NORRIS GEORGE & OSTROW PLLC

ATTORNEYS AT LAW
THE ARMY NAVY OFFICE BUILDING
1627 EYE STREET, N.W., SUITE 1220
WASHINGTON, D.C. 20006
TEL: (202) 973-0103

March 15, 2018

Fannie Mae M.TEBs*

R. Wade Norris, Esq.
wnorris@ngomunis.com
(202) 973-0110 (direct)
(202) 744-1888 (cell)

Ethan Ostrow, Esq.
eostrow@ngomunis.com
(202) 973-0111 (direct)
(224) 216-2490 (cell)

Fannie Mae M.TEBs

- Fannie Mae M.TEBs product attempts to **lower long-term borrowing rates** in **two major ways**:

  1. **Monthly, tax-exempt, next business day pass-through of an MBS payment lowers bond coupon by 25-30 basis points** (versus traditional semi-annual pay bonds). **Very attractive bond rates** – e.g. **10-year Treasury** (2.90%) + **70 bps = 3.60%**.

  2. **Very competitive guaranty/servicing spread – e.g. 100 bps** – versus more usual 125-140 basis points.

- **Produces a combined savings of 50-60 basis points: → All-in borrowing rate ≈ 4.60%**.

- **Very attractive loan terms – 35-year loan amortization** to balloon 15 to 16 years after placed-in-service/**1.15 DSCR/90% LTV**.

- **Over the past two years, Fannie Mae has now closed** over 20 M.TEBs type financings in nine states having an aggregate dollar amount of **over $300 million.** It has **another $650 million** of **M.TEBs** financings **in its pipeline**.

Moderate Rehab M.TEBs

- The initial **Fannie Mae mod rehab structure M.TEBs** involved a 16-year tax-exempt monthly MBS pass-through bond for mod rehab projects.
- The **rehab may be as high as $40,000 or $50,000** or a bit more **per door**, so long as there are no substantial tenant relocation or re-tenanting issues.
- The Fannie Mae mod rehab DUS loan is funded by the DUS Lender at closing of the Bonds and commences amortization almost simultaneously with the issuance of the Bonds. **No separate construction loan** is involved under this structure.

New “Forwards” M.TEBs

- Fannie Mae’s new **“forwards” M.TEBs** product is for **new construction/sub rehab projects**. This product is just emerging and is rapidly gaining wide acceptance.
- This product not only offers very competitive rates and other underwriting terms, but **Fannie Mae has shown great flexibility in permitting earn-out and/or other supplemental loan funding** if supported by underwriting at conversion.
- The structure combines a 17 to 18-year fixed rate tax-exempt MBS monthly pass-through Bond with a **taxable draw down construction loan from a bank** or other construction lender.
- It entails **2.5-3.5 points of construction period negative arbitrage (see below)**, but for many projects this disadvantage is more than offset by the favorable terms and flexibility on supplemental funding.

Borrowing Rates for M.TEBs

- Both versions of M.TEBs (mod rehab and "forwards") combine very low all-in borrowing rates:

	Moderate Rehab Loan	**"Forwards"** M.TEB (New Construction/Sub Rehab)
10-Year Treasury	2.90%	2.90%
Spread	.70	.80
Tax-Exempt Bond Coupon/MBS Pass-Through Rate	3.60%	3.70%
Guaranty/Servicing	1.00	1.10
All-in Borrowing Rate*	**4.60%**	**4.80%**

*Excluding ongoing issuer, trustee, rebate fees and about 2 to 2.5 points of construction period negative arbitrage in the "Forwards" M.TEBS structure. Taking into account 2.5 points of negative arbitrage, the equivalent permanent rate would be **comparable to about a 5.00% permanent rate on the "Forwards" structure** when compared to other draw down executions.

Calculation of
Negative Arbitrage on Forwards M.TEBs

Let's assume in our Forwards M.TEBs financing above we have a 24-month origination period (24-month "Termination Date" – i.e., Bonds redeemed if Conversion is not achieved by that date) with one six-month extension to a 30-month "Outside Termination Date" for Conversion.* Bond maturity = 30 months + 16 years or 18.5 years out.

Negative Arbitrage Calculations:

2-Year Period to Outside Termination Date:

First 24-months: 3.70% bond coupon – 2.25% 24-month U.S. Treasury yield x 2 years = 2.90%**

Additional Negative Arbitrage (45-day period from Conversion/DUS Loan closing through assumed delivery date of MBS): = 3.70% Bond Coupon x (45/360) = 0.46 ≈ 0.50%***

---

* Deposit of six months of additional negative arbitrage in bankruptcy remote funds is a condition to extension. See footnote below.

** Estimated additional negative arbitrage for six months, if needed, at today's U.S. Treasury Rates:
6-months (months 24-30): 3.70% bond coupon – 2.00% 6-month U.S. Treasury yield x ½ years = 0.85% additional deposit to extend.

***Round this to 0.50% for sizing additional negative arbitrage **deposit. Expected** negative arbitrage for this period is perhaps only half of this amount, or about **0.25%**, since the MBS is typically delivered within 2-3 weeks of conversion and funding of the DUS loan.

Tax Exempt Bond Coupon and All-In Borrowing Rate

Total Negative Arbitrage Deposit	
Months 0-24	2.90%
Months 24-25.5	0.50
Total Negative Arbitrage Deposit	3.40%

This 3.40% negative arbitrage deposit **raises our effective all-in borrowing cost** of 4.80% as shown above **to roughly 5.0%** or slightly higher in our example, when the forward M.TEBs structure is compared to drawn-down private placements and other executions for substantial rehab or new construction deals which do not entail a negative a negative arbitrage component. Of course, the all-in borrowing cost and its components may be higher or lower than the levels shown here due to a number of factors.

M.TEBs

- The authors served as Underwriter's Counsel on the first M.TEBs transaction, which closed in January 2015, and on about half of the 20 M.TEBs financings closed to date. As volume has increased and investor base, including cross over MBS buyers, has increased, the **spread of bond coupon to 10-year U.S. Treasury has continued to decline**.

- **Fannie Mae will now finance 0.75% for issuance costs within the Fannie Mae DUS Loan** – Raises rate but lowers out-of-pocket expense of execution to better compete with bank balance sheet and Freddie TEL and private placements.

- The structure offers **greater prepayment flexibility** – yield maintenance/prepayment premium versus 15-year absolute lock-out under most other structures.

- Due to the factors summarized above, **the use of the M.TEBs structure** has become much more **widespread and** the **growth** in its use appears to be **accelerating**.