Spotlight on Underserved Markets

USDA Section 538

Freddie Mac MULTIFAMILY

DUTY TO SERVE

USDA Multifamily Housing Loan Guarantee
An Overview of Demographic and Housing Characteristics

Safe, decent, affordable rental housing is an important resource for rural communities across the country. It allows for seniors to age in place and families to raise their kids where they have longstanding connections. It also supports the growth or preservation of towns and smaller cities across the country. The development and preservation of affordable rental housing in rural America is challenged, however, by subpar or aging infrastructure, lower incomes due to limited economies, and dispersed populations. Without some form of subsidy or incentive, the rents that properties are able to charge generally cannot support ongoing property operations or debt service. Over the years, various programs have been used in an effort to overcome these burdens and support the development and preservation of rural affordable housing, including the United States Department of Agriculture's (USDA) Section 515 program and associated Section 521 rental assistance, the Low-Income Housing Tax Credit (LIHTC) program, U.S. Department of Housing and Urban Development's (HUD) Section 8, and the USDA's Multifamily Housing Loan Guarantee program ("the program" or "the 538 program").

In this paper, we pay particular attention to the role of the 538 program, which was put into practice in 1998. This program is a primary means of debt financing in rural markets and, in conjunction with other public subsidies, supports approximately 51,000 rental units across the country. Though small compared with the multifamily housing market as a whole, the 538 program promotes strategic investment in the development of rural multifamily housing and preserves affordable housing for renters across the country.

In this report, we examine the program's impact on the multifamily housing market. We consolidate multiple data sources and evaluate impact through an analysis of the market size of this subsidy program, including geographic and demographic characteristics, and consider the primary and secondary mortgage markets for 538 guaranteed loans.

We find that:

- The 538 program has grown over time with appropriations increasing in recent years as demand continues to grow.
- The program is typically paired with other public subsidies, LIHTC being the most common.
- These properties are in areas with low incomes and high poverty rates, but are geographically dispersed across 49 states, with 24% of properties located in very small rural communities with populations of 2,500 or less.
- A variety of lenders have participated in the program, though the number of transactions is concentrated among a select few lenders who have created efficient and replicable models.
- The guarantee allows lenders to stretch beyond typical credit parameters for unguaranteed loans, which is often necessary to finance affordable rentals in rural areas.
- The presence of the 538 guarantee allows lenders to access liquidity from the capital markets through Ginnie Mae securitizations.
- Geographically, the properties are commonly close to urban areas, likely because higher population density is conducive to multifamily housing.

About the Program

The Section 538 program is designed to provide government guarantees on loans made for the development or preservation of affordable rural rental housing. Unlike USDA's Section 515 loan program, the 538 program does not provide a direct loan, nor does it subsidize rents. Instead, USDA guarantees up to 90% of the total development cost or the property value, whichever is less. For-profit entities may borrow up to 90% and nonprofit entities may borrow up to 97% of the total development cost or appraised value, whichever is less. The USDA provides highly flexible loan terms and attractive pricing. Instead of having its own rent restriction agreement, the program requires a property to have some form of Land Use Restriction Agreement or other measure that preserves the affordability of the units,[1] such as LIHTC, USDA Section 515, or HUD Section 8. The combination of multiple subsidy programs facilitates the preservation of rural multifamily housing where lenders may not otherwise be as active due to credit concerns and small loan sizes.

Eligible mortgage lenders fall into two primary categories. The first includes the network of banks/mortgage banks and often overlaps with Freddie Mac, Fannie Mae and HUD approved lenders. The second group includes the Federal Home Loan Banks or any state or local Housing Finance Agencies (HFAs). Lenders must recertify each year with the Rural Housing Service (RHS) to sustain eligibility with the program.

There are several parameters that a property must meet in order to qualify for the program. These generally include:[2]

- Rents for individual units are capped at 30% of 115% of area median income (AMI), adjusted for family size.
- Properties must contain a minimum of 5 units.
- The average rent for an entire project (including tenant-paid utilities) must not exceed 30% of 100% of AMI, adjusted for family size.
- The property must be in a USDA defined "eligible rural area.[3]"

Allocations of funds to properties have been determined through a Notice of Fund Availability (NOFA), which states the amount of annual appropriations available and the various scoring metrics that will be used in the competitive application process. However, USDA published in the Federal Register that effective November 14, 2019, the requirement for a NOFA has been eliminated.[4] USDA has identified the following priorities for allocations:[5]

- Smaller rural communities
- Communities with the greatest need and the highest percentage of leveraging
- Applications with the lowest interest rates
- Projects with the highest ratio of three- to five-bedroom units to total units
- Projects located on tribal lands

[1] 7 C.F.R. §3565.352.
[2] 7 C.F.R Section 3565.
[3] https://eligibility.sc.egov.usda.gov/eligibility/welcomeAction.do;jsessionid=fkbgjnfG37JO5+XzevhDn6nD
[4] https://www.federalregister.gov/documents/2019/10/15/2019-22426/section-538-guaranteed-rural-rental-housing-program-notice-of-funding-availability-elimination
[5] 7 C.F.R. 3565.5.

Primary Benefits of the Guarantee

Through conversations with developers and lenders, we identified five primary benefits to financing an affordable property with the Section 538 guarantee. These include:

- Flexible credit parameters: minimum DSCR of 1.15x and maximum LTV of 90% (97% for nonprofit borrowers) based on the 538 guaranteed loan only
- Low interest rates
- 40-year fully amortizing debt and up to 40-year terms, with a minimum of 25-year terms[6]
- Ability to underwrite Housing Assistance Payment (HAP) overhang in certain markets
    - HAP overhang occurs when the rents on a Section 8 property exceed the LIHTC or market rents. This can be a credit issue in cases where the HAP contract expires during the term of the loan because the borrower may not be able to charge the same rents
- Streamlined construction process due to lower costs of execution
- Seamless conversion from the construction phase to the permanent phase of the 538 guaranteed loan

The combination of these features allows lenders and borrowers to maximize proceeds, provides the lender with security to lend beyond their typical credit parameters, and ultimately, supports the preservation and creation of affordable housing in high-need markets.

Section 538 Market Overview

The availability of the guarantee is based on two factors: congressional authorization and market need as defined by developer interest. As part of the appropriation process, the USDA estimates market need and submits budget requirements to Congress on an annual basis. When the fiscal year funding is greater than $100 million, funds are allocated to states based on a predetermined formula.[7] If the available funds are less than $100 million, then the funds are competitively distributed across the nation.[8]

Since inception, the Section 538 program has guaranteed nearly $1.5 billion in loans per loan-level data. However, per USDA data analysis, more than half of the loan guarantee payouts have been used in the years following 2013 – representing recent growth in funding for the program.[9] This growth is consistent with congressional justifications as more than a third of the program’s total guarantees have occurred in 2016, 2017 and 2018.

The requested allocation from USDA to Congress increased by $20 million from 2019 to 2020, indicating an increasing demand. According to the congressional justification,[10] funding is estimated to build or preserve as many as 8,473 rental housing units in 2020 alone.

In the process of data collection, we’ve found data sources to be inconsistent regarding the annual loan amounts guaranteed by the 538 program and have noted two key sources: USDA publicly available loan-level data and the USDA budget congressional justifications from the Office of Budget and Program Analysis (OBPA).[11] For the purposes of property-level analysis throughout the paper, we use the publicly

[6] The minimum term of 25 years can be viewed as restrictive for owners looking to exit the program in less than 25 years.
[7] 7 C.F.R. Section 1940.560.
[8] http://www.ruralhome.org/storage/documents/538guide.pdf
[9] Source: Freddie Mac Tabulations of United States Department of Agriculture Data
[10] https://www.obpa.usda.gov/29rhs2020notes.pdf Page 29-21
[11] https://www.obpa.usda.gov/explan_notes.html

available data. However, it is our assumption that the publications within congressional justifications are more accurate for loan amount aggregations. As a result, we've included both sources for an analysis of the market size. For our review of property-specific information, we use loan-level data from USDA and the National Housing Preservation Database (NHPD) throughout the paper for demographic and geographic evaluation.

Figure 1: Section 538 Loan Guarantees by Year

Fiscal Year	Loan Amount	Percent of Total
1997	3,800,000	0.3%
1998	-	0.0%
1999	9,716,049	0.7%
2000	13,057,103	0.9%
2001	-	0.0%
2002	24,430,541	1.7%
2003	40,157,817	2.7%
2004	68,912,987	4.7%
2005	59,242,503	4.0%
2006	70,755,119	4.8%
2007	71,272,666	4.8%
2008	90,925,573	6.1%
2009	97,515,883	6.6%
2010	115,615,377	7.8%
2011	26,142,794	1.8%
2012	69,840,388	4.7%
2013	50,373,450	3.4%
2014	109,248,958	7.4%
2015	99,498,370	6.7%
2016	177,228,593	12.0%
2017	138,714,425	9.4%
2018	142,216,673	9.6%
Total	**1,478,665,269**	**100.0%**

Source: Freddie Mac Tabulations of United States Department of Agriculture Public Data

Figure 2: Section 538 Loan Guarantees by Year Per OBPA

Fiscal Year	Appropriation	Used Allocation	Percent
2007	$ 62,998,000.00	$ 90,356,000.00	6.2%
2008	$ 200,000,000.00	$ 131,255,000.00	9.0%
2009	$ 300,000,000.00	$ 120,852,000.00	8.3%
2010	N/A	$ 129,130,000.00	8.9%
2011	N/A	$ 30,898,000.00	2.1%
2012	$ 130,000,000.00	$ 104,255,000.00	7.1%
2013	$ 150,000,000.00	$ 52,227,000.00	3.6%
2014	$ 150,000,000.00	$ 136,162,000.00	9.3%
2015	$ 150,000,000.00	$ 113,912,000.00	7.8%
2016	$ 150,000,000.00	$ 186,935,000.00	12.8%
2017	$ 230,000,000.00	$ 176,970,000.00	12.1%
2018	$ 230,000,000.00	$ 185,640,000.00	12.7%
2019	$ 250,000,000.00	-	-
Total	**$ 2,002,998,000.00**	**$ 1,458,592,000.00**	**100.0%**

Source: USDA Budget Congressional Justifications

While the program has grown over time, the amount guaranteed has varied between funding years. Though the requirement for a NOFA has been eliminated, it has historically had an important role in the program. As a requirement of the 538 application process, developers must submit a preliminary eligibility letter from USDA's Rural Development (RD) office alongside the tax credit application. If the NOFA was published after the tax credit application deadline, a developer may not have received credits to finance the project – this has made the timing of the process crucial. To better assist developers in the timing of their equity draws for construction payments, the program currently accepts applications on an ongoing basis in lieu of the NOFA process, based on the previous year's NOFA.

Though the allocation appears inconsistent between years, our outreach to lenders confirmed that the use of the guarantee has historically aligned with the annual amounts approved through the NOFA. This may be reflective of market appetite, but it could also be driven by the timing of the NOFA, which may limit the number of projects that would like to apply for the guarantee. We understand that the allocation of funds to support the program is generally approved as requested because the program is supported by its guarantee-fee income rather than direct appropriation of funds. The USDA may charge or adjust fees on an annual basis to cover the projected costs of the guarantee. This has allowed for an increasing trend in allocations in recent years.

Alignment with Other Subsidy Programs

Most properties with Section 538 guarantees also rely on other federal subsidies, predominately LIHTC.

Figure 3: Section 538 Guarantees in Conjunction with Federal Subsidy Programs

Program	Properties		Units		Units Per Property
538 and 515	369	38.3%	18,619	36.4%	50
538 but not 515	595	61.7%	32,471	63.6%	55
538 and LIHTC	652	67.6%	34,322	67.2%	53
538 and S8	82	8.5%	4,444	8.7%	54
538 and HOME	123	12.8%	6,534	12.8%	53
538 Total	**964**	**100.0%**	**51,090**	**100.0%**	**53**

Source: Freddie Mac Tabulations of NHPD data

Nearly 70% (652/964) of properties guaranteed by the 538 program have a LIHTC agreement. The LIHTC program can be used for the purposes of new construction or rehabilitation of existing buildings and has either 4% or 9% terms.[12] The 9% credit is subject to a competitive process governed by state housing finance agencies through the Qualified Allocation Plan (QAP). The 4% credit is not as competitive, rather it is tied to each state's annual bond cap and a different allocation process that has become more competitive over time in many jurisdictions (in the current market). Typically, the 9% tax credit contributes equity of 70% of the project's costs, leaving 30% to be filled by various forms of debt or cash equity, often not needing other federal assistance to construct a project. The 4% credits are obtained by right in connection with tax-exempt bond financing. Using the 4% tax credit reverses the ratio debt to equity: The 4% tax credits would provide 30% of the equity along with 70% tax-exempt debt with the balance comprising other sources of debt and equity (to complete the capital stack).

Of LIHTC properties that have loans with the 538 guarantee, approximately 84% are using the 9% tax credit. The 9% credit not only provides substantial equity for projects, but it also ensures rents are kept affordable to low-income individuals (at or below 60% of AMI). Additionally, with greater equity in the capital stack, there is less need for debt, which makes the loan sizes on these deals particularly small. Since there is no minimum loan size for the 538 program, the guarantee helps to enable smaller loans to be made.

[12] https://www.novoco.com/resource-centers/affordable-housing-tax-credits/lihtc-basics/about-lihtc

Figure 4: Section 538 Guarantees with Tax Credit Programs

Tax Credit	LIHTC Properties		LIHTC Units	
4%	237	47%	10,924	44%
9%	424	84%	20,712	84%
4 and 9%	157	31%	7,726	31%

Source: Freddie Mac Tabulations of NHPD Data

To better understand the 538 loan size relative to the property's need, we evaluated the average Loan-to-Cost (LTC) ratio per USDA's section 538 datafile. We found that the weighted average LTC was just 21.2%. Since most of the properties are subsidized by the 9% LIHTC, the majority of the syndicate is tax credit or cash equity, with the remainder being about 20-25% of debt. The underwritten value of these properties is often determined using restricted rents, which can be drastically below market rents in some locations, consequently decreasing the potential value of the property.

Historically, the guarantee has been useful in aiding the construction of new affordable housing projects. However, in recent years, there has been a shift toward projects with substantial rehabilitation. As a result, the program has an almost even split of rehabilitation and construction projects throughout its duration. Since 2005, there have been 562 rehab projects and 555 new construction projects.

Figure 5: New Construction versus Preservation-Rehabilitation

Program	Properties		Units		Units Per Property
New Construction	555	48.6%	29,016	49.6%	52
Rehab/Repair	562	49.3%	28,315	48.4%	50
Other	24	2.1%	1,181	2.0%	49

Source: Freddie Mac Tabulations of USDA data

Geographic Distribution of 538 Guaranteed Loans

Section 538 properties are located across 49 states, the one exclusion being Utah, based on USDA data (though Ginnie Mae data[13] reveals properties located in Utah not captured below). The properties are generally dispersed with clusters being found in California, Georgia and Ohio.

Figure 6: Distribution of Section 538 Properties by State[14]

State	Construction	Rehab	Total	
Alaska	1	8	9	0.8%
Alabama	3	6	10	0.9%
Arkansas	12	3	16	1.4%
Arizona	45	3	49	4.3%
California	91	102	194	17.0%
Colorado	1	8	10	0.9%
Connecticut	0	0	2	0.2%
Delaware	0	4	4	0.4%
Florida	6	20	27	2.4%
Georgia	39	62	101	8.9%
Hawaii	1	0	1	0.1%
Iowa	0	8	8	0.7%
Idaho	9	10	19	1.7%
Illinois	9	3	12	1.1%
Indiana	4	13	21	1.8%
Kansas	5	6	11	1.0%
Kentucky	9	17	26	2.3%
Louisiana	6	5	11	1.0%
Massachusetts	1	0	2	0.2%
Maryland	4	5	9	0.8%
Maine	0	4	5	0.4%
Michigan	11	11	23	2.0%
Minnesota	1	1	2	0.2%
Missouri	1	0	1	0.1%
Mississippi	2	11	13	1.1%
Montana	3	0	3	0.3%
North Carolina	46	30	76	6.7%
North Dakota	4	7	13	1.1%
Nebraska	0	1	1	0.1%
New Jersey	1	2	3	0.3%
New Mexico	2	7	9	0.8%
Nevada	4	2	6	0.5%
New York	0	2	2	0.2%
Ohio	87	26	113	9.9%
Oklahoma	9	32	41	3.6%
Oregon	0	6	6	0.5%
Pennsylvania	5	11	16	1.4%
Rhode Island	1	0	1	0.1%
South Carolina	8	37	45	3.9%
South Dakota	3	2	5	0.4%
Tennessee	25	32	57	5.0%
Texas	43	22	68	6.0%
Virginia	2	3	5	0.4%
Virgin Islands	0	1	1	0.1%
Vermont	2	0	3	0.3%
Washington	0	20	20	1.8%
Wisconsin	3	0	3	0.3%
West Virginia	43	7	53	4.6%
Wyoming	3	2	5	0.4%
Grand Total	555	562	1,141	100.0%

*There are 24 loans that are labeled as neither new construction or rehab

Source: Freddie Mac Tabulations of USDA Data

While, for eligibility, all 538 properties must be within USDA defined rural markets, we have been unable to obtain a shapefile of this geography that would allow us to map 538 properties within USDA's rural definition. Therefore, for purposes of this paper, we evaluate the distribution of these properties in the context of the Federal Housing Finance Agency's (FHFA's) Duty to Serve definition of rural markets.

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[13] https://structuredginniemaes.ginnienet.com/multifam/MultifamilySearch.aspx
[14] Freddie Mac Tabulations of USDA data

According to FHFA's definition, a rural area is defined as either:[15]

1. A census tract outside of a metropolitan statistical area (MSA) as designated by the Office of Management and Budget (OMB), or
2. A census tract in an MSA but outside of the MSA's Urbanized Areas as designated by the U.S. USDA's Rural-Urban Commuting Area (RUCA) Code #1, and outside of tracts with a housing density of more than 64 housing units per square mile in USDA's RUCA Code #2.

Per FHFA's definition, nearly 75%, or 714 multifamily properties, with Section 538 guarantees are located in rural areas and contain a total of 36,616 units. This equates to just 2.28% of the total rural multifamily rental stock of 1,447,994 multifamily units.[16] Though the program may be small relative to the size of the market as a whole, the guarantee has substantial impact in preserving long-term affordability. Additionally, we found that more than half of the properties (51.8%) are located within MSAs. Although the program aims to provide housing in underserved rural areas, the distribution toward MSAs suggests a general preference for properties in areas with higher populations, which is generally consistent with the distribution of multifamily properties in Duty to Serve rural markets overall.

Figure 7: Section 538 Properties in FHFA Defined Rural Areas

Geography	Properties		Units		Units Per Property
DTS Rural	714	74.1%	36,616	71.7%	51
Non-Rural	250	25.9%	14,474	28.3%	58
MSA	499	51.8%	27,311	53.5%	55
µSA	275	28.5%	14,933	29.2%	54
Super Rural*	190	19.7%	8,846	17.3%	47
MSA and Rural	249	25.8%	12,837	25.1%	52
Super and µSA Rural	465	48.2%	23,779	46.5%	51

*Super Rural consists of rural areas outside of µSAs and MSAs
Source: Freddie Mac Tabulations of NHPD Data

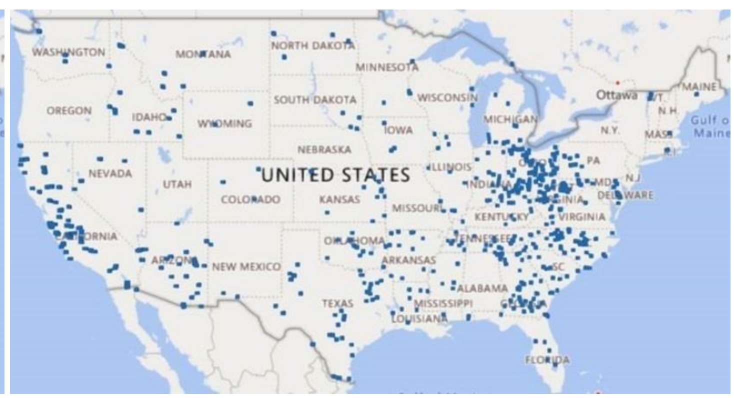
The distribution of identifiable properties is especially apparent when viewed on a map as is demonstrated in figures 8, 9 and 10 on the following page.

[15] https://www.fhfa.gov/DataTools/Downloads/Pages/Duty-to-Serve-Data.aspx
[16] 2017 5-Year ACS

Figure 8: Map of All Section 538 Properties[17]

Figure 9: Distribution of 515 and 538 Properties

Figure 10: Distribution of 538 Properties



Since more than half of the properties are located within an MSA, we look at urban boundaries as defined by the U.S. census.[18] The census defines an "Urban Cluster" as tertiary cities with populations between 2,500 and 50,000. An "Urbanized Area" is any place with more than 50,000 people. Through data analysis, we found that 57% of properties are located in an Urban Cluster and 19% of properties are in Urbanized Areas. Any location outside of these two urban boundaries are considered rural – just 24% of Section 538 properties are located in a rural geography per the census. This distribution may be related to the idea of urban sprawl and the outward growth of metropolitan areas. As cities continue to grow over time, the previously rural areas surrounding cities experience population growth, which changes the classification of these areas from rural to urban.

[17] All property-level maps were created using data from the NHPD

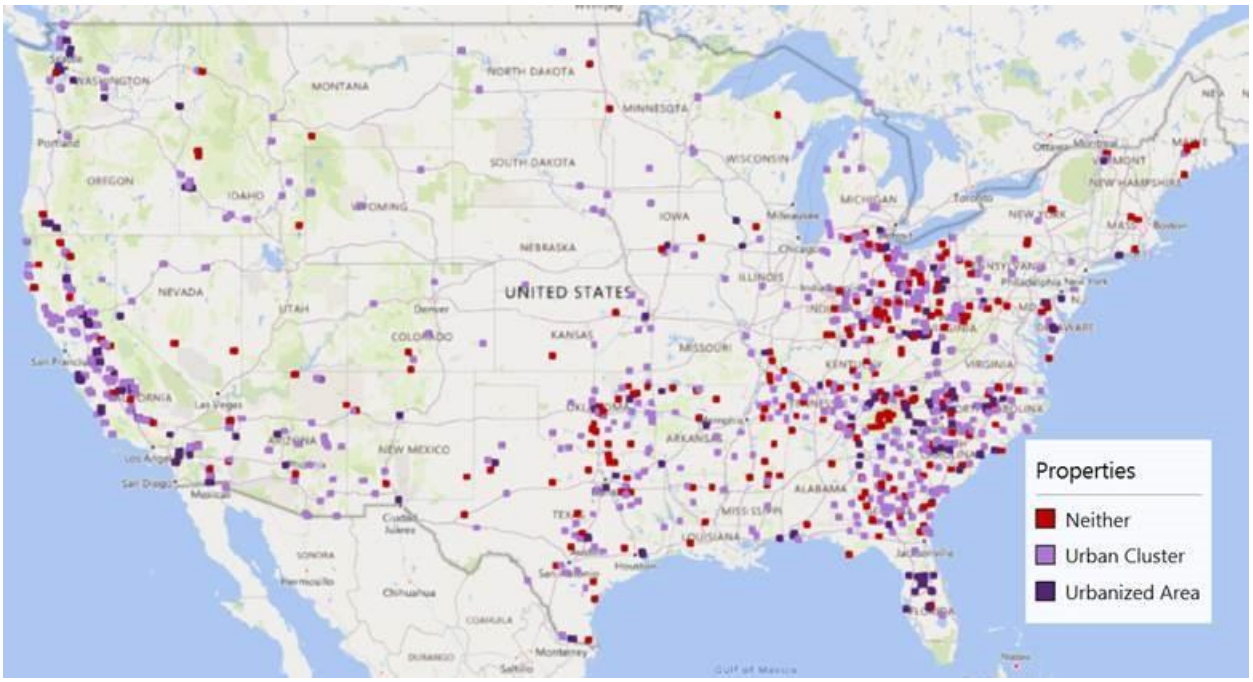
[18] https://www.census.gov/programs-surveys/geography/guidance/geo-areas/urban-rural/2010-urban-rural.html

Figure 11: Distribution of Section 538 Properties by Urban Type Per Census

	Section 538 Properties		Population Per Geography	
Urban Cluster	655	57%	29,331,148	10%
Urbanized Area	216	19%	219,922,123	71%
Rural	270	24%	59,492,267	19%
Total	**1,141**	**100%**	**308,745,538**	**100%**

Source: Freddie Mac Tabulations of USDA and Census Data

Figure 12: Map of Section 538 Properties Per Census Geographies



Source: Freddie Mac Tabulations of USDA Data and Census Data

Demographic Characteristics of the 538 Market

Section 538 properties span the nation and are often located in census tracts that are burdened by low incomes and high poverty rates. The median poverty rate for census tracts containing a 538 property is 18.96%. By comparison, the median poverty rate in rural areas is 15.87% and the national median poverty rate is just 14.60%. The average median income in the United States is approximately $57,652. This decreases to $45,998 within rural areas and falls to only $42,718 in census tracts with a 538 property. Similarly, the average median rents are considerably higher for the nation at $982, as compared with $715 for areas with 538 properties. Though rents are lower in tracts with 538 properties than the nation, rents are actually higher than median rents in rural areas generally. This suggests that tenants living in tracts with a 538 property are more cost burdened than renters in rural areas generally. In Figure 13, the data shows that average rent as a percentage of income is greater for households in tracts with a 538 property than in rural tracts. We conclude that Section 538 properties are in areas that demand affordable housing options for low-income individuals.

Figure 13: Demographic Statistics

	Tracts with a 538 property	Rural	National
Average GINI	0.4985	0.4877	0.4815
Poverty Rate	18.96%	15.87%	14.60%
Average Median Income	$ 42,718.70	$ 45,998.87	$ 57,652.00
Average Median Income - Owner	$ 54,810.38	$ 55,120.93	$ 73,252.00
Average Median Income - Renter	$ 26,315.47	$ 27,682.63	$ 36,653.00
Average Median Rent	$ 715.76	$ 690.11	$ 982.00
Average Rent as % of Income	30.05%	28.31%	30.30%

Source: Statistics are estimated based on Freddie Mac Tabulations of the National Housing Preservation Database and the 2017 5-year American Community Survey

Primary and Secondary Market Participants for 538 Loans

Primary Market

The guarantee program has grown to support the evolving needs of affordable rental housing in rural areas, but that growth is clearly reliant on multiple federal housing subsidies. Without the additional support of subsidized rents or equity contributions, many of these projects would not be possible. Indeed, the program, by definition, requires the presence of a deed restriction enforcing income limits which ensures that the tenants are lower income individuals.[19] The loan guarantee allows lenders to stretch beyond their typical credit parameters and lend at greater capacities to close gaps in the capital stack. There is a large network of lenders, with a select few who specialize in the funding of loans backed by the Section 538 guarantee. These lenders have established efficient methods to provide liquidity to the rural housing market.

[19] http://www.ruralhome.org/storage/documents/538guide.pdf

Figure 14: Section 538 Properties Financed Per Lender

Lender	Number of Properties	Percent
Alerus Financial	1	0.1%
Allied Home Mortgage Capital Corporation	5	0.4%
Bangor Savings Bank	2	0.2%
Bank of America	1	0.1%
Bank of Bozeman	1	0.1%
Bank of Oklahoma	9	0.8%
Bellwether Enterprise	107	9.4%
Bonneville Mortgage Company	375	32.9%
CB&T - A Division of Synovus Bank	4	0.4%
Centennial Mortgage	9	0.8%
Churchill Mortgage Investment	187	16.4%
Compeer Financial	1	0.1%
First Housing Development Corporation	1	0.1%
First National Bank of River Falls	1	0.1%
First Security Bank	8	0.7%
Greystone Servicing Corporation	53	4.6%
JP Morgan Chase	6	0.5%
KeyBank	10	0.9%
Lyons Federal Bank	1	0.1%

Lender	Number of Properties	Percent
Main Street Bank	1	0.1%
Mascoma Bank	1	0.1%
Merchants Capital Corporation	40	3.5%
Missouri Housing	1	0.1%
New Mexico Mortgage Finance Authority	1	0.1%
Northfield Savings Bank	1	0.1%
ORIX Real Estate Capital	131	11.5%
Pennsylvania Housing Finance Agency	2	0.2%
Peoples National Bank	2	0.2%
PNC Mortgage	120	10.5%
Rabobank	1	0.1%
Regions Bank	1	0.1%
Security National Bank	2	0.2%
SunTrust	2	0.2%
TD Bank	1	0.1%
UMPQUA Bank	1	0.1%
USDA Rural Development	9	0.8%
West Virginia Housing Development Fund	42	3.7%
Grand Total	1,141	100.0%

Source: Freddie Mac Tabulations of USDA Data

There have been 37 multifamily lenders participating in the 538 program, but the number of transactions is concentrated among the six largest. These include Bonneville Mortgage Company, Churchill Mortgage Investment, ORIX Real Estate Capital, PNC Mortgage, Bellwether Enterprise and Greystone Servicing Corporation. These lenders have developed processes for origination and servicing, as well as securitization via Ginnie Mae, that have allowed them to provide liquidity to rural markets through the 538 program.

Secondary Market

While the guarantee provides various benefits to borrowers and lenders alike, it appears that the primary benefit of the guarantee is regulatory; it allows access to the secondary market by enabling lenders to securitize loans with the 538 guarantee. The key, and potentially only, secondary market participant for these loans is Ginnie Mae – a government agency. Ginnie Mae securitizes these loans, packages them in Real Estate Mortgage Investment Conduits (REMICs), along with HUD-insured multifamily and health care loans, and sells them to investors. As of May 2015, the maximum amount of the loan that can be securitized by Ginnie Mae may not exceed 70% of the total development cost. This is an increase from the previous 50% LTC which was set in 2005.[20]-[21]

[20] https://www.ginniemae.gov/OldGinnieMaeContent/APM/05-03.pdf
[21] https://www.ginniemae.gov/issuers/program_guidelines/Lists/MBSGuideAPMsLib/Attachments/50/APM_15-07.pdf

Figure 15: Ginnie Mae Securitization

Issue Year	Original Balance	Pool Count
2005	$ 20,967,198	13
2006	$ 22,748,825	18
2007	$ 55,087,338	51
2008	$ 70,988,994	61
2009	$ 111,060,487	85
2010	$ 111,137,209	63
2011	$ 73,487,149	63
2012	$ 95,707,181	71
2013	$ 66,217,068	44
2014	$ 53,221,437	46
2015	$ 109,955,295	95
2016	$ 189,900,657	131
2017	$ 159,422,158	120
2018	$ 246,117,428	130
Total	**$ 1,386,018,424**	**991**

Source: Ginnie Mae Issuance per Credit Suisse

Investors tend to view two types of risk when purchasing these REMICs: credit risk and prepayment risk. Prepayment risk is perceived to be lower on 538 guaranteed loans where there is a subordinate USDA 515 mortgage which does not allow for prepayment. The program has a 1-year delinquency rate of less than 0.5%, reflecting consistent occupancy across properties. While the 538 guarantee and the Ginnie Mae guarantee mitigate credit concerns associated with these loans, there remains potential prepayment risk. Investors generally receive principal plus interest payments, but, in cases of early prepayment, would only receive payments at par unless there are prepayment penalties associated with the loan. Since these loans have near-zero default rates, the risk associated with early prepayment is in line with typical multifamily loans with much less credit risk. [22]

Conclusion

Our review of the Section 538 program demonstrates that the program supports some of the markets that are in greatest need of affordable rental housing across the country. The program aids in both the renovation and construction of properties, provides liquidity where needed and ultimately increases support for rural areas.

The benefits of the guarantee are clear: It maximizes loan proceeds for borrowers, facilitates access to the capital markets through Ginnie Mae and allows lenders to provide liquidity to rural markets at highly attractive mortgage rates. The impact of the program can be significant, but its scale is tied to the annual appropriations process, which has continued to increase over time – reflecting positive market demand for the guarantee. The network of experienced lenders, in combination with Ginnie Mae, have established an efficient primary and secondary market for the securitization of these loans. The combination of the 538 guarantee with federal, state, or local subsidies allows for more efficient financing for the preservation or construction of affordable multifamily housing in rural areas that have not historically supported affordable multifamily rental housing in a pure market environment.

[22] We've gathered much of this information through conversations with Credit Suisse, an investor in loans backed by the 538 guarantee