GREEN LOAN MARKET HEATS UP

Financing programs offered by GSEs reward apartment owners with lower interest rates for reducing water and energy usage.

By Taylor Williams

Mike Schell, a partner at NALS Apartment Homes, which owns and manages more than 15,000 units across the country, was looking to refinance Sage Stone Apartments in Glendale, Arizona.

Built in 2000, the property was on the cusp of eligibility for a green loan offered through Freddie Mac and Fannie Mae. The two government-sponsored enterprises (GSEs) grant lower interest rates on loans for multifamily properties whose owners have undertaken steps to reduce water and energy usage.

In April 2017, Schell obtained a 10-year, $16.7 million Fannie Mae loan for the refinancing of the property, which NALS purchased in 2009. NALS saved about 15 basis points on the fixed interest rate thanks to its sustainability efforts.

"Residents are increasingly interested in living in communities that are sensitive to sustainability concerns," says Schell. "In addition, the loan pricing and utility cost savings are very attractive to us."

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>
> *— Peter Giles, Vice President of Production and Sales at Freddie Mac's Multifamily Division*

Green Loans 101

Apartment owners that choose to apply for a green loan must first evaluate water and energy consumption. They hire third-party engineering companies to conduct a series of tests and surveys to determine how much water and energy their property uses. These reports project certain levels of savings that can be achieved through practices such as installing low-flow toilets, removing aerators from kitchen sinks or showerheads and limiting the ranges of thermostats.

If the reports indicate that implementing such changes can reduce water and energy usage by 20 percent, the property qualifies for a Fannie Mae green loan. Freddie Mac's green loans call for proof of 15 percent reduction of water and energy usage.

Upon accepting a property into a green loan program, the GSEs give borrowers credit to offset the costs of buying and installing the water- and energy-saving equipment.

These fledgling green loan programs are rapidly growing in popularity. Since launching its Green Advantage program in August 2016, Freddie Mac has provided roughly $6 billion in green loans. Of that total, approximately $3 billion in loans closed in the first quarter of 2017.

Fannie Mae has financed roughly $8.6 billion in green loans over the last year-and-a-half, including $5 billion in the first quarter of 2017. This figure exceeds the GSE's entire 2016 green loan production.

Typically, the upgrades that achieve these reductions in water or energy usage are only available on multifamily properties that were developed before 2000. Fannie Mae will consider accepting properties developed after 2000 into a green loans program, but Freddie Mac will not.

Freddie Mac requires a minimum energy-saving investment of $350 per unit versus no minimum investment for Fannie Mae. Freddie Mac requires the completion of energy-saving upgrades to be made within 24 months of the initial water and energy usage reports, compared with 12 months for Fannie Mae.

According to industry sources, savings from obtaining a green loan instead of a conventional loan vary from deal to deal, but can be as much as 35 to 39 basis points.

Steve Whitehead, senior vice president and managing director at NorthMarq Capital's Dallas office, says the 45 to 60 days it takes to process a green loan is fairly similar to the closing time frame for conventional loans.

Steve Whitehead
NorthMarq Capital

"NorthMarq hasn't found that Freddie's Green Up or Fannie's Green Rewards programs have added any additional time to the closing time frame," says Whitehead. "The supplementary green report is done at the same time as other due diligence. It adds additional work but can be done in the same time frame as a conventional loan."

NorthMarq recently closed a 10-year Freddie Mac Green Up loan for Horizons at Fossil Creek, a 420-unit property in Fort Worth that was built in the late 1990s. The borrower qualified for the loan by simply agreeing to swap out the toilets and showerheads.

"In most cases, water savings represent the easiest and most cost-effective means of qualifying for the program," says Whitehead.

For multifamily owners and investors, these programs offer opportunities to cut operating and maintenance costs and reinvest in their assets, ultimately driving up the values of their properties.

For lenders, green loans represent a chance to boost overall loan production and to provide debt in markets where lending is otherwise constrained.

Thinking Outside the Cap

Green loans can be exempt from the lending cap established by the Federal Housing Finance Agency (FHFA), which oversees the GSEs. In 2017, for loans funded under Fannie Mae's Green Building Certification program or Freddie Mac's Green Certified program, a minimum of 20 percent of units in a multifamily project must be deemed affordable in order to take advantage of this exclusion.

NALS refinanced Sage Stone Apartments in Glendale, Arizona, in April 2017 with a $16.7 Fannie Mae green loan. Qualifying for a green loan saved the company 15 basis points on the interest rate.

The cap figure for each GSE is $36.5 billion. Certain types of loans, such as those for Section 8 housing or other low-income properties, are also exempt from the cap.

In 2016, roughly one-third of both GSEs' total lending volume was not subject to the cap, and that figure could rise as high as 40 percent in 2017, according to NorthMarq's Whitehead.

Allan Edelson, managing director at Walker & Dunlop, believes that the cap-exempt status of most green loan programs is integral to their growth and success.

Allan Edelson
Walker & Dunlop

"Last year, there was more demand for Fannie and Freddie money than what the cap allowed, so they had to ration a bit," says Edelson. "So the FHFA decided to exempt green loans from the cap, and it's this exemption that's given life to these programs. The exemption enables GSEs to give significant pricing breaks to owners, which makes owners willing to spend money on green practices."

Edelson also notes that some property owners are motivated by concern for the environment alone. But from a monetary standpoint, the combination of marginally lowering expenses and significantly lowering interest rates can result in anywhere from 2 to 4 percent savings in operating expenses, he says.

In 2016, Walker & Dunlop provided approximately $1.5 billion in green loans through Fannie and Freddie in 45 transactions. More recently, the firm closed a $20.8 million Fannie Mae loan on behalf of M3 Multifamily for Centennial Crossing at Lenox Place, a 264-unit, Class B community in Goodlettsville, Tennessee, a suburb of Nashville.

The loan featured a debt-service coverage ratio of 1.37 and a 30-year amortization schedule. The 4.3 percent interest rate on the loan represented an undisclosed amount of savings stemming from upgrades to the property's water systems.

Berkadia provided approximately $1.5 billion in green loans through the GSEs in 2016 alone. Kim Cozza, managing director at Berkadia, believes that the lower pricing of green loans versus conventional loans has been the biggest incentive for borrowers, and thus the primary driver of demand for green loans.

"It wasn't really until 2016 that the price differentiator for the interest rate spread was large enough to incentivize," says Cozza. "We immediately began marketing the programs. The pricing benefit alone just made sense as something that would fit the majority of our multifamily loans."

Walker & Dunlop recently closed a $20.8 million Fannie Mae green loan for Centennial Crossing at Lenox Place in Goodlettsville, Tennessee. The firm provided roughly $1.5 billion in green loans throughout 2016.

Kim Cozza
Berkadia

Berkadia, which is currently on pace to exceed last year's total of $1.5 billion in green loan transactions, closed two green loans in the first quarter of 2017 totaling roughly $62.6 million.

The firm arranged a $41.5 million adjustable-rate loan for The Glenn, a 396-unit property in Orlando, through Freddie Mac's Green Up program. The borrower, Insula Capital, replaced all exterior and common-area lights with LED bulbs to qualify for the loan.

Berkadia also arranged a $21.1 million Fannie Mae loan on behalf of Atlantic Pacific Cos. for the acquisition of Advenir at Walnut Creek, a 256-unit community in Mansfield, Texas. This property was developed after 2000, making it something of an exception to the rule.

Real Savings

According to Peter Giles, vice president of production and sales at Freddie Mac's multifamily division, implementing the upgrades can generate anywhere from 22 to 31 percent energy savings.

A 2015 Freddie Mac study found that if property owners can cut their utility costs by 10 percent, they could lower their asking rents to levels that are affordable enough to attract an additional 10 percent of the market. Given that 78 percent of renters prefer to live in environmentally friendly properties, according to Freddie Mac's renter research survey, this slashing of utility costs represents a means of creating competition for units, which leads to more money in landlords' pockets.

Giles cites a 430-unit property in Texas that was built in 1990 and underwent the gamut of water-saving upgrades as the epitome of the savings borrowers can achieve from green loans. The improvements on this property, which is located in a state with a serious water shortage, have thus far reduced water usage at the property by about 5 million gallons per year, which has translated into roughly $105,000 in spared utility costs.

"It's a win-win," says Giles. "We have seen an overwhelmingly favorable response from both lenders and borrowers that find the process fast, simple and efficient. We expect our suite of products and requirements to evolve as the program's popularity increases."

Peter Giles
Freddie Mac

Giles adds some color to the numbers, noting that 5 million gallons is enough to fill eight Olympic-sized swimming pools.

"Numbers like that make it easy to see why this program has taken off," says Giles. "The growth has exceeded our expectations, and we are optimistic that it will continue to grow for years to come." ■