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The Biggest Real Estate Closing Problems Ever: Pitfalls in Dismantling Fannie and Freddie

By Dr. Thomas A. Musil
drtommusil@gmail.com

There is almost uniform agreement to scale back and ultimately eliminate FannieMae and FreddieMac. Doing so will solve the existing problems with the troubled single family home loans but likely create numerous long-term financing availability problems for rental and seniors housing. The Fannie and Freddie, as government sponsored enterprises were responsible for providing funding for single family mortgages through the operation of a secondary mortgage market which expanded the flow of funds to augment homeownership. Subprime mortgages changed that and now Fannie and Freddie are the recipients of $134 billion in taxpayer bailouts and are operating under the conservatorship of the Federal Housing Finance Agency.

Secretary of the Treasury Timothy Geithner has released a phase out plan for both agencies that will be implemented over the next decade. It is likely that the plan, outlined in a February 11, 2011 treasury report, identified the future form of Fannie and Freddie. There are few questions about the viability and needed reforms for the agencies and our current secondary residential mortgage finance market. However, a major pitfall in the proposed reforms lies in the law of unintended consequences of the proposed reforms and how the reforms will impact rental and senior housing programs.

Fannie and Freddie have played a valuable role in providing mortgage funding for investment and development of the nation's 17 million multifamily rental housing units. Fannie and Freddie's performance in rental and senior housing finance has been substantially superior to their private sector counterparts. If we look at the most recent period when the housing market collapsed and private sector lenders turned away from investment in multifamily rental mortgages, Fannie and Freddie remained active.

During the third quarter of 2010 Fannie addressed the multifamily rental housing financing gap by generating about 50% of the multifamily securities issued. Fannie and Freddie combined; hold over 31% of all multifamily rental housing mortgage debt. At the end of the quarter of 2010 loan delinquency rates, according to the Mortgage Bankers Association's Commercial/Multifamily Delinquency Report—where mortgages were 60 days or more behind on payments ---were less than 1% for Fannie, Freddie and life insurance companies. For multifamily commercial mortgage backed securities the delinquency rate at the end of 2010 was 8.95% for loans 30 or more days delinquent or the properties taken back by the lenders. For banks and thrifts the delinquency rate was 4.19% for loans 90 or more days delinquent or in non-accrual.

Creating multifamily rental housing mortgage debt for smaller properties (less than $5 million) is not an easy matter. Fannie and Freddie provide clear and undisputed benefits in providing standardization, economies of scale and by securitization, lower mortgage costs. The borrowers who develop or purchase smaller rental properties are investors businesses, or community development corporations facing more challenging mortgage underwriting needs. These smaller rental housing properties are the backbone of the rental market and because of their smaller size and geographic dispersion, play a key role in providing affordable housing. There is a significant risk that these smaller investors will not conform to the underwriting approach of large scale mortgage backed securities programs that will dominate the market with the total elimination of Fannie and Freddie.

America's need for affordable multifamily rental and senior housing will continue to grow. This is clear. Seniors, echo-boomers, single person households and even the U.S. government's view that homeownership should not be encouraged for all households, will drive rental housing demand. Secretary Geithner's plan must reflect the reality of rental housing demand and not the poor state of affairs created by the single family mortgage debacle or the 2012 elections. Reliance on existing federal and state programs as well as private sources of multifamily rental mortgages is unjustified. The existing multifamily rental and senior housing finance resources and secondary market infrastructure of Fannie and Freddie should be retained. If not, a more expensive and socially demoralizing lesson will result and present itself as the perfect sequel to our current mortgage debacle.