You Ask and We Answer

2018 Targeted Affordable Housing Seller Workshop

June 7, 2018

Freddie Mac MULTIFAMILY

You Ask and We Answer

1. Knowing Your Borrower
2. HAP Overhang
3. Tax Abatements

Knowing Your Borrower

You Ask and We Answer

Key Takeaways

- By the end of this session you should take away the following objectives
  - » Review and identify good organizational structures
  - » Identify Designated Entities for Transfer (DETs)
  - » Identify Borrower Principals

Why an Org Chart Matters

- The org chart is essentially a road map for understanding the organizational structure of a Borrower and Guarantor and determining control

*Control as defined in Article XII of the Loan Agreement is

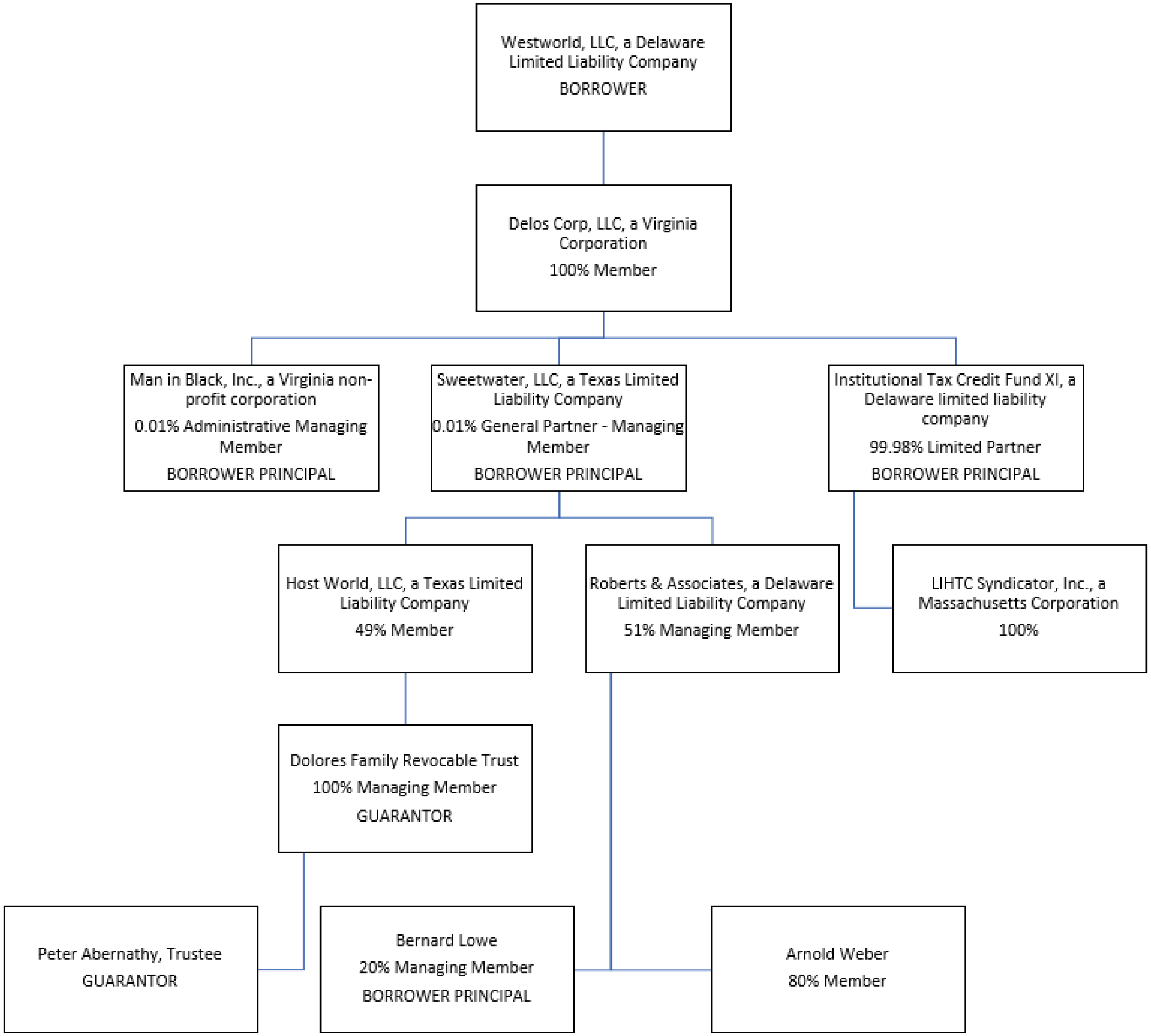
  » “Control” means to possess, directly or indirectly, the power to direct or cause the direction of the management or policies of a Person, whether through the ownership of voting securities, by contract or otherwise, including the power to elect a majority of the directors or trustees of a corporation or trust, as the case may be.

- Provides a framework for evaluating transfer provisions or other document modifications (provided in the PLIM)
- Highlights non-standard structures (i.e., TICs)

Guiding Principles for an Org Chart

- A good org chart will
  - Include the role and percent ownership for all individuals and entities
  - Identify who has control at each level
  - Drill down on intermediate entities until the entity type is either an individual, public company, or pension/investment fund
  - Identify the state of formation for Borrower and SPE Equity Owner
  - Note the guarantor and SPE Equity Owner
  - Add up to 100%
  - Be easy to read and understand
  - Does **not** include PPI (e.g., federal tax id number or SSN)

Sample Organizational Chart



Designated Entities for Transfers

- Purpose of identifying Designated Entities for Transfers (DETs)
  - » Determine which entities, in addition to Borrower, are subject to restrictions on transfers of ownership interests
  - » Determine which entities will need to remain in the organizational structure unless Lender's approval has been obtained
- What is the effect of being named a DET?
  - » A DET cannot make any transfer that Borrower cannot make under the Loan Agreement
  - » If an entity is **not** named a DET, there is no requirement to obtain Lender's approval to a transfer of ownership interests in that entity
    - – **Note**: the current Loan Agreement requires that a transfer of the property or the transfer of a managing interest or more than 50% of a non-managing interest in Borrower always requires Lender's approval

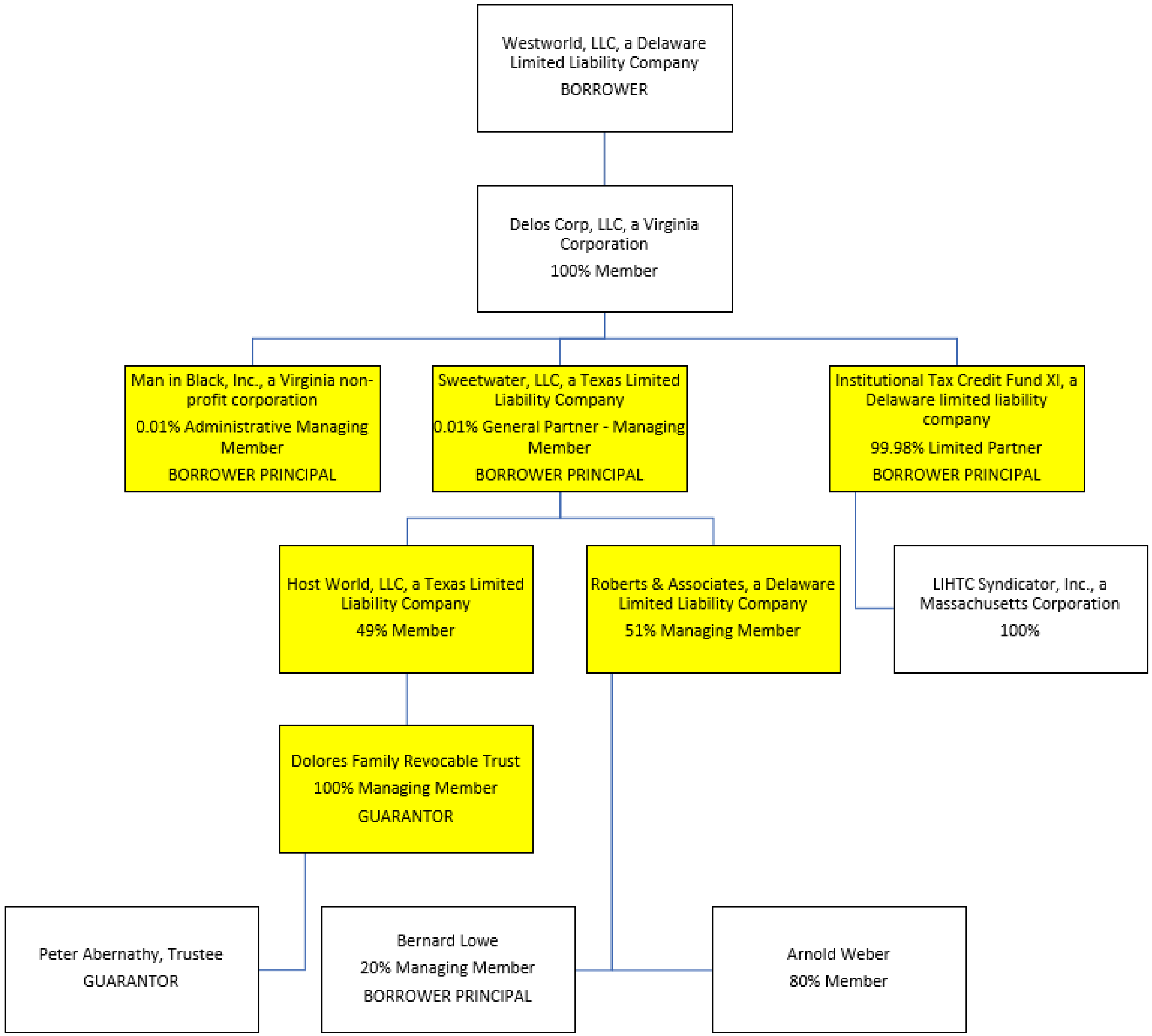
Designated Entities for Transfers, continued

- Determining who will be a DET
  - DETs are entities in the organizational structure of Borrower
    - General Partners
    - Managing Members
    - Guarantors that have an Ownership Interest
      - **MUST BE SHOWN ON THE ORG CHART**
    - Entities with 25% or more interest in Borrower or another entity that have been underwritten **and** Underwriting has determined that such entities should not be allowed to transfer more than 50% of their respective interests without Lender's consent
  - DETs are **not** individuals
  - DETs must be included on the organizational chart and have percentage of ownership interest stated

DETs

- How does the concept of DETs tie into the org chart
  - “Draw a line”: Any intervening entities between the Borrower and the individuals/entities that you expect to remain in the deal must be listed as a DET; in other words, draw a line between the two and include all entities in between
  - The org chart must identify the owners (both percentage and control) for every DET; if not, Servicer cannot determine whether or not a future transfer is permitted
  - Do not “leap frog” over any entities in the chain back to the Borrower – if there is a gap in the chain, the ability to keep any individual or entity past that “gap” in the deal is lost

DETs



Designated Entities for Transfer (DETs)
Judgement Calls

What Is a Borrower Principal?

- Distinguishing a DET from a Borrower Principal
  - A Borrower Principal is
    - any Guarantor
    - any individual or entity that controls the operations of the Borrower
    - any member or limited partner that owns directly or indirectly 25% or more of interests in Borrower
    - any general partner of Borrower (for a partnership)
    - any manager or managing member of Borrower (for a limited liability company)
    - any manager or managing member of a Borrower Principal within Borrower’s org structure (for a limited liability company)
    - any shareholder that owns, directly or indirectly, 25% or more of the voting stock of the corporation (if Borrower is a corporation)
    - any joint venture partner
    - any foreign investors with a 10% or greater collective interest in the Borrower

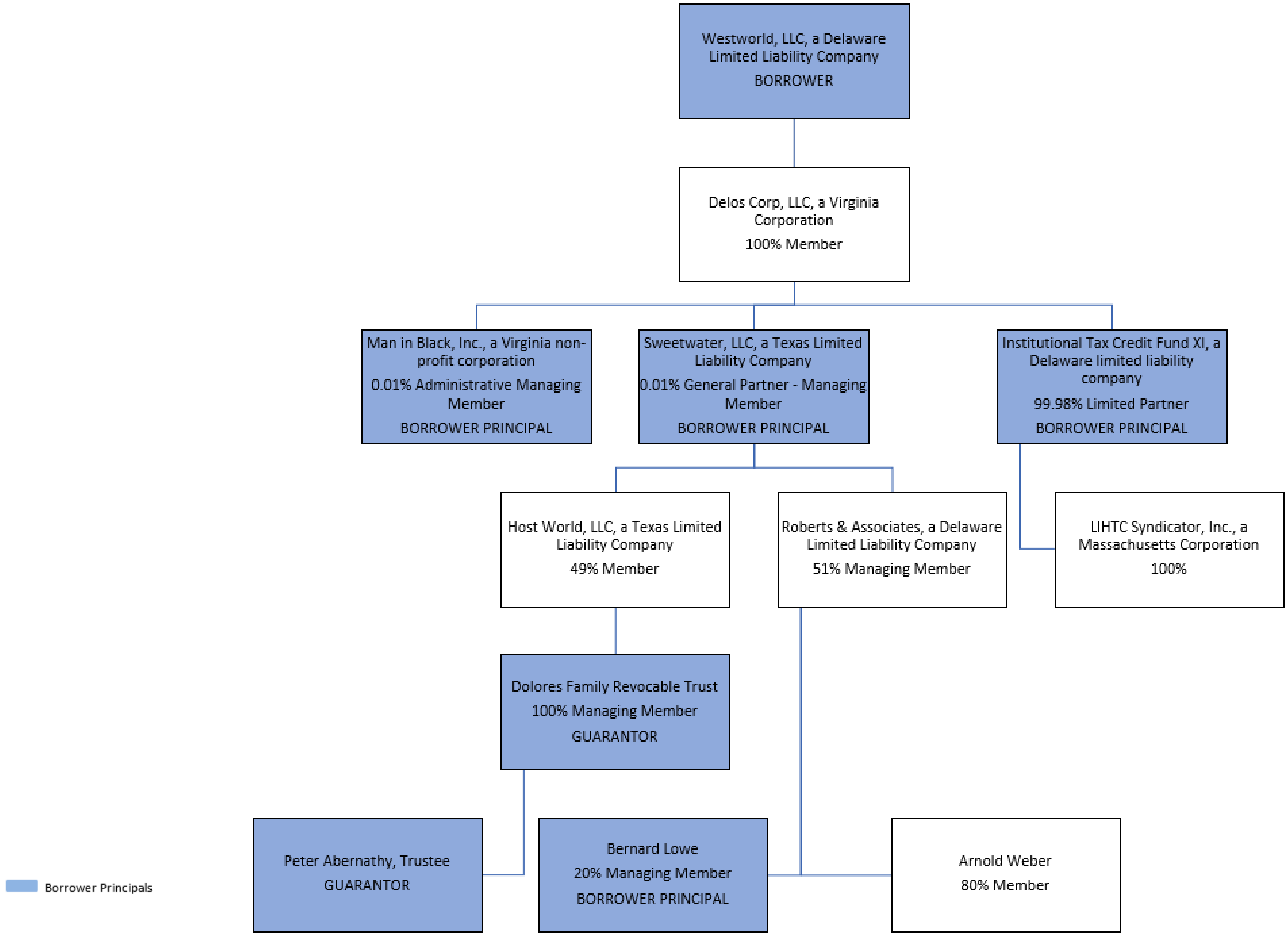
What Is a Borrower Principal, continued

- Borrower Principals obligations under loan documents include
  - Delivering financial statements
  - Making representations about the Borrower and/or the Property
- Borrower Principals must be identified in the underwriting phase for purposes of
  - Collecting Due Diligence (via Form 1115, credit reports, etc.)
  - Checking the Office of Foreign Assets Control (OFAC) specially designated nationals list

Borrower Principal Requirements

- **Need Form 1115/1116/Financial Statements on**
  - Borrower Entity
  - First Level – Individual or Entity that directly owns or controls Borrower entity
    - Includes LIHTC syndicators and direct equity providers
    - If First Level is a pass-through entity, then move down to next person or entity with control
  - Final Level – Individual or Entity that ultimately controls the property and/or holds greater than 25% ownership
    - Individual
    - Guarantor
    - Public Company / REIT / Trust / Fund
  - Non-U.S. Equity Holder with 10% or greater interest in Borrower

Borrower Principals



HAP Overhang

You Ask and We Answer

Key Takeaways

- By the end of this session you should take away the following objectives
  - How Freddie Mac defines HAP Overhang
  - How it is used when calculating Gross Rent

What Is Overhang

- HAP Overhang
  - When the Project-Based Section 8 HAP contract rents exceed the appraiser’s concluded market rents
- Voucher Overhang
  - When Tenant based Voucher rents exceed max LIHTC rents

Can I Underwrite Overhang?

- HAP Overhang
  - Yes, (a) if the loan can pass the Freddie Mac Refinance Test using market-rate rents instead of the higher HAP rents; (b) The remaining contract term is equal to or longer than the loan term (Long-term Contract)
  - Up to 10% Overhang; Above that you should expect a shortened amortization period or lower loan amount
- Voucher Overhang
  - Yes, if…
    - The property has a long history of accepting voucher tenants
    - Vouchers are prevalent in the market
    - Voucher tenants make up a small percentage (<25%) of the overall rent roll
  - We want to know how easy it will be to replace that income if a voucher tenant leaves and will it have a large impact on the bottom line

Tax Abatements

You Ask and We Answer

Key Takeaways

- By the end of this session you should take away the following objectives
  - » What is a Tax Abatement
  - » What does it mean to be on the Approved Abatement list
  - » How abatements should be underwritten

PILOTs and Tax Abatements

- Payment in Lieu of Taxes (PILOT)
  - A PILOT is a form of abated taxes that is generally pursuant to an agreement between the Borrower and the taxing authority
  - Generally sets forth an agreed upon amount that Borrower will pay to the taxing authority
  - Term of PILOT is fixed at execution
- Tax Abatements – Statutory
  - A tax abatement is a statutorily authorized reduction or exemption from ad valorem taxes on a mortgaged property
  - Tax Abatement may be full or partial
  - Tax Abatement may be finite or infinite

Tax Abatements – The "Approved List"

- The Approved List is for seasoned abatement programs – We know them
  - » To get on the list
    - – Requires full PLIM analyzing abatement statute and requirements (Abatement Analysis Sections I and II)
    - – Legal and Underwriting review and approval
  - » No negative inference
    - – Fear not, if your abatement isn't on the approved list
    - – Abatements approved one-off as well

PILOTs and Tax Abatements

- Step 1
  - » If abatement term is 2 years or less – use full taxes
  - » If abatement expires 10+ years after loan term – use abated taxes
  - » If abatement expires 20+ years after origination – use abated taxes
  - » If abatement runs full term of fully-amortizing loan – use abated taxes

- Step 2
  - » If none of the above apply, and the loan passes Freddie Mac Refinance Test with full taxes – use abated taxes

PILOTs and Tax Abatements, continued

- Step 3
  - » If loan fails Refinance Test with full unabated taxes, a cash flow analysis must be performed
    - – Analysis must show that the DCR does not decrease by more than 0.05x from policy-compliant program DCR during loan term, or 0.10x for the first 10 years after the loan term
    - – Cash flow analysis must show that the loan can achieve a minimum 1.20x DCR and maximum 85% LTV at refinance
    - – Inputs (growth rates, refinance cap rate and note rate) must be taken from Freddie Mac Refinance Test

PILOTs and Tax Abatements, continued

- Step 4
  - » If loan fails cash flow analysis, proceeds must be reduced

Tax Abatement Cash Flow Analysis

- Things to remember
  - » Inputs to Cash Flow Analysis must come from Freddie Mac Refinance Test for your property's MSA
  - » Inputs
    - – Rent Growth
    - – Expense Growth
    - – Vacancy Rate
    - – Refinance Interest Rate
    - – Refinance Cap Rate
  - » Account for Interest-Only Period
  - » Analysis must run at least 10 years past the loan term

Tax Abatement Cash Flow Analysis, continued

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Tax Abatement Cash Flow Analysis using Freddie Mac Proforma (templated dated 4/25/18)										
	Fill In									
Applied Other Income Growth Rate		3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
Applied Expense Growth Rate		3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
Ground Lease Growth Rate	2.92%									
Management Fee	3.00%									
Fixed Note Rate or Comparable Fixed Rate	3.80%									
Loan Amount	$19,740,000									
Amortization Period (mos)	360									
Residential Rent Growth		2.33%	2.68%	2.63%	3.35%	3.60%	3.60%	3.60%	3.60%	3.60%
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Gross Potential Rent-Residential	$5,038,752	$5,156,155	$5,294,340	$5,433,581	$5,615,606	$5,817,768	$6,027,207	$6,244,187	$6,468,978	$6,701,861
Residential Concessions	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Residential Vacancy (% of GPR)	4.00%	4.48%	5.25%	5.70%	5.90%	4.10%	4.10%	4.10%	4.10%	4.10%
Residential Vacancy ($)	$201,550	$230,996	$277,953	$309,714	$331,321	$238,528	$247,116	$256,012	$265,228	$274,776
Residential Bad Debt	$0	$0	$0	$0	$0	$0	$0	$0	$0	$
Short Term Premiums	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Residential NRI	**$4,837,202**	**$4,925,159**	**$5,016,387**	**$5,123,867**	**$5,284,285**	**$5,579,239**	**$5,780,092**	**$5,988,175**	**$6,203,750**	**$6,427,085**
Commercial Income	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Commercial Vacancy %	10.00%									
Commercial Vacancy ($)	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Commercial NRI	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Coop Maint Fee	$109,005	$111,545	$114,534	$117,546	$121,484	$125,858	$130,389	$135,083	$139,946	$144,984
Utility Reimbursement	$0	$0	$0	$0	$0	$0	$0	$0	$0	$
Laundry	$0	$0	$0	$0	$0	$0	$0	$0	$0	$
Parking	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Cable	$0	$0	$0	$0	$0	$0	$0	$0	$0	$
Miscellaneous Other Income	$0	$0	$0	$0	$0	$0	$0	$0	$0	$
EGI	**$4,946,207**	**$5,036,704**	**$5,130,921**	**$5,241,413**	**$5,405,769**	**$5,705,097**	**$5,910,481**	**$6,123,258**	**$6,343,695**	**$6,572,0**
Full RE Taxes	$1,112,742	$1,146,124	$1,180,508	$1,215,923	$1,252,401	$1,289,973	$1,328,672	$1,368,532	$1,409,588	$1,451,876
Actual RE Taxes	$446,010	$472,770	$505,865	$541,275	$568,339	$1,289,973	$1,328,672	$1,368,532	$1,409,588	$1,451,876
Insurance	$100,000	$103,000	$106,090	$109,273	$112,551	$115,927	$119,405	$122,987	$126,677	$130,4
[illegible]	$768,996	$792,0	[illegible]	[illegible]	$865,512	$891,477	[illegible]	$945,768	$974,141	[illegible]

Tax Abatement Cash Flow Analysis, continued

Total Exp w/o RET & Reserves + Ground Rent	$2,471,345	$2,541,620	$2,614,032	$2,689,012	$2,767,728	$2,852,629	$2,937,050	$3,024,039	$3,113,675	$3,206,039	$3,30
NOI w/ Actual Taxes	**$1,932,852**	**$1,924,568**	**$1,911,468**	**$1,909,437**	**$1,964,830**	**$1,451,769**	**$1,530,046**	**$1,611,844**	**$1,697,311**	**$1,786,600**	**$1,879**
Amortizing DS	$1,103,760	$1,103,760	$1,103,760	$1,103,760	$1,103,760	$1,103,760	$1,103,760	$1,103,760	$1,103,760	$1,103,760	$1,103
Amortizing DCR w/ Actual Taxes	1.751	1.744	1.732	1.730	1.780	1.315	1.386	1.460	1.538	1.619	
NOI w/ Full Taxes	**$1,266,120**	**$1,251,214**	**$1,236,825**	**$1,234,789**	**$1,280,768**	**$1,451,769**	**$1,530,046**	**$1,611,844**	**$1,697,311**	**$1,786,600**	**$1,8**
DCR w/ Full Taxes	1.147	1.134	1.121	1.119	1.160	1.315	1.386	1.460	1.538	1.619	
Tax Savings	$666,732	$673,354	$674,643	$674,648	$684,062	$0	$0	$0	$0	$0	
IO Period	3 years		Actual Taxes	Per Refi Test	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year
				Refinance Rate	6.12%	6.18%	6.24%	6.31%	6.39%	6.43%	
Legend				UPB	$19,006,355	$18,618,122	$18,214,876	$17,796,036	$17,361,001	$16,909,143	$16,43
Blue = User Input				Debt Service	$1,385,078	$1,365,464	$1,344,404	$1,323,224	$1,301,765	$1,273,201	$1,23
Red = LST I&E Data				DCR	1.42	1.06	1.14	1.22	1.30	1.40	
Black = Output / User input not required				Refinance Cap Rate	7.59%	7.76%	7.93%	8.10%	8.28%	8.44%	
				Refinance Value	$25,887,089	$18,708,362	$19,294,401	$19,899,309	$20,498,922	$21,168,245	$21,9
Maturity Risk Analysis				Refinance LTV	73.42%	99.52%	94.40%	89.43%	84.69%	79.88%	7
Maturity Year	10										
			Full Taxes	Per Refi Test	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Yea
NOI	$1,786,600			Refinance Rate	6.12%	6.18%	6.24%	6.31%	6.39%	6.43%	
Forecasted Cap Rate	8.44%			UPB	$19,006,355	$18,618,122	$18,214,876	$17,796,036	$17,361,001	$16,909,143	$16,43
Interest Rate	6.43%			Debt Service	$1,385,078	$1,365,464	$1,344,404	$1,323,224	$1,301,765	$1,273,201	$1,2
UPB at Maturity	$16,909,143			DCR	0.92	1.06	1.14	1.22	1.30	1.40	
				Refinance Cap Rate	7.59%	7.76%	7.93%	8.10%	8.28%	8.44%	
DCR	1.40			Refinance Value	$16,874,412	$18,708,362	$19,294,401	$19,899,309	$20,498,922	$21,168,245	$21,
LTV	80%			Refinance LTV	112.63%	99.52%	94.40%	89.43%	84.69%	79.88%	