Freddie Mac
Multifamily®

A Closer Look:

Our Mission-critical Targeted Affordable Housing Business

Freddie Mac Multifamily's commitment to promote rental housing affordability is rooted in our public mission and our DNA. The vast majority of apartments we fund are considered affordable to moderate- and lower-income households. Part of this support comes through our Targeted Affordable Housing (TAH) business, which serves an important niche within the lower-income multifamily rental housing market.

What Is Affordable Rental Housing?

The U.S. Department of Housing and Urban Development (HUD) deems a unit affordable if the gross rent (rent plus tenant-paid utilities) equals no more than 30 percent of the household's income. HUD further defines affordability by income level, as follows.

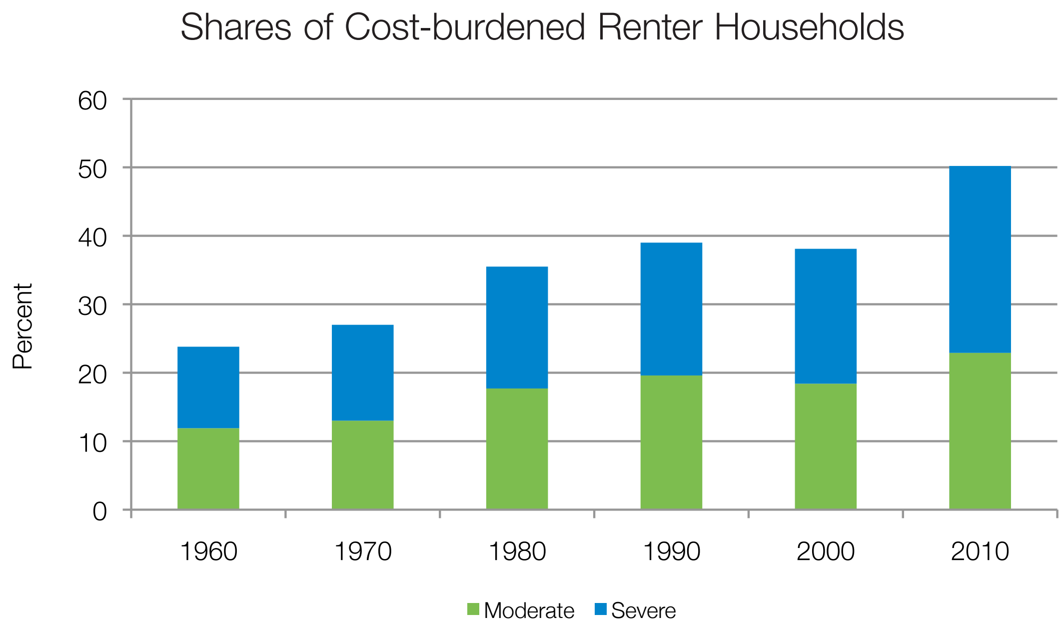
- **Moderate-income housing** – Affordable to renters earning local area median income (AMI)
- **Low-income housing** – Affordable with 80 percent of AMI
- **Very low-income (VLI) housing** – Affordable with 50 percent of AMI
- **Extremely low-income housing** – Affordable with 30 percent of AMI

Because we don't know a tenant's household income except in properties with regulatory agreements, we use rent as a proxy to determine affordability.

How Available Is Affordable Rental Housing?

Now is the most challenging time in 50 years to find adequate, affordable rental housing, especially for lower-income households, for a combination of reasons. Increasing number of renters. Elevated unemployment and underemployment. Stagnant incomes. Rising rents. Comparatively little construction during the recent financial crises, leading to low apartment inventory and vacancy rates. Rising construction costs.

According to the U.S. Census Bureau's American Community Survey 2000-2011, more than half of all U.S. renters are "rental-cost burdened," up from around 40 percent of renters in 2000. Nearly 30 percent of renters – that's more than 11 million households – spend at least 50 percent of their income on housing. Lower-income households in particular tend to spend a larger portion of their incomes on rent. High rental-cost burdens leave families with less to spend elsewhere, such as on food, clothing, and health care.

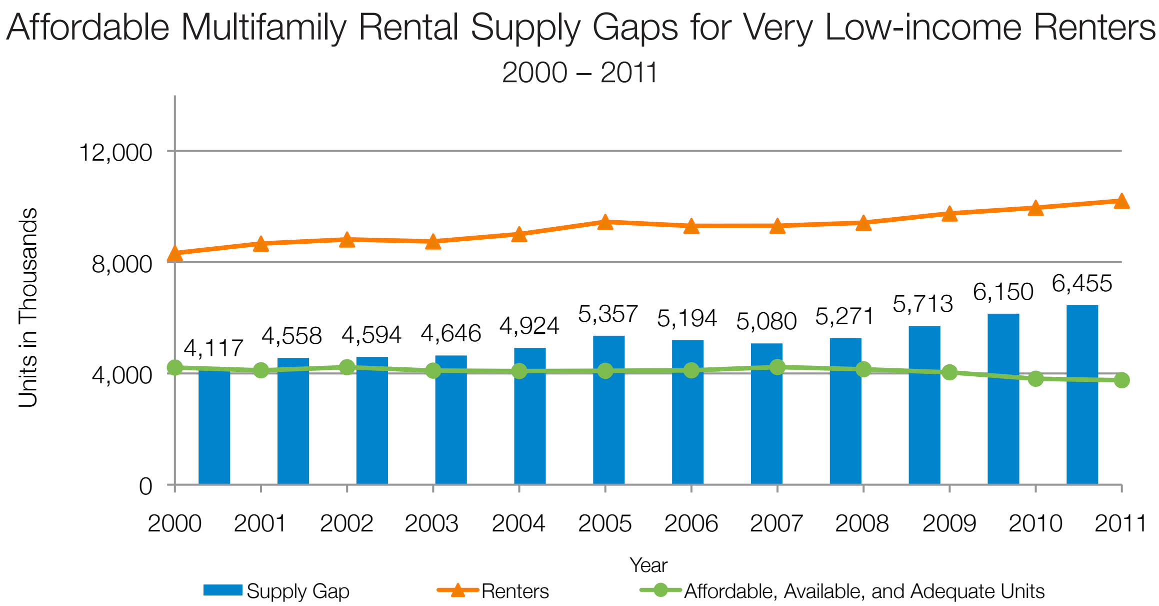


Source: America's Rental Housing*, Harvard University Joint Centers for Housing Studies, December 2013*

The simple fact is that the number of renters far outstrips the number of affordable apartments. Low vacancy rates generate competition, which drives up rents, making them more expensive at a time when jobs and income growth are harder to come by.

- There's currently a gap between supply and demand of around 1.4 million multifamily rental units, the Kansas City Federal Reserve Bank found in its fourth-quarter 2013 study, *The Demographic Shift from Single-Family to Multifamily Housing*. The number of apartments affordable to lower-income renters in particular has been shrinking steadily, according to the Harvard University Joint Center of Housing Studies' (JCHS's) June 2013 report, *The State of the Nation's Housing*.
- Over the last four years, nominal rents increased by 12.4 percent. Meanwhile, median household incomes increased by an average of 4.3 percent.
- The national apartment vacancy rate fell from 8 percent at the end of 2009 to 4 percent at the end of first quarter 2014, according to Reis, Inc. – the lowest level since 2001.
- The JCHS projects that the number of renter households will grow by between 4.0 million and 4.7 million in the next 10 years.
- The rate of construction must exceed long-term averages for an extended period to meet demand. More supply would boost availability, thereby helping to lower rents and improve affordability.

Our own research – captured in our December 2012 report to our conservator, the Federal Housing Finance Agency (FHFA) – revealed a severe lack of suitable affordable rental housing for lower-income households across all markets. That situation isn't expected to improve anytime soon. The following chart illustrates the shortfall for lower-income renters. (For a summary of our research, see A Closer Look, Multifamily Market Impact Analysis on the Market Commentary page of FreddieMac.com/Multifamily.)



Source: American Community Survey, 2000-2011

The economics of funding the lower-income market segment make attracting private capital to it a perennial challenge – even more so in difficult economic times. Private funding sources (such as life insurance companies, banks, and conduits) tend to focus mainly on high-end properties and top-tier markets along the U.S. coasts. And in times of economic stress, private sources tend to leave the market altogether. Without public-mission-oriented funding sources, investment in lower-income housing would drop sharply. Supply of units would continue to contract, further driving up rents and, as a result, demand for lower-income housing. Such a chain reaction would widen an already severe supply gap.

What Is Targeted Affordable Housing?

Targeted affordable housing (TAH) properties are those that receive federal, state, or municipal government subsidies to pay for a portion of development or operating costs. In exchange, developers/owners (borrowers) commit to keeping all or a portion of the apartments affordable to renters at certain AMI levels – including VLI in many instances – for between 15 and 55 years, depending on the jurisdiction and type of governmental support involved. This typically includes limiting gross rents to 30 percent of the applicable AMI (that is, 50 or 60 percent) specified for the property. About 14 percent of multifamily rental properties receive some form of government assistance, according to JCHS's December 2013 report, *America's Rental Housing*.

Subsidies may be direct or indirect. The primary direct federal subsidy is HUD's Section 8 Housing Program, which assists eligible renters in paying their monthly rent.

Indirect subsidies include block grants and tax credits. Funding flows from federal programs to state agencies to help the states support multifamily rental housing development according to their specific priorities. In turn, the state agencies allocate funds to developers, including not-for-profit housing organizations. The U.S. Treasury Department's Low-Income Housing Tax Credit (LIHTC) Program, administered by state housing agencies, is the main source of federal support for lower-income rental housing construction and rehabilitation. The tax credits are competitively awarded to developers, who then sell these credits to institutional investors to raise capital. Another indirect subsidy is provided through tax-exempt financing by state and local housing finance agencies for qualified multifamily properties, which financing also includes LIHTC.

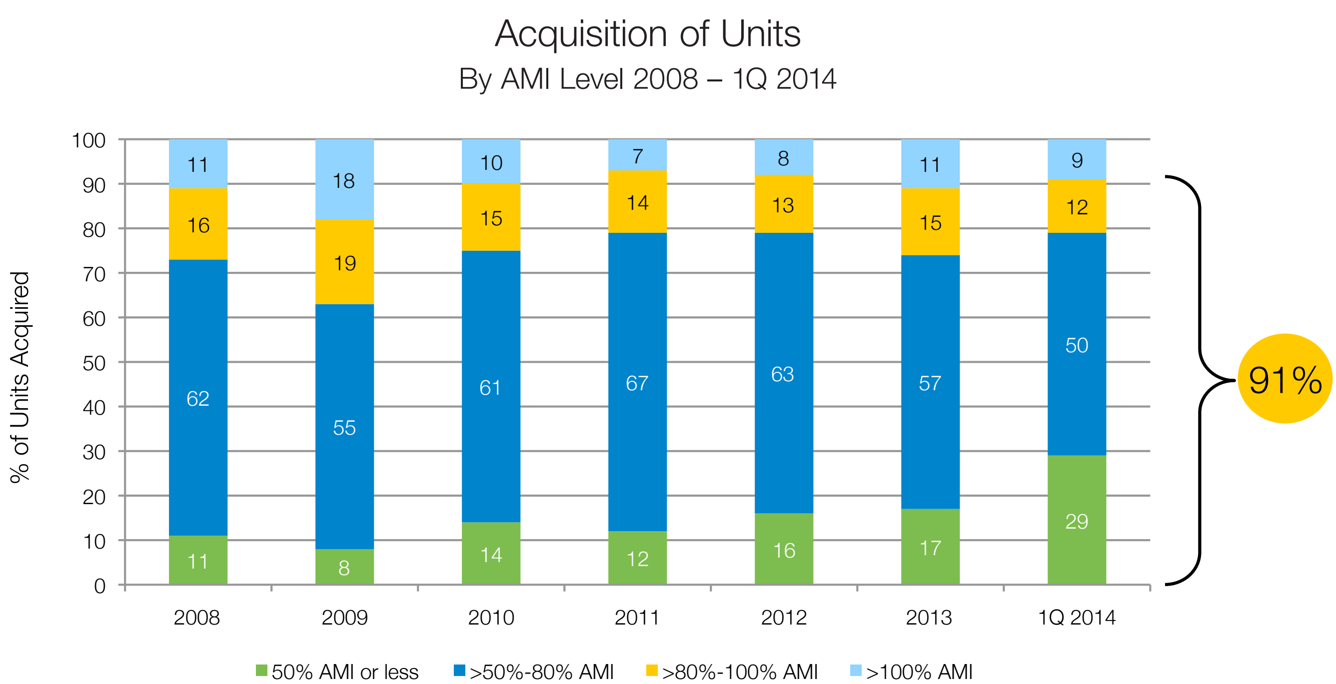
With LIHTC-generated equity funding and state and local grants or soft loans (which usually carry lower-than-market interest rates and the required payments on which come only from available cash flow), developers/owners can borrow less money to develop their properties. By carrying less mortgage debt, they can offer lower rents to tenants. They also agree to comply with housing and tax regulations. This might include certain requirements established in the state's award allocation for services and features to be provided, such as enrichment programs for resident children and adults, day care, or support for special-needs populations. The developers/owners must submit reports annually to the relevant agencies to verify that they are complying with all requirements.

TAH properties come in a range of sizes and profiles based on the state's priorities and the local market's capacity. For example, properties with LIHTC may be intended in full or in part for seniors, farm workers, or tenants with special needs.

Funding a TAH property – pulling together various layers of government support and helping to ensure that developers/owners understand and adhere to all of the related regulations – tends to be a more complex undertaking than funding a conventional property. It demands specialized knowledge and expertise. That's why only certain seller/servicers, with specialized production and underwriting staffs, make mortgage loans on subsidized multifamily rental properties.

How Does Freddie Mac Multifamily Support TAH?

On average, more than 90 percent of the apartments that Freddie Mac Multifamily finances are affordable to moderate- and lower-income households. More than 15 percent of the apartments are affordable to VLI households. Our TAH team focuses on the market segment that involves some form of government subsidy.



Source: Freddie Mac

Freddie Mac Multifamily's TAH segment reflects our commitment to promoting adequate, affordable rental housing nationwide to all market segments and in all economic conditions. It is a vibrant and important part of Freddie Mac Multifamily's business. The TAH transactions that we execute make a positive difference in the tenants' lives and in their communities.

Dedicated TAH Team

Our TAH Production & Sales team works closely with our seller/servicers, agencies at every level of government, well-qualified borrowers, and our TAH Underwriting team to identify and structure transactions that make business sense for all parties involved. Under our “prior approval” approach, we structure and underwrite each mortgage loan before investing. TAH investment decisions are based on sound real-estate fundamentals: the property’s sponsorship, equity investment, quality of maintenance and operations, and sustained cash flow. The TAH team also collaborates with colleagues in Pricing, Capital Markets, and Servicing and with specialists in our Legal, Finance, and Credit Risk Management departments.

Each transaction is unique – we structure each mortgage loan to fit borrower, property, and market conditions, while managing credit risk appropriately.

Although our TAH business differs in many ways from our conventional business, the same underlying business approach runs throughout Freddie Mac Multifamily:

- We take an integrated, end-to-end view of our business and focus intently on quality at every stage of the loan life cycle.
- We work only with an approved network of seller/servicers and qualified borrowers.
- We apply the same credit philosophy to TAH and conventional loans alike.
- Servicing standards are the same for all of our loans. These standards also apply regardless of whether a loan is held in portfolio or securitized.

(For more information on the Freddie Mac Multifamily business as a whole, see A Closer Look, Multifamily Business Primer on the Market Commentary page of FreddieMac.com/Multifamily.)

TAH Focus Areas

The TAH team’s main focus areas are preservation and tax-exempt financing, which we historically supported through credit enhancement and now will emphasize through a new offering, investments in tax-exempt loans. We have a range of initiatives in place to make it easier for our TAH seller/servicers to do business with us and to meet developers/owners’ needs, and continually look for ways to enhance our support for the TAH market. Our aim is to help make financing TAH properties possible – effectively, competitively, and efficiently.

Over the last couple of years, we’ve emphasized providing preservation financing on properties that originally were developed with LIHTC 10 or more years ago. Through our involvement, developers/owners receive low-cost financing for the balance of the LIHTC compliance period and beyond; they also can seek new LIHTC allocations at the end of the compliance period. This way, they can maintain the property as affordable to lower-income renters for many years into the future. Preservation is a rapidly growing and increasingly important part of our business. Before 2012, our preservation financing accounted for 20 to 30 percent of our TAH production. In 2013, almost half of the TAH properties we financed involved preservation.

Most of the TAH cash mortgages we purchase today are supported by LIHTC or Section 8 contracts. As part of our concentrated effort to promote VLI properties, we actively seek out and finance Section 8 properties.

We securitize many of the TAH loans we buy to help in providing borrowers with effective, efficient mortgages and in transferring credit risk away from taxpayers. Given the limited volume of TAH loans and the complexities surrounding them, however, securitization activity is less than on the conventional side of our Multifamily business.

Our team continually works to find new ways to support TAH financing and to transfer credit risk away from taxpayers. For example, to support certain properties with tax-exempt financing, we recently launched our Direct Purchase of Tax-exempt Loans initiative. Here’s how it works:

- One of our TAH seller/servicers makes a direct loan to a city, county, or state housing authority in exchange for a tax-exempt note.
- Freddie Mac Multifamily purchases the tax-exempt loan (evidenced by the note) from our seller/servicer.
- The city, county, or state housing authority that issued the tax-exempt note then lends the loan proceeds to a borrower to finance a multifamily housing community that offers affordable rents.

- Freddie Mac Multifamily aggregates the tax-exempt loan with other tax-exempt loans, and then securitizes the pool of loans through our M-Deal structure, which we have used for the past 10 years to enable sponsors with bonds to securitize their investments.

Among the benefits of this execution:

- Helps increase access to credit for affordable rental housing as well as significantly lowers the borrower's issuance costs and ongoing cost of capital.
- Simplifies the closing process.
- Enables Freddie Mac Multifamily to securitize more of our TAH business volume, thereby reducing our credit risk. Through M-Deals, we create Agency investment opportunities for investors, who will be the first to absorb any credit losses.

This initiative should increase opportunities for funding TAH properties.

Business Volume

From 2005 through 2013, more than 15 percent of the apartments that Freddie Mac Multifamily financed were VLI, on average. Our TAH business makes up an average of 10 percent of Freddie Mac Multifamily's annual purchase volume. (The size of the TAH business is at least partly constrained by tax laws around bonds and LIHTC equity.) However, it accounts for 35 percent of the VLI apartments that we fund.

What Lies Ahead?

A large and growing number of people pay more than 30 percent of their income on housing. The gap between the number of people needing affordable housing and the number of adequate, available units is wide. Government subsidies help with developing properties and keeping them affordable – especially for lower-income renters.

Freddie Mac Multifamily will continue to support preservation as well as new construction of multifamily rental units across all property segments. More units, even market-rate units, will ease current supply/demand pressures on rents. In addition we will continue to fund transactions that promote the acquisition, refinance, and rehabilitation of TAH properties to keep them affordable to lower-income tenants. And we will continue to look for ways to enhance our support for this business.

Our conservator, the Federal Housing Finance Agency (FHFA), appears to agree with Freddie Mac Multifamily's focus on affordable multifamily rental housing. It has encouraged our new initiatives, such as the Direct Purchase of Tax-exempt Loans program to support TAH developments, and, in other underserved areas, financing for manufactured housing rental communities and small-balance loans for smaller properties. In that same spirit, purchasing loans associated with affordable housing, small multifamily properties, and manufactured rental housing communities doesn't count toward the volume cap that FHFA set for us in its 2014 scorecard for the GSEs.

We remain committed to the TAH segment and to supporting it through all economic cycles.