FEDERAL RESERVE BANK OF SAN FRANCISCO

Community Investments Vol. 15, Issue 2 Ginnie Mae Project Loans Maintain Affordability

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Introduction

Multifamily mortgage-backed securities issued by Ginnie Mae offer investors the opportunity to purchase AAA-rated securities that provide prepayment protection in times of falling interest rates. Because many of these securities finance affordable rental housing for low-and moderate-income families or nursing homes for low-income patients, banks can garner positive consideration under the Community Reinvestment Act (CRA).

Ginnie Mae project loans are one of the most prevalent affordable multifamily mortgage-backed securities (MBS) available in the primary and secondary market. In fiscal year 2002, HUD provided approval to insure 1,104 properties totaling 146,991 units and amounting to almost $6.5 billion in mortgages. Ginnie Mae issues typically finance Section 8 rental housing, Low Income Housing Tax Credit (LIHTC) projects, or Medicaid-assisted nursing homes.

Ginnie Mae Project Loans

Ginnie Mae project loans are backed by a pool of one or more mortgage loans. Each multifamily mortgage is secured by a completed project, insured by the Federal Housing Administration (FHA) and administered by the Department of Housing and Urban Development (HUD). Mortgage insurance covers the lender if the borrower defaults on the insured loan. Ginnie Mae multifamily mortgage-backed securities increase the supply of mortgage credit available for housing by channeling funds from the capital markets into the mortgage market. Ginnie Mae guarantees the timely payment of principal and interest on the securities because the securities are full faith and credit obligations of the U.S. Government that carry 0% risk-based capital weightings.

Program Descriptions - Rental Housing

Ginnie Mae multifamily mortgage loans are insured under various programs.

Sections 221(d)(3) and 221(d)(4) insure mortgage loans to facilitate the new construction or substantial rehabilitation of multifamily rental or cooperative housing for moderate-income families, the elderly, and the handicapped-often projects using LIHTCs. Section 221(d)(3) is used by nonprofit sponsors and Section 221(d)(4) is used by for-profit sponsors. In fiscal year 2002, under the 221(d)(3) and 221(d)(4) programs, HUD insured mortgages for 207 projects totaling $2.5 billion.

Section 220 insures loans for multifamily housing projects located in urban renewal areas and other areas where local governments have undertaken designated revitalization activities. Because of the termination of urban renewal and the general decline in the number of revitalization areas, the Section 220 program is used much less than the basic multifamily new construction and substantial rehabilitation program {i.e. Section 221(d)(3) and (4)}. In fiscal year 2002, only five Section 220 projects totaling $76.9 million were insured.

Risk-sharing Program allows qualified state and local housing finance agencies to originate and underwrite affordable housing loans using municipal bond funds. The program provides full FHA mortgage insurance to enhance the HFA bonds to investment grade.

Section 232 insures mortgage loans to facilitate the construction and substantial rehabilitation of nursing homes, intermediate care facilities, and assisted living facilities. Section 232/223(f) allows for the purchase or refinancing with or without repairs of existing facilities not requiring substantial rehabilitation. Nursing homes and assisted living facilities that have a large percentage of patients receiving Medicaid assistance may be considered as community development activities for the purpose of CRA. Clarifying documentation for the CRA regulation extends community development beyond housing and small business to include health facilities, or social services targeted to low- or moderate-income persons.

Section 223(f) allows loans for refinance or purchase of existing apartments, both conventionally financed and FHA insured. No 232 health care facilities are included. Section **223(a)(7)** allows existing apartments already FHA insured to be refinanced. Of the 363 **223(a)(7)** loans closed during fiscal year 2002, 232 (64%) were OMHAR transactions.

OMHAR: Mark-to-Market Program

The Office of Multifamily Housing Assistance Restructuring (OMHAR) was established by the Multifamily Assisted Housing Reform and Affordability Act of 1997 (MAHRA) to administer the Mark-to-Market (M2M) program. OMHAR works with property owners, participating administrative entities, tenants, lenders, and others with a stake in the future of affordable housing. The M2M program was created to reduce above market Section 8 rent payments on thousands of privately owned, federally subsidized rental units to rates more in line with prevailing market rents, while preserving a critical part of the nation's affordable housing stock.

Under M2M debt restructurings, owners of subsidized properties refinance part of their mortgage balance at lower interest rates and with deferred payments. This enables owners to continue to provide affordable housing even after HUD's Section 8 subsidies are reduced. In conjunction with the

M2M refinance, the Section 8 rents will be reduced to HUD fair market rents, and will remain on the project for the term of the loan. The debt restructuring plan also requires that the project remain affordable for at least 30 years. Ginnie Mae and OMHAR developed a security that enables Ginnie Mae to securitize loans originated under the M2M program. This security increases the liquidity of investment capital available to the multifamily mortgage finance market.

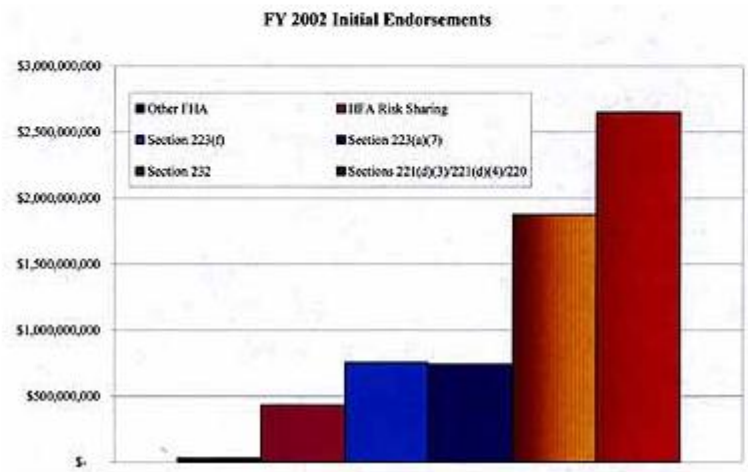
Prepayment Protection

Multifamily mortgage-backed securities often offer investors more prepayment certainty than MBS backed by single-family loans. Typically, multifamily MBS offer prepayment protection either through lock-outs, prepayment penalty periods or yield maintenance periods. During a lock-out period, the borrower is prohibited from voluntarily prepaying the underlying mortgage. With Ginnie Mae project loans, it is common for a security to carry either a ten-year lock-out period, or five years of lock-out protection coupled with declining prepayment penalties. Typically, the prepayment penalties start at five percent of the outstanding principal balance and decline one percent each year.

Given the current historically low interest rates, multifamily MBS provide investors with varying levels of prepayment protection. However, as interest rates increase, investors should understand that these securities could trade to their stated final maturities, instead of to the end of their lock-out or prepayment penalty periods. For Ginnie Mae projects loans which commonly have 30- to 40-year state final maturities, this could result in extending the securities duration by 20 years.

Market Availability

Ginnie Mae project loans are liquid, fixed income securities. Investors may purchase new issue securities in to-be-announced (TBA) form for forward settlement, usually 30 to 60 days from purchase. Currently, the CRA suitability of specific issues coupled with their favorable prepayment characteristic have increased the demand for Ginnie Mae project loans.



[1] Federal Financial Institutions Examination Council
Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestments; Notice, Thursday, July 12, 2001, §§ _____.12(h)-563e.12(g)-1