enterprises' housing goals are national goals, and though HUD requires geographic information to be provided by the Enterprises, HUD has not take action to address geographic issues previously. Since the shortage of affordable rental housing is a problem for every state and most metropolitan areas, FHFA should consider how well the Enterprises are serving all of these jurisdictions.

Analysis of the Enterprises' purchase data reveals significant geographic concentration and very limited presence in rural areas. The Enterprises' mortgage purchases were concentrated in California and other large states: 52.9 percent of Fannie Mae purchases and 44.2 percent of Freddie Mac purchases were in California from 1993 to 2006. Of the 119,737 mortgages purchased by the Enterprises during this period, 79.7 percent of the properties were located in top ten mortgages purchased states, and 91.5 were in the top 20 (Appendix A, Table 3).

The Enterprises purchases are also concentrated by metropolitan area. Nearly 58 percent of multifamily properties the Enterprises financed are in ten metropolitan areas. The Los Angeles metropolitan area is the location for 24.2 percent of these properties. The top 20 accounts for 69.2 percent of mortgages purchased (Appendix A, Table 4).

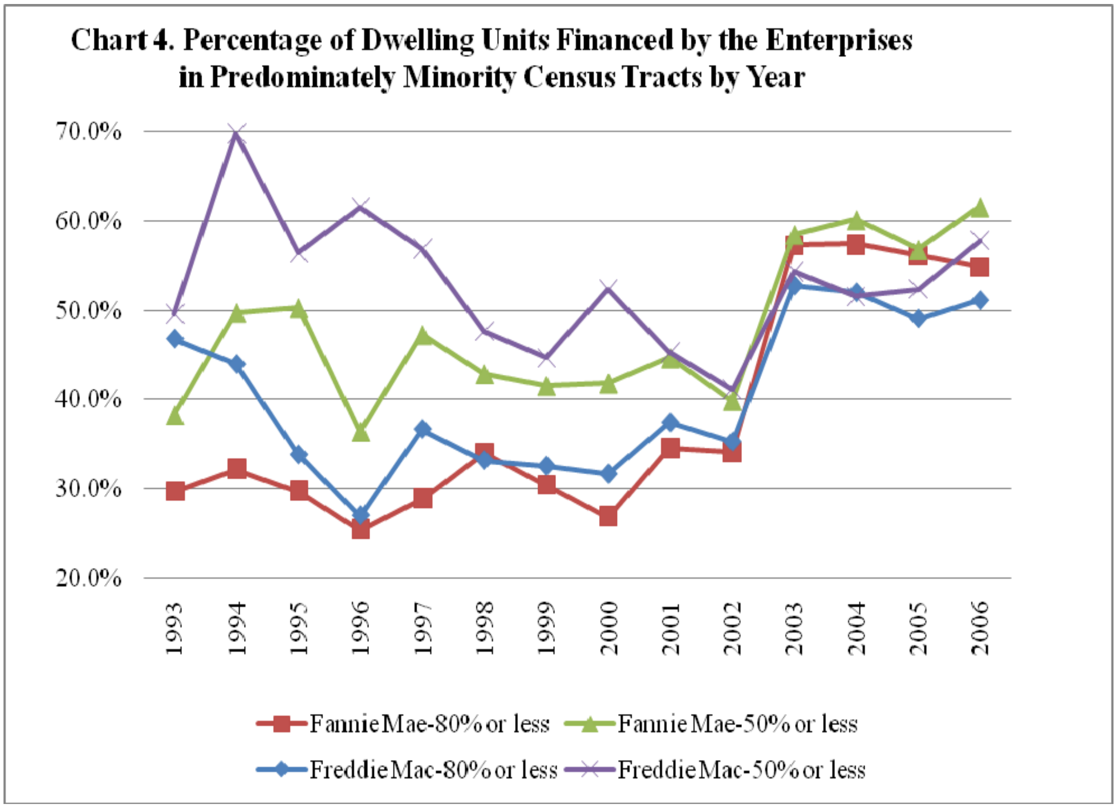
The Enterprises' activities in nonmetropolitan areas were not proportional to the percentage of nonmetropolitan renter households. In 2003, 16.8 percent of all renters lived in nonmetropolitan areas.[42] Fannie Mae purchased 1,299 multifamily mortgages secured by properties in nonmetropolitan areas from 1993 to 2006. This represents 1.8 percent of all Fannie Mae purchased during this period. Freddie Mac's percentage was greater with 2.3 percent of all multifamily mortgage purchases associated with non-metropolitan areas.

The housing goals may have contributed to the Enterprises' practice of concentrating their mortgage purchases. The database includes an underserved area variable that is correlated with low-income areas from 1996 to 2006. According to HUD regulation, an underserved area is a census tract with median income at or below 120 percent of the area median income and a minority population of 30 percent or more; or a census tract with a median income below 90 percent of its area median income. The majority of the Enterprises' multifamily mortgage purchases were in underserved areas; however, if California is excluded, that is not the case. More than 59 percent of the underserved mortgages the Enterprises' purchased were originated in California. When California is excluded, mortgages secured by properties in underserved areas represented slightly less than one-half (49.7 percent) of the Enterprises' purchases. The Enterprises' heavy focus on California may have been driven by a desire to meet housing goals.

The Enterprises financed low-income dwelling units primarily in heavily minority census tracts in recent years. The majority of the Enterprises' low-income dwelling units were located in areas with a percentages of minorities greater than 30 percent from 2003 to 2006. The percentage of the Enterprises' low-income dwelling units in heavily minority areas percentage did not exceed 40 percent until 2003. From 2002 to 2003, this percentage increased from 34.1 percent to 57.3 percent for Fannie Mae, and from 35.2 percent to 52.8 percent for Freddie Mac.

[42] Joint Center for Housing Studies of Harvard University, America's Rental Housing: Homes For a Diverse Nation, 2006, Table A-6

As discussed above, the Enterprises used their multifamily mortgage purchases to meet their housing goals. In this case, it appears that the multifamily dwelling units in minority areas were used to meet the Underserved Areas Housing Goal (Chart 4).



The majority of low-income dwelling units financed by Enterprises' purchases are not in low-income areas. The percentage of low-income dwelling units located in low-income areas from 1993 to 2006 financed by Fannie Mae is 27.7 percent and 29.7 percent for Freddie Mac. The percentage of very low-income dwelling units in low-income areas was 41.5 percent during that period for the Enterprises (Chart 5).

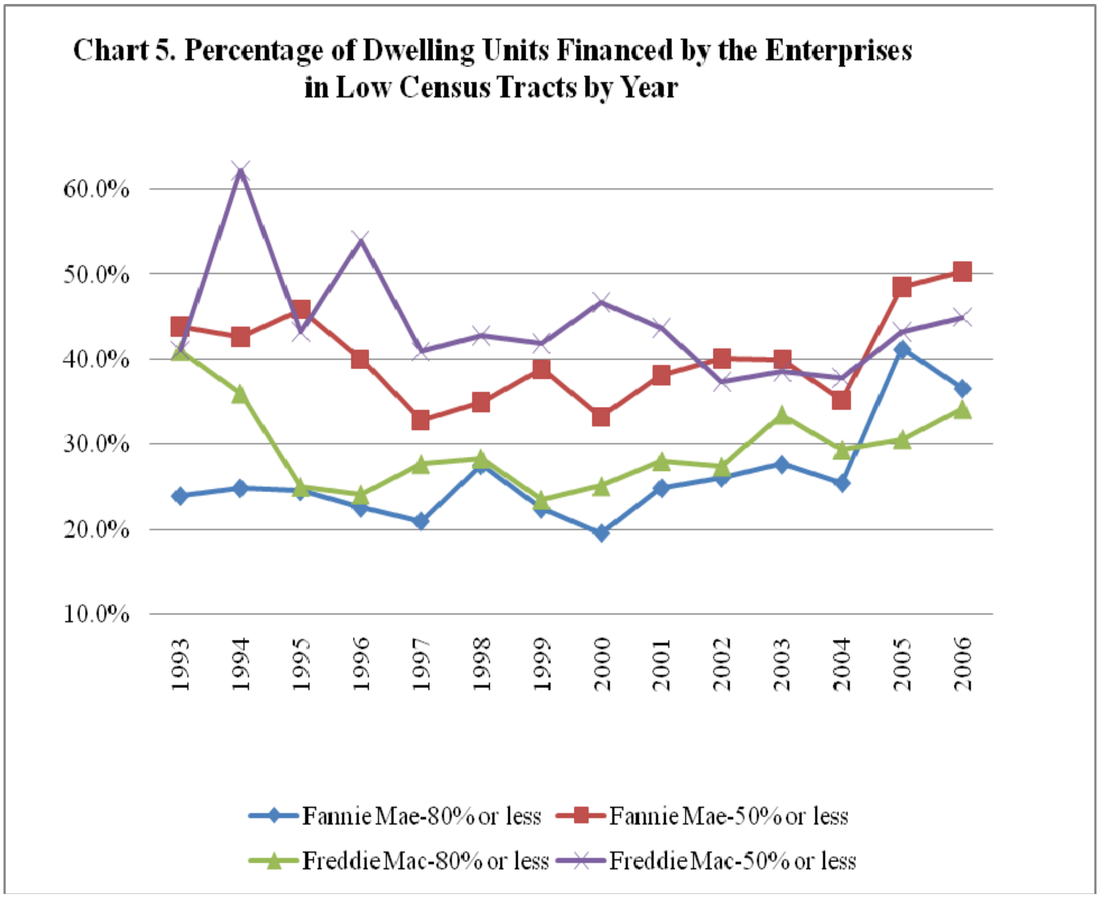


Chart 5. Percentage of Dwelling Units Financed by the Enterprises in Low Census Tracts by Year
60.0%
50.0%
40.0%
30.0%
20.0%
10.0%
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
Fannie Mae-80% or less
Fannie Mae-50% or less
Freddie Mac-80% or less
Freddie Mac-50% or less

VIII. Policy Framework

When establishing the Multifamily Special Affordable Housing Goal, FHFA should employ a multifaceted approach. The housing goal should lead the Enterprises to finance low-income and very low-income dwelling units in a manner that serves the nation's credit needs. It also needs to channel funds into the most efficient forms of multifamily housing. The approached laid out would lead the Enterprises to finance both low and very low-income dwelling units in both metropolitan and nonmetropolitan areas while encouraging them to consider geographic distribution of their mortgage purchases and to increase their financing of small multifamily properties with dwelling units affordable to low-income and very low-income households.

The Multifamily Special Affordable Housing Goal should be a dwelling unit percentage housing goal with a dollar volume component similar to the Special Affordable Housing Goal and the Special Affordable Multifamily Purchase Subgoal. Congress' primary objective with the housing goal is to increase the number of low-income households served by the Enterprises through their multifamily dwelling unit financing activities. A dwelling unit percentage housing goal is a more direct means of assessing how well the Enterprises are achieving this objective compared to a dollar volume goal. As discussed above, a dollar volume housing goal could lead to fewer households being served if the Enterprises employ a strategy to acquire properties with the highest per dwelling unit unpaid principal balances. This would be counter to Congress' primary objective.

A dollar volume housing goal approach does have the benefit of establishing a floor for the Enterprises' multifamily mortgage purchase activities. A dwelling unit percentage housing goal could be achieved by reducing purchases to reduce the size of the denominator. This was not an issue under the previous housing goal approach because the Enterprises financed multifamily dwelling units to offset their performance among single family dwelling units. Without a need to use this strategy, reducing overall purchases may be a prudent approach for the Enterprises. Therefore, FHFA should develop a purchase subgoal for very low-income dwelling units. This subgoal would meet Congress' mandate to require the Enterprises to invest in very low-income dwelling units, and establish a floor as a backstop if the Enterprises did attempt to reduce their mortgage purchase activities to meet a dwelling unit percentage housing goal.

At what percentage or dollar amount the Multifamily Special Affordable Housing Goal and the Multifamily Special Affordable Housing Subgoal for very low-income dwelling unit is a question that cannot be addressed here. Where these thresholds are set have safety and soundness and political implications that the Director of FHFA must take into account. The Director should strongly take into consideration the Enterprises' historic performance in these areas and the performance of multifamily mortgages generally when establishing the thresholds.

The data analysis demonstrates that the Enterprises do not adequately provide support for the multifamily mortgage market for nonmetropolitan properties. Given this, FHFA should establish a goal for financing low-income dwelling units located in nonmetropolitan areas. Because incomes in nonmetropolitan areas are lower, financing very low-income dwelling units would be more difficult for the Enterprises. This subgoal could be a dwelling unit percentage subgoal for low-income dwelling units that qualifying under the Multifamily Special Affordable Housing Goal.

In association with the Multifamily Special Affordable Housing Goal requirements, FHFA should require the Enterprises to submit annual reports on their small property financing activities and the geographic disbursement of the mortgages they purchase. For the purposes of reporting on small multifamily properties, small multifamily property should be defined as those with 5 to 50 dwelling units. Under the unpaid principal balance approach, second mortgages under $5,000,000 could be classified as small multifamily mortgages. Furthermore, most studies classify properties based on number of dwelling units, not on the unpaid principal balance of the properties' mortgages. Additional information would have to be collected to determine whether goal-related requirements should be used to encourage the Enterprise to finance small multifamily properties and diversify their mortgage purchase geographically. Congress' interest in small property financing and the Enterprises' mission to provide access to credit throughout the nation seems to suggest that Congress would want FHFA to perform more research in these areas and remain abreast of the Enterprises' mortgage purchase activities related to them. Requiring the Enterprises to report on these issues may also lead them to take affirmative steps themselves to address their shortcoming in these areas to discourage future regulation by FHFA.

Appendix A

Table 1: Dwelling Units the Enterprises Financed By Year and Income Level

	Fannie Mae			Freddie Mac			
Year	**Total**	**80% or less**	**50% or less**	**Total**	**80% or less**	**50% or less**	**Grand Total**
1993	183,601	159,527	28,513	10,794	9,784	3,306	194,395
1994	221,451	180,707	30,839	45,538	41,001	10,919	266,989
1995	235,354	134,289	19,858	68,381	60,752	7,925	303,735
1996	275,666	217,060	23,340	98,574	88,631	11,413	374,240
1997	253,463	200,968	42,240	117,188	99,679	17,583	370,651
1998	394,345	321,057	67,528	344,716	304,633	65,024	739,061
1999	294,186	247,209	49,105	264,300	217,058	47,610	558,486
2000	289,891	234,769	44,735	219,756	182,412	40,617	509,647
2001	503,909	395,976	71,484	436,859	373,006	92,678	940,768
2002	461,397	348,398	82,778	637,896	534,785	167,711	1,099,293
2003	809,703	550,432	109,595	743,208	572,685	174,757	1,552,911
2004	439,125	331,550	76,501	606,084	523,729	196,275	1,045,209
2005	476,249	348,980	95,531	488,301	433,590	132,898	964,550
2006	767,840	600,804	172,068	706,804	630,625	232,255	1,474,644
Grand Total	**5,606,180**	**4,271,726**	**914,115**	**4,788,399**	**4,072,370**	**1,200,971**	**10,394,579**

Table 2. Dwelling Units Financed and Mortgages Purchased by the Enterprises by Year

	Fannie Mae		Freddie Mac		Grand Total	
Year	**Mortgages**	**Dwelling Units**	**Mortgages**	**Dwelling Units**	**Mortgages**	**Dwelling Units**
1993	1,374	183,601	78	10,794	**1,452**	**194,395**
1994	1,421	221,451	273	45,538	**1,694**	**266,989**
1995	4,163	235,354	407	68,381	**4,570**	**303,735**
1996	1,460	275,666	622	98,574	**2,082**	**374,240**
1997	1,553	253,463	742	117,188	**2,295**	**370,651**
1998	7,259	394,345	2,409	344,716	**9,668**	**739,061**
1999	1,944	294,186	1,493	264,300	**3,437**	**558,486**
2000	1,449	289,891	1,153	219,756	**2,602**	**509,647**
2001	4,640	503,909	5,745	436,859	**10,385**	**940,768**
2002	6,842	461,397	6,381	637,896	**13,223**	**1,099,293**
2003	18,463	809,703	15,573	743,208	**34,036**	**1,552,911**
2004	4,562	439,125	5,399	606,084	**9,961**	**1,045,209**
2005	8,623	476,249	2,767	488,301	**11,390**	**964,550**
2006	7,897	767,840	5,045	706,804	**12,942**	**1,474,644**
Grand Total	**71,650**	**5,606,180**	**48,087**	**4,788,399**	**119,737**	**10,394,579**

Table 3. Total Number of Mortgages Purchased by the Enterprises by State							
State	**Fannie Mae**	**Freddie Mac**	**Grand Total**	**State**	**Fannie Mae**	**Freddie Mac**	**Grand Total**
California	37,839	21,253	**59,092**	**South Carolina**	238	314	**552**
New York	6,825	3,016	**9,841**	**Alabama**	234	271	**505**
Texas	3,169	3,855	**7,024**	**Utah**	230	219	**449**
Illinois	2,199	2,487	**4,686**	**District of Columbia**	251	152	**403**
Washington	2,739	921	**3,660**	**Kansas**	153	232	**385**
Florida	1,717	1,912	**3,629**	**Kentucky**	162	212	**374**
New Jersey	1,098	818	**1,916**	**Nebraska**	159	167	**326**
Ohio	875	1,027	**1,902**	**Mississippi**	131	162	**293**
Georgia	874	1,003	**1,877**	**New Mexico**	134	148	**282**
Arizona	1,068	744	**1,812**	**Iowa**	144	123	**267**
Colorado	1,268	437	**1,705**	**Arkansas**	93	142	**235**
Pennsylvania	913	791	**1,704**	**New Hampshire**	89	133	**222**
Maryland	950	716	**1,666**	**North Dakota**	108	97	**205**
Oregon	1,026	523	**1,549**	**Idaho**	90	67	**157**
Michigan	754	689	**1,443**	**Delaware**	50	90	**140**
Minnesota	948	418	**1,366**	**Rhode Island**	78	40	**118**
North	498	771	**1,269**	**Maine**	46	50	**96**
Virginia	563	663	**1,226**	**Alaska**	61	35	**96**
Massachusetts	693	404	**1,097**	**South Dakota**	46	33	**79**
Nevada	580	479	**1,059**	**Montana**	36	20	**56**
Tennessee	399	447	**846**	**West Virginia**	19	35	**54**
Indiana	341	432	**773**	**Wyoming**	18	20	**38**
Louisiana	388	265	**653**	**Hawaii**	18	17	**35**
Wisconsin	352	294	**646**	**Vermont**	11	7	**18**
Missouri	295	322	**617**	**Guam**		11	**11**
Oklahoma	274	325	**599**	**Puerto Rico**	1	1	**2**
Connecticut	290	277	**567**	**Virgin Islands**	2		**2**
				Grand Total	**71,537**	**48,087**	**119,624**

Table 4. Total Number of Mortgages Purchased by the Enterprises by Metropolitan Statistical Area

	1993-2004	Total	2005-2006	Total
1	Los Angeles-Long Beach, CA, (PMSA)	**23,352**	Los Angeles-Long Beach-Santa Ana, CA MSA	**5,598**
2	New York, NY, (PMSA)	**6,882**	New York-Northern New Jersey-Long Island, NY-NJ-PA MSA	**2,152**
3	San Diego, CA, (MSA)	**5,094**	San Francisco-Oakland-Fremont, CA MSA	**1,156**
4	San Francisco, CA, (PMSA)	**4,554**	Seattle-Tacoma-Bellevue, WA MSA	**1,102**
5	Chicago, Il, (PMSA)	**3,946**	Dallas-Fort Worth-Arlington, TX MSA	**785**
6	Oakland, CA, (PMSA)	**3,561**	San Diego-Carlsbad-San Marcos, CA MSA	**717**
7	Orange County, CA, (PMSA)	**3,115**	Houston-Sugar Land-Baytown, TX MSA	**530**
8	San Jose, CA, (PMSA)	**2,190**	Chicago-Naperville-Joliet, IL-IN-WI MSA	**489**
9	Seattle-Bellevue-Everett, WA, (PMSA)	**1,673**	Phoenix-Mesa-Scottsdale, AZ MSA	**380**
10	Sacramento, CA, (PMSA)	**1,670**	Atlanta-Sandy Springs-Marietta, GA MSA	**379**
11	Dallas, TX, (PMSA)	**1,390**	Minneapolis-St. Paul-Bloomington, MN-WI MSA	**301**
12	Riverside-San Bernardino, CA, (PMSA)	**1,365**	Philadelphia-Camden-Wilmington, PA-NJ-DE-MD MSA	**295**
13	Houston, TX, (PMSA)	**1,305**	Boston-Cambridge-Quincy, MA-NH MSA	**276**
14	Washington, DC-MD-VA-WV, (PMSA)	**1,244**	Riverside-San Bernardino-Ontario, CA MSA	**272**
15	Atlanta, GA, (MSA)	**972**	Washington-Arlington-Alexandria, DC-VA-MD-WV MSA	**269**
16	Denver, CO, (PMSA)	**957**	San Jose-Sunnyvale-Santa Clara, CA MSA	**260**
17	Portland-Vancouver, OR-WA, (PMSA)	**948**	Miami-Fort Lauderdale-Miami Beach, FL MSA	**249**
18	Minneapolis-St. Paul, MN-WI, (MSA)	**895**	Detroit-Warren-Livonia, MI MSA	**235**
19	Philadelphia, PA-NJ, (PMSA)	**895**	Portland-Vancouver-Beaverton, OR-WA MSA	**229**
20	Phoenix-Mesa, AZ, (MSA)	**851**	Baltimore-Towson, MD MSA	**226**
Grand Total		**66,859**		**15,900**