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Richard Berner
Director
Office of Financial Research
U.S. Department of the Treasury
717 14th Street NW
Washington, DC 20220

Dear Director Berner:

I am writing to bring to your attention the recent increase in investor owned rental properties and the development of single family rental backed securities. It is my belief that the development of these new financial products deserves thorough federal review and oversight. The mission of the Office of Financial Research (OFR) is to improve the quality of financial data available to policymakers and to facilitate more robust and sophisticated analysis of the financial system. I believe that your office is perfectly positioned to provide further details on these new financial products, and I ask that you work to address unanswered questions about how these bonds are structured.

California's Inland Empire, which I represent, was hit particularly hard by the wave of foreclosures that occurred as a result of the financial crisis. Between 2008 and 2011, Riverside County saw 134,910 household foreclosures – a rate of one in every ten homes. After the flood of foreclosures, the Inland Empire housing market has seen record low prices and interest rates. Despite these strong incentives to buy, families and first-time homebuyers are finding it hard to purchase a home. It is increasingly the case that these homes are being purchased by investment companies looking to rent out the property, leaving the family purchaser of modest means shut out of the market. Many of the properties were distressed or real estate owned (REO) before institutional investors purchased them and converted them to rentals. While Southern California provides a clear example of this new trend, it is not the only region that has seen a rise in investment owned properties. Similar stories are coming out of Florida, Arizona, Nevada, and Georgia.

Now, these same investors have developed a new financial product linked to rental properties, a single family rental backed security. Last fall, Blackstone partnered with Deutsche Bank to announce the first rental backed security, offering $479 million in bonds backed by the rental income from some 3,207 properties in Arizona, California, Florida, Georgia, and Illinois. At the end of January, another large investor, American Homes 4 Rent announced a partnership with JPMorgan Chase, Goldman Sachs and Wells Fargo to sell $500 million in similar bonds. If these offering are successful, more firms may be encouraged to follow Blackstone and American

Homes 4 Rent's lead. According to a report by the Center for American Progress, the market for rental backed securities could grow to $70 billion by 2016.

The Federal Reserve as well as a few ratings agencies raised concerns about these new bonds. Moody's Analytics gave the bonds in the highest traunch a Triple-A rating, but Fitch and Standard & Poor's refused to give the bonds a Triple-A rating, citing their limited track record and vulnerability due to the intricacy of maintenance expenses, capital expenditures, property tax fluctuation, and the potential for local municipality involvement. Additionally, a report by economists at the Federal Reserve raised concerns about the impact of rental backed securities on local housing markets where a majority of the properties are located, and argued that, "it will be important to monitor the development of markets for bonds backed by rental-income streams for the development of potentially destabilizing structures or concentrated exposures."

One of the OFR's core functions is to monitor potential vulnerabilities in the U.S. financial system. The issues raised by Fitch Ratings and the Federal Reserve point to possible risk that could harm renters and local housing markets if these bonds are affected by a downturn. It is with that in mind, that I request that the OFR gather additional information about these new financial instruments. I would hope that any study would include:

1. Clarification on how the bonds are structured to determine whether the entire portfolio would go into default if the rental properties don't meet certain performance criteria.
2. Specific details about how well the properties must perform and what vacancy rate was assumed when structuring the bond.
3. How consumers, renters, and housing markets would be impacted if poor performance forced the properties to go into default or be sold.
4. Further information about what happens when these bonds mature, and the likelihood that the borrower would be unable to refinance the bonds and be forced to sell properties to repay bondholders.
5. Details about how the riskier traunches are sold and whether they are being re-packaged into collateralized debts obligations (CDOs) and resold with higher ratings.
6. The possible impacts on the stability of the U.S. financial system if rental backed securities continue to grow in popularity, and predictions for how quickly this new market could grow.
7. Policy or regulatory suggestions to minimize potential risk for financial markets and renters.

Proper oversight of new financial innovations is key to ensuring we don't go down the same road of the unchecked sub-prime mortgage backed security, and create an unsustainable bubble that will wreak havoc when it bursts. I encourage the OFR to collect data on rental backed securities so that all parties can have a thorough understanding of the potential risks associated with these bonds. For further information, please contact Amanda Eaton, on my staff, at 202-225-2305.

Sincerely,

Mark Takano
Member of Congress