October 2023

COMMUNITY CAPITAL MANAGEMENT

CCM Sector Spotlight: Agency CMBS – Financing Affordable Multifamily Rental Housing

In our core fixed income impact strategy, we allocate within a sector opportunity set that is distinct from other core fixed income managers, providing another way to actively manage our portfolio's risk/return objective. Our strategy's opportunity set is the result of our pioneering approach to security selection that includes both impact and financial criteria. **This perspective takes a closer look at the strategy's agency commercial mortgage-backed securities (CMBS) sector, which only includes loans financing affordable multifamily rental housing. The strategy does not include loans financing office space, nor does it invest in the equity of commercial real estate properties.**

What is Agency CMBS?

Agency CMBS are pools of one or more loans, mostly representing mortgages on new, recently renovated affordable multifamily properties, or refinancing affordable multifamily properties issued by Fannie Mae, Freddie Mac, and/or Ginnie Mae. Pools can also include mortgages on assisted living facilities and mental health complexes. We are not investing in the equity of commercial real estate properties, and we are not investing in other sectors within commercial real estate such as office, industrial, or retail. Rather, we are investing in bonds financing **affordable** multifamily rental housing properties for low- and moderate-income (LMI) people. Agency CMBS is typically a liquid sector with various market participants, including insurance companies, money managers, commercial banks, and state and local governments. It tends to have predictable cashflows because of its stated final maturities and prepayment protections.

Affordable multifamily for low- and moderate-income (LMI) people is defined as:

Low-income: someone whose total annual income is less than 50% of the area median income (AMI) or average income for the community where he or she lives.

Moderate-income: someone whose total annual income is above 50% but less than 80% of the AMI or average income for the community where he or she lives.

Agency CMBS vs. Non-Agency CMBS

There are two types of CMBS:[1]

1. **Agency CMBS:** loans pooled by government-sponsored entities (GSEs)
2. **Non-Agency CMBS:** loans pooled and securitized by private lenders

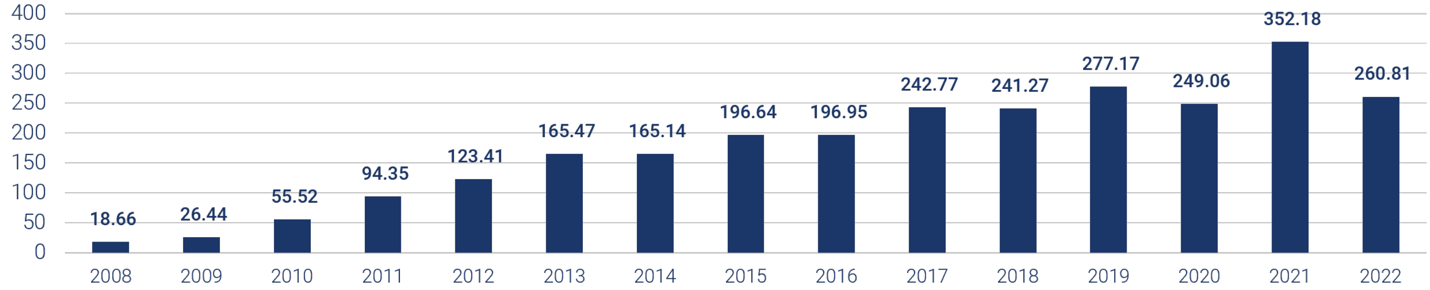
Sector	CCM CMBS*	Non-Agency CMBS
Multifamily	Yes	Yes
Office	No	Yes
Industrial/Warehouse	No	Yes
Hotel	No	Yes
Other	No	Yes

**At CCM, we almost exclusively invest in agency CMBS. If we invest in non-agency CMBS, the exposure is to affordable multifamily rental housing.*

Issuance

Agency CMBS issuance has increased significantly since 2008. During the global financial crisis, U.S. government agencies stepped in to fill the void created by private lenders that reduced loan originations as credit conditions tightened. After the crisis, government agencies maintained their efforts by expanding multifamily property lending to promote affordable housing.[2]

Total Agency CMBS Issuance
2006 - 2022



Source: J.P. Morgan, Commercial Mortgage Alert, Fannie Mae

Agency CMBS Issuers

The largest agency CMBS programs are Fannie Mae's Delegated Underwriting and Servicing (DUS®) bonds, Ginnie Mae Project Loans, and Freddie Mac's K-Series. Overviews of these three programs are highlighted below.

Fannie Mae DUS®[3]

In 1988, Fannie Mae began purchasing multifamily loans through its DUS program and holding them in its portfolio. In August 1994, the company began securitizing DUS loans and created DUS MBS. Fannie Mae creates DUS MBS supported by loans on multifamily properties with a minimum of five units. Most of its MBS are backed by a single loan on a multifamily asset. Alongside Fannie Mae's guarantee of timely payment of principal and interest, DUS MBS offer lower-spread volatility relative to many comparable products, stable cash flows that are easy to model, superior call protection, and liquidity enhanced by the substantial number of dealers engaged in market making.

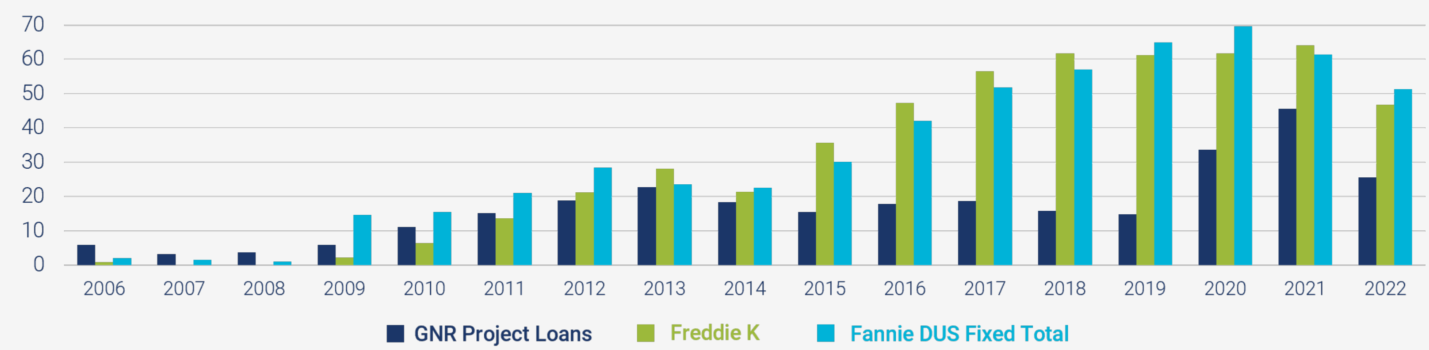
Ginnie Mae Project Loans

Ginnie Mae's multifamily program was created in 1971 to meet the growing demand for affordable rental housing for LMI persons and families. Since its inception, Ginnie Mae has guaranteed nearly $450 billion in multifamily MBS, financing the construction and renovation of multifamily housing including apartment buildings, nursing homes, and assisted living facilities.[4] By guaranteeing pools of multifamily loans that are sold to investors in the global capital markets, Ginnie Mae enables lenders to reduce mortgage interest rates paid by property owners and developers. In addition, these projects stabilize and bring jobs to communities across the country.

Freddie Mac Multifamily K-Deals

With a mandate to support affordable housing and provide financing liquidity to the rental market, Freddie Mac issues multifamily loans backed by occupied, income-producing multifamily properties. Freddie Mac Multifamily K-deals (Freddie K) is one of its major agency CMBS products. The underlying loans are typically 10-year fixed-rate or floating-rate loans, with a 30-year amortization period, backed by multifamily properties. Fixed-rate loans usually have strong call protection and muted prepayment activities, while floating-rate loans have limited prepayment protection and higher prepayment speeds. Freddie K deals include senior tranches guaranteed by Freddie Mac and unguaranteed subordinate tranches, which are subject to credit risk.[5]

Issuance: Fannie's DUS® / Ginnie Mae Project Loans / Freddie Mac Multifamily K-Deals
2006 - 2022



Source: J.P. Morgan, Commercial Mortgage Alert, Fannie Mae

Criteria for Security Selection

Our criteria for security selection focuses on two key aspects of each bond:

Financial: Given that the mortgage principal is guaranteed by one of the agencies, our primary risk is how cashflows (interest and principal payments) may deviate from our expectations. Most mortgages on these properties have prepayment penalties, preventing almost all voluntary prepayments; however, the risk remains of an involuntary prepayment, typically a mortgage default, where the principal is paid earlier than originally expected. As such, we look at occupancy levels and other factors to gain confidence that the property will be able to meet its debt obligations.

Impact: We must have a high degree of confidence that the use of, or intent of, proceeds will result in positive environmental and/or societal outcomes as defined by one or more of our impact themes or that the issuing entity supports one or more of our impact themes. These affordable rental housing properties typically have long-term contracts in place to preserve their affordable housing units for an extended period. Additionally, many properties are built and/or renovated with features that align with our impact themes beyond affordable housing. For example, a property may have an on-site childcare center, aligning with our impact theme of Education and Childcare, or it may have been renovated for energy efficiency, aligning with our impact theme of Environmental Sustainability.

Impact Case Study: Agency CMBS (Fannie Mae DUS)

Meadow Glen Apartments

Sacramento, CA

Image Source: https://www.meadowglenliving.com/

Meadow Glen Apartments is a Low-Income Housing Tax Credit (LIHTC) property for families in Sacramento, California (Sacramento County). To qualify for the LIHTC allocation, the property owner agreed to reserve all 168 residential units for low-income residents for a period of 55 years. Specifically, all 168 low-income units are reserved for residents earning no more than 60% of the area median income. The property is in a moderate-income, high-minority, high-poverty census tract where 92% of the population are minorities and 25% live below the poverty line. All units are accessible.

Meadow Glen Apartments were built in 2001 and consist of 12 two-story buildings that offer two- and three-bedroom units. Property amenities include 24-hour access to maintenance and management, on-site security personnel, and a barbecue area with a grill, a playground, a clubhouse, and a pool. Individual units feature a full-sized washer and dryer. Four parks reside within half a mile of the apartments: Silva Field, Steve Jones Park, Kemble Park, and Kemble School Park.

Peak Living is the property manager of Meadow Glen Apartments. Peak Living offers exceptional real estate management services to conventional, affordable, senior housing, and student apartment communities. Peak Living offers two programs for residents of Meadow Glen Apartments looking to improve credit and/or prepare for homeownership: RentPlus and The Advantage Program.

Impact themes this investment helped support:

- Affordable Housing
- Economic Inclusion
- Minority Advancement
- Poverty Alleviation
- Seniors, Veterans, and the Disabled

RentPlus is an online service for residents looking to improve credit through on-time rent credit reporting and a complete range of financial tools. RentPlus helps residents manage and budget expenses. FinStrong is a personalized education program provided by RentPlus that aims to enhance financial knowledge and aid individuals in achieving their monetary goals. The Advantage Program (TAP) is a real estate matchmaker program between those looking to buy a home and real estate agents and lenders who help guide individuals on their path to owning a home. Participating in TAP is 100% free and can get individuals up to $1,295 (or more) toward the cost of their home purchase. The program strives to improve lives by helping renters achieve financial success and purchase a home (even with no or low credit).

[1] https://www.cmbsloans.us/cmbs-financing-blog/agency-cmbs-vs-non-agency-cmbs-what-you-need-to-know
[2] https://www.invesco.com/content/dam/invesco/apac/en/pdf/insights/2021/september/what_are_us_agency_cmbs.pdf
[3] https://multifamily.fanniemae.com/financing-options/conventional-products/dus-mbs ; https://multifamily.fanniemae.com/news-insights/multifamily-wire/fannie-mae-multifamily-reports-2021-financial-results#:~:text=Working%20with%20our%20DUS%C2%AE,volume%20cap%20of%20%2470%20billion
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