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Fannie Mae M.TEB: Hilltop Apartments

BY SCOTT BEYER
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Maximizing Investor Proceeds, Assuring Permanent Affordability

The Hilltop Apartments was a previously market-rate rental apartment project that sits near the eastern city limits of Washington, DC, in the Deanwood neighborhood. Built in the 1960s, it had become a run-down project within a gentrifying area, and the natural market direction might have been to demolish it and build new market-rate housing that commanded higher rents.

But Boston-based WinnCompanies, one of America's leading affordable home providers, purchased the property for $9.3 million in 2017. It teamed up with Greystone, a New York City-based real estate investment and advisory firm, and one of the nation's top lenders for Fannie Mae multifamily. The goal of the two companies was not to demo Hilltop Apartments, but repair it and convert it from market-rate to permanent affordability. That way Hilltop could be part of what prevented displacement in a changing area. The partners determined the most suitable and effective bond execution for the project was Fannie Mae's M.TEB.

Fannie Mae has a number of financial products designed to spur more home production. The government-sponsored and publicly-traded company has some that encourage single-family home ownership, and others that back repair or maintenance of multifamily rental housing, by improving the financing available to developers. Its M.TEBs, which package mortgage-backed securities as tax-exempt bond collateral, are one of those latter products.

percent Low Income Housing Tax Credits (LIHTC).[4] The M.TEB structure was created and refined by attorneys at Tiber Hudson, a Washington, DC-based law firm that specializes in, among other things, construction law. The first M.TEB deals closed in 2016, and within a couple years, the attorneys drafted a way that M.TEBs could be used for new construction and sub-rehab deals. Allison King, one of the attorneys who helped with the policy, described how it works by email:

The Forward M.TEBS structure involves a construction phase (ending on the conversion date), and permanent phase. Prior to closing, the borrower obtains forward commitments from the Fannie Mae permanent lender and Fannie Mae to deliver the permanent loan and a mortgage-backed security (MBS) once the project is placed in service and certain conditions are met.

At closing, the Issuer issues long-term tax-exempt bonds, which are sold by the underwriter and proceeds are delivered to the trustee. [The] borrower simultaneously closes on a construction loan. The construction lender will fund draws to the trustee enabling the trustee to disburse a corresponding amount of bond proceeds to pay project costs, and ensure the bonds are cash collateralized during the construction phase.

Upon conversion, the permanent loan and MBS are delivered, which the trustee will purchase with cash collateral. The MBS will collateralize the bonds during the permanent phase. The borrower will make monthly payments which are passed through the permanent lender, to the trustee, then to bondholders. The bonds, permanent loan and MBS will mature on the same date.

M.TEB Benefits

A couple of the M.TEB benefits she cited were immediate funding, a three percent vacancy waiver, a 40-year amortization waiver, 90 percent LTV, 1.15x coverage for four percent LIHTC projects with at least 90 percent of units meeting affordability requirements and the lowest spread in the industry. Additional benefits described by Fannie's term sheet include faster closings and guaranteed direct

LIHTC M.TEB Program, for a loan amount of $7.15 million over a 17-year permanent loan period. It had a 4.49 percent note rate (~200 spread to index). The forward commitment from Fannie let the companies take out a construction loan upon completion of the renovation, once the property had reached the stabilization level of 90 percent occupancy.

Subordinate financing came from the DC Department of Housing and Community Development's Housing Production Trust Fund. The fund, which has a $100 million annual commitment through transfer taxes and general funds, distributes pre-development loans, under the condition that borrowers keep their properties affordable over a certain period. And the Hilltop project also received bond regulatory agreements with the DC Housing Finance Agency.

All this underwriting meant that the 106-unit project could be converted almost completely to high-quality affordable housing. A two-phase renovation helped to repair kitchens, balconies and finishes; replace HVAC units; seal exterior walls; upgrade electrical panels; and more. The exterior of the 2.68-acre project got new fencing and landscaping. The LIHTC conversion means that 90 percent of units are affordable to households making 60 to 80 percent AMI; the remaining units are market-rate.

P.J. McDevitt, director of affordable housing multifamily loan origination at Greystone, said Fannie Mae's role in the project was crucial.

"The real benefits to this structure from a permanent loan perspective, which would be the level where we sit on it at Greystone, is that by providing the MBS to the bond investor market, you're able to drive down some spread. And what that does is it lowers the interest rate, which allows borrowers to increase their proceeds."

He added that Fannie Mae's execution process is straightforward, and the agency easy to work with in getting projects completed. "Fannie Mae is one of the best partners we can possibly have," he says.

"Even in the current market, Fannie Mae Forward MTB transactions have continued to be sold at very attractive rates with all-in mortgage rates coming in under four percent," she writes. "We believe the structure will continue to be used in the four percent LIHTC space for the foreseeable future."

This means that more projects, like Hilltop, which used that combo of funding sources to preserve affordability in eastern DC, are ripe for these market-to-BMR conversions.

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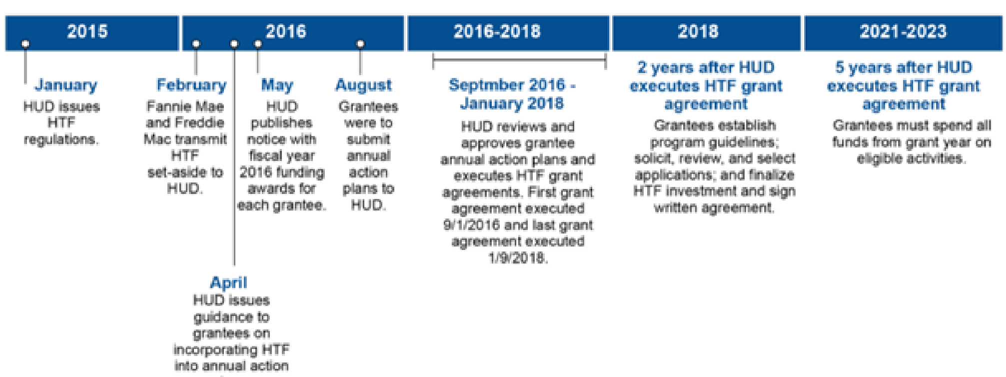
Figure 3: Timeline of Key Events for the 2016 Housing Trust Fund (HTF) Grant Year



Source: GAO summary of Department of Housing and Urban Development (HUD) information. | GAO-23-105370

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