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Fannie Mae Tax-Exempt MBS Pass-Through Bonds ("M.TEBs")

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M.TEBs Basics

- The **Fannie Mae** Tax-Exempt MBS Pass-Through Bond ("**M.TEBs**") structure is a **16-18 year fixed r**ate, (S&P) AA+ or (Moody's) **Aaa-rated publicly offered tax-exempt bond issue** for affordable multifamily rental projects.
- **We closed the first Fannie Mae M.TEBs issue in January of 2015***, and there have **now** been **over 100** of these financings **aggregating over $2.0 billion** in principal amount closed in a number of states.
- The structure is available for **moderate rehabilitation** projects (called an **"Immediate M.TEB"**), as well as for projects involving **new construction or substantial rehabilitation** (called a **"Forwards M.TEB"**).
- In the Forwards M.TEB, a **taxable bank lender is brought into the financing** to fund construction draws (and tax-exempt bond proceeds are escrowed) **until** construction and rehab is complete and the project has reached stabilized occupancy (e.g. 1.15:1 debt service coverage for 90 consecutive days – also called **"Conversion"**).

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* **Wade Norris** and **Ethan Ostrow**, together with their prior colleague, the late **Ad Eichner**, worked with Fannie Mae and other participants in 2014 and 2015 to develop the structure and documentation for the Fannie Mae M.TEBs product. This led to the closing of the first M.TEBs financing in February, 2015. Messrs. Norris and Ostrow then served as underwriter's counsel on the first seven M.TEBs financings which closed over the next two years, and NGO has served as underwriter's counsel on many subsequent M.TEB financings.

M.TEBs Basics

- M.TEBs bonds are structured as a **monthly, tax-exempt, next business day pass-through of an MBS pass-through payment** of the monthly payment of principal and interest on the underlying fully funded DUS Loan, which the Fannie Mae DUS Lender extends to the Borrower.
- The **proceeds of the M.TEBs Bonds** are, in effect, used by the Trustee to fund the acquisition of the Project and a rehab reserve for a mod rehab project or to provide permanent financing for a new construction/sub-rehab project.
- The **proceeds of the DUS Loan** are used by the Trustee to **acquire the MBS from the DUS Lender** when issued **to collateralize the Bonds**.
- The **interest rate on the M.TEBs Bond** is equal to the **"pass-through rate" on the MBS**, which is simply the stated **interest rate on the DUS Loan less** what is normally a 120-140 basis points **guaranty/servicing fee,** which is retained by Fannie Mae and the DUS Lender.
- We structured the M.TEBs bond **as close as we could get it to be a "tax-exempt MBS."** Note **denominations down to $1.00 and amortizing prepayments down to $0.01.**
- **Monthly pass-through of P&I payment on MBS – on a tax exempt basis – one Business Day later.**

M.TEBs Basics

- The 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 (2.50%)** + **70 bps** = **3.20%**.
     - Buyers want the security of an (almost) **immediate, monthly agency pass-through.**
     - Structure allows holder to **exchange M.TEB for very liquid Fannie Mae taxable MBS** after placed-in-service date, which further lowers the rate.
  2. **Competitive guaranty/servicing spread – e.g. 120-140 bps**.

- **Produces a combined savings of 35-50 basis points over traditional semi-annual pay bond structure: → All-in borrowing rates between 4.40% and 4.60% in recent transactions**.
- **Very attractive loan terms – 40-year loan amortization** to balloon 16 – 18 years after placed-in-service/**1.15 DSCR/90% LTV**.

Borrowing Rates for M.TEBs

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

10-Year Treasury	2.50%
Spread	0.70
Tax-Exempt Bond Coupon/MBS Pass-Through Rate	3.20%
Guaranty/Servicing	1.30
All-in Borrowing Rate*	**4.50%***

* Excluding ongoing issuer, trustee, rebate fees and about 2 points of net construction period negative arbitrage in the "forwards" M.TEBs structure (see Appendix A discussion below). Taking into account 2 points of **net** negative arbitrage on this "forwards" M.TEBs product, the equivalent permanent rate would be **comparable to a permanent lending rate about 20 basis points higher on the "forwards" structure** when compared to other draw down executions.

DETAILED PRICING DATA on Miscellaneous Recent Fannie Mae M.TEBs Offerings

OS Date	Issuer	Project	Bond Amount	Maturity	Bond Coupon	10-Year UST Rate	Spread to 10-Year	Mortgage Loan Rate	Guaranty & Servicing Fee
12/17/20	SC State HF&DA	3 Projects	$14.5 Mil	1/1/37; 16 yrs	1.68%	0.94%	0.74%	2.72%	1.04%
7/14/21	Dallas HFC	Westmoreland Station	$30.0 Mil	2/1/42; 19.5 yrs	1.82%	1.37%	0.45%	3.26%	1.44%
8/19/21	HFA of Palm Beach County	St. Andrews	$24.0 Mil	9/1/39; 18 yrs	2.0%	1.24%	0.76%	2.91%	0.91%
8/19/21	HFA of Palm Beach County	St. James Residence	$35.0 Mil	9/1/39; 18 yrs	2.0%	1.24%	0.76%	2.95%	0.95%
9/14/20	TDHCA	Ridgewood at Panther Creek	$40.0 Mil	5/1/38; 16.5 yrs	2.17%	1.28%	0.89%	3.215%	1.045%
9/14/20	TDHCA	Pineview at Grogan's Mill	$34.0 Mil	5/1/38; 16.5 yrs	2.17%	1.28%	0.89%	3.20%	1.03%
9/23/21	DCHFA	The Guild O2	$10.9 Mil	11/1/10; 19 yrs	1.93%	1.41%	0.52%	3.34%	1.41%
10/5/21	DCHFA	3 Projects	$17.4 Mil	11/1/35; 17 yrs	2.03%	1.54%	0.49%	3.45%	1.42%
12/9/21	HFA of Pinellas County	Jordan Park Apartments	$27.1 Mil	1/1/2042; 20 yrs	2.30%	1.49%	0.81%	3.76%	1.46%
12/14/21	FHFC	Royal Park Apartments	$14.454 Mil	1/1/2040; 18 yrs	2.30%	1.44%	0.86%	3.65%	1.35%
12/16/21	HFA of Broward County	Solaris Apartments	$4.6 Mil	1/1/2040; 18 yrs	2.35%	1.44%	0.91%	4.00%	1.65%
12/20/21	CalPFA	Siesta Senior Apartments*	$9.946 Mil	1/1/2040; 18 yrs	2.55%	1.43%	1.12%	3.86%	1.31%
12/22/21	Monroe HA	Icemorlee Apartments	$14.135 Mil	1/1/2039; 17 yrs	2.07%	1.46%	0.61%	3.33%	1.26%
1/20/22	FHFC	Allegro at Hacienda Lakes	$17.450 Mil	2/1/2040; 18 yrs	2.55%	1.83%	0.72%	3.91%	1.36%
1/27/22	Beaufort HA	Hilton Head Gardens	$12.5 Mil	3/1/2038; 16 yrs	2.40%	1.81%	0.59%	3.66%	1.26%
1/28/22	Beaufort HA	Spanish Trace Apartments	$10.0 Mil	3/1/2039; 17 yrs	2.57%	1.78%	0.79%	3.83%	1.26%
2/3/22	CMFA	26 Point 2 Apartments	$11.825 Mil	3/1/2040; 18 yrs	2.65%	1.82%	0.83%	3.76%	1.11%
2/10/22	HA of the City of Columbia, SC	Arrington Place Apartments	$5.644 Mil	3/1/2039; 17 yrs	2.75%	2.03%	0.72%	4.47%	1.72%
2/11/22	CalPFA	Acme Family Apartments*	$9.934 Mil	3/1/2040; 18 yrs	3.15%	1.92%	1.23%	4.46%	1.31%

***Taxable bonds**

Special Fannie Mae Programs Can Lower Borrowing Rates Even Further

- For **projects designated as "green"** by one of a number of Fannie Mae approved organizations, the "green" M.TEBs may trade at a **5-10 basis points lower coupon**.
- In addition, Fannie Mae can **underwrite 75% of the projected operating cost savings realized by the "green" project owner** and **25% of the tenant savings for up to an additional 5% of loan proceeds if supported by the loan-to-value test**.
- Under Fannie Mae's **Healthy Housing Rewards Program pricing discounts** on the guaranty/servicing fee of **up to 30 basis points** may be available for **Enhanced Resident Services** and discounts of up to **15 basis points** for **Active Design**.
- In the present market, **one or more of the foregoing** can **reduce the all-in borrowing rate of the M.TEBs execution to 4.10% or 4.20% or lower** and thus make the M.TEBs structure even more competitive.

Moderate Rehab "Immediate Delivery" M.TEBs

- The **mod rehab "immediate delivery"** structure M.TEB involves a 16-17 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** or construction lender is involved under this structure.

M.TEBs Premium Pricing

- The very strong demand for Aaa-rated tax-exempt muni bonds has enabled **very attractive premium pricing** on Fannie Mae M.TEBs.
- Fannie Mae will allow the underwriter to sell the M.TEBs bonds at **a premium of up to 6%** for **tax-exempt executions** and up to 3% on taxable executions (discussed below).
- On a forwards M.TEBs, this premium **will be held in escrow** until Conversion of the DUS Loan to the permanent phase and will be paid out to bondholders in the event of a non-origination call.
- However, once Conversion is attained, this premium **can be released to cover the negative arbitrage** on a forwards M.TEBs offering (discussed below) **and/or to cover other costs**.
- At present, **premium pricing is very attractive**, requiring an increase to the mortgage loan rate of only about **7 basis points for every point** of premium generated, up to about 4 points of premium.

M.TEBs Premium Pricing

- On such a premium execution with, for example, 3 points of premium, the chart on slide 5 would be as follows:

10-year Treasury	2.50%
Spread	0.91*
Tax-Exempt Bond Coupon Rate	3.41%
Guaranty/Servicing	1.30
All-In Borrowing Rate	4.71%

- Generates 3 points of premium to cover forwards M.TEBs net negative arbitrage (estimated at about 2 points, as discussed below) and other costs and produces a
- still very competitive all-in borrowing rate.

* 7 basis point increase in spread for every point of premium generated

Taxable Fannie Mae M.TEBs

- We have recently been involved in several **taxable Forwards M.TEBs** for **projects not using 4% LIHTC.** This may be a project eligible for **9% LIHTC** or a **workforce housing financing** where targeting is above low income housing tax credit income levels.
- Because there is no effective "forwards" market for taxable Fannie Mae MBS securities, a taxable MBS can produce the lowest borrowing rate. Indeed, the demand for Fannie Mae MBS products is so strong, the **rates on these executions are very close to the rates on tax-exempt "forwards" M.TEBs executions**.
- Under this model, **at Conversion, the taxable MBS bondholders agree to accept delivery of the taxable MBS in full payment for the taxable M.TEBs bond**, and the taxable MBS bond is canceled.
- We believe **these executions could substantially broaden** the M.TEBs market as we finish out 2021 and move into 2022.

“Forwards” M.TEBs

- Fannie Mae’s **“forwards” M.TEBs** product is for **new construction/sub rehab projects**.
- 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, who is at risk on the real estate prior to “Conversion,” as described above.
- The M.TEBs bonds **pay interest only** on a monthly basis **prior to delivery of the MBS at Conversion**.
- On a Forwards M.TEBs financing, there is an **“escrow” period of 24 to 36 months** to allow construction, rent up and stabilization while **the taxable bank loan is at risk**.

“Forwards” M.TEBs

- **During this “escrow” period**, the Forwards M.TEBs Bonds are **secured by a verified escrow of cash and U.S. Treasury Securities,** which is shown to be sufficient to fully secure the issue and assure timely payment of the interest on the Bonds prior to delivery of the MBS and to fully repay the Bonds in the highly unlikely event that MBS is never delivered.
- The **closing of the Fannie Mae DUS Loan occurs at “Conversion”** to stabilized occupancy and the **Fannie Mae MBS is delivered** to the Trustee **a week or two following “Conversion.”**
- This product not only offers **very competitive rates** (there is no conventional taxable forward delivery Fannie Mae MBS structure) **and other underwriting terms**.
- **Fannie Mae has also shown great flexibility in permitting earn-out and/or other supplemental loan funding** if supported by underwriting at conversion.

"Forwards" M.TEBs – Negative Arbitrage Has Become Positive Arbitrage

- At this time, the forwards M.TEBs structure entails roughly **3.9 points of gross construction period negative arbitrage: 3.20% M.TEB coupon – 2.50% investment rate on 2.5-Year U.S. Treasury x 2.5 years = 1.75 points.** See Appendix A for sample calculations.
- However, under this structure the Borrower has **two sets of construction period interest** – (i) the interest on the M.TEBs bonds, and (ii) the interest on the taxable bank construction loan.
- **Two sets of construction period interest** may **increase tax credit basis and thus 4% LIHTC proceeds, since most Section 42 lawyers and accountants will allow both sets of interest to be included in tax credit basis on a new construction/sub-rehab project**.
- As shown in Appendix A, under current market conditions, **the additional 4% LIHTC proceeds may more than offset the net negative arbitrage by a point or more.**

Other Pluses and Minuses of M.TEBs

- **A disadvantage** of M.TEBs is that the **rate can only be set roughly 2-3 weeks before closing** when the M.TEBs are sold in the public markets; whereas certain bank and **other** private placement **structures may allow the borrower to lock** a **spread** to an index (**or** in a few cases, maybe even an **interest rate**) **at a much earlier stage**.

- For many projects this disadvantage and the negative arbitrage associated with forwards M.TEBs are more than **offset** by the **very low permanent borrowing rates** and flexibility on supplemental funding which the M.TEBs structure provides.

- **Fannie Mae will 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 private placements.

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

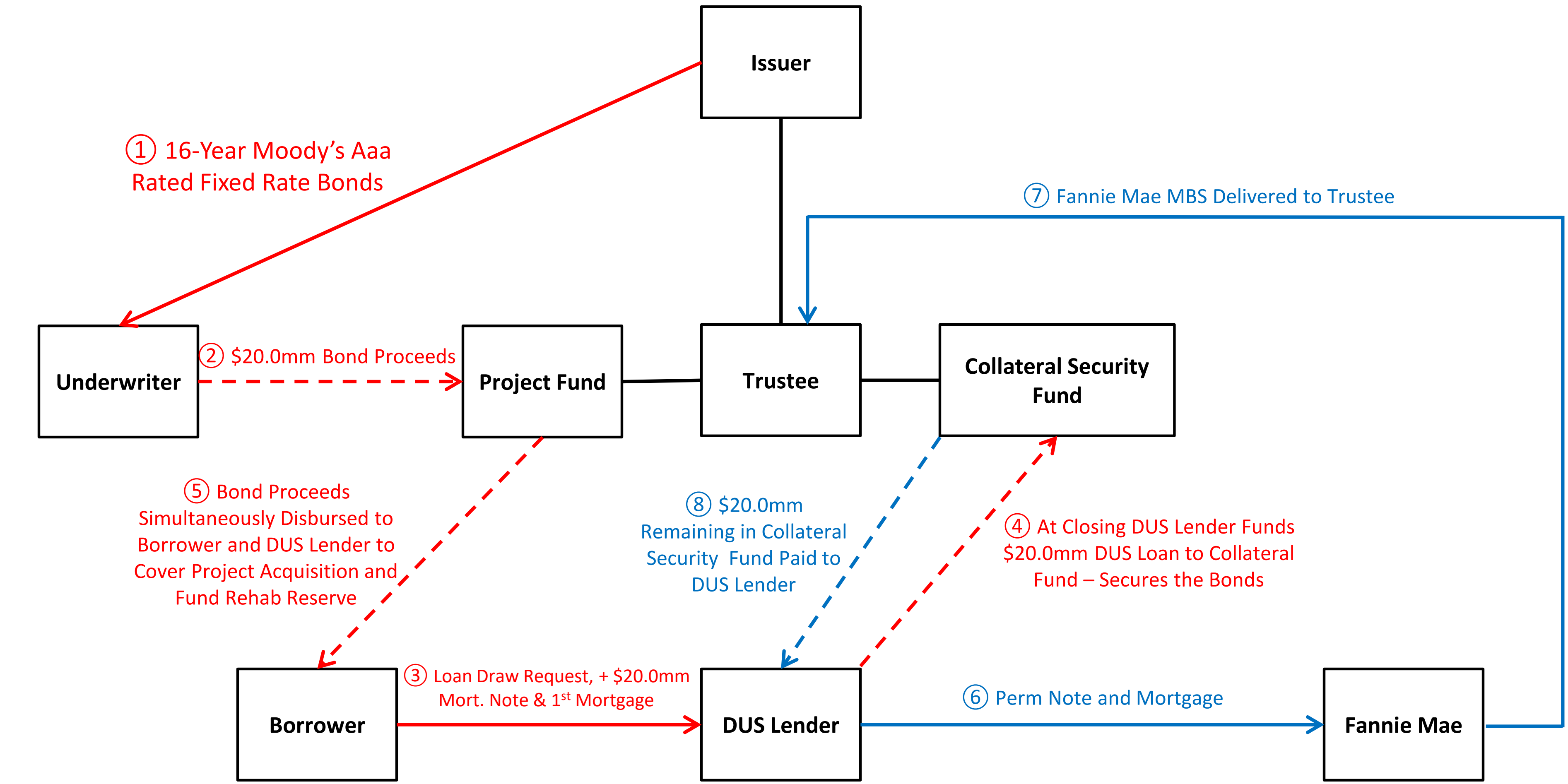
- Due to the factors summarized above, **the use of the M.TEBs structure** has become much more **widespread and** the growth in its use appears to be **accelerating**.

M.TEBs – How Does It Work?

- **Immediate Delivery (Mod Rehab) M.TEBs**
  - **Two pots of money** under the Indenture.
  - **($ Pot 1)** The fully funded "immediate delivery" **M.TEBs Bonds close** and the Bond proceeds deposited into Proceeds Fund and are released to enable the Borrower to acquire the Project and fund a rehab reserve.
  - **($ Pot 2) The Fannie Mae DUS Lender funds the Fannie Mae DUS Loan at closing** from its own funds **in the same amount** as the Bonds; deposited into a Collateral Security Fund under the Indenture.
  - **On a fully-funded "Immediate M.TEB" for mod rehab projects, the DUS Loan proceeds in the Collateral Security Fund will be used 10-15 days after closing by Trustee to purchase the MBS** with respect to the fully funded DUS Loan.
  - **The Fannie Mae MBS becomes the long-term security for the M.TEBs Bonds.**

Fannie Mae **Mod Rehab** M.TEBs Structure*

($20.0 million Bonds and $20.0 million DUS Loan Close Simultaneously – Two Pots of Money)



At Closing: Steps 1-5

2-3 Weeks Post Closing: Steps 6-8

Cash ————

Paper Securities - - - - -

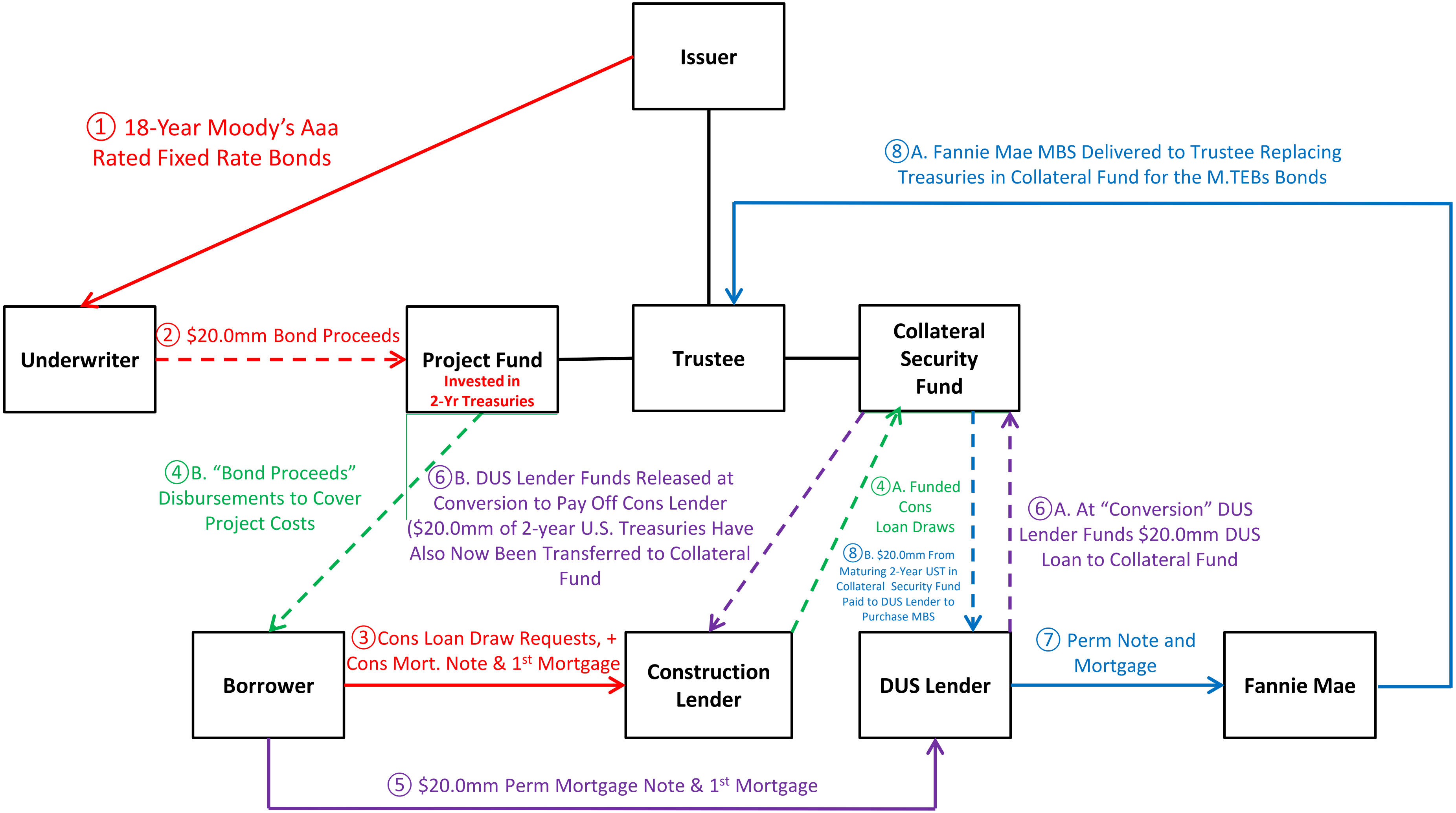
* Press F5 key to watch in Slide Show Mode.

M.TEBs – How Does It Work?

- **Forwards (Sub Rehab/New Construction) M.TEBs**
  - Substantial rehabilitation or construction is funded by a **taxable bank loan**.
  - Forwards M.TEBs are **secured by a verified escrow of cash and U.S. Treasury securities** for the **first 2.5 to 3.0 years** to allow time for construction, rent up and stabilization (“Conversion”).
  - **Monthly pay, interest only** tax exempt bonds during this period.
  - **If Conversion is attained** within the time permitted in the Fannie Mae Forward Commitment, then the **MBS** is delivered and **becomes the collateral for the M.TEBs**, which become a level pass-through of principal and interest.
  - **At Conversion**, the **escrow** of cash and U.S. Treasury securities matures and is, in effect, **used to retire the taxable bank loan**.

Fannie Mae **"Forwards"** M.TEBs Structure*

($20.0 million Bonds; $20.0 million Taxable Construction Loan; $20.0 million DUS Loan)



At Closing: Steps 1-3

During Construction, Rent-Up: Step 4

At Conversion: Steps 5 & 6

2-3 Weeks Post Conversion: Steps 7 & 8

Cash ———

Paper Securities - - - - -

* Press F5 key to watch in Slide Show Mode.

M.TEBs – How Does It Work?

- Note language from typical M.TEBs Official Statement cover page:

Maturity Date: ______ 1, 20__; Final Payment Date: ______ 26, 27, or 28, 20__; Interest Rate: __%; Price: __%; CUSIP No.: ___†

- M.TEBs carry **same kind of inherent payment lag as a Fannie Mae MBS**; they pay **on the 26th day of the month** (unless Trustee is closed day after MBS pays or a holiday weekend, in which case 27th or 28th day), the investor gets a **pass-through of principal and interest paid** on the underlying loan at the MBS Pass-Through Rate **through the end of the prior month**.

- This lasts through the final payment date, which will be 26, 27 or 28 days after the stated maturity date. The M.TEBs buyer, **like the buyer of an MBS**, never makes that up; **yield on this is slightly lower than stated MBS Pass-Through Rate** by the impact of the never recovered 26-28 day payment lag.

The Bottom Line

- In the current market, the M.TEBs bonds trade at very low, **competitive** interest rates.
- **Guaranty/servicing fees have risen** from about **100 basis points to, most often, around 120-140 basis points** since the FHFA placed volume limits on both GSE's (Fannie Mae and Freddie Mac) in September of 2019.
- Moreover, **the rate on the 10-year U.S. Treasury Bond has risen about 150 basis points** from a low of 0.52% in August of 2020 to around 1.50% today.
- However, **the spread** at which M.TEBs Bonds trade to the U.S Treasury **has fallen significantly** since the summer of 2020.
- **Result: the all-in borrowing rate** for Fannie Mae M.TEBs **remain** as **low** as they were in 2020 before U.S. Treasury rates rose, **and are highly competitive with other executions** at around **3.80% to 4.00% or possibly lower.**
- We are beginning to see **taxable forwards M.TEBs offerings** for deals using **9% LIHTC** or **workforce housing.**

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Summary – Major M.TEBs Considerations

- **Takes advantage of an even tighter spread of quasi-governmental GSE securities to a higher, but still low 10-year U.S. Treasury yield**.
- **Competitive guaranty/servicing fees** & **liberal waivers.**
- **All in borrowing cost** of at around **3.80%-4.00%, or lower,** for most executions at the present time.
- For sophisticated developers, this **structure allows potentially more flexible prepayment options**; **yield maintenance** through 10 years and fee maintenance for 5 years thereafter, **versus** absolute **16-year lock-out** associated with most private placements (although such prepayment flexibility may trigger a **10-15 basis points higher bond coupon**).
- The M.TEBs product may be more attractive for immediate delivery mod rehab projects **where the issuer charges very low** (e.g., 6 or 7 to 12.5 basis points per year) or no **ongoing fees** versus an issuer which charges 25-50 basis points in ongoing fees**.**
- **Short-term cash backed bonds plus taxable Fannie Mae MBS sale** may be a **better option for mod rehab projects in the present market** where a taxable MBS sale may also produce low rates, but high ongoing issuer fees may be a disadvantage to long-term fixed rate bonds.

APPENDIX A

NEGATIVE ARBITRAGE– "IMMEDIATE DELIVERY" MOD REHAB M.TEBs

- M.TEBs: 2 sets of funds prior to delivery of MBS.
- **Max 45 days**: 2.60% Bond/Pass-Through Rate x 60/365 days ≈ **only 43 BPS of Max Neg Arb**.
- **M.TEBs Expected Neg Arb**: ¼ of that ≈ **10 BPS, or even less net negative arbitrage** after increase in 4% LIHTC → **Negligible Negative Arbitrage**.

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NEGATIVE HAS BECOME POSITIVE ARBITRAGE ON FANNIE MAE "FORWARDS" M.TEBs

Assume the forwards M.TEBs coupon is 3.20% and 2.5-year U.S. Treasuries yield 2.50%. Thus, **there are about 1.75 points of negative arbitrage** (3.20%-2.50%=0.70% x 2.5 years) on the forwards M.TEBs over a 2.5-year pre-Conversion period. But on top of the pre-Construction interest paid on the taxable draw down bank loan (which is included in the eligible basis), the borrower is also paying interest on the M.TEBs bonds at a rate of 3.20% for 2 years, or **6.4 points of "additional interest" over a two-year construction period***. This is **6.4 points of additional 4% tax credit basis**. If an extra $1.00 of tax credit basis generates about 40¢ of LIHTC proceeds, **these 2.6 points of additional 4% LIHTC proceeds will more than offset our 1.75 points of negative arbitrage.** The net gain in tax credit proceeds will be even greater if the project is eligible for state tax credits, as well.

* We assume a construction period of 24 months; post-construction interest is not includable basis.

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