**March 2018**

**Direct Purchase of Tax-Exempt Loans**

On August 27, 2014, Freddie Mac closed the first tax-exempt loan (“TEL”) under Freddie Mac Multifamily’s Direct Purchase of Tax-Exempt Loan Initiative.

**Description of the Initiative** – Under the Initiative:

* Freddie Mac Seller/Servicers -- or construction lenders in new construction or substantial rehab deals -- make loans (Funding Loans) to state and municipal issuers of tax-exempt bonds (Governmental Issuers).
* Governmental Issuers, in turn, loan the proceeds of the Funding Loans to developers (Project Loans) to finance the acquisition, rehabilitation, or construction of affordable multifamily properties.
* Freddie Mac issues commitments to the Seller/Servicer, which provide the conditions under which Freddie Mac agrees to purchase from the Seller/Servicer the promissory notes evidencing the Funding Loans (Governmental Notes or TELs).
* Because the Project Loans are intended to meet the requirements for the issuance of tax-exempt obligations under Section 142(d) of the Internal Revenue Code of 1986, as amended (Code) and for the granting of 4% low-income housing tax credits under Section 42 of the Code, interest paid on the TELs is expected to be excluded from gross income for federal income tax purposes.\*

**Documentation –** The Funding Loan is documented with:

* A Governmental Note (as described above).
* A Funding Loan Agreement among the Governmental Issuer, the Seller/Servicer (or construction lender) and a Fiscal Agent, which is a bank with trust powers appointed by the Governmental Issuer.
* The Funding Loan Agreement operates much as a Trust Indenture does in a bond transaction.
* The Fiscal Agent performs functions similar to those of a bond trustee in that it takes an assignment of the Project Loan documents from the Governmental Issuer and administers the Project Loan for the benefit of the holder of the Governmental Note.
* The Project Loan is documented with:
* A Project Note.
* A Project Loan Agreement.
* A security instrument and other ancillary documents.
* Continuing Covenant Agreement - In addition to the Funding Loan and Project Loan documents, for each TEL the Seller/Servicer and the borrower enter into a Continuing Covenant Agreement which:
* Contains customary Freddie Mac borrower covenants and representations and warranties.
* Is assigned by the Seller/Servicer to Freddie Mac upon Freddie Mac’s purchase of the Governmental Note.

**TELs and Securitization** – The TELs will be:

* Acquired and held by Freddie Mac until an optimal principal balance is aggregated, and then securitized through either our ML-Deal or Multi PC structures.
* In an ML-Deal execution:
* The fixed-rate TELs are transferred by Freddie Mac to a trust, treated as a partnership for federal income tax purposes\*
* Any related fixed-rate taxable loans are transferred by Freddie Mac into a taxable loan trust, treated as a REMIC for federal income tax purposes\*
* In exchange for the fixed-rate TELs, the trustee, on behalf of the TEL trust, issues floating-rate Freddie Mac Guaranteed Certificates (Tax-Exempt ML Certificates) and Non-Guaranteed Certificates, privately placed with the B-piece buyer
  + Interest payments on the Tax-Exempt ML Certificates, up to the weighted average coupon (WAC) of the fixed-rate TELs, is not expected to be subject to federal income tax.\* Any interest payments in excess of the WAC, including interest paid by the Freddie Mac Guarantee, will be subject to federal income tax
  + All income received on real estate owned (REO) collateral will be subject to federal income tax
* In exchange for the fixed-rate taxable loans, the Trustee, on behalf of the taxable loan trust, issues floating-rate Freddie Mac Guaranteed Certificates (Taxable ML Certificates) and Non-Guaranteed Certificates, privately placed with the B-piece buyer
* Freddie Mac will sell the Tax-Exempt and Taxable ML Certificates to the Placement Agents who will sell the Tax-Exempt and Taxable ML Certificates to the market
* In a Multi PC execution:
* The TELs are transferred by Freddie Mac to a grantor trust
* In exchange for the TELs, the trustee, on behalf of the trust, issues fully guaranteed Freddie Mac Multi PCs where the tax-exempt benefit is expected to be passed on to the investor.\*

**Affordable Housing** – By acquiring Governmental Notes through its Direct Purchase of Tax-Exempt Loans Initiative and securitizing them through the ML-Deal or Multi PC structures, Freddie Mac will continue to support affordable multifamily housing while transferring a substantial portion of its risk to private investors.

**\***Freddie Mac is not rendering tax or legal advice and appropriate tax and legal counsel should be consulted on all tax and legal aspects and ramifications of the Initiative and its structure.