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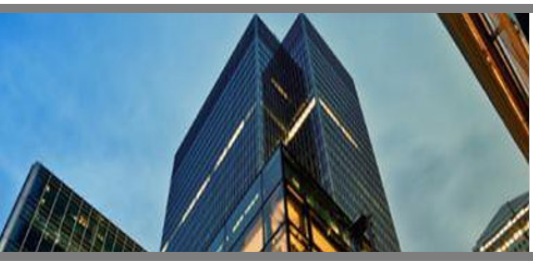
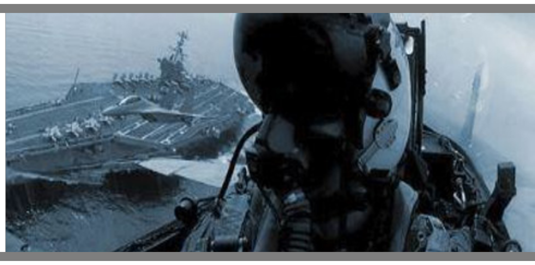
Securitized Products Special Topics

Manufactured Housing: Resilient Segment Amid Potential Multifamily Softness





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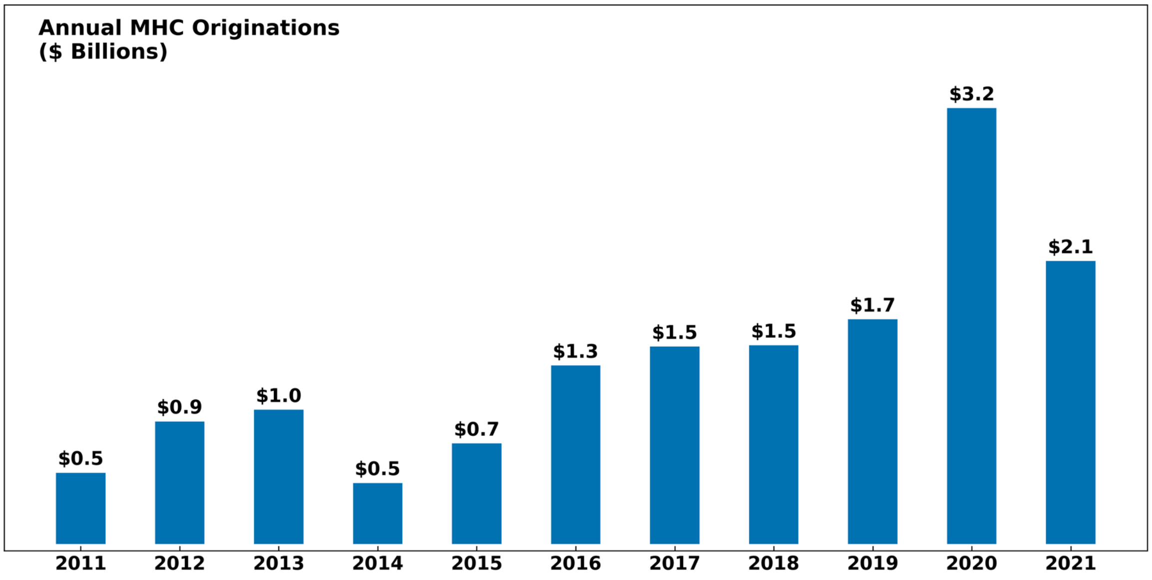
MHC Strength May Impact DUS Prepay Trajectory

The rising volume of manufactured housing loans across Fannie Mae's DUS pools underscores how diversifying collateral can impact multifamily bond dynamics. Manufactured housing communities ("MHC") accounted for $3.2 billion and $2.1 billion DUS originations in 2020 and 2021, respectively, up from $1.6 billion in 2019, and <$1 billion annual MHC originations in 2011-2015 (Figure 1). The rise of MHC volume in agency deals dovetails with potentially upcoming issuance of private-label MHC securitizations, on the heels of rising loan originations. Several MHC lenders are lining up transactions in the coming months, according to press reports.

Figure 1. Manufactured Housing Communities DUS Originations ($ Billions)

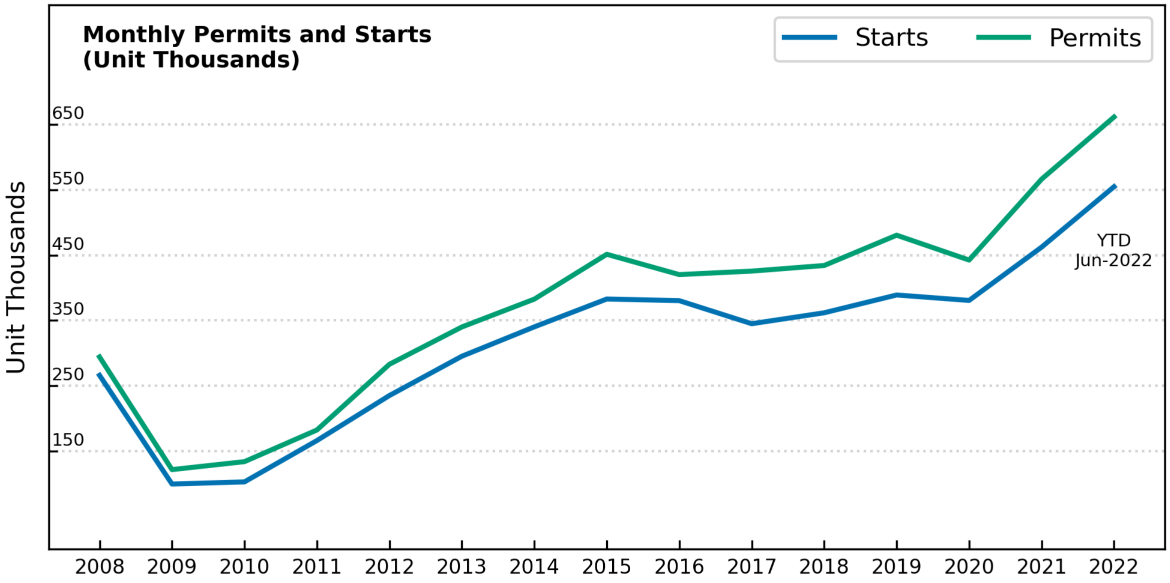


Source: Fannie Mae and Academy Securities

MHC could feature unique prepayment dynamics in the near term. Peaking valuations and robust transaction activity in the sector could drive prepayments as landlords pursue refi cash outs on their properties. MHC valuations reached an all-time high of $46,970 per pad in 2Q 2021, according to JLL. Buyer demand for MHC remains high amid limited supply and robust operational performance in the sector. The inflationary environment can support the economical advantage and affordability of MHC, according to market participants. Interestingly, majority of consumers noted they would consider purchasing a manufactured home, according to a recent Freddie Mac survey. Large REIT landlords, such as Sun Communities and Equity Lifestyle Properties, noted in recent disclosures that they plan to remain active in the transactions market.

In contrast, prepayments may decelerate among other DUS segments, following high prepay activity during the pandemic. Rising rates and multifamily-specific headwinds should reduce borrowers' incentive to refinance. Notably, Fannie tempered its multifamily outlook in a just released mid-year outlook, citing persistent inflation, recession expectations, and elevated new multifamily supply. Multifamily permits and starts rose 13% and 15% in June, extending the upward construction trend that began in mid-2020 (Figure 2). The pending supply may soften the robust rent growth and price appreciation multifamily properties saw in recent years in most markets.

Figure 2. Multifamily Starts and Permits (Unit Thousands)



Source: US Census Bureau, Bloomberg, and Academy Securities

Contrasting Pressures on Yield Maintenance Prepayments

Voluntary prepayments remain a concern for DUS investors that may have purchased bonds at higher premiums in recent years. Still, the prevalent yield maintenance ("YM") prepayment penalties in fixed-rate DUS pools are designed to reduce investor prepayment risk. The penalty (or premium) payment equates to the difference between the mortgage loan rate and the prevailing Treasury rate at prepayment, taking into account the remaining tenor until the YM end date (usually six months before the loan's maturity). Fannie passes over to the investor a portion of the premium that accounts for the difference between the MBS pass through rate and the Treasury rate.

The current elevated rate environment should create competing pressures on YM prepayment activity. Higher Treasury rates lower the prepayment penalties. But rising rates also reduce borrower's incentive to prepay. Borrowers will likely need to refinance into higher mortgage rates, potentially depressing refis even on highly appreciated properties. MHC borrowers may still choose to refi and prepay amid this trade-off.

Involuntary Prepayments to Remain Low

Involuntary prepayment via defaults across DUS pools should remain muted, even in a recessionary environment. Investors do not receive prepayment premiums in defaults. MHC, in particular, feature very low loss rates compared to the other DUS segments (Figure 3). The sector recorded only one credit event across fixed-rate DUS pools, leading to net loss of 0.06%, according to Fannie. For comparison, the much larger multifamily cohort recorded 0.43% net loss.

Figure 3. Fixed-rate DUS Credit Events and Loss Rates by Property Type (Dollars in Millions)

Property Type	Loan Count	Loan Acquisition UPB	Credit Event Count	Credit Event Acquisition UPB	Net Severity	% Net Loss of Liquidated Acquisition UPB
Multifamily	46,858	$504,519	578	$3,114	27.21%	0.43%
Manufactured Housing Community	2,450	$18,450	1	$16	24.54%	0.06%
Seniors	1,539	$17,501	5	$26	33.93%	0.09%
Dedicated Student	896	$11,993	15	$132	17.65%	0.67%
Cooperative	426	$3,065	2	$5	18.42%	0.06%
Multiple Properties	253	$3,202	9	$67	39.61%	1.34%
Military	251	$3,413	0	$0	NA	0.00%
Other	6	$27	0	$0	NA	0.00%

Source: Fannie Mae and Academy Securities

In turn, condemnation-driven involuntary prepayments without penalties remain a risk (albeit likely a remote one) to holders of DUS bonds with higher premium book values. Following the purchase in 2019 of two Fannie DUS properties in King County, WA, via eminent domain, two loans (Kendal Ridge Apartments Homes, AN4480, and Emerson Apartments, AN7451) prepaid without penalties. The GSEs revised their deal documents shortly thereafter to reduce the risk of such unexpected no-penalty prepayments. But the changes are narrowed and somewhat nuanced, and we cannot rule out similar events in the future that hurt bonds that trade at a premium and suddenly prepay at par without penalty.

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