What a difference a decade makes. This time 10 years ago, the United States was hitting its lifetime peak in a plethora of mortgage metrics, and not all of them were good. Actually, most of them proved to be plainly disastrous for homeowners and lenders alike.

The peak in housing prices: July 2006. We are still, nationally, at 88 percent of the average price back then. The portion of the population living in an owner-occupied dwelling was more than 69 percent. Today it’s hovering around 64 percent. The total outstanding mortgage-backed securities (MBSs) in 2008 was about $9.5 trillion. Now we’re at $8.7 trillion.

The upshot of this seismic shift in the domestic housing market is that the multifamily sector has seen dramatic growth in the last few years. In fact, one of the few components of inflation that shows any sign of life is rent. Significant portions of housing starts these days are apartment complexes.

So if you haven’t yet been introduced to multifamily MBSs, please allow me.

**Growth sector**
Community bankers are getting around to actually liking the MBSs that are backed by multifamily loans. That sector, like the loans that act as collateral, has seen remarkable growth in the last five years. As the product depth has grown, so has the liquidity of the securities.

Fannie Mae and Freddie Mac both have multifamily products. They have similarities to the generic single-family MBSs, but are not identical. Many community bankers like the multifamily story for no other reason than diversification. Like all other Fannie/Freddie securities, these have 20 percent risk weighting, have a guaranteed timely payment of principal and interest, and are generally “pledgeable.”

**Fannie Mae DUS bonds**
Delegated underwriting and servicing (DUS) securities comprise the largest segment of the multifamily sector. Because these usually are collateralized by a single loan on a large development, the pool size can range from $1 million to $50 million. They have fixed rates with balloon dates in generally 10 years, so the average life at the outset is around nine years.

Because DUS bonds are fixed-rate and can trade at significant premiums, a risk-averse portfolio manager should immediately wonder how the prepayment risk is alleviated on a single loan pool. The answer is that a prepayment penalty makes it extremely unlikely for an early voluntary prepayment to occur.

The cash flows from DUS bonds are very little until balloon date, owing to the 30-year amortization period. It is possible to find seasoned issues, so a buyer can target a specific average life or maturity date.

**Freddie Ks**
An alternative to the DUS bonds is the Freddie Mac “K” program. These securities are backed by pools of multifamily loans instead of a single credit. The pools can be quite large; the typical deal size is more than $1 billion. These are also “structured” pools, with multiple tranches of varying seniority to cash flows and prepay risk.

These too are fixed-rate and can have long average lives, but shorter tranches are available. Another benefit (in the mind of the typical community banker) is that certain classes can have “current coupons,” meaning they can be purchased at prices very close to par. Therefore, prepayment risk, which is very low
to begin with, can be essentially eliminated.

The reason prepayments are infrequent is that Freddie Ks have several forms of prepayment protection. The two most common are “yield maintenance” and “defeasance.” In either case, the investor is virtually assured of receiving the expected yield and cash flows.

**Check them out**

It’s time for the required caveats. While multifamily MBSs have become more prominent recently, they still in aggregate are a relatively small component of the entire mortgage market. One reason they yield more than generic securities is that their liquidity, though improving, is less.

Also, the cash flows in either product are back-loaded, so there is little reinvestment income initially. These are suitable alternatives to long agency or corporate bonds, or long average-life MBSs. If your community bank’s portfolio is in the form of a barbell, these are excellent anchors for the long end.

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**Multifamily Mortgage-Backed Securities**

ICBA Securities’ exclusive broker Vining Sparks has a number of research reports and inventory positions for Fannie Mae delegated underwriting and servicing securities and Freddie Mac K bonds.

To learn more, contact your Vining Sparks sales rep or visit [www.viningsparks.com](http://www.viningsparks.com).