
Freddie Mac Introduces Finance Mechanism to Mitigate Construction-Loan Risk for Workforce Housing Developers.

New non-LIHTC Forward Commitment Program is part of a coordinated delivery of new products intended to innovate workforce housing finance and spur investment.

Call it the chocolate float.

When CBRE Affordable Housing announced in July a $26.7 million forward commitment from Freddie Mac to help finance the mixed-income, adaptive reuse of the Lowney Chocolate Factory in Mansfield, Mass., not much was broadcast about the financing beyond term-sheet basics.

At the time, the 10-year fixed-rate loan (which included two years of interest-only payments) was just part of a larger capital stack that included EB-5 program equity and commitments from the National Park Service, the Massachusetts Historical Commission, the MassHousing Workforce Fund, and construction lender Citizens Bank.

As it turns out, Freddie Mac was test-driving the viability of a new financing vehicle targeting workforce housing developers and modeled after similar programs already proven successful within the low income housing tax credit (LIHTC) arena. "When we launch any new products, we typically have already done a deal or two to make sure what we've come up with works successfully," explains Freddie Mac vice president of targeted affordable sales and investments David Leopold. "Backing up further, we try to make sure any offering isn't just our own thinking but addresses real gaps in the market. When we hear about good ideas or needs not yet met, that's when we engage."

Targeting Higher AMIs

Officially rolled out in September, Freddie Mac's Non-LIHTC Forward Commitment program provides unfunded forward commitments for affordable housing developed by nonprofits as well as subsidized, rent-restricted affordable housing developed by for-profit developers for new multifamily construction or substantial rehabilitation. Specifically, Freddie underwrites and commits to making permanent mortgage loans on affordable rental housing projects prior to construction, offering developers a unique tool to manage the interest-rate exposure from construction lending, even for properties not funded with tax credits.

"Our goal is to provide liquidity to the whole market from a product-development standpoint," says Leopold. "The need for non-LIHTC forwards has been growing, and the market evolutions that have made it acute include the increased efforts by more states and local jurisdictions to create new ways to subsidize affordable housing targeted to higher area median incomes (AMIs), so [as to provide] more workforce housing in comparison to standard LIHTC-driven affordable housing."

While Freddie Mac non-LIHTC forwards are available to nonprofit affordable housing developers that commit all units to either workforce or affordable housing rent levels as defined by the Federal Housing Finance Agency (FHFA), the program is also open to for-profit developers who are willing to cap 80% of unit rents at 100% to 150% of the AMI (depending on the market), with another 10% of units subject to FHFA rules for uncapped volume and the remaining 10% of units open to market-rate rents.

The idea, Leopold says, is to provide loan mechanisms to help developers mitigate construction-loan interest-rate risk and variability and offer additional liquidity to maximize the value of state and local workforce housing subsidies. “More and more programs are expanding into workforce housing,” Leopold says. “There’s strong interest on the borrower side that corresponds with local and state agencies providing tax abatements, allocations of HOME funds, and locally generated subdebt, all of these subsidies that a decade ago were paired with LIHTCs that are now stand-alone with restrictions above the 60% AMI level.”

Costs a Driving Factor

Development costs are also driving demand for new workforce housing–financing mechanisms. Elie Rieder is CEO of Castle Lanterra Properties, a Suffern, N.Y.–based owner–operator of a workforce and market-rate housing portfolio that includes assets in Colorado, Texas, Georgia, Alabama, New Jersey, Florida, Virginia, and Maryland. He says the dramatic increase in construction costs makes it no longer economical to build workforce housing in the absence of innovations in finance. “Without the direct government subsidies that are often provided to affordable housing,” Rieder says, “workforce housing generally doesn’t benefit from the same types of financing structures that affordable housing can enjoy.”

According to Rieder, land costs across his markets have spiked 62% since 2012, with a corresponding 25% increase in labor and materials, creating a so-called “missing middle” market as developers veer toward high-end luxury or heavily subsidized affordable housing to get deals to pencil out. “With this supply-and-demand mismatch, we’re now faced with an acute shortage of reasonably priced rental housing for those who earn too much to qualify for subsidized housing but fall well short of the necessary income requirements to purchase a home or afford to rent a luxury unit,” Rieder says.

Freddie Mac expects the total volume for 2019 Non-LIHTC Forward Commitments to reach $250 million, further signaling the government-sponsored enterprise’s focus on workforce housing–finance innovation. In May, Bridge Multifamily Fund Manager and Freddie Mac Multifamily announced the closing of a transaction by which Freddie Mac will purchase and aggregate a year’s worth of loans (up to $500 million) for Bridge to acquire, improve, and preserve workforce and affordable housing across the country.

“That’s the context of the non-LIHTC forward program—an ongoing expansion to cover all affordability and liquidity gaps across all levels in multifamily,” Leopold says. “It’s one of a coordinated delivery of products that will be aimed at providing capital and expanding our relevance within workforce housing.”

Back at the Lowney Chocolate Factory, the 36-month forward commitment from Freddie Mac will provide 130 units of mixed-income housing in the building that originally produced Oh Henry! candy bars and the chocolate chips for Chips Ahoy! cookies before closing down in 2011. Certainty of execution and interest-rate mitigation provided by the commitment also allowed for a total construction loan of $32.5 million, offset by $9 million in combined tax credits from the National Park Service and the Massachusetts Historical Commission.

“Leading this program off with the Chocolate Factory has been a great splash,” Leopold says. “Adaptive reuse is always cool; historic preservation is cool for those of us who love real estate, but, more importantly, it was a priority of the community and we wanted to help them do it.

“Like so many markets across the country, this is a high-cost area, and the more we can help to create new, affordable units in areas of opportunity, the better."

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