

CAPITAL FLOWS TO THE MULTIFAMILY INDUSTRY

Historically, the apartment industry has relied on a variety of capital sources, each with its own focus, strengths and limitations, to meet its liquidity needs. These capital sources together have provided the apartment sector with \$100-\$150 billion annually – reaching as high as \$225 billion last decade – to develop, refinance, purchase, renovate and preserve apartment properties.

Fannie Mae and Freddie Mac: A Critical Liquidity Backstop in All Markets and All Economic Cycles

- The Government Sponsored Enterprises (GSEs), Fannie Mae and Freddie Mac, have served as the cornerstone of the multifamily housing finance system in the modern era, successfully attracting private capital to the sector. Unlike any other single source of capital, they offer long-term debt for the entire range of apartment properties (market-rate workforce housing and subsidized properties, large properties, small properties, etc.) and are active in all markets (primary, secondary and tertiary).
- The GSEs' multifamily programs have served as a backstop to the industry, increasing at times of market dislocation when other capital sources leave the market, and decreasing as private capital returns. This was seen most recently during the 2008 financial crisis, when virtually all private capital left the market. Today, they currently hold 32% of the outstanding multifamily mortgage debt. Between 1990 and 2014, they accounted for 41% (\$281.8 billion) of the net increase in mortgage debt.

Commercial Banks: Short-Term Financing for Smaller, Local Borrowers

- Commercial banks and thrifts generally serve as a source of credit for smaller, local borrowers to finance construction, acquisitions and ownership. They typically provide floating rate or short-term fixed rate debt, and often their willingness to extend this credit is based on the availability of permanent take-out financing offered by the GSEs.
- The banks currently hold 33% of outstanding multifamily mortgage debt. Between 1990 and 2014, they provided 28% (\$190.1 billion) of the total net increase in mortgage debt. They provided limited amounts of capital to the industry during the financial crisis and have taken a more active role in lending during 2013 and 2014. They face constraints on returning to the pre-recession levels due to higher risk-based capital requirements, and new FASB accounting standards, which impose meaningful limits on the ability of banks to provide capital to commercial real estate.

Life Insurance Companies: Target High-Quality Properties, Capital Allocations Change with the Market

- Life insurance companies tend to restrict their lending to a handful of primary markets and to high-quality, newer construction apartment properties. They do not generally finance affordable apartments, and their loan terms typically do not extend beyond 10 years. Importantly, they enter and exit the multifamily market based on their investment needs and economic conditions. On average, they have generally provided 10% or less of the annual capital needed by the multifamily industry, but that number has gone as low as 3%.
- They currently hold 6% of outstanding multifamily mortgage debt. Between 1990 and 2014, they accounted for 4% (\$26.4 billion) of the net increase in multifamily mortgage debt.

FHA: Reliable Capital Source but Limited Mortgage Products and Capacity Issues

- FHA offers high-leverage, long-term mortgages with 35-year terms and 80-83% loan-to-value ratio for the construction, substantial rehabilitation, and acquisition and refinancing of apartments. The loans FHA offers are frequently used for construction lending.
- After the 2008 financial collapse, they became a vital source of construction capital for apartments, and now FHA/Ginnie Mae currently holds 9% of outstanding multifamily mortgage debt. Between 1990 and 2014, they accounted for 10.9% (\$75.8 billion) of the total net increase in mortgage debt.



- Capacity issues, long processing times and statutory loan limit requirements prevent FHA from serving a larger share of the multifamily market. They are also in the process of implementing more stringent underwriting and loan documents to reduce, not expand, the number of loans they will fund.

CMBS/Conduits: Volatile Capital Source

- The CMBS market did not become a material source of capital to the apartment industry until the mid-1990s, peaking at 16.5% of the market (\$17.6 billion a year) in the housing bubble years of 2005-2007.
- The CMBS market completely shut down after the 2008 crisis. Today, the CMBS market is showing signs of recovery; however, regulatory changes imposed by financial regulatory reform legislation will mean that it will not return to its pre-bubble levels of lending.
- The CMBS market now holds 8% of the outstanding multifamily mortgage debt, although many of these loans have been referred to special servicers because of the aggressive underwriting and higher leverage employed during the housing boom.

Source: Federal Reserve Report Mortgage Debt Outstanding