What Just Happened

So much has transpired in recent weeks that it has been enough to give both lenders and borrowers whiplash. Back in June and July, the lending and financial markets were stable. The 10-year Treasury yield appeared to have bottomed out in the low 2.0% range (down significantly from the 3.24% high in November 2018) and interest rate loan spreads held steady, resulting in attractive and predictable all-in interest rates. Many borrowers decided it was a good time to refinance, and lending activity picked up steam. But from early August through mid-September, several unpredictable developments took place, a few of which will likely impact residential and commercial real estate lending for years to come.

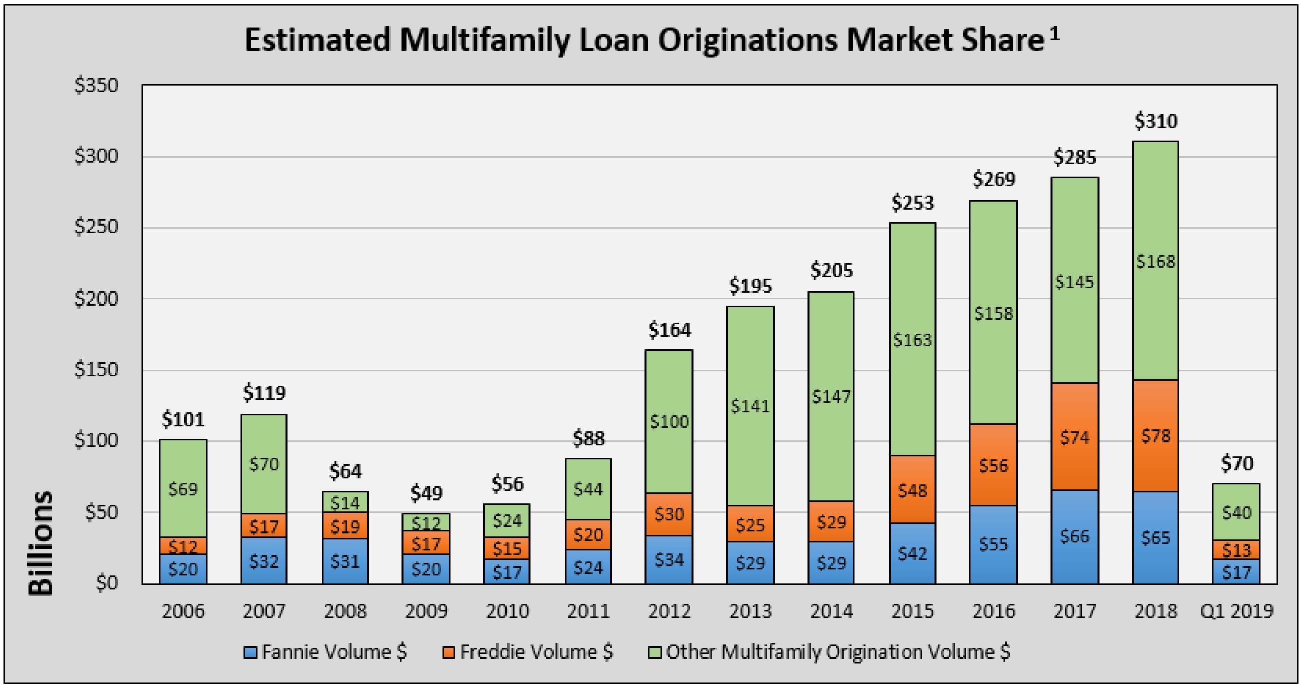
To help us assess where we may be headed, let's first take inventory of the events that took place over a six week period that ended the market's period of calm:

- In early August, tariff tweets and exchanges with China fuel concerns of a recession.
- On August 14th, the yield on the 10-year Treasury fell below that of the 2-year Treasury for the first time since 2007, another potential signal that a recession may be looming.
- The 10-year Treasury yield continues to tumble, and drops below 1.50% by the end of August.
- In response to the drop in Treasury yields and the Federal Housing Finance Agency's (FHFA) concerns over their growing market share, Fannie Mae and Freddie Mac (the Agencies) implement a series of interest rate spread increases in an effort to slow their lending volume.
- On September 5th, the Treasury issues the Housing Reform Plan, which provides a broad outline for long-term restructuring of the Agencies.
- On September 13th, the FHFA releases their Scorecard for the Agencies, which provides much needed clarity for the Agencies by outlining multifamily lending caps and volume targets for the 4th quarter of 2019 through 2020.
- The Federal Reserve on September 18th cut the federal funds rate a quarter percentage point.

The recent volatility of U.S. Treasuries and the unpredictable nature of politics, while disruptive to our business in the short term, may or may not be impactful to lending in the long term. However, the restructuring of the Agencies and the plans coming forward from the new FHFA director stand to be significant events that may shape the cost and availability of capital for multifamily borrowers for quite some time.

One immediate takeaway from the FHFA's Scorecard is that the Agencies are open for business, and we expect interest rates to remain attractive. The FHFA's Scorecard will allow each Agency to lend at an annual rate of $80 billion through 2020, which is similar to their current run rate. Additionally, 37.5% of the Agencies' lending volume is required to be "mission-driven," meaning it will be required to go toward certain affordable housing property types, including Manufactured Home Communities (MHCs). Because of this, it is our expectation that MHCs will continue to receive more favorable interest rate spreads relative to conventional apartments.

When determining the lending caps to be applied to the Agencies, the FHFA focused on the Agencies' current and historical market share within the multifamily lending sector. The following graph depicts annual multifamily lending volume since 2006 as well as the Agencies' market share.



Fannie Mae and Freddie Mac Multifamily Originations Market Share (%) 2006 - Q1 2019

2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Q12019
32%	**41%**	**78%**	**75%**	**57%**	**50%**	**39%**	**28%**	**28%**	**36%**	**41%**	**49%**	**46%**	**43%**

Source: Fannie Mae Multifamily Business Information August 2019

Notes:

[1] Estimated competitive market size is Fannie Mae's internal estimate of multifamily originations activity

Multifamily loan originations in 2019 are expected to hit about $350 Billion which represents about a six-fold increase from annual levels in 2008 through 2011 when the Agencies annual market share was as high as 75%. The Great Recession demonstrated the value of the Agencies as they continued to provide capital at a time when little money was available through private lending sources. As such, their market share grew over that period. Since then, while their market share has decreased slightly, the Agencies still comprise close to half of the multifamily lending market (and likely more than half of the MHC lending market), and their underwriting and interest rate pricing have a major influence on the overall multifamily lending market.

Long-term reform of the Agencies remains uncertain in spite of the recent activities by the Trump Administration. After all, the Agencies have been at the foundation of the 30-year home mortgage, which is not common outside of the U.S. and is considered a mainstay of our housing market. Prior to the financial crisis, Fannie Mae and Freddie Mac were private companies backed by an implicit government guarantee. During the 2008 mortgage meltdown the Agencies fell out of favor after racking up losses (primarily on the residential side) and reportedly questionable lending and business practices, which resulted in them being placed into government conservatorship. Since that time, however, they have returned billions in dividends to the Treasury, and provided the underpinning for the successful housing recovery placing them back in political favor.

On March 27, 2019, President Trump issued a Presidential Memorandum directing the Secretary of the Treasury to develop a plan for administrative and legislative reforms to address this unfinished business of the financial crisis. This led to the Treasury Department's September 5th release of The Housing Reform Plan. Per the Treasury Department, "The Treasury Housing Reform Plan consists of a series of recommended legislative and administrative reforms that are designed to protect American taxpayers against future bailouts, preserve the 30-year fixed-rate mortgage, and help hardworking Americans fulfill their goal of buying a home . . . The Plan includes nearly 50 recommended legislative and administrative reforms to define a limited role for the Federal Government in the housing finance system, enhance taxpayer protections against future bailouts, and promote competition in the housing finance system."

The latest reform plan once again envisions having a private/public ownership of the Agencies which some are calling "Back to the Future" since a similar government backstop approach was in place prior to conservatorship. Replacing institutions that underpin the housing market is extremely complicated, particularly during an election cycle. Multifamily lending, including lending for MHCs, represents a relatively small portion of the Agencies' overall lending activity, but it is considered key to addressing affordable housing needs and underserved markets. While long-term reform remains uncertain, there does appear to be a commitment to maintain market stability as well as public policy support for affordable housing.

Overall, the lending market remains very healthy due to favorable property fundamentals, low loan defaults and readily available capital. In the near term, we expect to see interest rate spreads stabilize as the Agencies and other lenders manage their pipelines for the remainder of this year with an eye toward resetting for next year. In the meantime, there remains a wide range of lending sources available including Agencies, life insurance companies, banks and CMBS lenders, and MHCs continue to be a favored property type among most lenders.

Tony Petosa, Nick Bertino, and Erik Edwards of Wells Fargo Multifamily Capital specialize in providing financing for MHCs through Fannie Mae, Freddie Mac, conduit, and balance sheet lending programs. For more information or for a copy of their "Manufactured Home Community Financing Handbook," please contact: Tony at (760) 438-2153 or tpetosa@wellsfargo.com; Nick at (760)438-2692 or nick.bertino@wellsfargo.com; Erik at (760) 918-2875 or erik.edwards@wellsfargo.com; or visit www.wellsfargo.com/mhc.