REIT Wise®

NAREIT's Law, Accounting & Finance Conference

March 30 - April 1

2016

Housing Finance Potpourri

March 30-April 1, 2016

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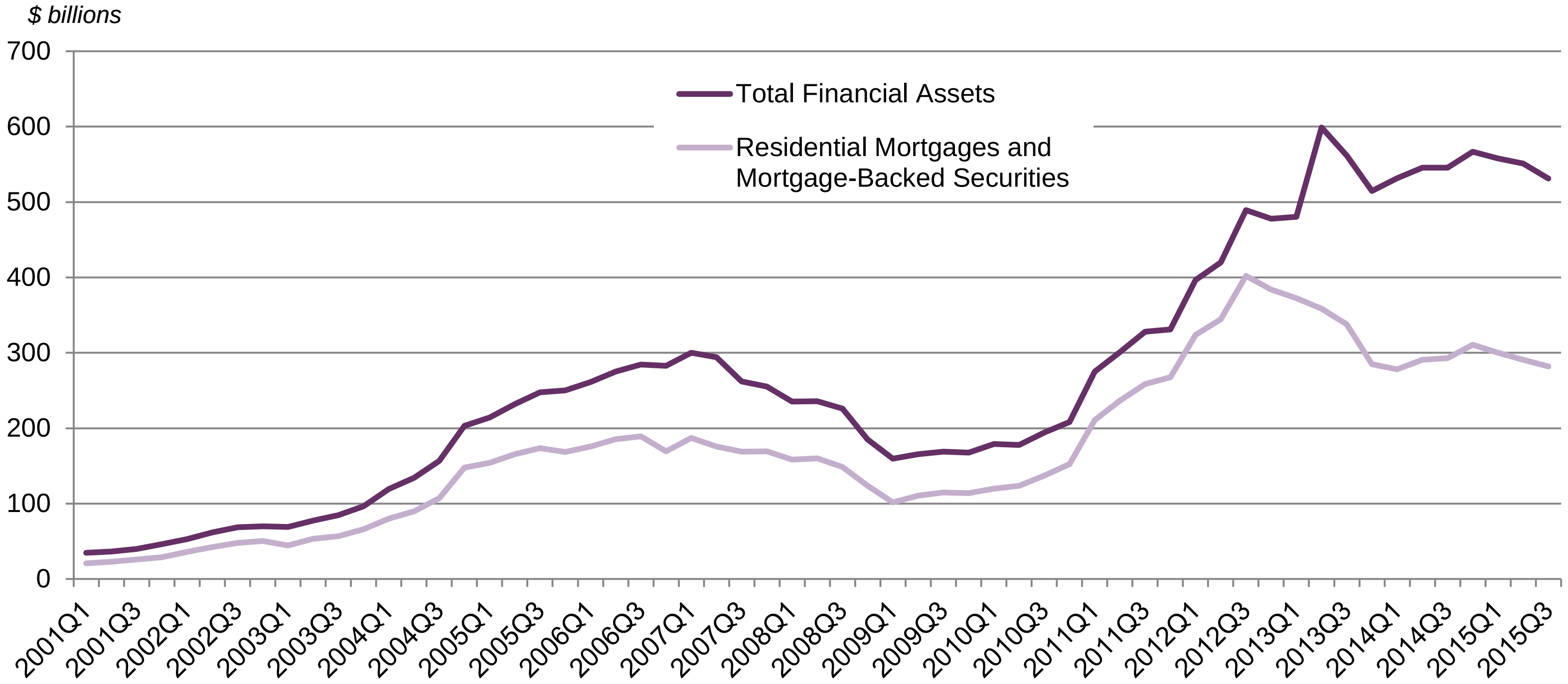
FHLB Membership

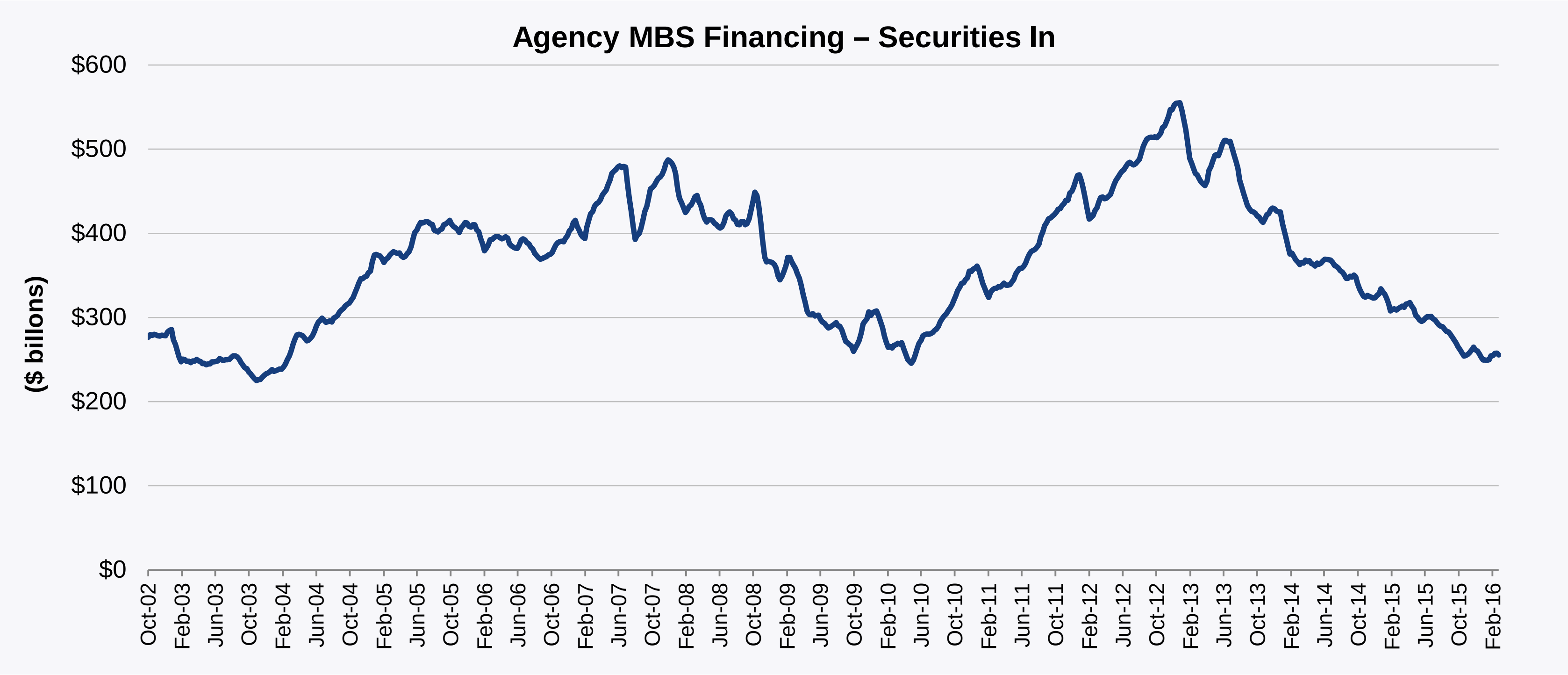
- REITS support the mission of the FHLBs and benefit the larger mortgage market.
  - Deep mortgage focus, provides liquidity and funding to the mortgage market
  - Could help build the non-QM market
  - Diversifies REIT funding sources and provides valuable long term financing
- Risks posed by captives are low, and can be managed without a ban.
  - Overall exposure is small
  - Can manage current and future risks using existing tools (overcollateralization, credit limit)
  - Strengthening the membership approval process for insurers can address safety concerns
- Why did the FHFA say no?
  - They felt congress should decide which institutions should be in or out.
  - They did not believe they had a good way to draw the line (REITs, Public hedge funds, private hedge funds, not mortgage related entities).

Mortgage REITs, Assets



Source: Federal Reserve Flow of Funds

Access to Repo is contracting



Source: Federal Reserve Bank of New York

Tax Code as applied to REITS and the Securities Act of 1940 needs to be amended to accommodate CRT Securities

REIT Tax Legislation (enacted in 1960)

- Intended to permit retail investors to invest in real estate through a tax-efficient vehicle (REITS generally don't pay corporate taxes).
- REITS must pass:
  - 75% asset test: 75% of the value of their total assets are represented by real property, mortgages on real property, other real estate assets, cash and cash equivalents, and government securities.
  - 75% income test: 75% of their gross income needs to be from interest on mortgages, rents from real property, gains from real property or mortgage sales, and other real estate income.
- GSE Risk Sharing Securities (CAS and STACR) are debt obligations of the GSEs.
- They do not represent interest in mortgages or other interests in real estate: the principal repayment on the securities contains an embedded derivative which references the performance of a group of mortgage loans.
- CAS and STACR are good REIT assets (as they are government securities), but are not good REIT income.
- Other securities can be problematic as well.
- Securities backed by non-performing loans (NPLs) or re-performing loans (RPLs) are generally not REMICS and are not good REIT assets or income. REMICs require that there be no active management of the assets. This makes them unsuitable for NPL/RPL deals.
- NPL/RPL deals have been the largest single category of non-agency issuance in 2014, 2015 and thus far in 2016.

Tax Code as applied to REITS and the Securities Act of 1940 needs to be amended to accommodate CRT Securities (Cont.)

Securities Act of 1940

- Mortgage REITS are investment companies because they are engaged primarily in the business of investing, reinvesting, or trading in securities.
- However, there is an exemption to SEC registration 5(c)3(c) for entities who are engaged in "purchasing or otherwise acquiring mortgages and other liens on and interest in real estate."
- To meet the exemption criteria, the entity must hold:
    - At least 55% of the assets in "qualifying mortgages," which includes real estate, loans fully secured by real estate, assets that are the functional equivalent of the above, such as whole-pool agency MBS, and certain commercial real estate B-notes.
    - At least 80% of the assets must be "qualifying mortgages" or real estate related assets.
- Agency CMOs and non-agency private label securities do not qualify for the purpose of the 55% rule, as they are not whole pools. They do qualify under the 80% rule.
- GSE Risk Sharing Securities (CAS and STACR) do not qualify under the 55% rule because they are debt obligations of the GSEs and do not represent interest in mortgages or other interests in real estate. They may qualify under the 80% rule.
- NPL/RPL loan deals do not count toward either requirement.