Freddie Mac MULTIFAMILY

Impact Investing in Underserved Communities

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Speakers	Corey Aber, Vice President of Mission, Policy & Strategy, Freddie Mac Multifamily Luba Kim-Reynolds, Senior Director of Investor Relations & ESG Initiatives, Freddie Mac Multifamily Michael Lohmeier, CEO, IMPACT Community Capital

Corey Aber [00:00:00] So Luba, a lot of times on the podcast when we talk about having an impact in communities, we typically talk to property owners or property managers, right? And we'll talk to some of the organizations in communities that provide a lot of support. But we spent enough time talking to people who lend and invest money for the specific goal of having an impact. Think it's time we round out the story.

Luba Kim-Reynolds [00:00:19] That's right. That sounds like it's been long overdue.

Corey Aber [00:00:28] Hello and welcome to this episode of the Freddie Mac Multifamily podcast. I'm Corey Aber.

Luba Kim-Reynolds [00:00:32] And I'm Luba Kim-Reynolds.

Corey Aber [00:00:34] Today on the show, we're really excited to be joined by Michael Lohmeier, who is the chief investment officer at IMPACT Community Capital. He oversees the strategy and execution of IMPACT's investment programs, including managing almost $3 billion of investments for major institutional investors with about $2.5 billion in affordable housing. Mike, thanks so much for being here today.

Michael Lohmeier [00:00:55] Thank you for having me. It's a real pleasure to be here to talk with you today about IMPACT Community Capital and the work we've done with Freddie over the last decade or so. We're really excited about the partnership.

Luba Kim-Reynolds [00:01:06] We are very excited about this partnership as well. So maybe for our listeners, Mike, you can go a little bit more what IMPACT's business is and what it makes it unique.

Michael Lohmeier [00:01:16] I'd love to, Luba. Thank you. So IMPACT, as Luba mentioned, is a really unique place. We were founded in 1998 by several large insurance companies, and they saw the need to make impact investments at scale in multifamily rental housing. And they wanted to create a vehicle to do that. And so, our one of the unique things, of course, is our ownership. We continue to be owned by several large insurance companies, but also our mission, which is to provide fiduciary, quality, institutional investment solutions to insurance companies and other institutional investors while we drive capital to communities to improve the lives of low-income families across the United States. The mission itself is quite unique. And then what also is unique is the way that we do our business. So, we are a [U.S. Securities and Exchange Commission; SEC] registered investment advisor. We're one of the few [SEC] registered investment advisors that focuses solely on making impact investments.

One of the other really unique things that has come about besides our ownership is the way that we do business. As I mentioned kind of in my intro, we have a long partnership with Freddie Mac, which speaks to our ability to access capital markets through Freddie Mac's assistance, which provides liquidity to our investors. It also is another way in which we meet our mission, which is to help provide investment

solutions for institutional investors. Many investors aren't ready to join us on the journey in the whole loan multifamily debt space, but they are willing and excited and do invest in Freddie Mac securities that are issued backed by those loans. And so, the partnership with Freddie allows us to further our mission and meet more investors.

IMPACT is also unique in that everything that we do is driven to make impact investments. And that flows through our investment process into our reporting and into the way that we engage with our investors. And one of the unique ways, particularly in multifamily investments, is that we look at the gap in rents between market rents and the rents charged at the properties we're financing as both a key measure of our impact, which has to do with the amount of monthly rent savings tenants are receiving at these properties. But also, it's a measure of risk. And that's really important is that we drive impact investing. Our ESG [Environmental, Social and Governance] focus flows through not just our reporting, but also the investment process. The way that we structure and create products are all through an impact and ESG lens, and we think that makes us very unique.

And then lastly, I'll say, when we do all of this, we're seeking market rates of returns for our investors, our investors, our large institutions. We act as a fiduciary on their behalf. And we think that these investments in affordable housing — particularly affordable housing debt — provide a really unique, low risk, low correlation, stable investment with risk-adjusted returns that are attractive to investors. We really think of it as a core investment idea that's good for liability-driven investment strategies, asset liability matching strategies, as well as in core, real estate and core fixed-income portfolios.

Luba Kim-Reynolds [00:04:12] This is great. And I am especially excited about this episode because Mike, whatever you guys do, it's really bringing everything together, right? You have expertise in the loan side but also in the capital markets side. And I think that's so important kind of to see the whole story, how this plays out. You mentioned the word impact investing a few times. Do you want to kind of drill down a little bit more what exactly that means for you or in general?

Michael Lohmeier [00:04:43] I think our definition probably aligns with many in the market. You know, Luba, you know this, but unfortunately, there's no Webster's Dictionary version or Oxford [English] Dictionary version of the word impact investing, so, it has a lot of different meanings. For us, it means the intentional seeking of investment opportunities that will have a positive impact in low-income communities and for low-income families. And so that's why I mentioned we have this measure that we use, which is the gap between rents, and that's an important measure for us. But it also is part of the way that we look at the partners we work with. So, we try to align with mission-aligned, mission-oriented investment firms as well as with partners like Freddie Mac, who have a strong presence in impact investments and sustainable investments. Because we know that we're all driving towards the same goal. And so, impact investment for us is really that intentionality, the measurement, as well as a holistic approach to the way that we look at it.

Corey Aber [00:05:38] Mike, you know, one of the things that you mentioned is really interesting here because I think often when people think about impact investing, they might think concessionary capital. It sounds like you're able to do this, you know, have a meaningful impact, finance affordable housing, finance housing where where the rents of the property are below market rents and below maybe other affordable housing rents. Yet do it with a really good risk-adjusted return. How do you factor all that together? What's the secret behind this?

Michael Lohmeier [00:06:09] The challenge is that intuitively, you would not think that by financing low- and moderate-income rental, multifamily rental housing, that it would be able to produce returns that are attractive to institutional investors. And the, so that's the challenge. And the challenge comes to, it is hard in that institutional investors need to be brought along a journey to understand the risk return profile and how, as I mentioned earlier, because of the lower rents in many of these communities, these properties, are fully occupied, they have stable income. They do pay their debt back at a higher percentage or

proportion than market rate properties. And so that shows through our performance metrics as well as much in the industry about how low the default rate is. And so, it's telling the story to institutions to understand that it's a low risk. We also do a lot of work on correlation. You know, it's it's not highly correlated with other investment classes in real estate or in fixed income. And so, what that means is that it's a diversifier in portfolios. And so, it's really about understanding the business case and being able to make the argument about the risk returns being attractive because the risk is so low. And so, it's getting through that perception of what, how risky these investments really are.

Corey Aber [00:07:27] You invest in a lot of different markets, too. And so how do you think about geography and use of market context with the investments that you make and some of your strategy?

Michael Lohmeier [00:07:37] Well I mentioned earlier that one of our key underwriting and impact metrics is this concept that we like to call The Gap, which is the difference between market rents and the rents at the property. And by geography, those numbers change dramatically. You know, in places like San Francisco and New York and Los Angeles, the gap between market rents and affordable rents can be a $1,000, $1,500 for larger units, maybe even $2,000 a month. And so, for families who are able to access a restricted, affordable housing property, it's like winning the lottery. And so those properties perform very well.

But in other markets — secondary and tertiary markets, many times in places like the Midwest, I'm from Illinois and so I always use the example of Decatur, Illinois — in which the market rents, in some cases, can be below the restricted rents or right on top of the restricted rents. And those properties are very difficult to finance because there's a lot of competition and there's other options for people to to live at. And one of the things that that does is it also helps remind us that we see the acute affordable housing crisis in big cities because we see the homelessness problem and we see people living in vans and in tents and things like that. In towns like Decatur and a lot of towns throughout rural America and in the Midwest and in the Southeast, you have a housing crisis that's a little bit different. There may be housing, but it's not safe, sanitary and affordable. And so, you still need to invest in communities like Decatur and Flint, Michigan, and all these other, you know, small-to-medium-sized towns throughout the country. Because they haven't had investment to build quality housing in many years, sometimes decades. And so, it's not just about the affordability, but it's also about creating new housing that's quality housing, that's safe and sanitary for people to live in in those geographies. So that's one way that we look at geography.

And the other way really comes down to underwriting and understanding your markets, which has a lot to do with things that are in the news today, like climate change, resiliency to climate change and the increasing role that storms — as we talk today and record this, obviously Hurricane Milton is battering Florida and the Tampa area — you need to understand those markets and what's driving the underwriting there. And are you underwriting insurance costs appropriately? Are you underwriting and looking at the design of the building? Is the building resilient? Are they putting the proper roofs on these buildings, the proper wind, the proper building envelope elements? And so that does drive, the geography drives underwriting as well. And it makes it a challenge in some markets to finance. Florida is a great growth market, we've seen a lot of people move there, but it's hard to finance affordable multifamily rental in Florida because of some of the challenges with resiliency to climate change.

Corey Aber [00:10:07] Mike, when we think about the, these challenges too, we talked about some of the different points of geography. We talked about broadly what you're, you're working on with managing returns and stuff. So how do you think about it — you know, maybe you've got different property types, you know, those that have, you know, public funding versus those that don't, for example.

Michael Lohmeier [00:10:26] Yeah, I think that's one of the long-term challenges is that some communities, particularly urban areas, it's very expensive to develop new housing. And then as we talked about rural areas, you know, it's maybe not as expensive to develop rural housing, but the economics are more challenged because of the rent restrictions and competing with market rate properties. It's hard to

make them cash flow. And so, in both cases, state and local governments are required to help fill the gap in the financing structure in urban areas and potentially providing rental assistance or other subsidies to make the long-term operating success in rural or more tertiary markets work. And it's the scarcity of the subsidy that's one of the biggest challenges that we face.

And I'll use an example, which is a great deal that we're doing in San Francisco. I'll leave the names out to protect the innocent, but it's a very large deal. It's 100 units in San Francisco and it's costing about $100 million to develop that. The first mortgage on that property is about $4 million. So, with tax credits and the significant subsidy from the city of San Francisco and from the state of California, this property is able to be developed. But without it, without that significant subsidy, the economics just don't work. And in rural areas I've mentioned they don't work for other reasons. So, geography and the ability for state and local governments to access subsidy is really important, and it helps drive where a lot of the geographies and where a lot of this development takes place.

Corey Aber [00:11:55] It's really interesting how many different sort of partners need to come together to make some of this work as well.

Michael Lohmeier [00:12:01] It is. You know, we like to take a lot of pride in what we do, but it's partners like Freddie Mac who help us do our job. It's partners and local communities like cities and states and the federal government, you know, through HUD [Department of Housing and Urban Development] and the other agencies that provide subsidy. We we have some very successful veterans deals, and the Veterans Affairs Department and HUD provide a lot of financing to help develop housing for veterans. And those are all really important sources of capital.

Luba Kim-Reynolds [00:12:30] So, Mike, let's add one more layer of complexity to get the affordable deal done, right. And we need to talk about the climate, so climate impact and climate risk. And I think oftentimes what people forget is that when dealing with affordable housing, right, the, there's a very big intersection between the climate and affordability. So, for example, on the impact side, how do you make the property more efficient? So oftentimes it translates into more affordable rents or on the resiliency side, because some of those climate risk really impacting some of those lower-income communities. So how do you make those properties more resilient? So, for you, Mike and your company, what are you guys kind of thinking about or maybe working towards to how to incorporate the impact as well as the resiliency?

Michael Lohmeier [00:13:21] We look at a lot of, a couple of levels. I mentioned earlier we talked a little bit about insurance and how it's different in some geographies. And you really have to take into account resiliency and the impact of storms, in particular in places like the Southeast. And that's certainly one element of it. So, when we look and we underwrite deals, having sustainable low energy or low carbon features in the design are helpful because they can reduce the energy costs long term to those properties. Having resilient features such as raising the first floor and building on pillars or having hardened roofs or, you know, storm shutters and things like that, can reduce insurance costs, which again help the property perform and provide better NOI [net operating income], which is, you know, a way then that rents can be more affordable. If you are managing expenses better, you can obviously, it's easier to restrict rents and to make the property work and to repay your debt, which is ultimately what we're most concerned about.

One of the challenges we face is that a lot of restricted, affordable housing in the United States is financed under the Low-Income Housing Tax Credit program. And by the time the deals come to lenders like ourselves, they're kind of baked already, the cake’s done because they've had to go through a design process and go through the qualified allocation planning process to get an allocation of tax credits. And so, they've worked through a lot of the design elements with their state allocators as well as with their tax credit investors. But what we are seeing and what's encouraging, is we're seeing a lot of features starting off with some of the stuff that's easier. You know, like ENERGY STAR® appliances and better windows

and construction standards to some of the things I just mentioned, which would be hardened roofs and storm shutters and things like that. But it's not, it's not easy.

I always look back on a deal that I did earlier in my career in about 2005 in Illinois when a famous architect designed a affordable housing property for formerly homeless. Very cool design, had a lot of green features that were ahead of their time for that period, like greywater systems. And I always kind of smile and chuckle a little bit about the story on the day they were trying to do the grand opening, they hadn't gotten state plumbing sign-off on the greywater system because the state of Illinois didn't have a greywater system plumbing standard at the time. And so, you know, while there's challenges in designing and making sure you can get the economics right and build the resilient features, there's also, are we bringing policy along with us at the state and local level to make sure that these features can be implemented? Because on the sustainable side, it's important to have the operating benefits of having lower cost energy or lower insurance payments that you can maintain the affordable rents. But it's also about actually having somewhere people can live and come back to when there are storms. And that's building stronger, more resilient properties. And that's a challenge that the industry is still facing because it drives up construction costs and it makes it very challenging when there's a scarcity of subsidy. So, we're seeing some good things. We've, we're pleased with some of the environmental and sustainable work that we've done. But it's really a challenge to to drive the industry in ways that we we think it needs to go from the seat that we're sitting in.

Corey Aber [00:16:36] Mike, that's a really good perspective, and I want to bring it back around to the tenant experience a little bit, too, because we haven’t talked about that. The more resilient, more efficient properties are, you know, fundamentally beneficial, have some tenant benefit, but also properties that are run with the tenants in mind, again, can be quite beneficial. And how do you think about that? How do you think about resident services and sort of tenant needs at the properties that that you're providing financing for?

Michael Lohmeier [00:17:03] We look at it both from an impact perspective and from an underwriting perspective. And I'll start with kind of the cold, hard underwriting case first, which is particularly if you're targeting extremely low-income populations or very low-income population — so populations at 30% of the area median income or maybe 40% or even lower. Those tenants need services. Many times, they've experienced homelessness recently, and some of the things that have, that lead to homelessness, which could include substance abuse or mental health issues. So, when you're targeting very low income, which from an underwriting perspective is a challenge, providing social services helps create a stable tenant base by helping them stay in those units, helping them be able to grow into being able to access job training, access mental health services, substance abuse services, also things like financial assistance and financial literacy so they understand how to budget and how to maintain themselves in the unit. And that provides a more stable underwriting income. And it also means that, you know, the engaged property manager is going to understand what's going on with each tenant. So, from an underwriting perspective, it's really important. So that's cold, hard fact. You know, we would like to get our loan repaid. We want the tenants, particularly when they're in a very low-income area tenant base to have the support system.

From a mission perspective, it aligns exactly with what we want. We understand that people could have various challenges in their lives and supporting them — not just with a warm space to live and a roof over their head, but also to help them move on in their lives and to become a better, more full version of themselves, entails support. And a lot of times they didn't have it. And so, you know, we mentioned veterans deals that we've worked on. And one of the more recent deals — which we're really excited about — is in Knoxville, Tennessee. And it has significant level of supportive services. Caseworkers for each tenant who can help those veterans through the process then of dealing with some of their mental health challenges, but also then being able to engage in the local community by job training, financial assistance as well as financial literacy. So, it's really important to bring the social services from an impact perspective because people will not be able to manage necessarily a permanent supportive home if they're not given the skillset to move on and address the other things that are going on in their life. And

so, we're really proud from an impact perspective of the work that we're doing, particularly with formerly homeless and then also with the veterans communities.

Luba Kim-Reynolds [00:19:40] Let's bring you back a little bit to the capital markets. As you mentioned, you provide this great support of lending in some of those very unique submarkets where we particular might not have a reach. So, it's very important to highlight for the listeners the partnership that we have with you and Freddie Mac, right, providing the liquidity for you through our bonds issuance and for you to go back and recycle this capital and start doing it all over again and again. And one of the things that we did and we're very proud of that we partnered up with you and issued our very first pooled Social Bonds transaction with you. I still remember that press release that we issued, and I know that was a great milestone for us as well. So, can you tell us a little bit more maybe how that help you with the recycling of the capital, why it's important to have the Social Bonds designation in some of the products that you do and partner up with us?

Michael Lohmeier [00:20:47] Sure. And you know, I think there's two elements to this in terms of, you know, issuing that first Social Bond and how the liquidity that working with Freddie Mac can provide. So, on the, on the loan side of the business, we focus primarily on deals that aren't well-suited to go directly to lenders that normally would participate with Freddie Mac, your your Optigo® lender community. Because they're smaller, they might have significant sub-debt or ground leases or what we like to say is some hair on the deal that makes it a little unique or it's small. And so, a lot of lenders, you know, they don't see the economics in doing a $3 million tax-exempt loan or a $800,000 taxable loan on a multifamily property. But that's where we specialize. And we've developed a way to access this, you know, this cadre of small loans and unique loans across the country. So, we aggregate them. And that's our primary function, is to underwrite and aggregate and then hold these. And our investors like that role. However, they've given us a limited amount of capital. And so, in order to recycle that and to be able to do more of that kind of lending and bring capital markets to communities and loans that normally wouldn't have access to it, we have to work with partners like Freddie Mac. So that's the loan side. There's the business case, which is we aggregate, but we don't have an unlimited amount of capital, and there is a need for these small loans to get financed and to find home on institutional balance sheets.

And on the other end, as I mentioned earlier, one of our goals, one of, a part of our mission is to drive institutional capital into impact investments, ESG investments, and in multifamily rental. And working with Freddie helps us create securities that are investable to a larger portion of the institutional investment space. Not every investor's ready to participate in a closed-end fund that holds small whole loans on multifamily rental, but they are willing to hold, you know, an A-1 class or an A-2 class of a Freddie issuance.

And then one of the other things that's really important Luba mentioned was the Social Bond designation. And being one of the earlier Social Bond issuances in the market and also being able to do the first one with Freddie, we were able to bring in additional set of investors that normally wouldn't look at multifamily as having ESG characteristics or having a social characteristic. And be able to have it labeled and having that rigorous framework about how we measure impact and how we report on it long term meant a lot to the, to the industry and provided us a really favorable execution, to be honest with you. That deal was one of the, essentially one of the most profitable deals for our investors in terms of being able to get liquidity as well as being able to drive pricing down, which ultimately ends up being favorable for our borrowers because we're able to then recycle the capital and offer them attractive terms.

Corey Aber [00:23:47] Mike, that is really good perspective and it's great to see how what you do working in communities across the country, working at properties across the country, how that is so tightly connected to what you do from a capital markets perspective, like drawing that connection from the beginning to the end and how capital flows flows around to really make these transactions work not just for today but allows you to keep going is really great perspective on on all the impact work that that we're doing here today. So, thank you so much for sharing that and thanks so much for being with us today.

Michael Lohmeier [00:24:18] Thank you, Corey. We really value the partnership that we've developed over the past 10 plus years with Freddie Mac in doing really unique and challenging and groundbreaking deals like the first Freddie Mac Q Series, the first Freddie Mac privately placed Participation Certificate swap. And as Luba and I just discussed, the first Social Bond. We look forward to the future and in continuing to develop new products in a partnership with Freddie Mac. Since 2014, Freddie has facilitated over half a billion of structured deals for impact, and that has meant that we've then recycled a similar amount of capital back in the communities across the United States. And I'm really appreciative of the time that they've give me today to help tell our story. And I look forward to working and seeing all of you in the near future.

Corey Aber [00:25:04] The Freddie Mac Multifamily Podcast is produced and supported by a team of our Freddie Mac colleagues, including our production lead, Jenny Nguyen, and our audio producer, Jackson Carmichael. To listen to more and keep up with the latest episodes, be sure to subscribe wherever you get your podcasts and check out our website mf.freddiemac.com/research for the full catalog of podcast episodes and original Freddie Mac research.