Preserving Affordability by Preserving Existing Workforce Housing

As the top small balance multifamily loan provider in the country, we are committed to keeping close tabs on rental housing statistics and market trends. This puts us in a unique position to provide meaningful feedback aimed at supporting continued affordability within the small multifamily space, which comprises a significant portion of our nation's workforce housing stock. We understand that the underlying mission of Fannie Mae and Freddie Mae is not only to provide liquidity, but to support stability and affordability within the U.S. housing market.

Yet statistics currently indicate that we are in the midst of a growing affordable housing crisis, with a near decade-long post-recession period of stalled wage growth that has failed to keep pace with inflation and rent growth. As Fannie Mae recently reported, more than one-third of U.S. households — about 44 million — are renters. Approximately 60% of those renter households are classified as low-income, earning between 51% and 80% of the local area median income (AMI)[i]. Perhaps more striking, one-quarter of all renter households are classified as severely cost-burdened — that is, contributing more than half of household income towards rent — according to the Joint Center for Housing Studies at Harvard University. Even if we woke up tomorrow to find that U.S. income growth had increased to match rent growth, there would still be an additional 1.3 million households falling into the severely cost-burdened category by 2025 based on demographic factors alone. The more likely scenario of rent growth outpacing income growth has more drastic implications. For every 25 basis points that rent growth outpaces income growth from 2015 to 2025, the number of severely cost-burdened renter households increases by 400,000 over the base-case 1.3 million figure referenced above[ii].

Of course, stagnant wage growth is only one factor at play. The lack of affordable housing development over the past decade has contributed to a supply-constrained market of housing relevant for the average American renter. Increasing land prices and construction costs have left developers with little option but to deliver luxury product where they can command higher rents. Construction activity during the current expansion has been particularly biased as a result. While more than one million Class A units were delivered between 2009 and 2016, just 33,400 Class B/C apartments have opened to greet new tenants[iii].

With these facts in mind, the current proposed plans for both agencies are in line with making an impact to solve the complicated problem of affordability in rental housing, and Arbor remains committed to delivering greater liquidity to small multifamily properties. In 2015, we formed an exclusive research partnership with Sam Chandan of Chandan Economics to better understand the unique fundamentals of small multifamily finance given the lack of available research and statistics covering this rapidly growing space. Recent findings show a $47.6 billion origination volume for acquisition and refinancings between $1MM and $5MM in 2016[iv]. Of that, approximately 13%, or $6.4B, was provided by Fannie Mae and Freddie Mac[v]. The remainder was sourced by a combination of financial institutions, community banks and community development financial institutions (CDFIs).

Expanding the agency market share will require a combination of new small loan securitization products, new offerings for SBL credit enhancement, the execution of plans to increase the purchase of small loans from institutions, and the development of correspondent programs with select sellers to offer agency products to clients of non-licensed institutions. These initiatives will all play an important role in supporting the goals of greater liquidity to the affordable housing market. We are happy to see that the agencies have developed some strategic, attainable and meaningful attention to this dilemma. It is a start to both a short and long-term approach that is crucial to our country's housing needs.

However, I would like to expand on the proposed plans by recommending one area of consideration that could enhance these efforts significantly. The National Housing Trust has found that for every new affordable unit that comes online, two are lost from deterioration, abandonment or conversion to more expensive housing. This statistic, coupled with the lack of new construction outside the luxury space, makes a strong case for preserving the existing affordable housing stock. As such, it is worth exploring the feasibility of developing a small loan renovation product that combines elements of a bridge loan with permanent financing to renovate Class B and C assets in tertiary markets.

This sector of the market is a crucial component of existing affordability, as Census data shows effective rents in the small asset market (5 to 49 units) to be roughly 25% more affordable than in large assets[vi]. In addition, these same small properties also provide greater living space with a greater prevalence of two- and three-bedroom units, making them suitable for families and other larger households[vii]. Sustaining our current inventory of small, affordable multifamily assets by developing incentives and products to support cost-effective financing should be considered a top priority.

A short-term finance product is currently one of the few available options for an investor considering the acquisition of a smaller property in need of significant repairs. Only after the asset is stabilized can the property owner utilize the benefits of a permanent agency loan. Because there is currently no single financing solution for such a transaction, many investors are discouraged by such a complicated execution that requires two administrative processes and duplicate loan costs. However, a creative solution that facilitates an acquisition and significant renovation in a cost-effective manner through a single loan product would — in my opinion — support the sustenance of our current affordable inventory. There is no simple solution addressing affordability, but such a product would help alleviate the deepening crisis we continue to confront by attracting new participants to invest in and preserve affordable housing in a cost-effective manner.

Though we will always have to consider the dynamic economic and political factors at play, innovative approaches and planning are two key factors in ensuring our nation's housing stock remains accessible to all Americans. The industry agrees there is a crisis to address — by working together, our individual experiences and ideas will help shape the best opportunity to make a meaningful impact. As a lender committed to the multifamily housing industry — and financing small multifamily properties, in particular — Arbor looks forward to working with all stakeholders to refine, develop and execute any and all strategic plans to address the growing issue of affordability within our nation's rental housing stock.

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[iv] Arbor and Chandan Economics. “Q1 2017 – Small Balance Multifamily Investment Trends Report”. *ALEXChatter.com*. 17 May 2017.

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