HOUSING

A Buyer's Market

Fannie Mae Acquisition Loans

For those receiving an abundance of real estate brokerage packages lately, one aspect is likely to stand out—the high prices sellers are asking for in today's frothy acquisition market. Due to those high prices, as well as factors such as fewer closing contingencies, quicker closings and all-cash offers, now can be an ideal time to consider selling well-performing affordable apartment buildings.

Conversely, now can be an intriguing time for buyers as well, due in large part to the low cap rates prevalent in today's market. One of the reasons cap rates are so low is because benchmark rates like the 10-year Treasury are approaching historic lows, which can allow a buyer to afford more debt and increase offer prices. It is important to remember that for both buyers and sellers, loan products need to be carefully reviewed, especially when looking at projects with affordable restrictions. This article will examine how to finance acquisitions using an often overlooked funding option from Fannie Mae—Fannie Mae Multifamily Affordable Housing (MAH) loans.

Due to the surging acquisition market, many owners are considering Fannie Mae MAH loans for acquisitions because they can offer a quick close, better terms and non-recourse financing. Simply put, Fannie Mae financing can offer more benefits than bank financing. Fannie Mae continues to be a staunch supporter of affordable housing and is committed to reviewing applications in a timely fashion. Fannie Mae typically uses a pre-review process on affordable loans, which allows them to review more complicated deal structures that are normally associated with affordable projects. Despite this review, it is reasonable to expect to close a Fannie Mae loan in three to four months; plenty of time to stay competitive in any acquisition.

In addition, Fannie Mae has terms that are generally more competitive than traditional banks, which can improve an offer price. Instead of a traditional 70% to 75% loan to value (LTV), on deals with some affordable restriction, Fannie Mae will allow a borrower to leverage up to 80%. For example, for a property that's listed for sale and would be appraised at $5 million, Fannie Mae could allow for 25% less in a down payment (Figure 1).

Figure 1:

	Bank	Fannie Mae
Price/appraised value	$5,000,000	$5,000,000
Loan amount	$3,750,000 (75% LTV)	$4,000,000 (80% LTV)
Equity required	$1,250,000	$1,000,000
	$250,000 Less in equity	

Alternatively, using the higher loan to cost (LTC) limit can allow for a stronger offer. Fannie Mae will allow a borrower to finance tenant-in-place repairs and cover up to 3% of the closing costs in the acquisition loan and the increased leverage point alone can result in an offer that is 20% higher (Figure 2).

Figure 2:

	Bank	Fannie Mae
Equity	$1,000,000	$1,000,000
Debt at LTC	$4,000,000 (75% LTC)	$5,000,000 (80% LTC)
Offer price	$5,000,000	$6,000,000
	$1,000,000 more in offer price	

Fannie requires the lower of LTC and LTV, it is not the choice of the borrower, and that is usually the limiting factor that dictates the maximum loan amount for an acquisition, although better rates and terms can also provide for improved return on investment (ROI). Fannie Mae only requires a 1.20 debt coverage ratio and can amortize for up to 30 years, which can reduce the debt payment and increase cash flow for the owner. These rates and terms can be even better if new tax credits are used or if there is a commitment to green renovations that will improve the property's energy efficiency.

To demonstrate its commitment to multifamily affordable housing, Fannie Mae has recently improved its loan underwriting process. This has made acquisition loans more competitive. They have eliminated the need to calculate a baseline underwriting that was based on historic operations and could have limiting factors on the underwritten and concluded income to support new debt. Although in theory this should not change the final concluded loan amount, it does eliminate a step and can reduce waivers, which can shorten processing times. They have also reduced the guarantee and servicing (G&S) fees for affordable projects which can lower interest rates by approximately 18 basis points.

Low-income housing tax credit (LIHTC) properties exiting their initial 15-year compliance period can be a great acquisition target. One loan product that can be very competitive for this property type is the Fannie Mae Adjustable Rate Mortgage (ARM) 7-6 program. With a note rate between 2.6% and 3.15%, no personal guarantees and a lockout provision that only lasts one year, it is a great alternative to a mini-permanent bank loan. It also features added flexibility as it can convert to a 10-year fixed-rate loan any time after the first year for those who prefer to lock in longer term rates.

Although a 1% prepayment premium is applicable following the lock-out period, it is typically waived if the loan converts to a fixed interest rate. The G&S fees will not change at conversion and minimal additional underwriting is required as the lender has to ensure that current NOI can support the new fixed rate. Although the loan amount may not increase at conversion, there is flexibility to request a supplemental mortgage loan if the property is eligible. Based on the 1-month LIBOR, the loan is generally limited by the LTV or LTC, though it is important to work with a lender so the loan amount can be appropriately sized. For example: a property needs to underwrite to a maximum lifetime note rate not to exceed 5.75%. For an an existing LIHTC project currently in year 10 through 13, this could be a great option to increase the cash flow while still preserving the ability to do another tax credit syndication at year 15 due to the minimal prepayment penalty of 1%.

Cody Doran of Sperry Van Ness, one of the largest multifamily real estate brokerages in the country, noted that three of his last four sales used a Fannie Mae loan product.

"Our clients appreciate the certainty of Fannie Mae because, when facilitated by an experienced lender, there won't be any surprises such as low appraised values or last minute changes to terms. Traditional banks are bound to the appraised values that they receive and have few ways to work directly with the appraiser," he said.

"A dedicated Fannie Mae lender has the ability to work with the appraiser to make sure they are accurately describing the area and valuing the asset. It is in everyone's best interest to make sure the appraised value concludes to the best, although not necessarily the highest, value available and it should not be limited by restrictive rules," he added.

Doran also noted that the peak market is only getting more challenging as he is seeing increasing foreign investment in tertiary markets.

"Although these all-cash buyers are only looking for large deals, so is everyone else, which is putting even more of a premium on bigger projects. Section 8 projects are being sold by their original owners that are finally able or willing to sell, with some selling for as high as $200,000 a unit. However, it is more reasonable to expect $35,000 to $40,000 in the Midwest, which generally results in cap rates in the 6.5% to 7% range."

He continued, "It's important to understand that affordable deals are well insulated due to the minimal competition and should expect to have cash flows to support the price per door. Also, it's important to understand the complicated restrictions that are common with affordable projects, so that you're going to market with a reasonable price but aren't leaving money on the table."

When putting together an offer on an affordable housing project, it is important to review all the options available. The pricing of the Fannie Mae ARM 7-6 product is based on short term LIBOR rates, and since uncertainty remains as to if and when the U.S. Federal Reserve will increase the Federal Funds Rate, ARM products are an attractive option for buyers looking for a quick and strong execution.

Brian Coate is a vice president with Lancaster Pollard in Columbus. He may be reached at bcoate@lancasterpollard.com.

Padam Singh is a vice president with Lancaster Pollard in Columbus. He may be reached at psingh@lancasterpollard.com.