

Arbor Commercial Mortgage's Response

1. Loan terms: The Enterprises currently offer permanent financing for multifamily properties with loan terms from 5- to 30-years. In 2012, of Fannie Mae's total multifamily loan production, 71 percent was 10-year term loans, 17 percent was 7-year term loans and only 5 percent was 5-year loans. At Freddie Mac, 57 percent of total loan production was 10-year term loans, 27 percent was 7-year term loans and only 6 percent was 5-year loans. Given the low utilization rate of the short term financing options, it appears that the benefit of the Enterprises' secondary market activity is to offer borrowers access to longer term permanent financing.

a. Should FHFA consider loan terms as a factor in how to reduce the Enterprises' multifamily businesses? If so, what loan terms or combination of loan terms should be targeted for contraction? Should shorter term loans only be used by the Enterprises for loss mitigation or maturity management purposes?

Arbor Response: It is important to allow the GSEs to continue to offer a range of products, including short-term loans, to satisfy the varying needs of borrowers and the market at large. In comparison with single-family financing, multifamily financing—by nature of its comparatively higher loan amounts—requires a more complex financing execution and carries with it a host of important factors, ranging from the owner's capital demands to asset size to geographic location to local market strength. Therefore, whether in a rising or falling interest rate environment or amid strong or weak market conditions, the best strategy is to provide borrowers with flexibility and loan term variety, in order to best meet their diverse financing needs. Numerous loan term

options allow GSE lenders to cast a wider net and compete more effectively for borrower business, keeping the cost of capital down for multifamily investors overall and, in turn, rental prices for Americans.

b. If the Enterprises ceased providing shorter term loans, such as 5-year term loans, would banks, commercial lenders and other private capital sources provide these loan products?

Arbor Response: If it is determined as a profitable opportunity, private capital would be attracted to the short-term loan products and the lesser credit and interest rate risk they possess as compared to longer term loans. However, with less competition in the market, private lenders might choose to place such loans at a much higher price point, hurting borrowers and multifamily investment overall and, in turn, leading to higher rents and a higher cost of living for Americans. Again, numerous loan term options allow GSE lenders to cast a wider net, provide greater stability and compete more effectively for borrower business, keeping the cost of capital down for multifamily investors overall and, in turn, rental prices for Americans.

2. Variety of loan products: The Enterprises currently provide a wide range of specially tailored multifamily loan products, execution types and financing structures, including full or partial term interest only loans, various types of adjustable or fixed rate loans, supplemental loans, credit facilities and other forms of financing for acquisition or refinancing of stabilized multifamily properties. Such a diverse range of financing options may discourage alternative sources of capital which otherwise might be able to provide specialized financing.

a. Should FHFA consider simplifying and standardizing the Enterprises' multifamily loan products? If so, which loan product or mix of loan products are most important for the Enterprises to offer? Which of the Enterprises' loan products would private financing sources most readily provide?

Arbor Response: The market's appetite for each GSE multifamily loan product dictates that loan product's specific demand. The diversity of loan products is naturally restricted by the lack of market demand for loan pools containing certain varieties of multifamily loan products. Proper underwriting regulations to reduce risk are already in place for GSE lenders with respect to each GSE loan product type and corresponding asset type, including student housing, military housing and manufactured housing, among others. In eliminating or standardizing some of the GSE product offerings, you are removing one of the key elements upon which the GSEs were built—the ability to scale their businesses and products based on industry-changing conditions. This scalability provides responsiveness to customer needs. It also allows the GSEs to supply a diverse range of financing options to best support the multifamily industry overall. These are cost effective options that help support the millions of American senior citizens, students, military personnel and working class families who live in rental properties today.

According to the Government Accountability Office Report in 2012, from 1994 through 2011 the vast majority of GSE financing has been traditional rental housing (87.7%). However, the 12.3% representing other housing types, ranging from student housing to manufactured housing, cooperative housing and seniors housing, still require cost-effective financing alternatives as well.

b. If the Enterprises' loan products were simplified and standardized, would this create an opportunity for private capital sources to expand their market presence by providing more specialized financing options to borrowers?

Arbor Response: Private capital may emerge to fill in market loan product gaps only when times are “good” and there is liquidity in the market. History clearly supports this trend. Private capital participation is often accompanied by relaxed underwriting practices, outsized returns, eventual loan defaults and the “boom and bust” cycles that, in turn, fall upon the shoulder of the taxpayers to remedy. Therefore, it is imperative to ensure the country’s finance system is anchored by a stable capital source that works well during all cycles. Clearly, the GSEs have served a countercyclical role since their inception and have provided stability and affordable, quality housing during all economic cycles. A removal or significant contraction of the GSEs will greatly diminish the stability in the marketplace.

From an overarching perspective, it is important to understand the various participants that are active today in the multifamily finance market, as any action impacting one surely affects the others. Thus, private lenders, secondary market institutions—in this case the GSEs—and their investors will all be affected by any level of GSE reform. Without proper levels of competition, such as GSE lenders, private capital will surely provide a higher cost of capital for borrowers in order to protect what private capital would surely characterize as riskier investments. Such a high cost of capital would more severely affect such specialty asset types as military, seniors, student and affordable housing, which would, in turn, negatively impact state governments as well as the

federal government, as the government already subsidizes the military, seniors, student and affordable housing industries in several ways. A higher cost of capital for multifamily investors in these specialized areas would eventually create a need for more subsidies from government entities, which, in turn, might establish the need for higher taxes for all Americans on both the state and federal level.

Also, at least for some time, there may be reluctance exhibited by private capital to expand its market presence, as private capital may not have the level of expertise the GSEs have in understanding the multifamily market nor the infrastructure, human capital and technology required to properly underwrite and manage such assets. In particular, during economic recessions, it is important to note that B- and C-class multifamily assets often require special servicing and attention. As it currently stands, the GSEs ensure they sustain quality housing as per their asset management guidelines in all economic cycles by closely managing the assets and making sure they maintain a quality of housing. If the GSEs involvement and role is drastically altered, the quality of housing would deteriorate significantly during a poor economic climate, in particular.

In addition, from an investor standpoint and given the economy during the past few years, there may be investor reluctance to enter the affordable market with the knowledge that a loan is not backed by the government. During the past three decades, multifamily has developed into a stable and predictable institutional investment, and a guarantee—government or otherwise—is critical in keeping liquidity fluid through all multifamily market cycles.

With private capital, both rental costs and market service will certainly be affected. Whatever the costs are to conduct business specifically within the multifamily arena, those costs are passed on to the borrower and, ultimately, the renter.

And as historical facts support, institutional and private capital typically focuses on top-tier markets. Private capital, as history indicates, will not be interested in tertiary markets and smaller loan balances and, therefore, by simplifying and standardizing the enterprises' financing options, there will be a significant risk of underserving a large portion of the nation's workforce housing population.

c. Should FHFA consider adopting common loan terms, product features and underwriting requirements for similar types of loans that are available from each of the Enterprises?

Arbor Response: Although we don't recommend simplifying current loan products, we do believe there could be an adoption of similar loan terms, product features and underwriting requirements among the enterprises to ensure consistency, to support the overarching goal of providing long-term stability, affordable and quality housing and to eliminate unhealthy competition that could compromise underwriting standards.

3. Limits on property financing: The Enterprises currently provide financing for a broad range of multifamily properties that serve households of varying income levels. The properties with the highest market rents are affordable only to upper income households and these loans often have high balances on a per unit basis. In the past, statutory per unit loan limits constrained the Enterprises from providing high balance loans to multifamily properties. More recently,

participation in this segment of the multifamily market has contributed to a substantial increase in the average size of Fannie Mae and Freddie Mac multifamily loans.

a. Should FHFA consider imposing limits on the maximum amount of financing that is available to a property under the Enterprises' loan products, with adjustments for high cost markets?

Arbor Response: Overall, this is a public policy issue as the government's role in providing stability in high cost areas must be examined and determined. Even with adjustments for high-cost markets, underwriting parameters for each market fluctuate so often and widely that capping the maximum financing allowed will effectively make the GSEs less competitive on larger loans within high-cost markets, creating a higher cost of capital for those markets without GSE competition in place. However, as a required solution for reducing the GSEs' loan origination volume, capping loan amounts is indeed the quickest path to volume reduction and will, theoretically, affect the least amount of borrowers possible. At the same time, private capital's historic preference for loans totaling more than \$30 million would ensure that at least a satisfactory level of financing remains available for such high-transaction-volume borrowers, depending on market conditions of course. But again, before such parameters can be determined, including those required in the responses to the following associated questions that follow, government must first determine its role in providing stability in high cost areas.

b. Should FHFA consider re-imposing multifamily loan limits? If so, should the loan limits apply on a per unit basis or on the basis of the maximum mortgage amount that is available to a property?

Arbor Response: In the past, multifamily loan limit provisions did not perform as intended and the same would generally be the case in today's market whether on a per-unit basis or on the basis of the maximum mortgage amount. However, when facing a choice between the two options, enacting loan limit provisions on maximum mortgage amounts would be the safest and surest way to reduce the GSEs' loan origination volume, as it would affect the smallest amount of borrowers while still providing the largest origination volume decrease in the quickest manner possible. All the while, effectively removing the risk associated with large loans totaling, for example, above \$50 million, will ensure that the GSEs' multifamily risk exposure is minimized.

Imposing loan limits on a per-unit basis would artificially limit GSE competitiveness on larger properties, even those considered as Class-A quality, which will lead, once again, to a higher cost of capital for owners of larger assets.

c. Should FHFA consider imposing limits on the maximum rents that can be recognized in loan underwriting based on a schedule of rents that are affordable to tenants up to a certain percentage of Area Median Income, adjusted for household size, for number of bedrooms and for high cost markets? If so, what should be the percentage of Area Median Income used to limit the underwriting rents? In addition, should FHFA consider imposing limits on the percentage of total units financed by the Enterprises in any calendar year

which have rents that exceed the maximum underwriting rents derived from applying this formula?

Arbor Response: Current GSE underwriting parameters are clearly proving effective, as evidenced by the small amount of delinquencies the multifamily market has exhibited since 2008 with Fannie Mae and Freddie Mac loans. Fannie Mae and Freddie Mac posted delinquency rates of 0.4% and 0.2%, respectively, for loans delinquent 60 days or more as of the first quarter of 2013, according to the Mortgage Bankers Association. The GSEs need to rely upon their lenders' in-place underwriting capabilities and experience in continuing to keep these delinquencies low. Current underwriting parameters already ensure that unsustainable rents are not considered in any new loan underwriting and that new market trends are properly considered. Imposing limits on the maximum rents recognized would artificially undermine the current underwriting process, which has performed properly.

d. If FHFA took some or all of the actions contemplated in a, b or c above, would other sources of financing be available to address the liquidity needs of this market segment?

Arbor Response: Yes, but only during a positive economic climate. Private capital will not present itself during times of illiquidity. Unlike the GSEs, private capital is not countercyclical.

4. Limits on business activities: The Enterprises currently provide a wide range of multifamily financing activities that may discourage alternative sources of capital that might otherwise be able to provide financing.

a. Should FHFA consider reducing the scope of the business activities engaged in by the Enterprises, such as by limiting their business to loans that provide new liquidity and prohibiting the purchase of seasoned loans or loan pools?

Arbor Response: Yes, as past purchases of non-GSE-originated loan pools has caused greater risk exposure for the GSEs. Such private capital-originated pools do not adhere to the same high underwriting standards upheld by the GSEs for their licensed lender originations, creating greater risk for investors. According to Securities and Exchange Commission data as of June 30, 2011, Non-Fannie Mae DUS loans posted an average delinquency rate of 1.005%. In comparison, DUS loans posted an average delinquency rate of 0.405%, which is less than half.

b. Should FHFA require that the Enterprises only provide loans that can be securitized and sold to investors? Should the Enterprises' portfolio purchases only be used for aggregating loans prior to securitization and to support special products for underserved market segments for which securitization may not be an option?

Arbor Response: Yes, the enterprises should be required to only provide loans that can be securitized and sold to investors. Yes, the enterprises' portfolio purchases should only be used for aggregating loans prior to securitization and to support special products for underserved market segments for which securitization may not be an option. This is directly aligned with the agencies' goals and overall mission.

c. If FHFA took some or all of the actions contemplated in a or b above, would this create the opportunity for private capital sources to expand their market presence by providing more financing options to borrowers?

Arbor Response: As stated previously and as history reflects, private capital will present itself only during a positive economic climate. Private capital will not present itself during times of illiquidity. If private capital's role is increased, the lack of competition from GSE lenders would lead to a higher cost of capital for borrowers. In addition, in this private capital-dominant scenario, what will prevent private capital from overheating the lending market through lesser underwriting parameters, similar to what happened before the last Great Recession?

As such, a governmental role in multifamily lending ensures a counter-cyclical and proper level of underwriting in both good times and bad, which in turn establishes affordable housing for all Americans, resulting in a strong overall economy as Americans are not forced to devote the majority of their disposable income to housing. Affordable, quality housing is, after all, the backbone of the economy. GSE-based financing support from the government, not private capital, reinforces that backbone on a perpetual basis, providing the means for a consistently stable economy.

5. Other alternatives: Are there other options that FHFA should consider to achieve the strategic goal of contracting the Enterprises' multifamily businesses to reduce their presence in the housing finance market and support the entry of private capital?

Arbor Response: In offering an alternative suggestion, there are a few points that must be considered. History shows that when there is liquidity in the market, private capital will expand its market presence. However, history also shows that when the economy retracts, private capital exits quickly.

So as a nation, we must reflect upon the birth of agency lending, examine the policy upon which it was developed and evaluate if those same goals are relevant in today's marketplace. Indeed, it could be argued they are more relevant than ever. The GSEs were originally created as part of a public policy effort to provide affordable housing and a quality of housing throughout all economic cycles. They have succeeded in serving this critical function.

Most recently, following the Great Recession of 2008, the GSEs maintained their finance liquidity levels even while private capital was forced to severely cut back on origination volume. According to the U.S. Government Accountability Office's analysis of Mortgage Bankers Association data, even while the recession lingered throughout 2008 and beyond, the GSEs provided somewhere between 57% to 86% of total multifamily originations from 2008 through 2011. This ensured market stability for the multifamily market as well as housing at large until the general economy righted itself once again.

If we vacate the original premise upon which the agencies were created and instead position them to serve merely as a source of liquidity, there will certainly be greater highs and lows present in origination volume. In addition, without the foundation of the GSEs and government regulation, underwriting standards will certainly deteriorate to extreme levels. And, without a doubt, the government will be asked to step in and stabilize the economy again without having the ability to participate in any of the profitability during favorable economic times.

In studying private sector default rates and risk levels during the height of liquidity while also examining the asset practices during those times, private capital default rates are drastically higher than the GSEs. That is because the GSEs maintain consistent and appropriate underwriting guidelines, sustain continuity and perform the critical element of asset management.

Despite the various opinions on GSE reform, one sentiment is indisputable. We need a consistent, reliable housing finance system in place fueled by a consensus on goals for our nation. We believe the current multifamily finance system works well and has a proven track record, thus we propose the following suggestions to help improve the current system. We believe these could be applied inclusively to both the single family and multifamily lending businesses.

- a) Regulate a standard that requires both Fannie Mae and Freddie Mac adhere to the same underwriting guidelines on originations and servicing to diffuse competition between the two entities and instead foster and ensure stable, affordable and quality housing through all cycles.
- b) Risk sharing has worked well within the multifamily lending sector and a similar risk sharing model should be instituted within single family financing. As we know, the distribution of risk to third-party financial institutions has negatively impacted default rates.

In conclusion, any reform must truly take into consideration the overall financial needs of the multifamily industry. As opposed to determining ways to reduce GSE involvement, we need to

determine the best approach to helping achieve reduced taxpayer risk while providing liquidity during all cycles. Private capital does not provide liquidity during all cycles. According to the National Multi Housing Council, more than one-third of our nation lives in multifamily rental housing and, as such, federal backing is necessary to ensure long-term multifamily investment liquidity and availability. However, it should be regulated and deployed with caution.

In pursuing reform, we need to be very careful not to drastically affect the capital for multifamily housing or undermine the public policy on which the GSEs were created—that is to provide affordable, quality housing options and overall liquidity. The GSEs’ multifamily programs have provided that liquidity for properties for several decades—liquidity that would otherwise not have been made available or put to work. The multifamily sector, therefore, supports workforce mobility, capital accumulation in order to save for eventual home ownership and a venue for retired workers and senior citizens. For investors, it provides a stable investment opportunity with predictable returns. In recommending and adopting reform, we need to exercise caution to make certain we position our housing finance industry for success while limiting taxpayer risk.