EXECUTIVE SUMMARY

Multifamily rental housing accounts for a sizable share of America’s housing stock, with an estimated 15.2 million occupied multifamily rental units. Current and future market conditions – including the ongoing economic and housing recovery, demographic forces and a change in attitudes towards homeownership versus renting – point to a growing need for rental housing, especially affordable rentals.

Fannie Mae has long played a significant role in the multifamily rental housing sector, and continues to do so, largely by packaging multifamily loans into mortgage-backed securities and providing a credit guarantee on the securities. The vast majority – roughly 90 percent – of Fannie Mae’s multifamily housing finance currently supports rental housing that is affordable to households earning at their area’s median income level. Through this function, Fannie Mae has continued to provide a reliable, safe, and sustainable source of financing to meet the nation’s rental housing needs.

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There are six key points regarding the multifamily sector and workforce rental housing:

1. **MOST MULTIFAMILY HOUSING IS “AFFORDABLE”**

According to data from the 2009 American Housing Survey by the U.S. Department of Housing and Urban Development (HUD), about 14 million of the estimated 17 million rental housing units across the nation are considered affordable to people earning less than their area’s median income (AMI) – where rent payments comprise no more than 30% of income.

A subset of affordable rental housing is known as “workforce” rental housing, defined by the Urban Land Institute (ULI) as affordable to households earning 60% to 100% of AMI.

In addition, there are different levels of rental affordability. For instance, a rental unit may be affordable to a household earning 100% of AMI, but not affordable to one earning 50% of AMI.

With these distinctions, multifamily housing is often classified into three distinct categories: Public Housing, Subsidized Affordable Housing, and Conventional Market Rate Housing.

- **Public Housing** consists of rental housing properties that are both publicly funded and publicly owned and managed by local housing authorities. It is financed by the federal government and typically serves the lowest income households – those earning less than 30% of AMI.

- **Subsidized Affordable Housing** consists of rental properties that are privately owned but receive some form of government-sponsored subsidy in return for keeping rents affordable to those at the lowest-income levels. These properties rely on a mix of public subsidy and private financing, and typically support households earning between 30% and 80% of AMI.

- **Conventional Market Rate** rental housing is also privately owned but charges rents consistent with the property amenities as well as local housing market prices and conditions. Typically, these property owners do not receive direct subsidies. Conventional market-rate properties may offer rental housing that is affordable to workforce households.

2. **MOST MULTIFAMILY PROPERTIES OFFER A MIX OF RENTAL UNITS AND RENT LEVELS**

A common misperception is that an entire apartment building will only offer one rent level for its units; in other words, a landlord will price all units for tenants earning 60% of AMI. In reality, apartment buildings frequently offer a variety of units with different rent levels – some tenants may pay market-rate rents while their neighbors pay below-market or government-subsidized rents.

The mix of rent levels is effective in leveraging public subsidies while increasing economic integration and limiting the concentration of poverty. For example, 70% of all the multifamily properties financed by Fannie Mae offer rental units
affordable to various levels of AMI, with the remaining 30% of the properties offering units affordable to just one AMI level.

3. A SHORTAGE OF AFFORDABLE AND WORKFORCE RENTAL HOUSING PERSISTS

Rental housing affordable to lower-income households increasingly is in short supply, especially in certain more high-density metropolitan areas, such as Washington, DC and New York City.

According to the HUD 2009 American Housing Survey report:

» The share of occupied rental units affordable to households earning 80% to 100% of AMI increased slightly to 15.5% in 2009 from 14.9% in 2007.

» The share of rental units affordable to households earning 30% to 50% of AMI fell to 25.9% from 26.4%.

» The share of rental units affordable to households earning less than 30% of AMI fell to 15.5% from 17.2%.

The decline in the share of affordable rentals has been occurring for at least a decade. According to the Harvard Joint Center for Housing Studies 2010 State of the Nation’s Housing report, the number of units affordable to households earning a full-time minimum wage declined by 15.6% from 1997 to 2007.

4. THE FINANCIAL CRISIS PUSHED MOST MULTIFAMILY HOUSING INVESTORS OUT OF THE MARKET

Parts of the multifamily mortgage sector experienced the same dynamic as the single-family home-purchase sector during the housing run-up. Rental housing saw a rapid influx of investment capital, decreased affordability for tenants, increased debt by owners, and a dramatic expansion of financing structures created for securities that were sold to global investors.

The housing market collapse reversed this dynamic and caused a rapid withdrawal of private investment capital from the multifamily market. Since the housing crisis began, new multifamily commercial mortgage-backed security (CMBS) issuances have practically ceased and other institutional lenders, such as life insurers and commercial banks, have severely curtailed their investment in financing multifamily debt. Fannie Mae, Freddie Mac, and the Federal Housing Administration have stepped in to fill the void and have become the primary multifamily financing options available today.

Roughly 90 percent of Fannie Mae’s multifamily housing finance currently supports rental housing that is affordable to households earning at their area’s median income level.
5. FANNIE MAE’S MULTIFAMILY BUSINESS – MARKET SHARE AND CREDIT PROFILE

As Fannie Mae helped to fill the multifamily housing financing void, the company’s share of new multifamily securities issued was nearly 50%, or roughly $10 billion, as of the third quarter of 2010. The company’s share of overall multifamily mortgage debt outstanding stood at 20%, or $168.9 billion, as of the second quarter of 2010, according to Federal Reserve data. (In comparison, the CMBS share was 12.5% and Freddie Mac’s was 11.2%.)

The credit profile of Fannie Mae’s multifamily book of business is significantly stronger than the rest of the commercial markets. For example, Fannie Mae’s multifamily serious delinquency rate (60 days behind on payments or more) was just 0.80%, compared with the CMBS rate of 12%, as of the second quarter of 2010. The credit performance of Fannie Mae’s multifamily book of business is attributable to the company’s multifamily business model, which requires borrowers to maintain a certain amount of equity and lenders to share the risk of loss on each loan. The company also has held to strong multifamily underwriting guidelines.

Fannie Mae’s multifamily business model and activities reflect the company’s role of remaining in the market through all housing and economic cycles, even when private-market participants withdraw. The company expanded its multifamily activity during the dislocation of the credit markets starting in late 2007, and as the Harvard Joint Center report noted, “Both in the wake of the currency crisis in 1998 and again after 9/11 and the 2001 recession, Fannie Mae and Freddie Mac stepped up portfolio purchases and guarantees of multifamily debt.”

Before and during the financial crisis, Fannie Mae has provided financing for nearly all segments of the multifamily rental housing market while containing credit losses. By guaranteeing multifamily loans in securities issuances and providing credit enhancement on multifamily housing bonds, the company has consistently supported both the subsidized affordable and workforce rental housing markets to create and preserve affordable rental housing.

6. MULTIFAMILY FUNDAMENTALS APPEAR HEALTHY

U.S. housing demand is expected to continue growing. Anticipated population growth due to immigration and positive birth rates, coupled with demographic trends, is expected to increase household formation. Compared to past trends, future household growth is expected to tip more toward renting, underscoring the need for reliable and stable financing for the multifamily sector, for several reasons:

» The “Echo Boomers” – offspring of Baby Boomers – are forming independent households. The prime renting age cohort, consisting of individuals aged 20 – 34 years, is expected to grow substantially between 2010 and 2030.

» Consumer attitudes toward homeownership are changing as a result of the housing crisis. According to Fannie Mae’s National Housing Surveys in 2010, while a majority of Americans
still want to own homes, a significant number recognize they may have to wait longer than previously expected.

» In response to the housing crisis, mortgage underwriting standards have been strengthened to ensure long-term success and sustainability of the borrowers and the loans, reducing the number of households that may qualify to obtain a mortgage. Moreover, many borrowers with unsustainable loans who lost, sold, or relinquished their homes in this cycle will need to rely on rental housing in the near term and possibly longer.

PURPOSE OF THIS PAPER
The following sections of this paper provide a fuller discussion of these issues and are based in large part on Fannie Mae’s experience in the market as a leading provider of multifamily housing finance.

WHAT IS AFFORDABLE RENTAL HOUSING?
Multifamily rental housing is a large and diverse sector and is generally defined as properties consisting of five or more individual housing units. To present the current state of the multifamily rental housing sector, this paper discusses how affordable housing is defined, how much rental housing is available, whether there is enough rental housing to satisfy demand, what the state of lending in the multifamily market is today, and what role Fannie Mae plays in the multifamily rental housing sector.

Multifamily rental housing accounts for a significant amount of the affordable housing available today. There are three primary segments of the multifamily market: Public Housing, Subsidized, and Conventional Market Rate Housing. All three types of multifamily housing can be considered affordable as demonstrated in the chart below.

The chart below illustrates the distribution of affordable multifamily housing, showing the number of units in each segment. The chart is based on data from the 2009 American Housing Survey and a HUD report.

**Public Housing**
This is the most well-known type of affordable multifamily housing. It is rental housing that is both publically-funded and publically-owned.
**Government-Issued Incentives and Subsidies**

One common, yet narrow, definition for affordable multifamily is a unit in a multifamily property that receives some form of government subsidy, such as a rental subsidy from HUD. These types of subsidies can include federal programs such as Housing Choice vouchers issued to tenants, low-income housing tax credits issued to developers, or state or local programs such as tax abatements and subordinate financing.

The government-issued incentives and subsidies can be separated into two primary categories of subsidy:

1. **Housing Choice Vouchers:** Affordable monthly rent subsidies provided to individual tenants who rent privately-owned housing. The voucher pays the difference between market rent in a locality and the rent that is affordable to the individual, so that the individual pays no more than 30% of monthly income towards rent.

2. **Assisted Housing/Subsidized Affordable Multifamily Housing:** Privately owned rental housing that receives public subsidies in exchange for affordability restrictions. Assisted Housing can sometimes be referred to as Subsidized Affordable Multifamily Housing. Public subsidies include:
   - Capital Financing – Low-interest-rate mortgages, mortgage insurance, tax-exempt bond financing, loan guarantees, and pre-development financing to reduce costs.
   - Low-Income Housing Tax Credits (LIHTC) – This program provides developers with tax credits that can be sold to reduce the amount of debt that must be borrowed to finance a multifamily building.
   - Rental Subsidies – HUD and U.S. Department of Agriculture (USDA) Rural Development provide rental subsidies, such as project-based Section 8 rental assistance, to property owners to ensure that some or all low income tenants pay no more than 30% of their income for rent.
   - Tax Abatement – Tax reduction or elimination of some or all of the state or local property taxes for rental housing with certain ownership structures, servicing low- and moderate-income renters.
   - Federal Grant Programs – The Community Development Block Grant (CDBG) and the Home Investment Partnership (HOME) programs are two leading examples. The programs provide block grants to local governments for the construction and renovation of rental housing properties.

Fannie Mae supports the affordable multifamily market by financing both conventional market rate rental properties and government subsidized rental properties that are privately owned.
Note that subsidy programs can be grouped into “supply” subsidies, which subsidize the development of affordable housing, and “demand” subsidies, which subsidize the rent. For example, Public Housing and the LIHTC program are examples of supply-side subsidies while the Housing Choice Voucher program is an example of a demand-side subsidy.

**Conventional Market Rate Rental Housing**

In contrast to subsidized affordable rentals, conventional market-rate rental housing is usually owned by private individuals or entities that charge rents consistent with the amenities offered by the property and local housing market conditions. In general, these property owners usually receive no public assistance. As the diagram on the page 5 shows, these unsubsidized units form the vast majority of the multifamily affordable sector.

**Workforce Rental Housing and Gaps**

Workforce rental housing is a subset of all affordable rental housing. As defined by ULI, workforce households are those earning 60% to 100% of AMI.

According to ULI’s J. Ronald Terwilliger Center for Workforce Housing, a workforce housing gap persists in high-cost areas that are major centers of employment, such as Washington DC, San Francisco, and Boston.

![2010 Two-Bedroom Housing Wage Diagram](image)

**2010 TWO-BEDROOM HOUSING WAGE**

*Represents the hourly wage that a household must earn (working 40 hours a week, 52 weeks a year) in order to afford the Fair Market Rent for a two-bedroom unit at 30% of income.*

*Source: National Low Income Housing Coalition • Out of Reach 2010 – June Update*
As the map illustrates, the Fair Market Rent on a two-bedroom apartment in most high-cost states requires significant income. Currently, the federal minimum wage is $7.25 an hour; local or state laws mandate a higher minimum wage in Washington, DC and in 14 states including California. It is likely that many households in these high-cost areas are spending more than 30% of income on rent.

**Affordability Is Determined Relative to AMI**

The definition of “affordability” in the multifamily affordable sector is based on the AMI in a locality – the midpoint household income for a metropolitan area or a non-metropolitan county, as calculated each year by HUD.

A unit of rental housing is considered affordable to an income group if the rent is no more than 30% of the maximum AMI for the income group. For example, for the Very Low Income group, if the AMI is $44,000, then the rent could not exceed $550 a month for the unit to be considered affordable. The following illustration provides other examples:

<table>
<thead>
<tr>
<th>POTENTIAL INCOME GROUPS BASED ON AREA MEDIAN INCOME (AMI)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rent Charged for Illustrative Purposes</td>
</tr>
<tr>
<td>Apartment 1: $300 per month</td>
</tr>
<tr>
<td>Apartment 2: $550 per month</td>
</tr>
<tr>
<td>Apartment 3: $750 per month</td>
</tr>
<tr>
<td>Apartment 4: $1,400 per month</td>
</tr>
<tr>
<td>Apartment 5: $5,000 / month</td>
</tr>
<tr>
<td><strong>Income ≤ 30% of AMI</strong></td>
</tr>
<tr>
<td><strong>[Extremely Low Income (ELI)]</strong></td>
</tr>
<tr>
<td><strong>30% AMI &lt; Income ≤ 50% of AMI</strong></td>
</tr>
<tr>
<td><strong>[Very Low Income (VLI)]</strong></td>
</tr>
<tr>
<td><strong>50% AMI &lt; Income ≤ 60% of AMI</strong></td>
</tr>
<tr>
<td><strong>60% AMI &lt; Income ≤ 100% of AMI</strong> Workforce Housing</td>
</tr>
<tr>
<td><strong>Not Low Income</strong> (Income greater than 100% of AMI)</td>
</tr>
</tbody>
</table>

**Substantial Subsidies Are Necessary to Keep Rental Units Affordable for the Lowest Income Tenants**

Since multiple households are sharing the same parcel of land, multifamily housing is generally more affordable than single-family housing. Nevertheless, units affordable to the lowest-income levels – those below 60% of AMI – can be challenging for developers to build or preserve. At 30% of AMI, most multifamily housing owners find it nearly impossible for rental income to cover operating expenses. As a result, these types of affordable units usually require multiple property-specific subsidies from several sources. In many cases, despite these subsidies, rents may still not be affordable to the lowest income households.
WHY IS IT IMPORTANT TO PRESERVE SUBSIDIZED AFFORDABLE RENTALS?

Subsidized Affordable Multifamily Definition

A Subsidized Affordable multifamily property incorporates a regulatory agreement or recorded restriction that limits rents, sets forth income qualifications for tenants, or places other restrictions on the use or occupancy of the multifamily property – all of which are designed to make the property affordable. While government entities generally impose these restrictions, property owners sometimes voluntarily record these restrictions in an attempt to preserve multifamily affordable housing for the future. In essence, subsidized affordable housing is privately owned rental housing that receives public subsidies in exchange for affordability restrictions.

Subsidized Affordable housing provides a significant amount of housing for those with lower incomes, particularly those earning under 50% of AMI. As a result, there is ongoing effort by Subsidized Affordable multifamily participants to develop and preserve properties with subsidies to maintain the stock of safe and affordable housing for the lowest income tenants.

Subsidized Affordable Multifamily Participants

Entities providing financing for Subsidized Affordable multifamily properties assume credit risk either by providing credit enhancement to the financing asset or by holding the loan in portfolio and taking both credit and interest-rate risk on the asset. The following diagram shows the range of possibilities for loan activities that may be undertaken by these entities.

Among the participating entities are Fannie Mae, Freddie Mac, FHA, and state housing finance agencies. Many large regional lenders also originate loans on properties with rent restrictions, but in the current lending environment, these loans are originated primarily for Community Reinvestment Act (CRA) credit.

Other direct lenders include nonprofit entities such as the Massachusetts Housing Partnership, mission-driven entities such as the New York-based Community Preservation Corporation and lender consortia such as the California Community Reinvestment Corporation are tasked specifically with developing and preserving affordable housing. Larger entities tend to keep loans in portfolio, although they may sell a pool at a later date.
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**Subsidies Reduce the Amount of Debt on a Multifamily Property, Making Rents Affordable**

Multifamily housing has the ability to deliver large amounts of affordable housing since multifamily apartment buildings or other multi-unit dwellings can house more families on a parcel of land than a single-family development.

Units affordable to the lowest-income levels, below 30% or even 50% of AMI, can be challenging to build or even rehabilitate using mortgage debt financing (e.g., loans) alone. Debt-only financing for construction of a new multifamily property usually leads to above-average market-rate rents to cover the cost of the financing. Extensive subsidies are required to minimize this resulting pass-along cost to tenants.

The primary subsidy program for stimulating the construction and rehabilitation of rental housing affordable to low-income households is the LIHTC program enacted in 1986. The program offers tax credits to developers that they can be sold to investors before construction begins. The cash from the sale of the tax credits reduces the amount of debt that must be borrowed for construction. As a result, the rents charged, which must also be used to pay down debt, can be offered at a discount to average market-rate rents.

In its January 2009 policy brief, *Meeting Multifamily Housing Finance Needs During and After the Credit Crisis*, the Harvard Joint Center for Housing Studies provides a useful example: For a multifamily development property to offer rental units affordable to a household earning at least 60% of AMI, then tax credits worth about 70% of the net present value of the property must be issued. In other words, it takes a large amount of subsidies to help finance and maintain the availability of these types of affordable rental units.
Housing Vouchers Help Very Low Income Households

Another form of housing subsidy is the federal rental voucher or certificate. To enable tenants to pay no more than 30% of their household income on rent, the federal government offers the Housing Choice Voucher program. The voucher pays the difference between the 30% of the household income and the fair market rent amount for that local area. Tenants must apply for these vouchers and must meet strict income requirements. The average voucher amounts to around $6,600 annually.

According to the 2008 State Housing Finance Factbook produced by the National Council of State Housing Finance Agencies, as many as 20% of households living in rental units generated by the LIHTC program still require vouchers so that the household is paying no more than 30% of its income for rent. Overall, HUD has estimated that there are 2.2 million households which qualify for housing vouchers, according to its 2008 report, *A Picture of Subsidized Households*.

Fannie Mae Participates in the Subsidized Affordable Market and Preservation

While focusing primarily on workforce rental housing, Fannie Mae is also active in the Subsidized Affordable market and the preservation of this housing. This can be a challenging market to serve due to the layering of subsidies necessary to make rents affordable to the lowest income households. As a result, Fannie Mae has several programs designed specifically for this market. The company’s Affordable Delegated Underwriting and Servicing (DUS®) program, Fixed-Rate Bond Credit Enhancement program, and Forward Commitments program are designed to aid in the development and preservation of rental units affordable to households earning 60% of AMI or less. Fannie Mae has financed about half a million rental units that have these types of layered subsidies.
HOW MUCH RENTAL HOUSING IS THERE?

As shown in the following table, according to the HUD 2009 American Housing Survey report, there are a total estimated 35.4 million occupied rental housing units in the U.S. This total includes the three most prevalent occupied housing structures:

- **Single-family properties** (one to four units) with about 18.8 million occupied units;
- **Manufactured housing** with about 1.4 million occupied units; and
- **Multifamily properties** (defined as having five or more units) with about 15.2 million occupied units.

Fannie Mae has provided financing on nearly four million of the estimated total 15.2 million occupied multifamily units in the U.S. That is about one-quarter of the nation’s total estimated multifamily rental units. As seen in the following table, the majority of these units are affordable to households with incomes between 50% and 100% of AMI.

### RENTAL UNITS SEGMENTED BY AMI FOR AFFORDABLE ESTIMATE

<table>
<thead>
<tr>
<th>Affordable to:</th>
<th>Estimated Single Family Rental (1-4 units) (C)</th>
<th>Estimated Multifamily Rental (5+ units) (C)</th>
<th>Estimated Manufactured Housing Units (C)</th>
<th>Estimated Total Rental (C)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income ≤ 30% of AMI</td>
<td>3.1M</td>
<td>2.5M</td>
<td>0.4M</td>
<td>6.0M</td>
</tr>
<tr>
<td>30% &lt; Income ≤ 50% of AMI</td>
<td>5.2M</td>
<td>4.0M</td>
<td>0.6M</td>
<td>9.8M</td>
</tr>
<tr>
<td>50% &lt; Income ≤ 60% of AMI</td>
<td>3.2M</td>
<td>3.0M</td>
<td>0.2M</td>
<td>6.4M</td>
</tr>
<tr>
<td>60% &lt; Income ≤ 80% of AMI</td>
<td>4.2M</td>
<td>3.5M</td>
<td>0.1M</td>
<td>7.8M</td>
</tr>
<tr>
<td>80% &lt; Income ≤ 100% of AMI</td>
<td>1.6M</td>
<td>0.9M</td>
<td>0.1M</td>
<td>2.6M</td>
</tr>
<tr>
<td>Income &gt; 100% of AMI</td>
<td>1.5M</td>
<td>1.3M</td>
<td>0.0M</td>
<td>2.8M</td>
</tr>
<tr>
<td>Total Market</td>
<td>18.8M</td>
<td>15.2M</td>
<td>1.4M</td>
<td>35.4M</td>
</tr>
</tbody>
</table>

**Source:** Data provided by HUD based on compilation of 2009 American Housing Survey Data for occupied units.

1 Cumulative (C) Column represents cumulative affordable units. For instance, if a unit is affordable at Extremely Low Income, i.e. affordable to income <= 30% of AMI, it is also affordable at the Very Low Income (<50% of AMI), therefore total units affordable at Very Low Income under the Multifamily Category is 2.5M + 4.0M = 6.5M.

Units segmented into Single and Multifamily rentals based on standard Fannie Mae definitions of Single and Multifamily. Units affordable to income >100% of AMI or higher represent upscale rental beyond a market's affordability.

### FANNIE MAE SHARE OF MULTIFAMILY MARKET BY AMI

<table>
<thead>
<tr>
<th>Market Multifamily Rental Units (5+ Units)</th>
<th>Fannie Mae Multifamily Rental Units (5+ Units)</th>
<th>Fannie Mae share of Multifamily Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>Estimated 5+ units (Millions)</td>
<td>Cumulative Units Available to AMI Category</td>
<td>Estimated 5+ units (Millions)</td>
</tr>
<tr>
<td>-------------------------------------------</td>
<td>-----------------------------------------------</td>
<td>-------------------------------------</td>
</tr>
<tr>
<td>Affordable to income ≤ 50% of AMI</td>
<td>6.5</td>
<td>6.5</td>
</tr>
<tr>
<td>Affordable to 50% of AMI &lt; income ≤ 60% of AMI</td>
<td>3.0</td>
<td>9.5</td>
</tr>
<tr>
<td>Affordable to 60% of AMI &lt; income ≤ 80% of AMI</td>
<td>3.5</td>
<td>13.0</td>
</tr>
<tr>
<td>Affordable to 80% of AMI &lt; income ≤ 100% of AMI</td>
<td>0.9</td>
<td>13.9</td>
</tr>
<tr>
<td>Affordable to income &gt; 100% of AMI</td>
<td>1.3</td>
<td>15.2</td>
</tr>
<tr>
<td>Total Market</td>
<td>15.2</td>
<td>15.2</td>
</tr>
</tbody>
</table>

**Notes:** Market data based on HUD compilation of 2009 American Housing Survey Data as of October, 2010. Fannie Mae AMI category for loan level affordability determined based on category at year of acquisition.
HOW AFFORDABLE IS MULTIFAMILY RENTAL HOUSING?

The vast majority of the 15.2 million occupied multifamily units in the U.S. – 92% representing an estimated 14.0 million occupied units – are affordable to households earning 100% of AMI or below. Additionally, 29% of the nation’s multifamily rental housing is affordable to households earning 60% to 100% of AMI.

Most Multifamily Rental Can Be Considered Affordable Housing

Most of the affordable rental housing supply falls into the 50% to 100% AMI segment alone, accounting for almost half – or 7.4 million units – of all multifamily rental units. There are significantly fewer units affordable to households earning less than 50% of AMI – about 6.5 million units in total. For households earning less than 30% of AMI, only 2.5 million occupied rental units are affordable. As a result, only about 16% of the 15.2 million occupied rental units available for rent in the multifamily market are affordable to households earning less than 30% of AMI. Moreover, many households are spending more than 30% of their income to rent an apartment.

Fair Market Rents and Market Rate Rents

There are many different levels of rental affordability in a metropolitan area and three primary definitions of asking rents:

- **Market rate rent** is an asking rent that is in line with other asking rents in the same general location for comparable units and amenities.
- **Below market rate rent** is any asking rent that is less than the average market rate asking rent.
- **Fair market rent** is determined by HUD, which publishes a list of what it considers to be fair market rents both at the metropolitan area level and at the national level.

According to HUD’s Fair Market Rent Program documentation: “Fair Market Rents are primarily used to determine payment standard amounts for the Housing Choice Voucher program, to determine initial renewal rents for some expiring project-based Section 8 contracts, to determine initial rents for housing assistance payment contracts in the Moderate Rehabilitation Single Room Occupancy program and to serve as a rent ceiling in the HOME rental assistance program. HUD
annually estimates Fair Market Rents for 530 metropolitan areas and 2,045 nonmetropolitan county areas. By law the final Fair Market Rents for use in any fiscal year must be published and available for use at the start of that fiscal year, on October 1st.”

**HUD’s Fair Market Rent Methodology**

According to HUD, “Fair Market Rents are gross rent estimates. They include the shelter rent plus the cost of all tenant-paid utilities, except telephones, cable or satellite television service, and internet service. HUD sets Fair Market Rents to assure that a sufficient supply of rental housing is available to program participants. To accomplish this objective, Fair Market Rents must be both high enough to permit a selection of units and neighborhoods and low enough to serve as many low-income families as possible.

The level at which Fair Market Rents are set is expressed as a percentile point within the rent distribution of standard-quality rental housing units. The current definition used is the 40th percentile rent, the dollar amount below which 40 percent of the standard-quality rental housing units are rented. The 40th percentile rent is drawn from the distribution of rents of all units occupied by recent movers (renter households who moved to their present residence within the past 15 months). HUD is required to ensure that Fair Market Rents exclude non-market rental housing in their computation. Therefore, HUD excludes all units falling below a specified rent level determined from public housing rents in HUD’s program databases as likely to be either assisted housing or otherwise at a below-market rent, and units less than two years old.”

**Fair Market Rent Exceptions by HUD**

HUD Section 8 program rules allow for Fair Market Rent exceptions to compensate for variations in rent levels and rental housing characteristics that exist within individual housing markets. According to HUD, a “Public Housing Authority may exceed the published Fair Market Rents by up to 20 percent for specified geographic submarkets of a larger Fair Market Rent area. Requests for [these] exceptions may not be granted for more than 50 percent of an Fair Market Rent area (as measured by population). Such requests must document the program-related need for the higher rents. Geographic area exceptions are usually a small part of the entire Fair Market Rent area and must be contiguous areas.” As a result, high-cost areas frequently require exceptions.

**Fair Market Rent Impact**

Fair Market Rents set by HUD may have an impact on low-income housing apartment operators and on housing markets. Since the Fair Market Rent determines the income stream for project-based Section 8 properties, it has a significant impact on the operating income for these properties. In addition, Fair Market Rents may exert downward pressure on prices in markets with less competition.
The national level fair market rent, as determined by HUD, along with the corresponding annual income levels necessary to afford each particular unit type’s rent, is illustrated in the following tables:

<table>
<thead>
<tr>
<th>2010 FAIR MARKET RENT</th>
<th>ANNUAL INCOME NEEDED TO AFFORD 2010 FAIR MARKET RENT</th>
<th>PERCENT OF FAMILY AREA MEDIAN INCOME NEEDED TO AFFORD FAIR MARKET RENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Zero Bedroom $713</td>
<td>Zero Bedroom $28,520</td>
<td>Zero Bedroom 43%</td>
</tr>
<tr>
<td>One Bedroom $805</td>
<td>One Bedroom $32,200</td>
<td>One Bedroom 49%</td>
</tr>
<tr>
<td>Two Bedroom $959</td>
<td>Two Bedroom $38,360</td>
<td>Two Bedroom 58%</td>
</tr>
<tr>
<td>Three Bedroom $1,254</td>
<td>Three Bedroom $50,160</td>
<td>Three Bedroom 76%</td>
</tr>
<tr>
<td>Four Bedroom $1,435</td>
<td>Four Bedroom $57,400</td>
<td>Four Bedroom 87%</td>
</tr>
</tbody>
</table>

Source: Out of Reach 2010 – June Update, National Low Income Housing Coalition.
1 *Fiscal Year 2010 Fair Market Rent (HUD, 2010; revised as of March 11, 2010).
2 Annual 2010 Area Median Income of $65,801 as estimated by National Low Income Housing Coalition.

Fair Market Rents Require More Than Minimum Wage Income

To afford HUD’s fair market rent level for a studio apartment of $713 per month, spending just 30% of annual income on rent, the annual household income would have to be $28,520. This is far above the federal minimum wage of $7.25 per hour, which would only yield an annual income of $15,080 based on a 40-hour work week and a 52-week year. A minimum wage earner would have to spend 50% of income to afford the studio apartment in this example, thereby illustrating the role of government subsidies in these high-cost areas.

To afford $959 per month for a two-bedroom apartment, a household would need to earn at least $38,360 or 58% of the National Low Income Housing Coalition’s estimated national annual AMI of $65,801. Moving to a three-bedroom apartment unit becomes significantly more expensive. It would take an average annual income of $50,160, or 76% of the estimated national annual AMI, to be able to afford a three-bedroom apartment at a fair market rent of $1,254 per month.
The map presents rents in select high-cost areas of New York City, Washington, DC, Chicago, Los Angeles, and San Francisco.

Market Rate Rents Can be Much Higher

HUD’s fair market rent level can differ from the actual market rate asking rent, as seen in the tables to the right.

The top table compares the HUD fair market rents at a national level by number of bedrooms to second quarter, 2010 market rate asking rents as estimated by REIS, Inc., a New York City-based real estate research firm. The market rate rent estimates are significantly higher than the HUD fair market rent levels.

The bottom table shows the disparity in household income levels necessary to afford market rate rents compared to fair market rents while spending no more than 30% of annual income on rent.

Sources: HUD, REIS

<table>
<thead>
<tr>
<th>2010 FAIR MARKET RENT (FMR) AND MARKET RATE RENT</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td>Zero Bedroom</td>
</tr>
<tr>
<td>One Bedroom</td>
</tr>
<tr>
<td>Two Bedroom</td>
</tr>
<tr>
<td>Three Bedroom</td>
</tr>
</tbody>
</table>

ANNUAL INCOME NEEDED TO AFFORD RENT

|                                | Fair Market Rent | Market Rate Rent |
| Zero Bedroom                   | $28,520          | $40,760          |
| One Bedroom                    | $32,200          | $40,920          |
| Two Bedroom                    | $38,360          | $48,880          |
| Three Bedroom                  | $50,160          | $56,760          |

Sources: National Low Income Housing Coalition; REIS national apartment data as of Q2 2010
A Tale of Three Cities

The difference in fair market rents and market rate rents is even more dramatic in metropolitan areas with a higher cost of living. The following table shows the price differential in three such metros: San Francisco, Los Angeles, and New York City.

Of the three, New York City reflects the largest difference in fair market rents and market rate rents as calculated using REIS national property data – $2,251. The difference is primarily due to the concentration of the REIS data in Manhattan, which carries a much higher asking rent level than the other New York City boroughs.

At the other end of the spectrum, the Los Angeles metro area has a difference of just about $200. Most likely this is because Los Angeles metro is a much larger area and therefore includes a more diverse selection of asking rents. San Francisco shows a difference of slightly more than $500, with a market rate of nearly $2,300, well above HUD’s fair market rent of $1,760.

The table shows scenarios where households must routinely spend well over one-third of gross income to be able to live in a two-bedroom apartment. For instance, in Los Angeles, a household earning 50% of AMI, $34,100, must spend over 57% of income to be able to afford the typical market rate rent for a two-bedroom of $1,627. A household earning $34,100 could afford to spend no more than $853 per month on rent to stay within spending one-third of gross income on rent. Only households earning 80% to 100% of area median income could comfortably live in the typical market rate apartment.

<table>
<thead>
<tr>
<th>Housing Costs</th>
<th>San Francisco</th>
<th>Los Angeles - Long Beach</th>
<th>New York</th>
</tr>
</thead>
<tbody>
<tr>
<td>Two bedroom at HUD determined Fair Market Rent (FMR)</td>
<td>$1,760</td>
<td>$1,420</td>
<td>$1,359</td>
</tr>
<tr>
<td>Income needed to afford 2 BR FMR</td>
<td>$70,400</td>
<td>$56,800</td>
<td>$54,360</td>
</tr>
<tr>
<td>Two bedroom Market Rate Rent</td>
<td>$2,281</td>
<td>$1,627</td>
<td>$3,610</td>
</tr>
<tr>
<td>Income needed to afford 2 BR Market Rate Rent</td>
<td>$91,240</td>
<td>$65,080</td>
<td>$144,400</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Area Median Income (AMI) / Monthly Rent Affordable</th>
<th>San Francisco</th>
<th>Los Angeles - Long Beach</th>
<th>New York</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual AMI / Monthly Rent Affordable</td>
<td>$93,400 / $2,335</td>
<td>$68,200 / $1,705</td>
<td>$78,300 / $1,958</td>
</tr>
<tr>
<td>80% of annual AMI / Monthly Rent Affordable</td>
<td>$74,720 / $1,868</td>
<td>$54,560 / $1,364</td>
<td>$62,640 / $1,566</td>
</tr>
<tr>
<td>50% of annual AMI / Monthly Rent Affordable</td>
<td>$46,700 / $1,168</td>
<td>$34,100 / $853</td>
<td>$39,150 / $979</td>
</tr>
<tr>
<td>30% of annual AMI / Monthly Rent Affordable</td>
<td>$28,020 / $701</td>
<td>$20,460 / $512</td>
<td>$23,490 / $587</td>
</tr>
</tbody>
</table>

1 Fiscal Year 2010 Fair Market Rent provided in Out of Reach 2010 - June Update, National Low Income Housing Coalition
2 “Affordable” rents represent the generally accepted standard within housing policy circles of spending not more than 30% of gross income on housing.
3 Market Rate Rents based on REIS 2nd quarter 2010 data for geography based on Metropolitan Statistical Area (MSA)
4 AMI = Fiscal Year 2010 Area Median Income (HUD, 2010) as provided by Federal Housing Finance Agency (FHFA) to Fannie Mae.
What is most striking in the comparison is not necessarily the difference in asking rents, but the difference in the estimated household income needed to afford the corresponding rental rates. It is likely that many households in these high-cost metros are not earning the income needed to afford the two-bedroom market rate rent apartment, but rather are spending more than one-third of gross income to pay the rent.

**Fannie Mae and Workforce Rental Housing**

The three metropolitan areas cited on the previous page may have higher costs of living on average, but they still include some rental units affordable across the spectrum of AMI.

As seen in the following chart, in a city as high-cost as San Francisco, Fannie Mae has financed nearly 30,000 units renting at between 80% and 100% of AMI. Fannie Mae also has financed over 67,000 units with rents affordable to households earning between 60% and 100% of AMI.

On a cumulative basis, Fannie Mae has financed approximately 89,000 units affordable to residents of San Francisco at or below AMI. On a cumulative basis in New York, Fannie Mae has financed approximately 312,000 units affordable to residents at or below AMI.

**Properties Can Offer a Mix of Rental Units**

As noted in the Executive Summary, a common misperception is that an entire apartment building will only offer one rent level for its units. In other words, a landlord will cater exclusively to tenants earning 30% of AMI. That may be true...
with certain properties. However, a great number of apartment buildings offer a variety of units with different rent levels, with some tenants paying market rate rents, while others are paying below market or government subsidized rents.

Once again using San Francisco, Los Angeles, and New York City as examples, the following table looks at examples of such properties located in each of these metros that have received multifamily financing from Fannie Mae. Based on information received by Fannie Mae, none of these three properties receive any rental subsidies.

The property located in Los Angeles is illustrative. It has 135 units of which 61 units have rents that exceed 100% of the metro’s AMI. There are 26 units each in the categories of between 80% and 100% and between 60% and 80% of AMI; three units are rented at between 50% and 60% AMI; 12 units are rented at between 30% and 50% AMI; and lastly, seven units are rented at below 30% AMI.

### Housing Policy Encourages Development of Mixed Income Housing

Over the last two decades, affordable housing policies have shifted from supporting large-scale, urban renewal projects during the 1950s, 1960s, and 1970s, to supporting smaller, mixed-income projects, supported by federal programs such as LIHTC initiated in 1986 and HOPE VI initiated in 1990.

These types of housing programs have restrictions on what percentage of a subsidized project’s units must be affordable at various percentages of AMI and what percentage of units can be offered at market rates. For instance, under the LIHTC program, 20% of the units must be affordable to households earning no more than 50% of AMI or 40% of units must be affordable to families earning no more than 60% of AMI. The remainder of the units may be offered at the market rate, unless the state allocating the tax credit has imposed greater restrictions, which is often the case.

---

### UNIT MIXTURE BY AMI FOR THREE SAMPLE FANNIE MAE LOANS

<table>
<thead>
<tr>
<th>MSA Name</th>
<th>San Francisco</th>
<th>Los Angeles</th>
<th>New York</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Number of Units:</strong></td>
<td>72</td>
<td>135</td>
<td>29</td>
</tr>
<tr>
<td><strong>Number of Units:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Above 100% AMI</td>
<td>1</td>
<td>61</td>
<td>12</td>
</tr>
<tr>
<td>Between 80% of AMI and 100% AMI</td>
<td>4</td>
<td>26</td>
<td>1</td>
</tr>
<tr>
<td>Between 60% of AMI and 80% of AMI</td>
<td>27</td>
<td>26</td>
<td>5</td>
</tr>
<tr>
<td>Between 50% of AMI and 60% of AMI</td>
<td>15</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>Between 30% of AMI and 50% of AMI</td>
<td>20</td>
<td>12</td>
<td>3</td>
</tr>
<tr>
<td>Below 30% of AMI</td>
<td>5</td>
<td>7</td>
<td>4</td>
</tr>
</tbody>
</table>

Source: Fannie Mae
IS THERE ENOUGH RENTAL HOUSING TO SATISFY DEMAND?

Supply and demand for multifamily rental units generally appear to be in balance. However, the supply of housing to lower-income households has fallen short of demand. As noted in the Executive Summary, according to the HUD 2009 American Housing Survey report, the multifamily rental units affordable at more than 80% of AMI climbed slightly in 2009 to 15.5% of all multifamily rental units, up from 14.9% in 2007. At the same time, the units affordable to households earning 30% to 50% of AMI fell to 25.9% from 26.4%. Units affordable at less than 30% of AMI recognized the largest loss, dropping to just 15.5% of all multifamily rentals in 2009, compared to 17.2% in 2007, as seen in the chart below.

According to Harvard Joint Center’s State of the Nation’s Housing 2010 report, from 1997 to 2007 the number of rental units affordable to households earning at a full-time minimum wage declined by 15.6%. Most of these units were demolished, lost to a natural disaster, abandoned, converted to non-housing purposes, or otherwise removed from the housing stock.

Source: Fannie Mae compilation of 2007/2009 American Housing Survey
WHAT IS THE STATE OF LENDING IN THE MULTIFAMILY SECTOR TODAY?

Provide Liquidity and Reliability

Fannie Mae’s housing mission compels the company to remain in the multifamily housing finance market in all geographic areas under all economic and market conditions. Other market participants, including banks, life insurance companies and the CMBS conduit market, may withdraw from the market during unfavorable conditions. For example, the life insurance industry significantly scaled back on issuing multifamily loan commitments in 2008. As seen in the chart below, only recently have the life insurers started to return to multifamily lending. Based on the latest data from the American Council of Life Insurers, the largest 25 life insurers were responsible for nearly $735 million in multifamily loan commitments in the second quarter of 2010.

Banks and thrifts have also seen a decrease in multifamily lending activity. According to the Federal Reserve’s second-quarter 2010 data, commercial banks and savings institutions saw a quarter-over-quarter decrease of $3.9 billion in their contribution to multifamily mortgage debt outstanding, as seen in the chart on the following page. The decline in the fourth quarter of 2009 was nearly $10 billion.

![LIFE INSURERS: LOANS COMMITTED FOR APARTMENTS](source: American Council of Life Insurers)
Leading multifamily housing stakeholders have cited the need for a reliable flow of capital for rental housing and the benefits of maintaining that supply.

In a joint report to the U.S. Treasury Department and HUD, the National Multi-Housing Council, the National Apartment Association, and the American Seniors Housing Association, stated that the “sufficient, reasonable and reliable source of liquidity” the GSEs have provided to the apartment sector “has attracted private sector investors to apartments, which
has enabled our industry to produce millions of units of housing for the hard-working Americans our communities rely on and for our senior citizens.” The report further added that a “…government-supported secondary market is absolutely critical to the multifamily sector and our industry’s ability to continue to meet the nation’s demand for affordable and workforce housing.”

The Harvard Joint Center for Housing Studies also confirmed the importance of support for multifamily housing finance. In a January 2009 policy brief, the Center concluded, “An efficient, smoothly functioning finance system is needed to insure the viability of the apartment building market and the multifamily industry. In normal times, multiple sources provide fresh credit to the multifamily market and industry. During this period of extreme distress, however, only federal sources are active in the multifamily finance market.”

In addition, through its Section 221 and 542(c) programs, FHA provides one-stop financing from construction through permanent financing. This is in contrast to the private sector where construction loans are usually separated from permanent financing loans with construction loans generally provided by one lender and permanent financing provided by another lender to minimize financing risk.

The following table shows the recent volumes1 of FHA-insured loans:

<table>
<thead>
<tr>
<th>Year</th>
<th>Total</th>
<th>New Constr/Substantial Rehab</th>
<th>Purchase/Refinance</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>$2.6B</td>
<td>1.4</td>
<td>1.2</td>
</tr>
<tr>
<td>2008</td>
<td>$2.3B</td>
<td>1.2</td>
<td>1.1</td>
</tr>
<tr>
<td>2009</td>
<td>$3.0B</td>
<td>1.6</td>
<td>1.4</td>
</tr>
<tr>
<td>2010</td>
<td>$9.5B</td>
<td>6.0</td>
<td>3.5</td>
</tr>
</tbody>
</table>

Source: FHA; Excludes loans endorsed under FHA section 232 Health Care Program and FHA Risk Share Program

1 as of August 2010
From 2007 to the present, FHA has been increasing the amount insured annually to aid construction financing. As the previous chart shows, in the past, under normal circumstances, FHA endorsements and insurance of multifamily mortgages were fairly evenly divided between new construction or rehabilitation loans and purchase or refinance loans.

The lack of private sector financing available for multifamily projects has resulted in a significant increase in FHA-insured multifamily mortgages. The amount of FHA-endorsed new construction/rehabilitation loans more than doubled year-over-year, from $1.4 billion insured in the fiscal year ending in September 2009 to approximately $3.5 billion in the fiscal year ending in September 2010. Purchase and refinance loans insured also increased from about $1.6 billion in the fiscal year ending in 2009 to approximately $6.0 billion for the fiscal year ending in 2010.

Despite FHA’s recent increase in multifamily production, Fannie Mae and Freddie Mac historically provide significantly more financing for the multifamily sector, as shown in the following chart:

**Ginnie Mae Multifamily Volume Follows Suit**

Since the dislocation of the credit markets in 2008 and thanks to increased FHA endorsements, Ginnie Mae has experienced a significant increase in issuance, as seen in the following table. Ginnie Mae does not buy or sell multifamily loans but instead guarantees that investors receive timely payment of interest and principal for MBS consisting of FHA multifamily loans.
More than $9 billion in Ginnie Mae multifamily securities were issued during the first nine months of 2010, compared to $6.7 billion issued in all of last year, for an annualized pace of over $12 billion for this year. However, even with the recent increase in activity, Ginnie Mae still holds less than 6% of the total mortgage debt outstanding as of the second quarter of 2010.

### WHAT IS FANNIE MAE’S ROLE IN THE MULTIFAMILY MARKET?

**Fannie Mae’s Multifamily Market Share**

Fannie Mae currently provides the largest share of the U.S. multifamily mortgage financing, and traditionally has been a leader in this market.

Prior to 2007, Fannie Mae’s share of total multifamily mortgage debt outstanding, as reported by the Federal Reserve, tended to be fairly stable, in the 16% range. That market share has increased since the housing crisis began. The company’s share of mortgage debt outstanding (not including bond credit enhancements) was 20% as of the second quarter of 2010. Freddie Mac’s share was 11.2%.

The share of multifamily financing from private sources moved in the opposite direction. The CMBS share of multifamily mortgage debt outstanding increased from slightly less than 12% in the early 2000s to a high of 16.5% in the third quarter of 2007. With the dislocation of the credit markets starting in

### MULTIFAMILY – MRS ISSUANCE

<table>
<thead>
<tr>
<th>($BN)</th>
<th>2009</th>
<th>2010 YTD</th>
<th>Q309</th>
<th>Q409</th>
<th>Q110</th>
<th>Q210</th>
<th>Q310</th>
</tr>
</thead>
<tbody>
<tr>
<td>MRS issuance ($BN)</td>
<td>26.4</td>
<td>24.5</td>
<td>6.7</td>
<td>8.2</td>
<td>7.8</td>
<td>7.1</td>
<td>9.6</td>
</tr>
<tr>
<td>Fannie Mae</td>
<td>17.5</td>
<td>10.6</td>
<td>5.3</td>
<td>4.5</td>
<td>3.2</td>
<td>2.7</td>
<td>4.6</td>
</tr>
<tr>
<td>Freddie Mac</td>
<td>2.1</td>
<td>4.4</td>
<td>-</td>
<td>1.0</td>
<td>2.1</td>
<td>1.2</td>
<td>1.2</td>
</tr>
<tr>
<td>Ginnie Mae</td>
<td>6.7</td>
<td>9.1</td>
<td>1.4</td>
<td>2.6</td>
<td>2.3</td>
<td>2.9</td>
<td>3.8</td>
</tr>
<tr>
<td>CMBS</td>
<td>0.1</td>
<td>0.4</td>
<td>-</td>
<td>-</td>
<td>0.1</td>
<td>0.3</td>
<td>-</td>
</tr>
</tbody>
</table>

**Share:**

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2010 YTD</th>
<th>Q309</th>
<th>Q409</th>
<th>Q110</th>
<th>Q210</th>
<th>Q310</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fannie Mae</td>
<td>66.3%</td>
<td>43.2%</td>
<td>78.9%</td>
<td>55.6%</td>
<td>41.5%</td>
<td>38.2%</td>
<td>48.4%</td>
</tr>
<tr>
<td>Freddie Mac</td>
<td>7.8%</td>
<td>18.1%</td>
<td>0.0%</td>
<td>12.2%</td>
<td>27.2%</td>
<td>16.4%</td>
<td>12.1%</td>
</tr>
<tr>
<td>Ginnie Mae</td>
<td>25.5%</td>
<td>37.1%</td>
<td>21.1%</td>
<td>32.2%</td>
<td>30.3%</td>
<td>41.2%</td>
<td>39.5%</td>
</tr>
<tr>
<td>CMBS</td>
<td>0.4%</td>
<td>1.6%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>1.1%</td>
<td>4.2%</td>
<td>0.0%</td>
</tr>
</tbody>
</table>

Source: Fannie Mae

### MULTIFAMILY MORTGAGE DEBT OUTSTANDING – 2Q2010

- **Fannie Mae**: 20.0%
- **Freddie Mac**: 11.2%
- **Ginnie Mae**: 5.6%
- **CMBS**: 12.5%
- **Banks-Thrifts**: 31.6%
- **State & Local Entities**: 8.7%
- **Life Insurers**: 5.6%
- **Other**: 4.8%

Source: Federal Reserve
the fall of 2007, the CMBS originators retreated, as seen in the chart to the right. The CMBS share fell to 12.5% in the second quarter of 2010.

Fannie Mae Offers Product Standardization
In an effort to promote, enhance, and maintain product standardization in the multifamily marketplace, Fannie Mae created the Delegated Underwriting and Servicing (DUS) product line in 1988 for purchasing individual multifamily loans. DUS has since evolved to become Fannie Mae’s principal network whereby underwriting is delegated to the DUS lenders, who retain credit risk over the life of the loan, enabling them to move quickly to arrange financing for borrowers.

The DUS program has been effective in providing liquidity for affordable multifamily properties. The majority of loans purchased through Fannie Mae’s 25-member DUS lender network are secured by properties with units that are largely affordable to households earning at or below 100% of AMI.

Fannie Mae and Credit Quality
Central to the DUS program is that the lender underwrites the loans following the DUS guidelines and retains credit risk on each loan. The impact of this combination of clear standards and loss sharing is evidenced in Fannie Mae’s low delinquency rate, as seen in the chart to the right.

Fannie Mae’s multifamily 60+-day delinquency rate was 0.80% as of June 30, 2010. The 60+ multifamily CMBS delinquency rate as of the same date was 13.18%, and the banks and thrifts 90+-day delinquency rate was nearly 4.0%

Fannie Mae Serves the Entire Rental Sector
Fannie Mae serves the rental housing needs of a wide range of Americans, from those at the lower end of the income scale up through middle-income households.

As seen on the chart on page 27, Fannie Mae has financed a wide array of affordable rental units over the past few years. Approximately 87% of multifamily units financed by Fannie Mae in 2009 were affordable to households at or below the median income of their communities. About 49% of all multifamily units financed by Fannie Mae were affordable to low- and very-low income households in low-income areas, and 48% of the multifamily units financed were located in underserved markets.
Fannie Mae Participates in Subsidized Affordable Housing

While focusing on workforce rental housing, Fannie Mae is also active in the subsidized affordable market. The layering of subsidies necessary to make rents affordable to the lowest income households makes this a difficult segment of the market to serve through debt financing.
Fannie Mae has several programs designed specifically for this market, including Affordable Delegated Underwriting and Servicing (DUS), Fixed-Rate Bond Credit Enhancement and Forward Commitments which are all designed to aid in the development and preservation of rental units affordable to households earning 60% of AMI or less.

### WHAT IS THE OUTLOOK FOR THE MULTIFAMILY SECTOR?

**Multifamily Fundamentals Improving**

The multifamily sector improved in 2010 despite stubbornly high unemployment and an extremely modest economic recovery and is expected to end the year on a strong note. REIS, Inc. reported that the third quarter, 2010 vacancy rate fell again by -60 basis points to 7.2% from 7.8% in the second quarter and from 8.0% in the first quarter.

Effective rents have now risen three quarters in a row. In addition, concessions, which are usually expressed in the form of a month or more of free rent, have been contracting all year.

According to REIS, “the second and third quarters typically are stronger periods, as most households make decisions to move and lease new apartments during this time.”

---

<table>
<thead>
<tr>
<th>Estimated 5+ units</th>
<th>Share of Fannie Mae Book</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lower Income Households (Affordable to income ≤ 60% of AMI)</td>
<td>1,602,557</td>
</tr>
<tr>
<td>Workforce Housing (Affordable to 60% AMI &lt; income ≤ 100% of AMI)</td>
<td>1,715,951</td>
</tr>
<tr>
<td>Subtotal Housing available to Working Households</td>
<td>3,318,508</td>
</tr>
<tr>
<td>Higher than Median Income (Affordable to income &gt; 100% of AMI)</td>
<td>449,884</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>3,768,392</strong></td>
</tr>
</tbody>
</table>

Note: Fannie Mae AMI category for loan level affordability determined based on category at year of acquisition.

Source: Fannie Mae, December 31, 2009
It appears that rental rates have fallen “far enough” to warrant an increase in occupancy levels. Other likely reasons for the overall improvement in multifamily include landlords experiencing a higher rate of tenant retention and declines in new apartment completions, thereby limiting the amount of competing supply.

The lack of new supply is clearly demonstrated in the following chart. McGraw-Hill Construction’s Dodge Pipeline data shows that new multifamily construction projects that are currently underway and expected to complete and become available for new tenants will keep declining over the next 12 months.

Healthy Long-Term Fundamentals

Despite the elevated unemployment rate, housing demand is expected to continue growing, with an ongoing need for reliable and stable financing for the multifamily sector. Some former homeowners will turn to renting. In addition, the labor market is slowly stabilizing and household formations are up from recently historic low levels.

More importantly, demographics are in the multifamily sector’s favor over the long-term. The Echo Boomers are starting to form independent households. The prime renting age cohort, which consists of individuals aged 20-34 years old, is expected to grow substantially between 2010 and 2030.
The Harvard Joint Center for Housing Studies also projects an increase in the demand for rental housing over the next decade. In “The State of the Nation’s Housing 2010,” the Center projects that changes in the age distribution of households will likely lift demand for rental housing over the next decade.

In addition to growth in the prime renting cohort, the Center projects that the number of older renter households will increase. Although figures may vary depending on immigration levels, as the adjacent chart shows, not only will the 20-34 year old group increase substantially, but the number of renter households over age 55 will likely rise by more than 3 million in the coming decade as the Baby Boom generation ages. With the lack of new supply, demand for multifamily housing should remain strong over the coming decade.
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