Though the two government-sponsored enterprises (GSEs)—Fannie Mae and Freddie Mac—are best known for their dominant role in the single-family mortgage market, they have also been major providers of multifamily housing financing for more than 25 years. Their role in the multifamily market, however, has declined substantially since the housing crisis and has reverted to more normalized levels. In addition, even as the GSEs continue to meet or exceed their multifamily affordable housing goals, their financing for certain underserved segments of the market has fallen steeply in recent years.

Given recent declines, policymakers and regulators should consider maintaining or increasing the GSEs’ footprint in the multifamily market, especially in underserved segments. The scorecard cap increases and exemptions recently employed by the Federal Housing Finance Agency (FHFA) to slow the decline in GSE multifamily volume have been somewhat effective, but they may not be enough to prevent the GSEs’ role from shrinking further.

The GSEs and Multifamily Housing

The GSEs purchase, package, and guarantee multifamily mortgage loans originated by lenders; they also provide credit enhancement of bonds issued by state and local housing finance authorities. Though the GSEs have been mostly buy-and-hold investors in multifamily loans and securities, since the housing crisis they have focused on aggregation and transfer of first-loss credit risk to private investors. Both Fannie Mae and Freddie Mac have well-established risk-sharing programs that transfer the vast majority of multifamily credit risk to the private sector, thus reducing the risk posed to taxpayers.
Freddie Mac shares multifamily credit risk with capital market investors through securitization, while Fannie Mae relies more on loan-level risk sharing with lenders.

The GSEs provide financing for various multifamily properties ranging from traditional apartments to rental housing targeted specifically at economically disadvantaged, underserved, and hard-to-serve communities. GSE multifamily loan programs can be roughly classified into three categories:

1. **General purpose multifamily**—financing for general purpose rental properties such as traditional apartments.

2. **Special purpose multifamily**—financing for purpose-built properties, or loans that require nonstandard underwriting, such as
   - senior housing—properties that include skilled nursing, independent living, or assisted living facilities;
   - student housing—apartment complexes built exclusively for students, located near major colleges and universities;
   - manufactured housing community loans—housing for underserved populations, particularly in rural areas, where manufactured housing communities are prevalent; and
   - small balance loans—financing for the acquisition of loan amounts ranging from $1 to $3 million, or up to $5 million in high-cost areas.

3. **Targeted affordable multifamily**—financing focused on the preservation, rehabilitation, and construction of “rent-restricted” properties that receive federal, state, or local government subsidies—such as the Low-Income Housing Tax Credit or Section 8 subsidies—to pay for a portion of development costs. In return, property owners agree to keep rents on a certain percentage of units affordable to low- or very low-income households. Both GSEs have targeted affordable housing programs that specialize in financing multifamily loans that are supported by government subsidies.

The US Department of Housing and Urban Development (HUD) deems a multifamily rental unit “affordable” if the rent payment constitutes no more than 30 percent of a household’s income. HUD further defines affordability by income level:

- moderate-income housing—affordable to renters earning 100 percent of the local area median income (AMI);
- low-income housing—affordable to renters earning 80 percent of AMI;
- very low-income housing—affordable to renters earning 50 percent of AMI; and
- extremely low-income housing—affordable to renters earning 30 percent of AMI.

The vast majority of multifamily units financed by the GSEs—80 to 90 percent—are considered affordable under HUD’s definition. This is partly because the GSEs focus on the rental needs of low- and moderate-income households, but it is also partly because of how HUD calculates the AMI. Because AMI is derived using household incomes of both renters and homeowners living in an area, and because
homeowners tend to have higher incomes than renters do, this measure of area median income tends to be higher than the area median income of just renters. As a result, rental units occupied by households with incomes higher than the “renter-only AMI” are considered affordable under HUD’s definition, essentially lowering the bar for determining how many units are affordable. Another reason most GSE-financed multifamily units are affordable is the level of area rents. Where rents are generally inexpensive and constitute less than 30 percent of the AMI, a large number of units become inherently affordable under HUD’s “30 percent rule.”

GSE Multifamily Financing Trends

Origination Volumes Have Grown over the Long Run, as Has Volatility

The dollar volume of GSE multifamily financing has grown steadily over the past 25 years from a combined $4.5 billion in 1990 to over $57 billion at the end of 2014. Though volumes have been considerably volatile year over year, the long-term upward trend has remained largely intact. Figure 1 shows multifamily business volumes for Fannie Mae, Freddie Mac, and both GSEs from 1989 to 2014. Between 1993 and 1999, combined volume grew every year, from $4.3 billion in 1993 to over $17 billion in 1999; annual growth rates, however, were volatile, ranging between 1 percent and 75 percent. The early 2000s witnessed tremendous increases in volume (and volatility) from $16 billion in combined volume in 2000 to nearly $67 billion in 2007. This uptick was followed by a post-crisis decline to $33 billion by the end of 2010 as the multifamily market shrank. As the market started to improve in 2011, GSE volumes started growing again, nearly doubling to over $62 billion by the end of 2012. They have remained relatively steady since then.

FIGURE 1

The GSEs’ Share of Total Multifamily Originations Is at a Post-Crisis Low

Fannie Mae’s and Freddie Mac’s combined share of total multifamily originations has fallen consistently since 2009, even as total origination volumes have nearly quadrupled (figure 2). The GSEs financed approximately 70 percent of all multifamily originations in 2008 and 2009, largely because purely private sources of financing pulled back significantly. But they have steadily lost market share ever since as private capital has returned. By the end of 2014, the GSEs' share of total multifamily originations had declined to just over 30 percent, slightly below their market share during the early 2000s.

**FIGURE 2**

**GSEs Share of Multifamily Originations Has Fallen Below Early-2000s Levels**

![Graph showing GSEs share of multifamily originations](image)

Source: Urban Institute calculations based on FHFA 2013 annual report to Congress, GSE reports and press releases, and Mortgage Bankers Association data.

Since the Crisis, Fannie Mae’s Multifamily Financing Has Shrunk More Than Freddie Mac’s

Figure 2 also reveals an interesting post-crisis trend that is playing out within the GSE segment of the multifamily market. As the GSEs lost market share to private players after 2009, the market dynamic between Fannie Mae and Freddie Mac shifted considerably. Fannie Mae has been the predominant provider of GSE multifamily financing since the late 1980s (figure 3). However, its market share has been declining since the early 1990s—a continuing trend that has even accelerated somewhat post-crisis. As recently as 2000–07, Fannie Mae was consistently financing 60 to 70 percent of GSE multifamily volume. But, by the end of 2014, Fannie’s market share advantage over Freddie had nearly vanished. The market was split almost evenly: 50.5 percent for Fannie and 49.5 percent for Freddie. One possible explanation for Freddie Mac’s market share gain is its securitization-based approach to...
risk sharing, which appeals to a broad range of capital markets investors and allows expanded access to capital. In contrast, Fannie Mae relies more on loan-level risk sharing arrangements with approved lenders, limiting its ability to attract capital from a broader investor base.

FIGURE 3
Fannie Mae’s and Freddie Mac’s Shares of GSE Multifamily Volume, 1989–2014

Source: Urban Institute calculations based on the FHFA 2013 annual report to Congress and GSE press releases.

GSE Affordable Housing Volume Trends and the Impact of the Federal Housing Finance Agency’s Scorecards

The Federal Housing Enterprises Financial Safety and Soundness Act of 1992 required HUD, then the regulator of Fannie Mae and Freddie Mac, to establish “housing goals” for mortgages purchased by the GSEs. The purpose of housing goals was to expand affordable housing opportunities for moderate-, low-, and very low-income families, by establishing minimum quantitative thresholds, generally in the form of number of units financed or the dollar volume of financing provided.

The GSEs’ performance against the housing goals was generally satisfactory until the recent financial crisis. The Housing and Economic Recovery Act of 2008, which was enacted in response to the recent crisis, transferred the general regulatory supervision of the GSEs, including the responsibility for the goals, to the FHFA. Post-crisis, the focus of both the GSEs and the FHFA turned to safety and soundness, and to the stability of the GSEs’ financial condition. However, as the multifamily market began improving in 2011, performance against multifamily goals also improved gradually; both Fannie and Freddie have either met or exceeded their multifamily goals in recent years.
In 2012, the FHFA introduced conservatorship scorecards for both GSEs to track their annual progress toward the longer-term strategic plan (FHFA Strategic Plan 2012). The scorecards include specific annual objectives and mandates that Fannie and Freddie must achieve during the year. Given that the multifamily market is a heterogeneous collection of several different segments, each of which has varying degrees of profitability, default risk, and origination and execution challenges, the impact of scorecard mandates tends to be distributed unevenly across these segments. I examined recent volume trends for the following three underserved segments of the multifamily market to better understand how recent volumes may have been affected by FHFA scorecard mandates:

1. subsidy-dependent targeted affordable multifamily housing,
2. manufactured housing community loans, and
3. small multifamily loans.

The FHFA’s 2013 Scorecard Reduced Overall Volumes, but Support for Underserved Segments Was Curtailed Even More

The FHFA’s 2013 Conservatorship Scorecard for Fannie Mae and Freddie Mac required each GSE to reduce multifamily new business volume by at least 10 percent in order to encourage more private capital into the multifamily market. In response, Fannie Mae and Freddie Mac cut their total volumes by 15 and 10 percent, respectively. Combined GSE volume fell by nearly 13 percent year over year, but volume for the above three underserved segments fell by nearly twice as much: 24 percent combined, with 27 percent at Fannie Mae and 17 percent at Freddie Mac.

The 2014 Scorecard Halted Overall Volume Declines, but Financing for Underserved Segments Continued to Plummet

Shortly after the Senate confirmed Melvin Watt as the new FHFA director, the agency issued its 2014 scorecard, which deviated from the 2013 scorecard in three ways concerning multifamily (FHFA 2014):

1. it dropped the requirement to reduce multifamily new business volume;
2. it required the GSEs to maintain 2014 volume at or below 2013 caps (i.e., $26 billion for Freddie Mac and $30 billion for Fannie Mae); and
3. it exempted the subsidy-dependent targeted affordable housing, manufactured housing community, and small multifamily loans from the cap to encourage more lending in these “cap-exempted” categories, especially in light of the 2013 cuts in these categories.

Once again, both GSEs responded to these scorecard changes, with mixed results (table 1). Freddie Mac used over 99 percent of its $26 billion cap, providing $25.8 billion in cap-subject financing and an additional $2.7 billion in the cap-exempt underserved categories, for a total volume of over $28 billion. Freddie Mac’s total 2014 volume grew by over 9 percent from 2013, while cap-exempted volume grew by 8 percent, almost certainly because of 2014 scorecard changes.
TABLE 1

Year-Over-Year Change in GSE Multifamily Volume, 2010–14

<table>
<thead>
<tr>
<th>Volume</th>
<th>GSE Total</th>
<th>Fannie Mae</th>
<th>Freddie Mac</th>
</tr>
</thead>
<tbody>
<tr>
<td>Multifamily total</td>
<td>$33</td>
<td>$45</td>
<td>$63</td>
</tr>
<tr>
<td>Year-over-year change (%)</td>
<td>36%</td>
<td>40%</td>
<td>-13%</td>
</tr>
<tr>
<td>Cap-exempt categories</td>
<td>$5.7</td>
<td>$7.7</td>
<td>$10.7</td>
</tr>
<tr>
<td>Year-over-year change (%)</td>
<td>35%</td>
<td>39%</td>
<td>-24%</td>
</tr>
</tbody>
</table>

Source: Urban Institute calculations based on GSE multifamily volume press releases (available from the author upon request).

In contrast, Fannie Mae used roughly 82 percent of its $30 billion cap, providing $24.7 billion in cap-subject financing and an additional $4.2 billion in cap-exempt categories, for a total volume of $29 billion, just 0.5 percent more than its 2013 volume. But more strikingly, financing for the three cap-exempted categories was slashed by an additional 25 percent, on top of 2013’s 27 percent cut.

Combined, the GSEs provided roughly $57 billion in multifamily financing in 2014, 5 percent more than in 2013, predominantly as a result of increases in Freddie Mac’s volume. Yet, combined financing for cap-exempt categories declined 15 percent in 2014, predominantly because of declines in Fannie Mae’s volume.

Steep declines in Fannie Mae’s cap-exempt volume in 2013 and 2014 partly reflect its above-average volume growth in these categories in 2011 and 2012, when Freddie Mac lagged. Thus, despite the 2013 and 2014 declines in the cap-exempt categories, Fannie Mae continues to channel a higher share of its multifamily volume toward cap-exempt categories than Freddie Mac does (figure 4). Figure 4 also shows that cap-exempt volume, as a share of total GSE multifamily volume, has been falling since 2010, with the rates of decline accelerating during 2013 and 2014.

FIGURE 4

Cap-Exempt Share of Total GSE Multifamily Volume Has Been Falling since 2010

Source: Urban Institute calculations based on GSE multifamily volume press releases (available from the author upon request).
FHFA’s 2015 Scorecard and Proposed 2015–17 Housing Goals

The 2015 scorecard sets caps at $30 billion for both Fannie and Freddie while keeping the 2014 exemptions in place (FHFA 2015). Though Fannie’s cap remains largely unchanged from last year, the 2015 scorecard raises Freddie Mac’s cap by roughly $4 billion, a move that would allow the firm to provide additional support to the multifamily market in 2015. According to the executive vice president of Freddie Mac Multifamily, David Brickman, the GSE expects “to have another year of double digit percent growth in our new business volume given that our volume cap for 2015 has been increased by 16 percent to $30 billion, and we expect to increase our activity in uncapped products, particularly small property loans.”

In August 2014, the FHFA issued a proposed rule that would set affordable housing goals for Fannie Mae and Freddie Mac from 2015 to 2017. The proposed rule would gradually increase the multifamily affordable housing goals for Freddie Mac by requiring the firm to finance an increasing number of low- and very low-income affordable units while keeping corresponding goals for Fannie Mae at 2014 levels. The proposed rule would also establish a new small loan subgoal that would require the GSEs to finance a minimum number of units through their small loan programs.

Key Conclusions

This analysis of the GSEs’ multifamily financing trends, especially the recent years, has three takeaways.

1. **Given recent volume declines, policymakers and regulators should consider maintaining or increasing GSEs’ role in the multifamily market.**

Fannie Mae’s and Freddie Mac’s combined multifamily market share of 30 percent at the end of 2014 is a post-recession low and is slightly below their market share during the early 2000s. The recent decline in the GSEs’ role also comes when rents are rising quickly nationwide as a result of historically low vacancy rates. Higher rental demand among millennials and former homeowners is expected to further increase the cost of renting in coming years.

Though the multifamily market continues to remain strong and private financing is readily available today, it is also poised to grow significantly because of rising property prices and higher future demand. This raises the question of whether the GSEs should continue to shrink their multifamily footprint even further below the level of early 2000s, a period of relatively stable housing market. The FHFA’s 2015 scorecard attempts to address this issue by raising the GSE combined volume cap to $60 billion ($30 billion each), $4 billion more than the 2014 combined cap. This represents a year-over-year cap increase of less than 7 percent. However, total 2015 multifamily originations are expected to rise by 14 percent over the previous year. Therefore, even if Fannie and Freddie fully exhaust their 2015 caps, their relative role in the multifamily market will continue to shrink.
2. The 2014 cap exemptions appear to have reversed the decline in financing for underserved segments at Freddie Mac.

Financing backed by pure private capital is likely to be concentrated within the more profitable mid-to-high end of the market. Though the GSEs are more focused on the mid-to-lower end of the market, when Fannie and Freddie were required to reduce 2013 multifamily volumes, a disproportionately large share of the decline was in the three underserved segments. The FHFA’s decision to exempt these segments from the 2014 cap seems to have been effective at Freddie Mac, but not in aggregate, indicating the need for additional provisions to support adequate financing for these segments.

3. Cap exemptions, by themselves, may not be enough to reverse the recent declines in underserved segments.

The fact that 2014 scorecard exemptions were unable to stem the decline at Fannie Mae (and in total) raises the question of whether exemptions by themselves are effective. The 2014 scorecard certainly removed the negative incentives inherent in the 2013 scorecard by introducing exemptions and by not seeking additional volume cuts. However, it failed to create positive incentives to motivate the GSEs to use those exemptions. FHFA’s proposed 2015–17 small loan subgoal attempts to address this issue within the small-loan segment; if finalized, it could begin to alleviate the recent declines in small-loan financing. But the lack of such incentives outside of small loans could lead to volume gains in the small-loan category only, potentially at the expense of other categories not subject to goals.13

Notes

1. See Fannie Mae (2014) and Freddie Mac (2013). Both GSEs have transitioned from holding multifamily loans in portfolios to sharing the credit risk of multifamily loans with private investors.

2. This is just one of several ways to classify GSEs’ multifamily financing. Because of the variety of multifamily properties, renter types, and loan products, these categories can often overlap. For example, a senior housing property that receives federal subsidies could also be classified as subsidized targeted multifamily housing.

3. Fannie Mae’s is the Multifamily Affordable Housing program, and Freddie Mac’s is the Targeted Affordable Housing program.

4. Freddie Mac’s multifamily business suffered heavy losses on mortgages originated during the 1980s, and the firm had stopped writing new multifamily business by the end of 1990. As a result Fannie Mae’s share of GSE multifamily financing exploded to nearly 100 percent by 1992, until Freddie Mac reentered the market in late 1993 with a share of just 4 percent.

5. To address the potential for conflict between the safety and soundness of the GSEs and increased commitment toward affordable housing under the goals, the law established the Office of Federal Housing Enterprise Oversight, within HUD, as the financial safety and soundness regulator of the GSEs.

7. See Fannie Mae (2011). Subsidized affordable housing and manufactured housing are designated “Underserved Markets” under the Housing and Economic Recovery Act of 2008. While the small loan segment is not statutorily designated as underserved, certain characteristics make this segment difficult to serve. For example, small loan borrowers tend to be individual investors or other small businesses that represent varied (and localized) credit risks and that invest in fewer properties, making underwriting small loans complicated and difficult to standardize. In addition, because cost of originating multifamily loans does not vary substantially with loan amount, small loans don’t offer large economies of scale and are therefore also more expensive to originate. Small loans also tend to have relatively higher delinquency rates and lower profitability, and they are generally backed by older properties. Collectively, all these factors limit the supply of small loan financing and make it difficult to meet demand for such loans.


12. Freddie Mac expects total 2015 multifamily originations to be $210 billion, which represents a 14 percent increase over 2014 volume of $185 billion (Freddie Mac 2015).

13. In June 2010, the FHFA issued a proposed rule regarding the GSEs’ duty to serve Underserved Markets; the final rule however was not subsequently issued. But according to the FHFA’s 2015 scorecard, the GSEs are required to “Prepare to implement Duty to Serve requirements upon publication of a final rule,” indicating that a final rule could be published in 2015. The FHFA could address the “lack of positive incentives” issue for statutorily designated Underserved Markets via the duty to serve final rule.

References


About the Author

Karan Kaul is a research associate in the Housing Finance Policy Center, where he researches topical housing finance issues to highlight the market impact of ongoing regulatory, industry, and related developments. He is also responsible for monitoring and reporting on mortgage market trends and current events weekly. He brings a deep understanding of key GSE reform issues, political landscape surrounding reform, and pros and cons of different approaches concerning their impact on mortgage rates, credit availability, private capital, and other factors.

Kaul came to Urban after five years at Freddie Mac, where he worked on various housing policy issues primarily related to the future of housing finance and the reform of the government-sponsored enterprises. Before Freddie Mac, Kaul worked as a research analyst covering financial institutions. He holds a bachelor’s degree in electrical engineering and an MBA from the University of Maryland, College Park.