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The Countercyclical Nature of the Federal Housing Administration in Multifamily Finance

Samuel D. Young
Erin K. Browne
Patricia C. Moroz
U.S. Department of Housing and Urban Development

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Abstract

Since the mortgage crisis of 2007–2008 and the resulting Great Recession, recognition has been growing of the importance of the Federal Housing Administration's (FHA) countercyclical role in supporting the nation's home mortgage lending market. Although much of the focus of this countercyclical role has been on FHA single-family mortgage insurance, this article examines the similar role that FHA plays for multifamily housing finance. Specifically, we examine FHA multifamily lending during the Great Recession. The paper begins with a high-level overview of the role FHA plays in multifamily financing and how an FHA-insured mortgage differs from conventional multifamily financing and multifamily mortgages insured by the government-sponsored enterprises, Fannie Mae and Freddie Mac. To provide real-world examples, we present two case studies: (1) the role FHA played in energy-affected markets during the oil price boom and bust in North Dakota and (2) an FHA-insured property under the Section 220 program in St. Louis that revitalized investment in the surrounding neighborhood. The report concludes with a discussion of FHA's current place in the multifamily financing space and looks forward to where it might be headed.

FHA Multifamily Finance

Overview

Multifamily housing is a vital component of the real estate market, as approximately 27 percent of U.S. households reside in multifamily housing. In fiscal year 2019, the Federal Housing Administration (FHA) had an insured portfolio of more than 11,500 loans with a total unpaid principal balance of $98.7 billion; it is still dwarfed, however, by the FHA single-family insurance portfolio, which totaled $1.3 trillion.

Since the mortgage crisis of 2007–2008 and the resulting Great Recession, recognition has been growing of the importance of the FHA's countercyclical role in supporting the nation's home mortgage lending market. Although much of the focus of this countercyclical role has been on FHA single-family mortgage insurance, this paper examines the similar role that FHA plays for multifamily housing finance. Specifically, we examine FHA multifamily lending during the Great Recession. This report begins with a high-level overview of the role FHA plays in multifamily financing and how an FHA-insured mortgage differs from conventional multifamily financing and multifamily mortgages insured by the government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac. To provide real-world examples, we present two case studies: (1) the role FHA played in energy-affected markets during the oil price boom and bust in North Dakota and (2) an FHA-insured property under the Section 220 program in St. Louis that revitalized investment in the surrounding neighborhood. The report concludes with a discussion of FHA's current place in the multifamily financing space and looks forward to where it might be headed.[1]

FHA: Historical Background

The Federal Housing Administration (FHA) was established in 1934 as a response to the Great Depression to help strengthen the housing market. The National Housing Act of 1934 created FHA and included two programs, Section 203 and Section 207. Section 203 insured lenders against losses on single-family homes, and Section 207 provided insurance on large-scale rental projects for low-income individuals, both for a fee or premium charge. Initially, FHA's Section 207 mortgages were not popular with builders because the large, amortizing mortgages on multifamily projects were new (Glick, 2016).

The single-family amortizing loan was commonplace, but those types of loans for multifamily housing were not. FHA attempted to encourage Section 207 borrowing by offering Large Scale Housing Bonds, which had a single Section 207 project as collateral. These federally issued government bonds were the first step toward collateralized mortgage-backed securities and were

[1] For examples of the recognition of FHA's countercyclical role, see the following:
Szymanoski, Edward, et al. 2012. The FHA Single-Family Insurance Program: Performing a Needed Role in the Housing Finance Market. Working paper series (December). HUD Housing Finance. https://www.huduser.gov/portal//publications/pdf/FHA_SingleFamilyIns.pdf.
Quercia, Roberto G., and Kevin A. Park. 2012. "Sustaining and Expanding the Market: The Public Purpose of the Federal Housing Administration," UNC Center for Community Capital University of North Carolina at Chapel Hill (December). https://communitycapital.unc.edu/files/2012/12/FHASustainingAndExpandingMarket.pdf.
Passmore, Wayne, and Shane Sherlund. 2018. "The FHA and the GSEs as Countercyclical Tools in the Mortgage Markets," Economic Policy Review 24 (3). https://www.newyorkfed.org/research/epr/2018/epr_2018_fha-and-gses_passmore.

offered for FHA rental programs, not single-family housing. To further encourage the purchase of these Section 207 bonds, FHA allowed commercial banks to hold Section 207 bonds and not to classify them as investment securities, exempting these bonds from restrictions under the Glass-Steagall Act of 1933. The government, however, continued to have difficulty placing the bonds and raising financing for low-income rental housing (synonymous with multifamily housing at the time) even through the national mortgage associations the 1934 National Housing Act created. Consequently, the government created its own, the Federal National Mortgage Association (FNMA), which later became known by its nickname, Fannie Mae. According to Jesse Jones, chairman of the Reconstruction Finance Corporation, which created FNMA, Fannie Mae was primarily intended to provide money for private enterprise, which planned large-scale housing projects (Federal Home Loan Bank Board, 1938).

Further innovation of multifamily finance occurred in the years that followed, as new program authorities were added in subsequent legislation. In 1938, Congress created Section 210 to insure advances (that is, construction loans) of multifamily units, instead of just insuring mortgages for the finished product. The same year, FHA also created Section 608, which insured loans for multifamily veterans' housing. In December 1946, President Truman issued a statement to "increase the proportion of rental units" and, in addition, authorized the issuance of $1 billion in FHA mortgage insurance to "be used primarily for rental housing" (Truman, 1946). Partly as a result, the number of multifamily units insured by FHA jumped from 45,571 during 1940–1944 to 265,213 during 1945–1949, and valuation increased from $188,466,000 to $2,022,878,000 (exhibit 1). In 1948, Congress passed Title VII of the National Housing Act to guarantee the interest for mortgages of rental housing, and in 1949, Section 803 was added to insure mortgages on rental housing for active-duty military personnel. In 1950, financing for cooperatives was added through Section 213, and in 1954, Sections 220 and 221 were added to provide rental housing in urban renewal districts. The Housing Act of 1956 added FHA insurance for rental housing targeted to individuals aged 60 and older, and in 1961, Section 239 was added to insure loans for condominium development. All those programs boosted FHA's involvement in multifamily finance. "From 1934 to 1958, the FHA insured…39.7 percent of all multifamily construction. In the postwar years…the agency insured well over 70 percent of the multifamily market" (Glick, 2016).

Exhibit 1

Multifamily Housing Mortgages Insured by Federal Housing Administration, 1935–1979 (dollar amounts in thousands) (1 of 2)

Year	Grand Total	
	Units	Amount
1935-39	29,777	114,429
1940-44	45,751	188,446
1945-49	265,213	2,022,878
1950-54	327,601	2,555,582
1955-59	172,946	2,387,437

Exhibit 1

Multifamily Housing Mortgages Insured by FHA, 1935–1979 (dollar amounts in thousands) (2 of 2)

Year	Grand Total	
	Units	Amount
1960-64	279,350	4,491,855
1965-69	268,290	4,270,387
1970	200,660	3,256,795
1971	222,685	3,983,829
1972	188,224	3,447,750
1973	120,414	2,286,175
1974	54,820	1,213,460
1975	38,044	976,252
1976	78,292	2,314,957
1977	109,882	2,817,762
1978	121,712	3,270,380
1979	95,154	2,727,723
Total	**2,615,448**	**42,406,103**

Source: U.S. Department of Housing and Urban Development (1979)

In the third quarter of 2019, multifamily residential mortgage assets totaled $166.2 billion, with $52.9 billion held by GSEs (Board of Governors of the Federal Reserve System [U.S.], 2020a, Table F.219). By comparison, single-family, one- to four-family residential mortgages totaled $335.8 billion during the third quarter of 2019, of which $213.5 billion in assets were held by GSEs (Board of Governors of the Federal Reserve System [U.S.], 2020a, Table F.218). Multifamily mortgage loans are still viewed by some people as riskier than single-family mortgages because multifamily property values, vacancy rates, and rents are more closely correlated to local economic conditions. Consequently, multifamily loan performance may be more sensitive to economic conditions than the single-family mortgage market (HUD's Regulation, 2000). GSEs have a larger presence in much of the single-family mortgage market, compared with the multifamily market, as highlighted in the preceding data.

How FHA Works

FHA provides mortgage insurance on loans made by FHA-approved lenders and insures loans made for single-family homes, multifamily properties, residential care facilities, and hospitals. The mortgage insurance protects lenders against the default of a property owner, and FHA will pay the unpaid balance of the loan to the lender of a defaulted mortgage. Borrowers pay mortgage insurance premiums to FHA, and those premiums provide income to the mortgage insurance fund.

FHA mortgage insurance allows lenders to carry less risk, and consequently, loan terms are generally attractive. Most multifamily FHA loans have a 40-year amortization term, a fixed interest rate, and are nonrecourse, which means that if the borrower defaults, his or her personal assets are not at risk. In addition, borrowers can lower their mortgage insurance premium (MIP) costs by meeting certain LEED[2] standards; however, FHA multifamily financing has offsetting challenges. The underwriting process is generally slower than conventional financing, and borrowers generally must meet Davis-Bacon wage requirements,[3] which can raise overall construction costs. Despite those challenges, the multifamily FHA mortgage insurance program is attractive to many developers.

Once an FHA-insured multifamily loan closes, the lender sells the loan in the secondary market, where it may be bundled with other loans into a mortgage-backed security (MBS), a process similar to the single-family mortgage market. The Government National Mortgage Association, known as Ginnie Mae, is the primary guarantor for FHA-insured multifamily loans packaged into MBS. During the mid-1990s, the share of multifamily mortgage debt guaranteed by Ginnie Mae increased slightly, from 3.8 percent in 1995 to 4.1 percent in 1997 (Bradley, Nothaft, and Freund, 1998). At the time, Segal and Szymanoski (1997) found that—

> Compared to single-family loans, multifamily loans confound[ed] investors with greater cash flow uncertainty and, hence, greater risk. Specific difficulties include the following: (1) the loans are often not homogeneous with regard to type of collateral, interest rate, amortization, covenants, subordinated financing layers, etc.; (2) underwriting standards often differ among originators; (3) loans are relatively large and therefore a single defaulted loan can constitute a relatively large fraction of a mortgage pool; (4) there is a lack of available information about the historical performance of similar loans; and (5) financial information about borrowers is sometimes unaudited or not prepared carefully. (p. 23)

As a result, FHA's role in multifamily lending was muted for some time. In 1973, a general moratorium was placed on HUD assistance programs by the Nixon Administration because of increasing budgetary outlays and perceived program management issues. Subsequently, Congress responded with sweeping legislation in 1974, which included the Multifamily Coinsurance Program, to correct some of the deficiencies. That program, however, had some very problematic aspects, leading to losses of approximately $10 billion. "Most observers agree that by the early 1990s, FHA had ceased to be an important player in the multifamily mortgage market" (Schnare, 2001: 12).

Following those challenges, the role of FHA in multifamily finance has surged in more recent years, particularly since the mortgage collapse in the late 2000s and the subsequent Great Recession. By the fourth quarter of 2019, the FHA multifamily portfolio had approximately 11,800 active loans,

[2] Leadership in Energy and Environmental Design (LEED) is the most widely used green building rating system in the world (see usgbc.org/help/what-leed).

[3] Davis-Bacon requirements ensure prevailing wage rates are paid for federal jobs. Davis-Bacon wage rates apply because of labor provisions in HUD's "Related Acts", such as the U.S. Housing Act of 1937, the National Housing Act, the Housing and Community Development Act of 1974, the National Affordable Housing Act of 1990, and the Native American Housing Assistance and Self-Determination Act of 1996. The Related Acts are often referred to as the Davis-Bacon and Related Acts or DBRA." This information can be found at: https://www.hud.gov/sites/documents/4812-LRGUIDE.PDF, on page 1-1.

with an unpaid principal balance of $104.6 billion—increases of 24 and 176 percent, respectively, since the end of the Great Recession. FHA multifamily insurance is used in a wide range of rental markets throughout the nation; however, the majority of units in properties with an initial endorsement in the past several years have been in Core Based Statistical Areas (CBSAs) with large populations. CBSAs with a population greater than two million accounted for 53 percent of all units with an initial endorsement date from 2015 through 2019; this proportion increases to 55 percent of units endorsed under the 221(d)(4) new construction/substantial rehabilitation program (HUD, 2020a). Nationwide, the most popular FHA multifamily programs during the period were 223(f) refinance/purchase apartments (representing 46 percent of all units), followed by 221(d)(4) new construction/substantial rehabilitation apartments (representing 20 percent of all units).

How FHA Differs from Fannie Mae and Freddie Mac

The primary difference between FHA and Fannie Mae and Freddie Mac is that FHA provides mortgage insurance for single-family and multifamily loans made by approved lenders, whereas Fannie Mae and Freddie Mac are more directly involved in multifamily finance, primarily by buying multifamily loans and packaging and selling those loans in MBSs.

In 1970, Fannie Mae and Freddie Mac began selling MBSs made up of FHA multifamily loans (Schnare, 2001). Fannie Mae and Freddie Mac had relatively limited roles in multifamily finance, with a combined market share of 5 percent of all outstanding multifamily debt in 1980, before slowly rising to about 9 percent by 1990. "Large losses in Freddie Mac's portfolio—triggered by poor underwriting standards and a soft multifamily market—led that company to suspend its multifamily operations between 1990 and 1993, creating a drag on agency growth" (Schnare, 2001: 11). Since that time, Freddie Mac has reentered the multifamily market, and both GSEs have continued to grow, rising to nearly 32 percent of all multifamily residential mortgage debt in 2019 (Board of Governors of the Federal Reserve System [U.S.], 2020a, F.219).

Fannie Mae

Fannie Mae is the largest guarantor of multifamily loans in the United States (Fannie Mae, 2020a: F219). It provides the market with liquidity by purchasing loans for multifamily properties, such as apartment properties, condominiums, or cooperatives with five or more individual units. As described by Segal and Szymanoski (1997)—

> Fannie Mae's basic multifamily operation consists primarily of (1) the Delegated Underwriting and Servicing (DUS) and Prior Approval programs; (2) negotiated transactions involving the purchase of existing portfolios through MBS swaps and certain REMIC [real estate mortgage investment conduit] executions; and (3) multifamily public finance activity, involving credit enhancement of housing bonds. (p. 44)

Fannie Mae uses the DUS program to work with a national network of participating lender customers, which allows lenders to share in the risk of the loans they sell to Fannie Mae (Fannie Mae, 2020b). Lenders can transfer their multifamily loans to Fannie Mae in one of two ways: (1)

sell the loan to Fannie Mae for cash or (2) take part in a swap transaction, in which the mortgage originator or note holder receives a Fannie Mae single-class MBS instead of cash. When a lender sells a loan for cash, it can use the proceeds to fund new lending activity. On the other hand, a lender may hold a swapped MBS and retain a portion of the interest payment as a fee, or the lender can sell the MBS to investors.

Freddie Mac

Freddie Mac's stated mission is to "provide liquidity, stability, and affordability to the U.S. housing market" (Freddie Mac, 2020a). Similar to Fannie Mae, Freddie Mac also purchases and securitizes loans. Both GSEs do not lend directly to borrowers but operate in the secondary market. Before 2009, Freddie Mac primarily held the mortgages it purchased, but it slowly began shifting to securitization. Today, about 90 percent of Freddie Mac's purchase volume is securitized, which shifts the loans off Freddie Mac's balance sheet and transfers the risk to MBS investors.

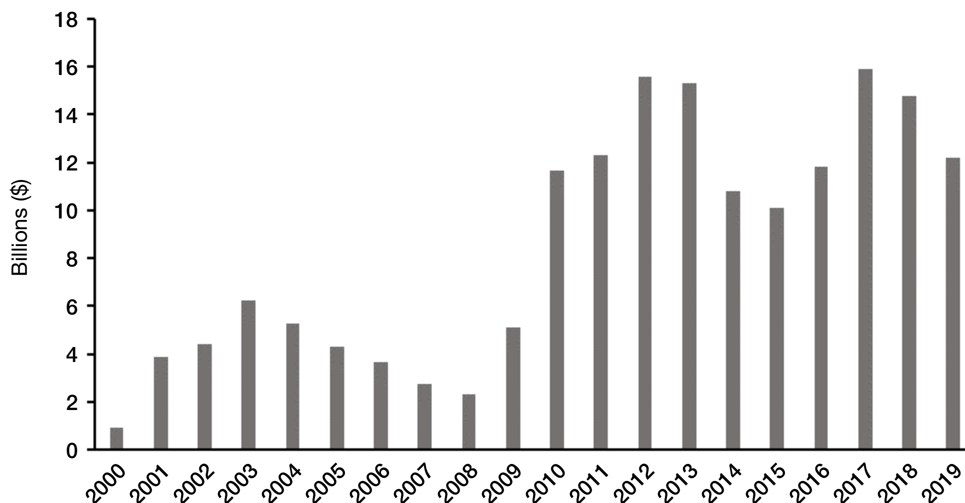
Freddie Mac's presence in the multifamily market is not as large as that of Fannie Mae. During the first quarter of 2020, Freddie Mac generated $10.0 billion in new multifamily activity, financing approximately 111,000 units (Freddie Mac, 2020b). By comparison, Fannie Mae "provided $14.1 billion in multifamily financing in the first quarter of 2020, which enabled the financing of 159,000 units of multifamily housing" (Fannie Mae, 2020a: 1).

Countercyclical Trends in FHA Multifamily Finance

The use of FHA in the multifamily finance industry is cyclical, with FHA being a more popular vehicle for multifamily finance when other financing options are limited. Typically, this occurs when lending becomes riskier, such as during recessionary periods, when housing demand tends to contract. A prime example of this at the national level was brought on by the Great Recession (December 2007 through June 2009), when the housing market collapsed and lending standards became extremely tight. During the third quarter of 2007, just before the Great Recession began, the net percentage of domestic banks tightening standards for commercial and industrial loans to large- and middle-market firms started to increase, with the percentage peaking at 83.6 percent in the fourth quarter of 2008 (Board of Governors of the Federal Reserve System [U.S.], 2020b). This measure of lending standard includes loans for multifamily residences, which fall into the commercial loan category because they are issued to businesses, not consumers, as loans for single-family residences are. As lending standards for commercial loans remained tight, the less risky nature of FHA loans became more desirable and the value of initial endorsements for multifamily residences insured by FHA skyrocketed—doubling in 2009 from the previous year and doubling again in 2010, as shown in exhibit 2.

Exhibit 2

Federal Housing Administration Multifamily Initial Endorsement Value by Year



Source: Federal Housing Administration Office of Deputy Assistant Secretary for Risk Management & Regulatory Affairs

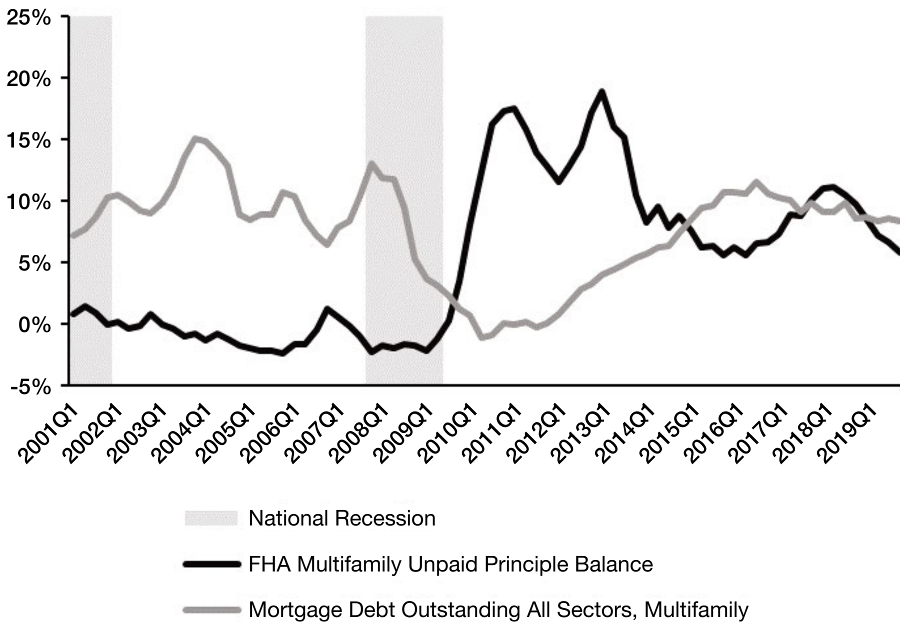
Although the Great Recession is well known for its effect on the home sales market in the form of home equity loss and a surge in foreclosures, the rental market was also negatively affected. Competition from single-family rentals and households doubling up pushed the apartment vacancy rate from 5.8 percent in the fourth quarter of 2006 to 7.8 percent in the fourth quarter of 2009, as the rental market softened (Axiometrics, a Real Page Company, 2020). Because the national rental market was soft during the recession, fewer apartments were built, and growth in mortgage debt outstanding for all multifamily sectors slowed precipitously; that growth slowed to an average annual rate of 4 percent—down from an average annual rate of 14 percent from 2001 through the third quarter of 2007. The unpaid principal balance for the FHA multifamily portfolio fared even worse than the industry as a whole, declining by an average annual rate of 2 percent during the recession, compared with an average annual decline of 1 percent from 2001 through the third quarter of 2007.

Although the United States exited the Great Recession in July 2009, the damaging effects of the housing market collapse lasted beyond that date, and lending standards, although relaxed somewhat, remained tight for several years. The rental market recovered before the home sales market, with the apartment vacancy rate beginning a downward trend in 2010. This period marked the beginning of the countercyclical rise in FHA multifamily lending, as the U.S. economy was still reeling from the Great Recession. The holdover of tight lending standards, combined with an improved rental market, contributed to a rapid rise in FHA multifamily lending, while industry-level measures of lending declined. In the second and third quarters of 2010, the mortgage debt outstanding for all multifamily sectors declined for the first time since 1995. By contrast, the unpaid principal balance of the FHA multifamily portfolio increased rapidly, filling the need for

multifamily financing when industry lending cut back. Exhibit 3 shows the countercyclical trends in year-over-year growth for both the mortgage debt outstanding for all multifamily sectors and the unpaid principal balance of the FHA multifamily portfolio that occurred in the years following the Great Recession. As shown, a strong countercyclical pattern emerged in the unpaid principal balance of the FHA multifamily portfolio in the period after the Great Recession officially ended. From the fourth quarter of 2009 through the fourth quarter of 2011, the average annual rate of change in mortgage debt outstanding for all multifamily sectors was zero, whereas the unpaid principal balance for the FHA multifamily portfolio increased at an average annual rate of 16 percent. During that time, the number of active FHA multifamily loans increased by 666, and the unpaid principal balance increased by $13.7 billion.

Exhibit 3

Year-over-Year Percentage Change in FHA Multifamily Unpaid Principal Balance and Mortgage Debt Outstanding All Sectors, Multifamily



FHA = Federal Housing Administration. Q = Quarter.
Sources: National Bureau of Economic Research; FHA; Board of Governors of the Federal Reserve System (U.S.), 2020a

Regional Trends

The use of FHA to finance multifamily rental housing varies by HUD region, but the change in the value of FHA multifamily endorsements since 2000 has been spread proportionally across the regions (see exhibit 4). In 2019, the share of initial endorsements for multifamily residences insured by FHA was highest in the Southeast/Caribbean region, with 22.5 percent, followed closely by the Southwest region, with 18.5 percent. The regions accounting for the lowest share of initial endorsements for multifamily residences insured by FHA in 2019 were the Great Plains, at 2.0

percent, and the Northwest, at 4.0 percent. The aforementioned regions have generally remained in the top and bottom rankings for FHA multifamily endorsements since 2000.

Exhibit 4

Notes on Geography	
1.	Guam, Puerto Rico, and the U.S. Virgin Islands are served by HUD programs but are not included in this analysis due to data limitations.
2.	HUD is organized into 10 regions [% of U.S. population, 2019 Census population estimates]:
	New England (Region I) [4.5%]: Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont New York/New Jersey (Region II) [8.5%]: New York, New Jersey Mid-Atlantic (Region III) [9.3%]: Delaware, Maryland, Pennsylvania, Virginia, Washington, D.C., West Virginia Southeast/Caribbean (Region IV) [21.2%]: Alabama, Florida, Georgia, Kentucky, Mississippi, North Carolina, Puerto Rico, South Carolina, Tennessee, U.S. Virgin Islands Midwest (Region V) [15.9%]: Illinois, Indiana, Michigan, Minnesota, Ohio, Wisconsin Southwest (Region VI) [12.9%]: Arkansas, Louisiana, New Mexico, Oklahoma, Texas Great Plains (Region VII) [4.3%]: Iowa, Kansas, Missouri, Nebraska Rocky Mountain (Region VIII) [3.7%]: Colorado, Montana, North Dakota, South Dakota, Utah, Wyoming Pacific (Region IX) [15.5%]: Arizona, California, Hawaii, Nevada Northwest (Region X) [4.3%]: Alaska, Idaho, Oregon, Washington

Note: Numbers may not add to 100 percent due to rounding.

In the years after the Great Recession, when endorsements for FHA multifamily properties were increasing rapidly, the number of units endorsed under the 221(d)(4) program that were new construction or substantial rehabilitation accounted for a growing proportion of multifamily construction in every region of the United States. In 2010, all but one region surpassed the average 2000–2019 ratio of new construction and substantially rehabilitated FHA multifamily units endorsed to multifamily units permitted. The highest proportion during that period was in the Mid-Atlantic region, where, in 2010, the ratio of new construction and substantially rehabilitated units insured by FHA to the number of multifamily units permitted was 51.0 percent. That ratio in the Mid-Atlantic region was only 5.5 percent in 2007. Other regions, where the ratio of new construction and substantially rehabilitated units insured by FHA to the number of multifamily units permitted was more than 30.0 percent in 2010, were the Southeast/Caribbean, Midwest, and Southwest regions. The respective shares for those three regions in 2007 were all less than 10.0 percent.

Regional Mini-Cycles and Case Studies

Two of the benefits of FHA multifamily insurance are that the insured loans have 40-year amortization and fixed interest rates and that they are nonrecourse. Those generous terms allow borrowers expense stability and afford HUD the ability to assume ownership of a multifamily asset in the event of a default. HUD generally sells the foreclosed asset to recoup losses and maintain solvency of the mortgage insurance fund. Those long-range loan terms potentially increase risk for FHA multifamily mortgage insurance proposals.

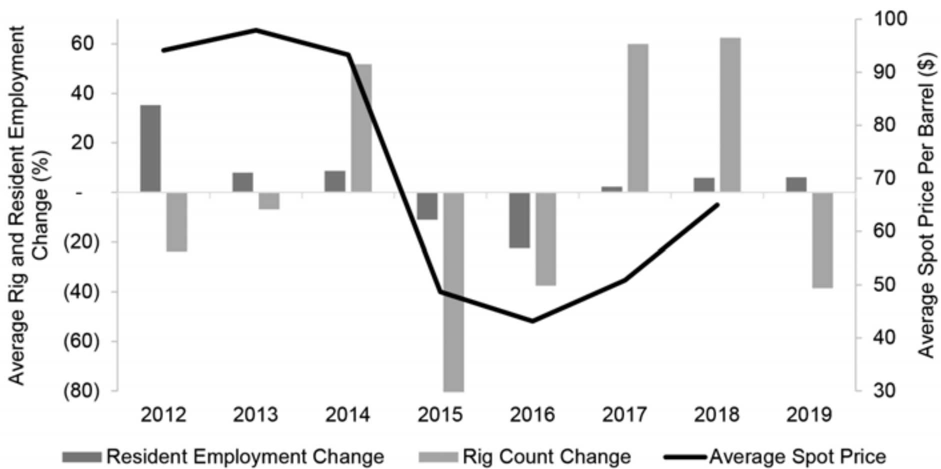
Case Study 1: Energy-Affected Markets

Multifamily developers are often interested in areas that experience sharp economic and population growth, such as energy-affected regions in Texas and North Dakota when energy prices were high. Energy development from hydraulic fracturing and directional drilling, funded by high energy prices, led to a boom in shale oil development in parts of the United States. From 2000 through 2005, oil spot prices averaged $35.24 a barrel annually before rising an average of 21 percent a year to an annual average of $91.91 a barrel from 2010 through 2014 (U.S. Energy Information Administration, 2020). The higher prices made shale oil reserves in the United States attractive for development, and energy companies flocked to areas such as North Dakota and Texas. Both states were most affected by upstream activities, which are characterized by recovering and producing crude oil and gas, including exploring for oil and gas, drilling wells, and operating the wells to deliver crude oil and natural gas to refining or distribution facilities.

The recovery and production of oil led to a sharp increase in the number of oil rigs and increased demand for energy-sector workers (see exhibits 5 and 6). According to the U.S. Bureau of Labor Statistics (2020), an average of 123,300 people were employed in the upstream oil and gas extraction sector from 2000 through 2005; that number increased 8.1 percent, annually, to an average of 181,900 from 2010 through 2014. During that period, the number of people employed in support activities for oil and gas operations rose 16.7 percent annually, from 124,800 to 270,300.

Exhibit 5

Crude Oil Spot Prices and Changes in Employment and Oil Rigs in Williams County, North Dakota

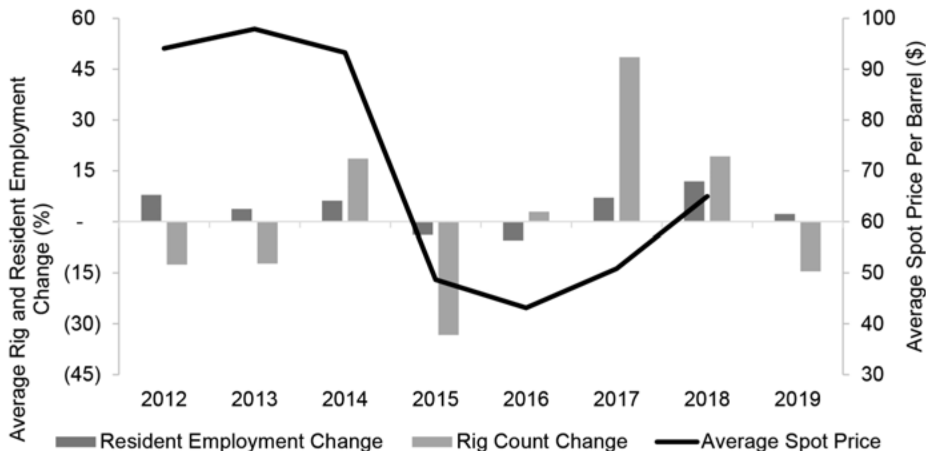


Notes: Resident employment based on 12-month averages. The Crude Oil Average Spot Price Per Barrel is based on the West Texas Intermediate (WTI) Cushing, Oklahoma price. Rig Counts are based on wells with a depth of 15,000 feet or less.

Sources: U.S. Bureau of Labor Statistics, 2020; U.S. Energy Information Administration Spot Prices for Crude Oil and Petroleum Products, 2020; Region Track Rig Count Web App 2020

Exhibit 6

Crude Oil Spot Prices and Changes in Employment and Oil Rigs in Midland Area, Texas



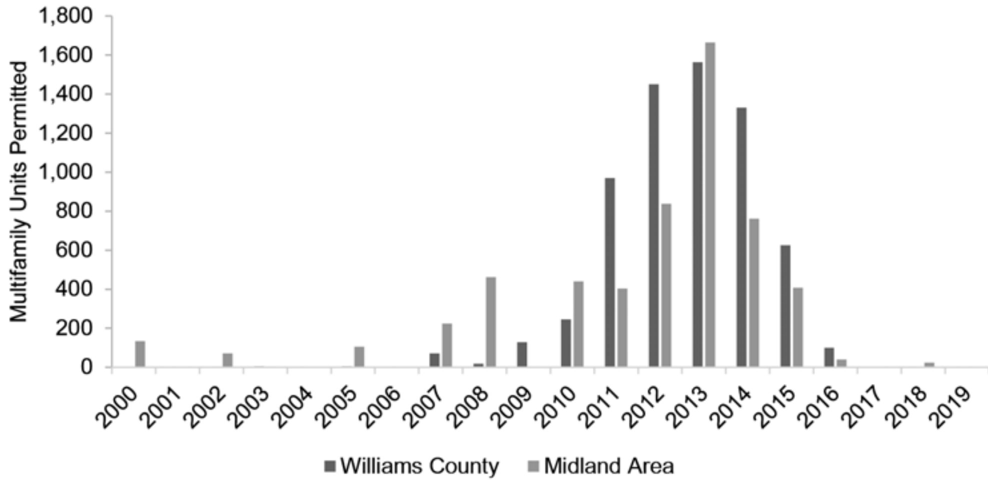
Notes: Resident employment based on 12-month averages. The Crude Oil Average Spot Price Per Barrel is based on the West Texas Intermediate (WTI) Cushing, Oklahoma price. Rig Counts are based on wells with a depth of 15,000 feet or less.

Sources: U.S. Bureau of Labor Statistics, 2020; U.S. Energy Information Administration Spot Prices for Crude Oil and Petroleum Products, 2020; Region Track Rig Count Web App, 2020

The rapid rise in employment and the surge in workers to these areas led to a sharp increase in demand for housing. Some of the demand was met by man camps and other temporary housing solutions; however, multifamily developers also rushed to fill the demand for rental housing by building new apartment properties. Both Williams County, North Dakota, and Ector and Midland Counties, Texas, (hereafter, the Midland area)—which sit atop the Bakken and Permian oil basins, respectively—underwent significant apartment development. From 2000 through 2005, virtually no new apartment units were permitted in Williams County, and an average of 50 apartments were permitted annually in the Midland area (see exhibit 7). Development activity rose sharply to an average of 1,125 apartments permitted annually in Williams County from 2010 through 2014 and an average of 820 apartments permitted annually in the Midland area. Some developers sought FHA mortgage insurance for their multifamily financing.

Exhibit 7

Multifamily Permits Issued in Williams County, North Dakota and the Midland,Texas, Area



Source: U.S. Department of Housing and Urban Development and U.S. Census Bureau, Building Permits Survey, 2000–2019 final data

Despite the increase in multifamily production in those two areas, FHA's role was limited. The transient nature of upstream oil sector jobs created additional risk when providing nonrecourse mortgage insurance. Consequently, none of the 5,575 apartments permitted in Williams County from 2010 through 2014 were supported by FHA mortgage insurance. During the period, apartment vacancy rates in the area were less than 2 percent, and average rents were more than $2,500 monthly. Following the decline in oil prices beginning in 2015, however, apartment vacancy rates surged to more than 20 percent, and average rents fell to less than $1,500 monthly. In the Midland area, FHA insured three market-rate apartment properties and one Low-Income Housing Tax Credit proposal during the period, with a total of 850 units (HUD, 2020b). The apartment vacancy rate in the Midland area averaged 4.3 percent from 2010 through 2014 before rising sharply to an average of 9.5 percent in 2015 and 2016 (Reis, Inc., 2020). Average asking rents rose from $660 during 2010 to $1,139 in 2014 before falling to $908 in 2016. Since 2016, apartment market conditions in the Midland area have become balanced, with a vacancy rate of 5.5 percent and average asking rents of $1,381. The developments insured by FHA in the Midland area have reached stabilized occupancy, and none are in troubled status (HUD, 2020b). By comparison, apartment market conditions in Williams County are still soft, with a vacancy rate of 8 percent and average asking rents of $1,450 (Greystar Worldwide, LLC, 2019). The limited exposure of the FHA mortgage insurance fund to volatile market conditions in energy-affected areas such as Williams County, North Dakota, and the Midland area of Texas constrained risk and preserved liquidity.

Case Study 2: Section 220 Development in St. Louis

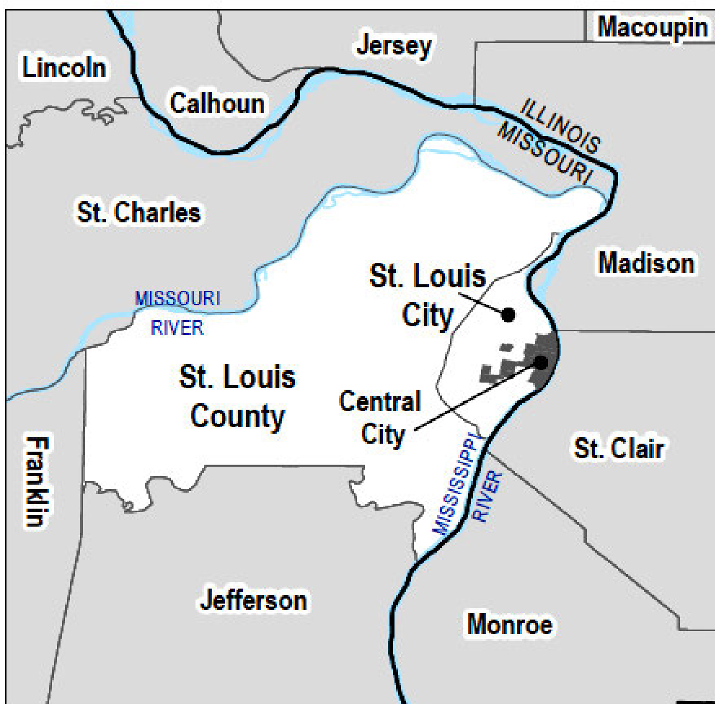
The attractive finance terms of FHA loans can be the catalyst for ongoing investment in an area. For instance, limited development activity in some urban areas can keep an area from growing.

Many developers do not want to be "first money in" and risk building in an untested market. HUD offers Section 220 mortgage insurance, which is designed "for housing in urban renewal areas, areas in which concentrated revitalization or code enforcement activities have been undertaken by local government, or to alter, repair, or improve housing in those areas" (HUD, 2018a).

In the city of St. Louis, the population has been declining overall since 1950. Growth has occurred in the Central City area since 2010,[4] however, because of redevelopment that has drawn young professionals to this concentrated area (HUD, 2018b). Exhibit 8 presents a map that shows the defining borders of the city of St. Louis and the Central City area. HUD's Economic and Market Analysis Division (EMAD) estimated that from 2010 to July 1, 2018, the population of the city of St. Louis decreased by an average of 1,575 people, or 0.5 percent, annually, to 306,300. During the same period, the population of the Central City area increased by an average of 820 people, or 1.8 percent, annually, to 50,225, as of July 1, 2018. As a result of growth in the Central City area, the population loss in the city of St. Louis overall slowed from higher levels during the previous decade, which had averaged 2,900 people, or 0.9 percent, a year from 2000 to 2010.

Exhibit 8

City of St. Louis and Surrounding Area



Source: HUD, Economic Market Analysis Division

[4] The Central City area includes 12 census tracts: 1162.00, 1171.00, 1174.00, 1193.00, 1255.00, 1256.00, 1257.00, 1266.00, 1273.00, 1274.00, 1275.00, and 1276.00.

Assisting state and local government efforts, HUD has contributed to redevelopment in the city of St. Louis by insuring mortgages for market-rate apartments under Sections 220 and 221(d)(4) in and around the Central City area. Exhibit 9 lists FHA-insured apartment properties in and near Central City, St. Louis, and exhibit 10 is a map of those properties. The largest and most prominent development, One Cardinal Way, was insured under Section 220. The 29-story, 297-unit high-rise apartment building overlooks Busch Stadium, home of the St. Louis Cardinals (HUD, 2018b). One Cardinal Way was one of the first properties to test the Central City market., HUD approved the application for One Cardinal Way in 2017, construction began in 2018, and the development was completed in August 2020 (Fannie Mae, 2020a). Similarly, the substantial rehabilitation of 168 units at the Monogram apartments occurred in 2017, when the development received FHA insurance, and was completed in 2018 (HUD, 2020b). Both the Monogram and the 70-unit apartments at 1815 Locust Street, currently in planning, are within approximately 1 mile of the stadium and One Cardinal Way. Development has spread throughout the Central City area, including the planned addition of 131 units at Preservation Square Apartments, located approximately 2 miles from One Cardinal Way (HUD, 2020a). Other apartment construction in St. Louis City, outside the Central City area, includes three additional properties located 5 to 7 miles from One Cardinal Way, with a combined total of approximately 500 units.

Exhibit 9

FHA-Insured Apartments In and Near Central City, St. Louis

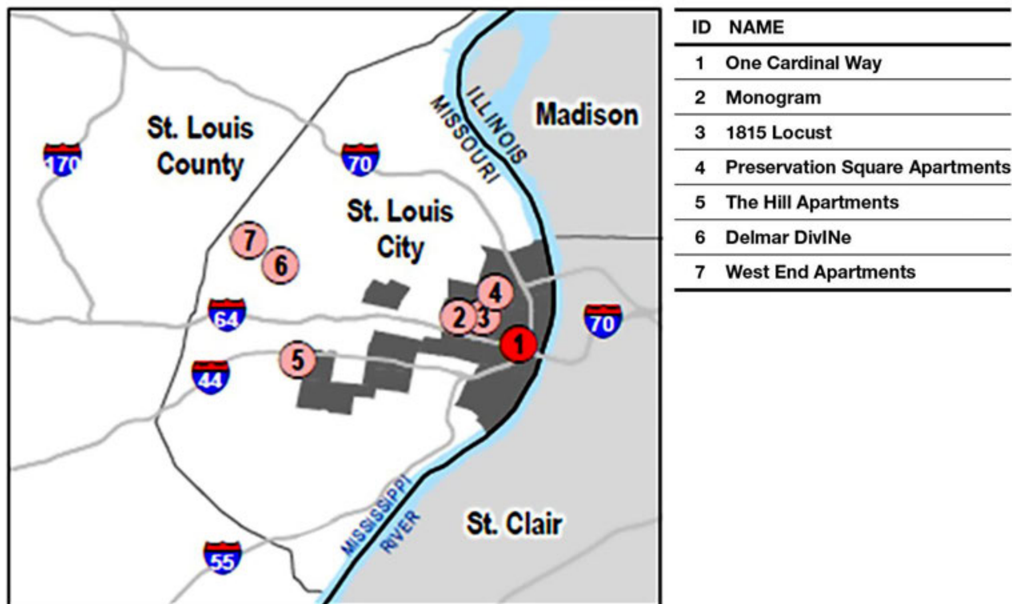
Apartment Property	Location	Total Units	Status (September 2020)	Distance (miles) to One Cardinal Way
One Cardinal Way	Central City	297	Complete	–
The Monogram	Central City	168	Complete	1.3
1815 Locust Street	Central City	70	Planning	1.3
Preservation Square Apts.	Central City	131	Planning	1.9
The Hill Apartments	St. Louis City	225	Planning	5.1
Delmar DivINe	St. Louis City	150	Planning	6.7
West End Apartments	St. Louis City	114	Under Construction	7.3

Note: Central City includes 12 census tracts in the city of St. Louis: 1162.00, 1171.00, 1174.00, 1193.00, 1255.00, 1256.00, 1257.00, 1266.00, 1273.00, 1274.00, 1275.00, and 1276.00.

Sources: Development Application Processing (DAP) System (HUD, 2020a); HUD (2020b)

Exhibit 10

FHA-Insured Developments In and Near the City of St. Louis



ID	NAME
1	One Cardinal Way
2	Monogram
3	1815 Locust
4	Preservation Square Apartments
5	The Hill Apartments
6	Delmar DivINe
7	West End Apartments

Source: Development Application Processing (DAP) System (HUD, 2020a)

Looking Forward

The Mortgage Bankers Association estimates that commercial and multifamily loans backed by income-producing properties are expected to total $683 billion during 2020—up 9 percent from the $628 billion closed during 2019 (Mortgage Bankers Association, 2020). "Total multifamily lending alone, which includes some loans made by small and midsize banks not captured in the overall total, is forecast to rise 9 percent to $395 billion in 2020, surpassing last year's expected record total of $364 billion" (Mortgage Bankers Association, 2020).

Approximately 1.6 million households were formed in the United States during each of the past 2 years. Single-family home permitting averaged 858,100 annually during 2018 and 2019, compared with an average of 1,418,900 annually from 2000 through 2006. By comparison, multifamily home permitting averaged 498,700 units annually during 2018 and 2019—the highest annual number since at least 2000 (HUD and U.S. Census Bureau, Building Permits Survey, 2020). The recent COVID-19 pandemic may temporarily depress household formation, but overall housing production has lagged behind household growth nationally since the Great Recession. This disparity will continue to encourage further housing production, including multifamily construction.

Class C multifamily units "rank as the tightest asset class on a national scale" (Axiometrics, a RealPage Company, 2020). Vacancy rates for Class C units averaged 4.0 percent in April 2020, compared with 5.3 and 4.6 percent, respectively, for Class A and Class B units nationally. From

December 2017 to April 2020, asking rents for Class C units increased 14.4 percent, to $1,149, compared with growth of 9.1 and 11.2 percent for Class A and Class B units, to $1,883 and $1,397, respectively (Axiometrics, a RealPage Company, 2020). Those market dynamics may encourage construction for more affordable Class C developments nationally.

The continued demand for multifamily housing and the record-setting lending environment should support the role of FHA multifamily mortgage insurance in the near future. To ensure that FHA is both meeting the needs of the market and acting responsibly as a public entity, FHA has instituted risk mitigation measures to hedge risk resulting from the uncertainty surrounding the COVID-19 outbreak in the United States. In addition, FHA continues to offer green mortgage insurance premium (MIP) reductions; low, fixed interest rates; and fully amortizing loans. Those incentives will likely ensure that FHA multifamily finance remains a key component of the multifamily financial market.

The countercyclical nature of FHA multifamily finance may become evident again in the near future in response to the economic impact of the COVID-19 pandemic. Whether the pandemic and the resulting economic slowdown have seriously affected trends in conventional financing is not yet clear; however, early indications seem to confirm that developers are now initiating a large number of developments using FHA multifamily financing. During the first quarter of 2020, multifamily residential mortgages fell to $98.3 billion from $102.7 billion during the first quarter of 2019 (Board of Governors of the Federal Reserve System [U.S.], 2020a, F.219). Initial endorsements for new FHA multifamily construction also declined during the period, from $906.4 million to $846.8 million, but rose to $1.21 billion during the second quarter of 2020 from $1.18 billion a year earlier (HUD, 2020c). Future research will confirm whether those data are the beginning of another countercyclical trend in FHA multifamily finance.

Data Limitations

The analysis in this paper presents a comparison of the net change in levels of mortgage debt outstanding for all sectors and the unpaid principal balance for the FHA multifamily portfolio. As such, the FHA data include new products and refinanced mortgages, including those that may not have previously been in the FHA portfolio.

The data presented on multifamily construction are the total number of multifamily units permitted and include apartments, condominiums, and townhomes. At the national level, the vast majority of those units are apartments; however, significant variations exist in the tenure makeup of multifamily units permitted by geography.

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Authors

Samuel D. Young is a Regional Director at the U.S. Department of Housing and Urban Development.

Erin K. Browne is a Senior Economist at the U.S. Department of Housing and Urban Development.

Patricia C. Moroz is a Regional Director at the U.S. Department of Housing and Urban Development.

Correspondence concerning this article should be addressed to Samuel D. Young, U.S. Department of Housing and Urban Development, 77 W. Jackson Boulevard, Chicago, IL 60604.
Email: samuel.d.young@hud.gov.

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