

Product for the Times

Multifamily ARM Loans Increase in Popularity

Fannie Mae and Freddie Mac adjustable-rate mortgages have become increasingly popular with affordable rental housing developers and owners, according to lenders and others.

Freddie Mac's multifamily ARM product has been around for years. Fannie Mae rolled out a new ARM product – the "7-6" ARM – in 2011 to supplement an existing "Structured" ARM. The latter, but not the more common 7-6 ARM, is restricted to loans of \$25 million or larger. The 7-6 refers to the seven-year term of the Fannie Mae 7-6 ARM and the 6% maximum pass-through rate for the associated mortgage-backed security.

The Fannie Mae and Freddie Mac ARMs can be used to refinance or acquire multifamily housing properties and are available through approved Fannie Mae and Freddie Mac lenders.

Timothy Leonhard, Managing Director-Dallas of Oak Grove Capital, an approved Fannie Mae, Freddie Mac, and FHA lender, says the GSEs' multifamily ARM loan is "a very good product. It's becoming increasingly more popular. It's probably represented 20 of our affordable housing production [in 2011]."



Timothy Leonhard

Popular for LIHTC Properties

Leonhard said that he's seeing developers/owners use the ARM product to refinance existing low-income housing tax credit (LIHTC) projects in Years 11 to 15 of their 15-year compliance period. This cuts their debt service costs and gives them maximum flexibility to re-syndicate the property with fresh tax credits after the end of the compliance period. At that point they can prepay the ARM for a small penalty, re-syndicate the property with fresh housing tax credits, and get a new fixed-rate loan.

The second big use, Leonhard said, is of developers using ARMs to acquire properties, either existing LIHTC projects near the end of their 15-year compliance period, or even non-tax credit properties. Again, they can then re-syndicate or syndicate the property with new tax credits.

According to Leonhard, the benefits of the agencies' multifamily ARMs to borrowers include prepayment flexibility, a low interest or "pay" rate, a nominal fixed pre-

payment penalty, and limited interest rate risk. He noted that the Fannie Mae and Freddie Mac ARMs most commonly obtained by affordable housing borrowers have an interest rate cap, provide for monthly adjustment of the interest rate at a spread over the prevailing 30-day LIBOR rate, have a prepayment lock-out in the first year, and permit prepayment afterwards for a fee equal to 1% of the outstanding loan amount – much less than the typical prepayment penalty for comparable fixed-rate loans with their "yield maintenance" requirements. Leonhard indicated that Fannie Mae and Freddie Mac will consider waiving the prepayment penalty if the borrower converts to one of their fixed-rate loan products.

The ARMs can have loan-to-value ratios as high as 80% and an amortization period of up to 30 years. ARMs typically have an interest rate cap "embedded" in the loan – as opposed to requiring the borrower to buy a rate cap from a third party. This is a feature of the Fannie Mae 7-6 ARM but not its Structured ARM, and is an option for the Freddie Mac ARM.

Leonhard, when interviewed in early December, estimated that the all-in borrowing rate – or "pay rate" – for an agency ARM pegged to the 30-day LIBOR would be around 3.35% for Fannie Mae's 7-6 ARM versus about 4.25% for a standard seven-year fixed-rate loan. He added the current rate for a Fannie Mae Structured ARM could be as low as 2.50% plus a fee for the third-party rate cap. The 30-day LIBOR rate then was about 0.25%.

The Fannie Mae and Freddie Mac ARMs allow borrowers to choose from an array of possible loan features. Freddie Mac, for instance, permits the borrower to choose a capped or uncapped ARM; terms of 5, 7, or 10 years; multiple indices and rate adjustment periods; and from four prepayment options. Fannie Mae's structured ARM offers terms of 5, 7, or 10 years.



"We're seeing more of this product (Fannie Mae 7-6 ARM) for acquisitions; that's where it's particularly useful," said Ginger McGuire, Senior Vice President of Lancaster Pollard, a Fannie Mae, FHA, and Rural Development lender. She said that developers can

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typically get approval and close within 90 days.

Agencies Seeing Growing Interest

Executives Bob Simpson of Fannie Mae and Christine Hobbs of Freddie Mac confirmed the growing popularity of their companies' multifamily ARM loans with affordable housing developers and owners. Simpson said the 7-6 ARM but not as much the Structured ARM has been used by affordable housing borrowers.



Bob Simpson

The two executives indicated that affordable housing borrowers are generally using the ARMs to refinance or purchase existing LIHTC properties near the end of their 15-year tax credit compliance period, which gives them the flexibility to re-syndicate the properties at some future point and benefit from a low interest rate in the interim. Simpson said Fannie Mae's 7-6 ARM is being used for both 9% and 4% credit projects.

"The shorter-term financing allows people to acquire the deals today at an attractive rate and price and then have the ability to reposition the property looking forward a couple of years," said Hobbs.

In addition to the low rate and prepayment flexibility, Hobbs felt that Freddie Mac's ARM has become popular with affordable borrowers because sellers of LIHTC properties still in their 15-year compliance period no longer have to post a recapture bond, and because of the large and growing number of LIHTC properties at or approaching the end of their compliance period.

Said Hobbs, " We expect this [Freddie Mac ARM] product...to be a growing part of our business [in 2012]."

California Transaction

In October 2011, Oak Grove Capital closed a \$34.2 million Fannie Mae Structured ARM made to Newport Beach, Calif.-based Mariman & Company to help finance the purchase of an existing 272-unit LIHTC property in Orange County. The property, Casa La Palma Apartments, was in the 13th year of its tax credit compliance period.

The seven-year ARM, pegged to the 30-day LIBOR rate, had a starting pay rate of 2.50% and was for 80% of the purchase price/appraised value.

Mariman & Company purchased all of the partnership interests in the property (general, limited, and special limited) and anticipates re-syndicating it within 30

months with 4% housing credits, said company Vice President Shawn Boyd. He noted that the low pay rate, flexibility regarding the timing of prepayment and re-syndication, and other features made the Fannie Mae ARM attractive.

According to Boyd, Mariman & Company, a small private trust, has traditionally been an owner-operator of market-rate multifamily housing properties. "We have a portfolio of a thousand units and are looking to double that," he says. "We're going to try to double it with the [acquisition] of additional tax credit communities."

"Our model is either to simply buy out the GP interest for straight cash, leave the limited partner in place, and then take it to Year 15 and re-syndicate it in Year 15," says Boyd. "Or buy the deal completely now, preserve the partnership that's in place to keep that chain of title, and then do the same thing, re-syndicate it in Year 15."

Preserving the partnership and chain of title averts a possible violation of the LIHTC program's so-called 10-year rule, which would disqualify the buyer from receiving housing credits for acquisition costs.

(ARM Term Sheets: <http://efanniemae.com>, <http://www.freddiemac.com>) **TCA**



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