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North Star AI/Minnesota RMA Joint Meeting

Multifamily Housing Market - Twin Cities and Capital Market Update

February 22, 2019

2019 Capital Markets National Multifamily Outlook

- **Strong Fundamentals Continue**
  - The multifamily market is expected to finish 2018 with solid rent growth and only modest increases in vacancy rates despite an elevated level of new supply. Some weakness in individual markets and submarkets is evident, but the overall multifamily market remains healthy.
- **Supply and Demand**
  - New supply will remain elevated through 2019 and into 2020 but rents and vacancies will continue outperforming historical averages due to robust demand related to the rising cost of homeownership, changing demographics and consumer preferences.



2019 Capital Markets National Multifamily Outlook

- **Cap and Treasury Rates**
  - Cap rates have fallen slightly over the past few quarters despite rising interest rates, and spreads remain near the long-run average. Cap rates may rise in 2019 if Treasury rates increase.
- **What Can We Expect in 2019?**
  - Industry experts expect 2019 to be another strong year for the multifamily industry. Homeownership affordability constraints and consumer trends will continue to drive demand, while strong rent growth will support property price growth.



Capital Markets and Interest Rate

- **Relationship of Capital Markets and Interest Rates to Value and Cap Rates**
  - Feasibility of new construction directly related to interest rate and capital market availability
    - Cost of capital directly impacts new construction feasibility
    - Debt leverage directly impacts feasibility of new construction
    - Interest rate directly impacts feasibility of new construction
    - Construction loan take-out / refinance risk directly related to feasibility of new construction
  - Value directly related to capital markets and interest rate
    - As-Stabilized Hypothetical Value impacted by cap rate assumptions
    - Interest rates have direct correlation on capitalization rates
      - Higher interest rates should correlate to higher capitalization rates
      - Cap to mortgage constant concept



Interest Rate Components

- **Real Risk-Free Rate**
  - This assumes no risk or uncertainty, simply reflecting difference in timing: the preference to spend now/pay back later versus lend now/collect later.

- **Expected Inflation**
  - The market expects aggregate prices to rise, and the currency's purchasing power is reduced by a rate known as the inflation rate. Inflation makes real dollars less value in the future.



Interest Rate Components

- **Default – Risk Premium**
  - This factors in the change that the borrower will not make payments on time, or will be unable to pay what is owed. This depends on the creditworthiness of the debtor.

- **Liquidity Premium**
  - This factors in the level of liquidity in the security. A less liquid security will lead to a higher interest rate.



Interest Rate Components

- **Maturity Premium**
  - All else being equal, a bond obligation will be more sensitive to interest rate fluctuations the longer to maturity it is.

- **What is the Nominal Interest Rate**
  - The nominal interest rate is equivalent to the Real Risk-Free Rate + Inflation Rate.



Multifamily Interest Rates – Current Indications

	Fannie Mae	Freddie Mac	HUD (3)	Bank
Refinance (1)	4.25%-5.25%	4.50%-5.00%	4.00%-4.45%	5.00%-5.50%
New Construction (2)	4.75%-5.50%	5.25%	4.75%-5.20%	5.35%-5.85%

(1) Assumes 10 year loan
(2) Assumes 3 year construction loan; GSEs are perm take out only; affordable only and not available for market rate multifamily
(3) Excluding MIP

Why are the rates so different?

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What Makes Up a Multifamily Interest Rate?

- **Base Index Rate**
  - This example, the base index rate is the 10 year treasury
  - If a 5 or 7 year index, the base rate would be lower
  - If a 20 or 30 year index, the base rate would be higher

- **Investor Spread**
  - For Fannie Mae and HUD, this is the spread that is required by the third party investor for the one off MBS/Ginnie Mae
  - For Freddie, the spread is established by Freddie Mac and is based on hedging for post closing pool securitization
  - For banks, the spread is the bank's cost of $ and balance sheet risk tolerance
  - The spread is the measure of risk for the bond being paid off
  - Not a one-to-one or direct movement to changes in the base index rate



What Makes Up a Multifamily Interest Rate?

- **G Fee and S Fee**
  - G Fee = Guaranty Fee
  - S Fee = Servicing Fee
  - Based on transaction risk profile

- **Other Fees**
  - Forward Premium Fee (new construction)
  - Bond Issuer and /or Trustee Fee (bond transactions)
  - Hedge Fees (variable rate transactions)

Key Takeaway: *Interest Rate is a function of the financing vehicle / product and subject to many variables. Key to understanding overall capitalization rate abstraction and development in value analyses.*



Other Factors Influencing Interest Rates

- **Property Type Eligibility**
  - Market Rate – Capped and Uncapped GSE Volume
  - CRA Credits
    - Higher investor demand for CRA investments
    - Affordable Components
- **Loan Size**
  - Small Balance Loans versus Large Loans
- **Leverage**
  - GS is based on risk
  - Lower leverage will have lower interest rate as less risk



Other Factors Influencing Interest Rates

- **Property Location**
  - Strong /National Markets
  - Secondary Markets
  - Watchlist Markets
  - Tertiary Markets
  - Rural Markets

- **Property Class**
  - Age / Condition will not impact interest rate; however, direct correlation to borrower sponsor, affordability, and financing vehicle

- **Sponsor Credit Worthiness**
  - Understand impact on interest rate with strong sponsor/borrower versus standard sponsor/borrower



Case Study

What is the Interest Rate?

What is the Cap Rate per the BOI?

- **Property Location:** *Mpls – St. Paul TCMA*
- **Tenant Base – Mix:** *Family Market Rate*
- **Affordability Restrictions:** *None*
- **AMI Rent Level:** *100% AMI*
- **Occupancy:** *Stable*
- **NOI:** *$425,000*
- **Investor Base:** *National*
- **Leverage:** *Full | Max*
- **Loan Term:** *5 year, 10 year, and 30 year*

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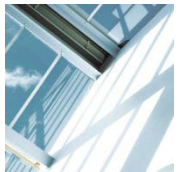


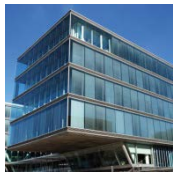

Case Study

UNIT C – STUDIO

UNIT A – ONE BEDROOM

UNIT B – TWO BEDROOM

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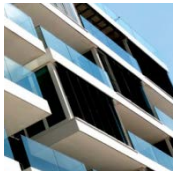

Case Study

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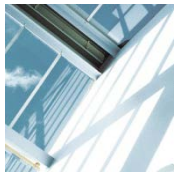

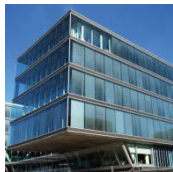

Case Study

AGENCY / Product	**Fannie Mae MBS**	**Fannie Mae MBS**	**Fannie Mae MBS**	**HUD**
Term/Amortization	**5/30**	**10/30**	**30/30**	**5, 10 or 30**
	MBS	**MBS**	**MBS**	**Ginnie**
Loan Term	5	10	30	up to 35 years
Amortization Term	30	30	30	35
NOI	**$ 422,812**	**$ 422,812**	**$ 422,812**	**$ 422,812**
Estimated Cap Rate	6.00%	6.00%	6.00%	6.00%
Cap Rate Indicated Value (UW NOI / Cap Rate)	$ 7,050,000	$ 7,050,000	$ 7,050,000	$ 7,050,000
Appraised Value	$ 7,050,000	$ 7,050,000	$ 7,050,000	$ 7,050,000
Correlated Value for UW	$ 7,050,000	$ 7,050,000	$ 7,050,000	$ 7,050,000
LTV %	80%	80%	80%	80%
Max LTV Loan:	**$ 5,640,000**	**$ 5,640,000**	**$ 5,640,000**	**$ 5,640,000**
Treasury Index:	**5 Year**	**10 Year**	**30 Year**	**10 year**
Treasury Rate as of:	2.490%	2.670%	3.000%	2.670%
Total Spread:	2.740%	2.550%	3.090%	1.930%
Estimated Net Rate (Estimated):	**5.230%**	**5.220%**	**6.090%**	**4.600%**
Mortgage Constant	6.611587%	6.604164%	7.264188%	5.753623%
Underwritten DSCR	1.25	1.25	1.25	1.25
Max DSCR Loan:	**$ 5,116,000**	**$ 5,121,000**	**$ 4,656,000**	**$ 5,878,000**
Suppoortable Loan Amount	**$ 5,116,000**	**$ 5,121,000**	**$ 4,656,000**	**$ 5,640,000**
Exit Strategy Loan Amount Result:	PASS	PASS	PASS	PASS
DSCR - Actual	1.250	1.250	1.250	1.303
LTV	72.6%	72.6%	66.0%	80.0%
Required Equity Dividend Rate / Band of Investment Analyses				
LTV	72.6%	72.6%	66.0%	80.0%
Mortgage Constant	6.61%	6.60%	7.26%	5.75%
	4.80%	4.80%	4.80%	4.60%
Equity	27.4%	27.4%	34.0%	20.0%
Equity Dividend Rate	**4.40%**	**4.40%**	**3.55%**	**7.00%**
	1.21%	1.20%	1.21%	1.40%
Cap Rate	**6.00%**	**6.00%**	**6.00%**	**6.00%**

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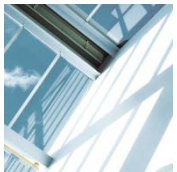


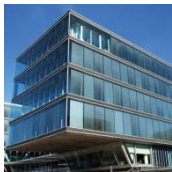

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Mortgage Constant	6.61%	6.60%	7.26%	5.75%
	4.80%	4.80%	4.80%	4.60%
Equity	27.4%	27.4%	34.0%	20.0%
Equity Dividend Rate	**4.50%**	**4.50%**	**4.50%**	**4.50%**
	1.23%	1.23%	1.53%	0.90%
Cap Rate	**6.03%**	**6.03%**	**6.33%**	**5.50%**
Value	$ 7,000,000	$ 7,010,000	$ 6,680,000	$ 7,680,000
Cap to Constant Value	$ 6,390,000	$ 6,400,000	$ 5,820,000	$ 7,340,000

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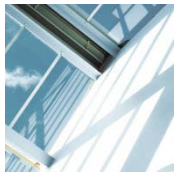


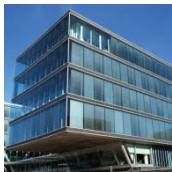

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- **Tenant Base – Mix:** *Affordable*
- **Affordability Restrictions:** *9% LIHTC*
- **Occupancy:** *Stable*
- **NOI:** *$425,000*
- **Investor Base:** *National*
- **Leverage:** *Full | Max*
- **Loan Term:** *5 year, 10 year, and 30 year*

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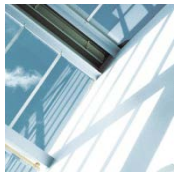


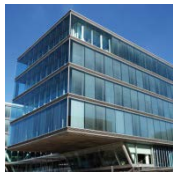

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Correlated Value for UW	$ 7,050,000	$ 7,050,000	$ 7,050,000	$ 7,050,000
LTV %	90%	90%	90%	87%
Max LTV Loan:	$ 6,345,000	$ 6,345,000	$ 6,345,000	$ 6,133,500
Treasury Index:	5 Year	10 Year	30 Year	10 year
Total Spread:	2.090%	2.110%	2.030%	1.580%
Estimated Net Rate (Estimated):	4.580%	4.780%	5.030%	4.580%
Mortgage Constant	6.137398%	6.281486%	6.463879%	5.738679%
Underwritten DSCR	1.15	1.15	1.15	1.15
Max DSCR Loan:	$ 5,990,000	$ 5,853,000	$ 5,687,000	$ 6,406,000
Suppoortable Loan Amount	$ 5,990,000	$ 5,853,000	$ 5,687,000	$ 6,133,500
Exit Strategy Loan Amount Result:	PASS	PASS	PASS	PASS
DSCR - Actual	1.150	1.150	1.150	1.201
LTV	85.0%	83.0%	80.7%	87.0%
Required Equity Dividend Rate / Band of Investment Analyses				
LTV	85.0%	83.0%	80.7%	87.0%
Mortgage Constant	6.14%	6.28%	6.46%	5.74%
	5.21%	5.21%	5.21%	4.99%
Equity	15.0%	17.0%	19.3%	13.0%
Equity Dividend Rate	**5.20%**	**4.65%**	**4.05%**	**7.75%**
	0.78%	0.79%	0.78%	1.01%
Cap Rate	**6.00%**	**6.00%**	**6.00%**	**6.00%**

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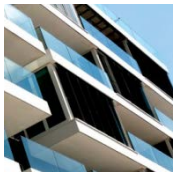

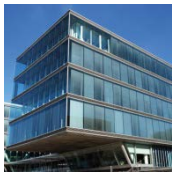

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AGENCY / Product Term/Amortization	Fannie Mae MBS 5/30	Fannie Mae MBS 10/30	Fannie Mae MBS 30/30	HUD 5, 10 or 30
Required Equity Dividend Rate / Band of Investment Analyses				
LTV	85.0%	83.0%	80.7%	87.0%
Mortgage Constant	6.14%	6.28%	6.46%	5.74%
	5.21%	5.21%	5.21%	4.99%
Equity	15.0%	17.0%	19.3%	13.0%
Equity Dividend Rate	**4.50%**	**4.50%**	**4.50%**	**4.50%**
	0.68%	0.76%	0.87%	0.59%
Cap Rate	**5.89%**	**5.98%**	**6.08%**	**5.58%**
Value	$ 7,170,000	$ 7,070,000	$ 6,940,000	$ 7,580,000
Cap to Constant Value	$ 6,880,000	$ 6,730,000	$ 6,540,000	$ 7,360,000

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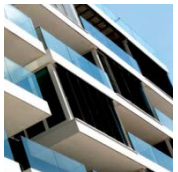

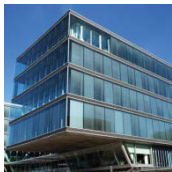

Key Takeaways

- **Interest Rate is a function of capital markets and risk**
- **Interest Rates are dependent upon financing vehicle**
- **Interest Rates are negotiated and influenced by transaction sponsor credit risk in addition to property characteristics**
- **Interest Rate and Capital Markets are in constant change**
- **Understand financing vehicles when determining and analyzing cap rates, equity dividend rates, and other price comparisons**
- **Keep current with capital markets, indexes and yield curves**

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