DEPAUL UNIVERSITY
INSTITUTE FOR HOUSING STUDIES

Issue Brief

Value Changes in the Multifamily Housing Market in Cook County and Implications for Multifamily Lending

OVERVIEW

This issue brief summarizes the recent property price declines and foreclosure experience on multifamily mortgages in Cook County over the period 1998 to 2009. Falling property prices in Cook County have put roughly $13 billion of multifamily mortgages (or approximately 30% of the total outstanding multifamily mortgage debt) at risk of default; have led to significant disinvestment by landlords; have caused the percent of multifamily mortgage loans in foreclosures to increase to 6.8% (or about $3 billion); have forced lenders to "pretend and extend" about $1.5 billion of multifamily mortgages to date; and have compelled most banks to cut back on their multifamily mortgage lending significantly. The reduction in multifamily mortgage lending raises the question of what will happen as $15 billion of multifamily mortgage debt (or about 33% of the stock of outstanding debt) matures between 2010 and 2015.

For better or worse, the combined activity of Fannie Mae and Freddie Mac currently account for 65 to 70% of all multifamily mortgage originations in Cook County. Thus, as it has turned out, Fannie Mae and Freddie Mac have become an indispensable part of today's multifamily mortgage market. Yet many policy advocates would like to reduce the size of the portfolios held by Fannie Mae and Freddie Mac in order to limit the taxpayers' exposure for high risk single-family mortgages and mortgage-backed securities. However, reducing the size of the portfolios held by Fannie Mae and Freddie Mac in the current environment could, all things considered, make the multifamily housing market worse off and the resulting volatility could impose large welfare losses on tenants.

The policy implications for the multifamily housing market, however, are markedly different over a longer run than in the immediate situation. Long-run policy, extending beyond the next five years, must necessarily take into account the extent to which Fannie Mae and Freddie Mac subsidize interest and create an incentive to take on excessive debt. Too much debt, as we have seen, can have a destabilizing effect on markets. Thus, over a longer run the theory supports a much more targeted policy approach in dealing with Fannie Mae and Freddie Mac.

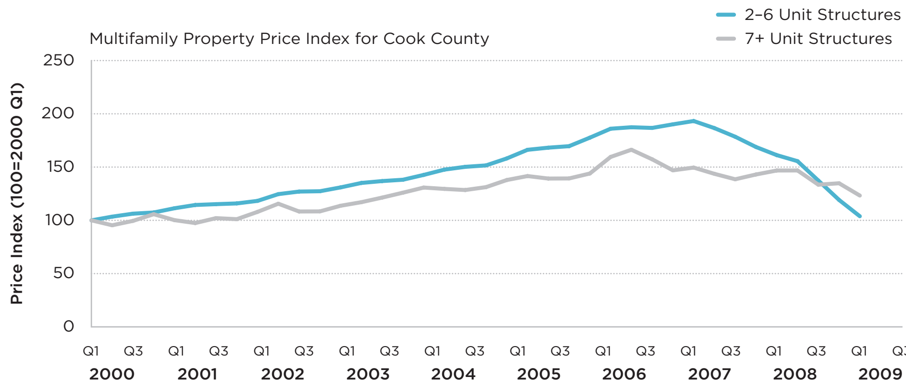
MULTIFAMILY PROPERTY PRICE DECLINES

Prices of large (7+ units) rental properties in Cook County have declined from an index value of 166 in the third quarter of 2006 to 123 in the second quarter of 2009, a decline of 26%. Prices of small (2-6 units) rental properties in Cook County have fallen from an index value of 193 in the second quarter of 2007 to 104 in the second quarter of 2009, a decline of 46% (see Figure 1).

Falling property values have increased the total value-at-risk of default of small 2-6 unit rental properties in Cook County to $12.6 billion (or about 43% of the outstanding mortgage debt on small 2-6 unit rental properties). For large 7+ unit rental properties, the total value-at-risk is $747 million (or about 5.4% of the total mortgage debt outstanding on large 7+ unit rental properties).

Figure 1

REPEAT SALES INDEX OF MULTIFAMILY PROPERTIES



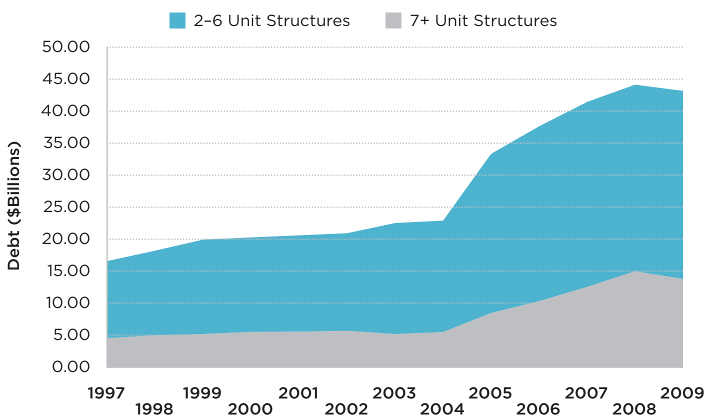
Source: Institute for Housing Studies, DePaul University. January 2010

LESS MULTIFAMILY MORTGAGE LENDING

Price declines and deleveraging imply less multifamily mortgage lending in Cook County. Multifamily mortgage debt on small 2-6 unit rental properties in Cook County, on average, grew from $17.4 billion in 2004 to $28.8 billion in 2007, an increase of 66% (see Figure 2). Debt on large 7+ unit properties also increased significantly over this same time period, from $5.4 billion in 2004 to $12.5 billion in 2007, an increase of 128%. However, as shown in Figure 3, new issuance of multifamily mortgage debt on small 2-6 unit properties in Cook County fell to $5 billion in 2008, down 39% from 2007, and fell even further in 2009. Similarly, the new issuance of multifamily mortgage debt on large 7+ unit properties in Cook County fell to $2.7 billion in 2008, down 45% from 2007, and fell again in 2009.

Figure 2

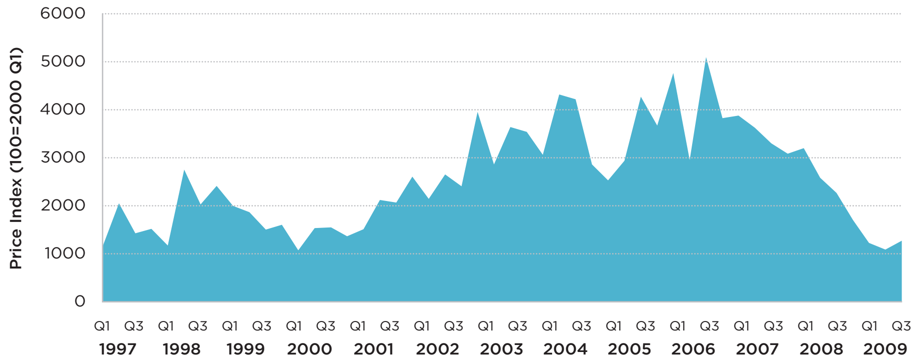
OUTSTANDING MORTGAGE ON MULTIFAMILY PROPERTIES IN COOK COUNTY



Source: Institute for Housing Studies, DePaul University, January 2010

Figure 3

TOTAL MULTIFAMILY MORTGAGE ORIGINATIONS IN COOK COUNTY



Source: Institute for Housing Studies, DePaul University, January 2010

MULTIFAMILY FORECLOSURES ARE INCREASING

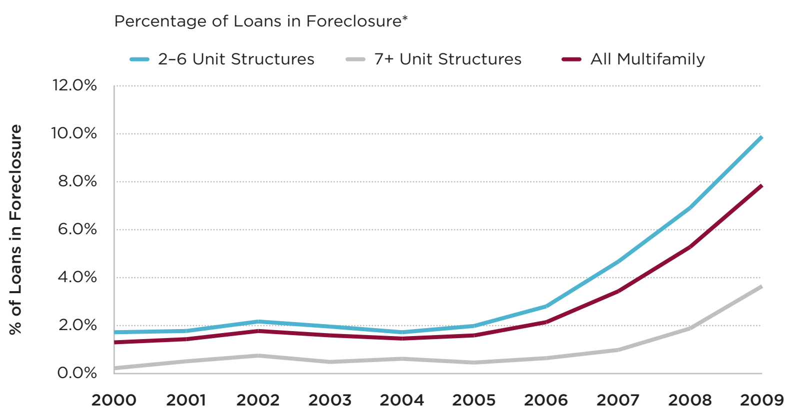
In 2009, new foreclosure filings continued at a record pace. With the exception of the second quarter of 2009, new foreclosure filings on both small 2-6 unit rental properties and large 7+ unit rental properties were higher than in the same quarter the previous year. On 2-6 unit rental properties, new foreclosure filings are between 1,900 and 2,100 per quarter. On 7+ unit rental properties, new foreclosure filings are between 50 and 100 per quarter. Figure 4 shows the increase in multifamily foreclosures as a percentage of loans based on outstanding loan amounts.

As of year end 2009, multifamily foreclosures on both small 2-6 unit rental properties and large 7+ unit rental properties are estimated to have impacted more than 32,000 units in the Cook County rental market. In contrast, there are currently about 38,000 single-family units in foreclosure in Cook County.

By loan cohort, foreclosures are led by loans originated between 2005 and 2007, a period of over-lending and over-spending. By income submarket, multifamily foreclosures in Cook County are highly concentrated (at least 3 to 4 times higher in concentration) in low- and moderate-income markets compared to higher-income markets. To illustrate, in low-income markets, multifamily foreclosure rates (as of the fourth quarter of 2009) are 13.9% on small 2-6 unit rental properties and 7.8% on large 7+ unit rental properties. In contrast, in high-income markets multifamily foreclosure rates are only 4.2% on small 2-6 unit rental properties and approximately 2% on large 7+ unit rental properties.

Figure 4

MULTIFAMILY FORECLOSURE RATE IN COOK COUNTY BY PROPERTY TYPE



Source: Institute for Housing Studies, DePaul University. January 2010

** Calculated based on outstanding loan amounts.*

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MULTIFAMILY PROPERTIES ARE AT RISK OF DISINVESTMENT

Disinvestment is expected to occur as rents and property values decline. The results of a value-at-risk analysis indicate that as many as 74,000 rental units in the city of Chicago—roughly one in eight—are experiencing a revenue shortfall, in which total revenues are less than total operating expenses. These revenue shortfalls should cause a significant amount of discontinued or decreased maintenance, which could impose considerable social costs (e.g., tenant dislocations, crime delinquency, fires, illness, etc.) on local communities and on individual tenants.

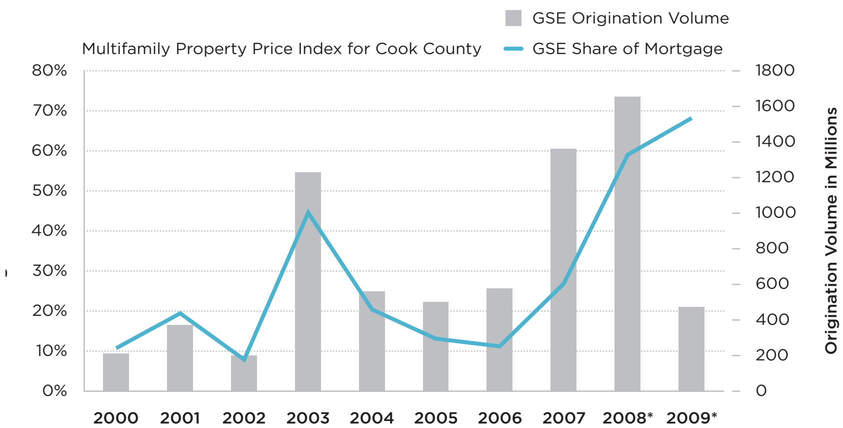
IMPLICATIONS FOR MULTIFAMILY LENDING

As local lending institutions have scaled back their lending to large 7+ unit properties in 2008 and 2009, Fannie Mae and Freddie Mac have essentially become indispensable to the Cook County multifamily mortgage market. The GSEs' share of lending to large 7+ unit multifamily properties in Cook County is around 65 to 70%. Fannie Mae and Freddie Mac are also indispensable to the small 2-6 unit multifamily mortgage market in Cook County, but for an altogether different reason. Certain policy prescriptions are clear from the analysis, including the need for Fannie Mae or Freddie Mac to provide continued liquidity and stability to the multifamily mortgage market. Long-run policy must necessarily take into account the extent to which Fannie Mae and Freddie Mac subsidize interest and create an incentive to take on excessive debt.

The analysis also sees an expanded lending role for FHA in this environment. FHA multifamily lending has always featured financing for the purchase, construction, and substantial rehabilitation of rental properties, and a strong case can be made that, if any one thing is most needed in this environment, it is joint financing for the purchase and rehabilitation of rental properties.

Figure 5

GSE MORTGAGE ORIGINATION ACTIVITY IN COOK COUNTY



Source: Institute for Housing Studies, DePaul University. January 2010

The Institute for Housing Studies (IHS) is a multidisciplinary academic research center that provides data and analysis to inform housing-related policy and resource allocation decisions.

IHS was created in 2007 as part of Preservation Compact, a multifaceted initiative to preserve Chicago-area affordable rental housing launched by the Urban Land Institute/Chicago and a coalition of public and private partners, including DePaul, with funding from The John D. and Catherine T. MacArthur Foundation.

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DePaul University

The Preservation Compact
A Rental Housing Strategy for Cook County

MacArthur Foundation