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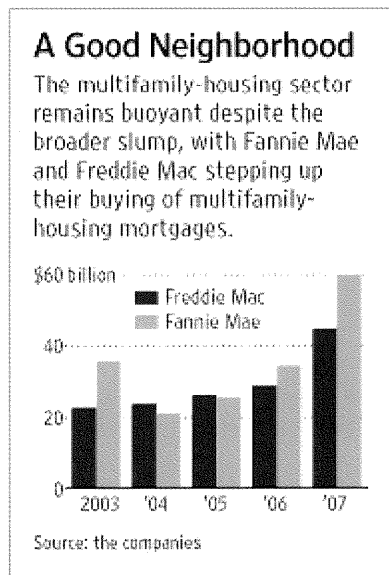
Multifamily Deals Multiply

Fannie and Freddie Provide Plentiful, Affordable Capital

By **JONATHAN KARP**
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As the pace of commercial real-estate sales grinds almost to a halt amid financial-market instability and concerns about property values, deal activity is still brisk in one corner of the industry: multifamily housing.

Fueling the deals and buoying apartment values is the rare availability of financing, thanks to government-sponsored **Fannie Mae** and **Freddie Mac**. Prompted by their mandate to provide market liquidity and funding for affordable housing, but also driven by a fresh opportunity for profit, both firms are expanding in the multifamily market to fill a vacuum left by private lenders.



"It's a good time in our business," says Thomas Toomey, president and chief executive of **UDR Inc.**, a Denver-based multifamily real-estate investment trust. "We have access to capital."

UDR recently benefited from that capital availability in its \$1.71 billion sale of 25,684 apartments -- nearly 40% of its portfolio -- to a joint venture of DRA Advisors LLC and Steven D. Bell & Co. Fannie provided the vast bulk of financing, reflecting its new aggressiveness in the sector. Mr. Toomey says six months ago the deal would have been impossible because of the dearth of financing.

To be sure, the economics of the business aren't enormously compelling. While there is decent demand for apartments as people flee from or are shut out of home ownership because of the mortgage squeeze, the sector isn't immune to the economic downdraft. Vacancies are creeping up at a time when empty condominiums and homes are competing for tenants, and rent increases are decelerating, according to Reis Inc., a New York research firm.

Still, multifamily players have remained active. **AvalonBay Communities Inc.** turned to Fannie and Freddie last month for \$265 million in mortgage financing on two apartment communities in northern Virginia. Before the credit crunch, AvalonBay, which is based in Alexandria, Va., borrowed heavily in the unsecured-debt market through Wall Street institutions.

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"We have diverted from that normal practice this year because of difficult conditions in that market and available financing from Fannie and Freddie," says Chief Financial Officer Tom Sargeant.

He says AvalonBay arranged the five-year financing in the Northern Virginia deal at an interest rate of 4.75%, as opposed to a private-market rate of 6.75%. "The spread between the two markets is historically wide," Mr. Sargeant notes.

Fannie's and Freddie's plentiful, affordable capital helped make apartments the second-best REIT performers, after the self-storage market, in the first quarter. Bucking the prevailing negative or meager returns, apartment REITs had a total return of 11.48% in the quarter, according to the National Association of Real Estate Investment Trusts. Because real-estate investments are so dependent on financing, the cost and availability of that debt has a direct impact on the value of properties.

The multifamily sector "is the beneficiary of the housing mess, and it feels like it has room to run," says Mike Kirby, chairman of Green Street Advisors Inc., a Newport Beach, Calif., REIT research group. He expresses some concern, though, that Fannie's and Freddie's aggressive lending is artificially propping up apartment prices.

A recent Green Street research report referred to the apartment-financing environment as "Neverland" because of the effective subsidies. "Fannie and Freddie are dominating the market. Normally, they are just players," Mr. Kirby says.

Fannie's and Freddie's purchases of multifamily mortgages and mortgage-backed securities set historic highs last year, surging particularly in the last quarter, when investment banks and other so-called conduit lenders withdrew from the market.

Mike May, senior vice president for multifamily at Freddie, says the apartment market helps his firm fulfill goals for lending to affordable housing. It's also good business at a time when Freddie's and Fannie's bottom lines have been hit by the housing crisis. "Freddie Mac's multifamily lending profitability compares favorably with the company's other business lines," he says.

For Fannie, the multifamily market is attractive from a number of perspectives, including its typically low delinquency rates, just one-tenth of 1% in January, says spokesman Jon Searles.

Gary Gordon, managing director at stock-research firm Portales Partners, says stronger fundamentals in the apartment market and tax benefits from affordable-housing financing combined to help Freddie earn about \$400 million last year from multifamily business.

In addition to keeping loans that it buys on its books, Freddie is moving forward on an initiative to pool apartment-building mortgages and resell them as securities, a development it hopes will keep its pricing competitive with investment banks when the market for mortgage-backed securities returns. Mr. May says the plan may allow Freddie to "pick up 5% to 10% additional volume" in the short run, and hold that share when financial markets stabilize.

While interest rates have fallen, Fannie's and Freddie's spreads above Treasury rates have been widening, raising questions about how long the relatively cheap money will last.