MARKET NEWS
YOUR QUARTERLY CAPITAL MARKETS UPDATE FOR 4Q|2018

NORTHMARQ CAPITAL

FEATURED ARTICLE

EMPOWERING FREDDIE MAC & FANNIE MAE TO SOLVE THE AFFORDABLE HOUSING CRISIS

By Eduardo Padilla, CEO, NorthMarq Capital

It is common knowledge that we have an affordable housing crisis in the U.S. Understanding what it means and the core elements of the solution continues to evade many of the disparate groups battling this growing problem. The definition of affordable housing covers a variety of issues, all with potential solutions. Whether we are talking about chronic homelessness or workforce housing, the core elements begin with a supply and demand imbalance impacted by capital availability and negative social perception of "low-income" rental housing. The facts are that nearly 50 percent of U.S. renters are cost-burdened and that percentage continues to grow. According to Freddie Mac, more than 20 million households spend at least 50 percent of their income on housing. Affordable rental housing is key in the effort to solve this crisis, and Freddie Mac and Fannie Mae (commonly referred to as the GSEs) play a critical role in this battle.

GOVERNMENT SUPPORT DRIVES CAPITAL

Availability of capital drives the creation and sustainment of rental housing. Capital comes in a variety of forms, but driving significant amounts into affordable housing generally requires some element of government support or incentive. Many business and political leaders are surprised to learn that the most prolific suppliers of capital in the affordable rental market are Freddie Mac and Fannie Mae. While they often do not get the credit they deserve, Freddie and Fannie deliver capital through mortgage programs that have come at no net-cost to the U.S. taxpayer for over two decades. Although it is correct to note these programs rely upon U.S. government credit support, they also have generated billions of dollars of profit for the U.S. Treasury. Even in the midst of the Great Recession, the multifamily divisions of Freddie and Fannie were profitable. Since the end of the Great Recession, Fannie Mae and Freddie Mac have, on a cumulative basis provided total dividends of $279.7 billion to the U.S. Treasury compared to the approximate $180 billion provided from the U.S. Treasury.

Even with virtually 100% of their profits paid to the Treasury Department, the agencies have dramatically reduced their risk exposure by changing the fundamental way they execute transactions. Through creative financial structures, they now transfer most of the credit risk to the private capital markets compared to the prior generation of business. In addition, with many years of experience and record of accomplishment, the multifamily divisions have proven their keen ability to underwrite risk. As of the second quarter, Freddie Mac's delinquency rate is currently 0.01%. An incredible performance record in light of the exceptionally large volume of business.

AFFORDABLE PROGRAMS

Freddie Mac's Multifamily Targeted Affordable Housing program for 2017 and YTD 2018 contributed $12.7 billion in financing for affordable housing. In addition, Freddie Mac has also introduced a new mezzanine-financing product for affordable housing that will effectively reduce the equity required in rental property development and acquisition. Fannie Mae's affordable lending programs exceed $8 billion for 2017 and YTD 2018, so the GSEs combined funding was over $20 billion since 2017.

Other key mechanisms for driving down the cost of housing are programs run by the Department of Housing and Urban Development (HUD), which include Section 8 direct rental subsidies and the federally supported low-income housing tax credit program (LIHTC).

(continued on page 2)

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(continued from page 1)

- Section 8 has been around for decades as an effective way to subsidize the cost of rent for lower income households and has little downside for the property owner.
- LIHTC is effective though complicated and has a high cost of execution. However, the cost to taxpayers is efficient as the dollars saved in tax credits go directly to the developer in exchange for committed rental restrictions.

While these programs are essential to the creation of affordable housing, Freddie and Fannie lending activities materially exceed the total capital amounts provided by these other programs.

AGENCIES ON THE FRONT LINE

Without Freddie and Fannie, today's affordable rental housing crisis would be dramatically worse. The GSEs' lending activity for a broad quality spectrum of rental properties at very competitive rates leads to sustained value in a marketplace that is often dominated by older, moderate rental-rate properties. We must fight to maintain naturally occurring affordable housing. Mortgage capital with attractive terms will be key to the achievement of this essential goal.

In addition, if Freddie Mac and Fannie Mae were allowed to capitalize their balance sheets from their own profit and add another layer of extremely low cost capital where it is essentially needed, unaffordable rental housing for lower income Americans could be dramatically improved.

The GSEs, together with HUD, are on the front lines of the battle to improve rental housing affordability and are doing so in a market-driven, cost-effective way. They have proven that a large production volume can be balanced with low-risk, and low-cost execution. This is no time to restrict the agencies or seek out far-fetched criticisms where none is deserved — Freddie Mac and Fannie Mae should be encouraged to continue on the current path and even DO MORE. ❖

FEATURED AFFORDABLE TRANSACTIONS

$8,300,000

The Conway Center by SOME

200 UNITS | WASHINGTON, D.C. | FHA

Client: *So Others Might Eat (SOME), an interfaith, community-based non-profit organization that assists low-income people in the District of Columbia.*

$8,350,000

The Provinces

118 UNITS | LITTLE CANADA, MN | FREDDIE MAC

Client: *Non-profit investor Aeon and the NOAH Impact Fund of Greater Minnesota Housing Fund (GMHF), a $25 million equity fund established to preserve NOAH properties in Minnesota.*

$3,960,000

Miami River Park Apts.

211 UNITS | MIAMI, FL | FANNIE MAE

Client: *Industry leader in the development and management of affordable apartment communities throughout the United States, with nearly 5,000 affordable units currently in their portfolio.*

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