How To Get Started With Agency Lending

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When you're taking out a mortgage for a commercial real estate deal, there are multiple financing options available to you.

If your deal qualifies for agency lending, chances are good it could work out to be the best financing option. There's a lot to know when it comes to agency lending.

In this e-book, we'll cover what exactly agency lending is — the three we discuss are Fannie Mae, Freddie Mac and Housing and Urban Development (HUD) — how it works for commercial real estate, how to qualify and how to put together the best team for your CRE deal.

What is Agency Lending?

The main lenders applicable to multifamily CRE are Fannie Mae, Freddie Mac and HUD. HUD is a government entity, and the funding is insured by the government directly. Fannie Mae and Freddie Mac, on the other hand, are government-sponsored enterprises (GSE). They are not government entities, but there are certain government regulations they must abide by.

Fannie Mae and Freddie Mac are not direct lenders. Instead, there are a limited number — around 30 — banks and institutions that are licensed to lend with Fannie Mae and Freddie Mac. Fannie Mae then sells its loan while Freddie keeps them on the balance sheet and securitizes the loan. If a buyer is interested in agency lending, he would apply through one of these institutions.

Fannie Mae and Freddie Mac: An Introduction

Fannie Mae is a shorthand name for the Federal National Mortgage Association (FNMA) and was established in 1938 during the Great Depression as part of the New Deal. The intention behind this agency was to provide affordable market-rate housing for individuals.

Freddie Mac is a shorthand name for the Federal Home Loan Mortgage Corporation. The agency was chartered by Congress in 1970 with the mission to "keep money flowing to the housing market, supporting greater stability and affordability."

These agencies made it easier for Americans to own homes by extending the mortgages to 30 years with a fixed interest rate. This financing structure decreased the down payment needed to purchase a home and allowed more Americans to buy property. Before Freddie and Fannie were established, down payments were typically around 50% rather than 20%.

Both Freddie Mac and Fannie Mae buy mortgages from lenders across the country. The agencies then pull the mortgages they buy into mortgage-backed securities and sell them to investors globally. These mortgage-backed securities are considered a more secure investment because they consist of a basket of mortgages rather than only one.

Fannie Mae and Freddie Mac both have multiple loan programs for multifamily property investors. These loans are suited for investors taking out a mortgage with properties of five units or more, including student housing, cooperatives and senior living. The mission of the multifamily division is to provide affordable rental housing for families with an income at or below the median income of their area, given that rent should not be more than 30% of one's monthly income.

Many people know about Fannie Mae and Freddie Mac in the context of the financial crisis. During this time, Fannie Mae and Freddie Mac both went under conservatorship of the Federal Housing Finance Agency (FHFA). The federal government stepped in to bail out these two agencies, and they received $190 billion. The agencies have since paid this money back but are still under conservatorship.


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Types of Properties For Agency Lending

As these agencies focus on the housing market, they mainly buy residential real estate mortgages. These agencies also work with multifamily properties above five units, student housing and senior living.

"Anything related to residential that's five units or more is the general rule for Fannie and Freddie," said Jonny Rahimi, former Senior Broker at Lev.

Multifamily is considered one of the more secure forms of property in commercial real estate, and has become an even stronger asset since 2008. After the financial crisis, "people weren't looking to necessarily put money down to buy anymore," Rahimi said. "There was a lot more demand to rent, and because of that, owners kept investing, and prices went up."

The Benefits of Agency Lending

For the most part, agency lending — particularly when it comes to multifamily — will likely be the most attractive type of financing for those who qualify for it.

"Generally speaking, they will offer the most competitive interest rates for lenders who qualify for these loans, with a fixed interest rate, and always non-recourse, because the asset is presumed to be strong enough where they are not going to need a personal guarantee," Rahimi said. Lenders can also get high leveraged deals of up to 80% with these agency lenders, he added.

AGENCY LENDER INTEREST RATES

One of the reasons agency loans are more competitive is because they offer lower interest rates. Many factors influence your interest rate, including where you are located in the U.S., if you're in a large metro area or more urban area, if you're seeking higher leverage or lower leverage and the loan term you're looking for.

But, in general, interest rates for agency lenders will be lower than other types of financing. This year, interest rates for HUD financing are going from mid-two percent to low-threes, Rahimi said. Interest rates for Fannie Mae and Freddie Mac are conventionally in the high-twos to low-threes, while the small balance loans are mid-threes to high-threes.

"For now, these are kind of expected interest rates, but historically if you look at the last half a century, they're low. The reason being because multifamily is considered such a strong asset that's relatively safe," Rahimi added.

How HUD Differs From Fannie Mae and Freddie Mac

Freddie Mae and Fannie Mae are usually grouped into the same category of agency lending — though there are differences between them. HUD is a separate agency all together, and there are some key differences between HUD and government-sponsored enterprises.

Elliot Haft, Originator at Dwight Capital, who focuses on HUD deals, explained that HUD is


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typically a 35-year loan, whereas Fannie and Freddie are typically seven to 10-year loans.

"I would say that the HUD requirements are a little bit more intensive than Fannie and Freddie, and it's because they are ensuring a loan for 35 years and they want to make sure that the properties were up to their standards for those 35 years."

For similar reasons, HUD typically also stays away from older properties or properties that add a lot of deferred maintenance, Haft said.

How to Qualify for Agency Lending

The Freddie Mac Small Balance Loan is designed for loans between $1 million and $7.5 million and is growing in popularity. With fixed-rate terms up to 10 years, and hybrid ARMs (adjustable-rate mortgages) up to 20 years, Small Balance Loans are an ideal choice for many multifamily investors. Fannie Mae and Freddie Mac work with stabilized assets. In CRE, this classification means the agencies lend to income-producing properties. Both Fannie and Freddie have a requirement that your average occupancy must have been above 90% in the last 90 days before you either refinance or do acquisition financing with them.

Fannie Mae and Freddie Mac will also request a T3 (a trailing three) which shows tenant occupancy for the last three months. The average occupancy should be 90% or higher during those three months.

A borrower will need to have some experience with real estate, and this requirement becomes more specific depending on the program you're applying to. But generally, "You don't need to have bought 100 different properties but you have to have a few buildings, or at least something that says you know what you're doing," Rahimi explained. But the main focus comes down to the property, and whether the property qualifies.

Additionally, to qualify for these loans, typically your bad debt and vacancy can't be above 15%. So if your units are 100% occupied and your rent is $100,000, you need to be earning $85,000 out of that $100,000.

Specific Loan Programs With Agency Lenders

There are several loan programs available through agency lenders. Each one is intended for a different type of property and has different requirements. Freddie Mac SBL is one of the more popular loan programs. In this section, we've outlined some of the specific requirements for this loan, in addition to listing some of the other common programs.

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Freddie Mac SBL stands for small balance loans. These can be used either to acquire multifamily or to refinance multifamily, as long as the borrower meets that criteria of 90% occupancy over the last 90 days.


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To qualify for Freddie Mac SBL, the borrower's net worth (their assets minus the liabilities), has to be equal to at least the loan amount, said Adam Reiss, Production Associate at Sabal, who focuses on these loans.

"In terms of liquidity, which is the amount of liquid assets you have to be able to verify, they're both going to want to see nine months of principal and interest payments."

That means if your monthly payments are $5,000, you'll have to show $45,000 liquid in the last two statements of your personal checking account.

The borrower also needs experience. To qualify for a Freddie SBA loan, Reiss said, the sponsor must have either owned at least one multifamily property for five years or owned three other multifamily properties, with the first of those three being bought at least two years ago.

FREDDIE MAC CONVENTIONAL

Freddie Mac's conventional loan programs come in several varieties, with fixed-rate and floating-rate programs offering loans between $5 million and $100 million.

FANNIE MAE DELEGATED UNDERWRITING AND SERVICING PROGRAM (DUS)

The Fannie Mae DUS is the most popular type of Fannie Mae multifamily loan. These loans start at $3 million with no set upper limit. Both fixed and floating rate options are available.

This program focuses on multifamily properties, including senior housing, student housing, manufactured housing, affordable housing, conventional housing and workforce housing.

DUS issues a single-asset mortgage-backed security "with a single loan as support for that collateral," Levin said in a Fannie Mae video from 2019. "It's not in an overall securitization, and that means that the investor and the borrower are directly tied together from the beginning to the end of that underwriting, closing and issuing of that security," he added.

FANNIE MAE SMALL BALANCE LOAN

Fannie Mae also offers a small balance loan, and it's one of their more popular loans for multifamily properties. These loans are up to $6 million dollars with a term from 5 to 30 years. You can find out more information about this loan on Sabal's website.

HUD PROGRAMS

HUD offers a variety of loans. One of the more popular loans is the 221(d)(4) loan, Haft explained, which is a construction loan with a term of up to 40 years, and up to a 40-year amortization. Another common loan is the 223(f) loan, which offers loan modification programs for existing homeowners with a loan term of up to 35 years.

Agency Loans Vs. Bank Loans

There are many reasons an investor may prefer an agency loan to a bank loan. Agency loans are non-recourse, which means that in the case of default, the lender can only seize the property. Bank loans, including commercial banks and credit unions, typically have recourse loans. These loans impose a higher level of risk for the borrower, as in the case of default, a lender can seize the borrower's other assets.

Agency loan interest rates are typically half to three-quarters a percent lower than a bank. Amortization will be longer too, at up to 30 years, while the amortization for bank loans is typically up to 20.

The following graph highlights the main differences between agency loans and bank loans:

Securing Agency Lending: A Step-By-Step Break Down of the Process

Fannie and Freddie are not direct lenders, which means you'll be receiving financing through a bank that will then sell this loan to the agencies.

Reiss explained how this process works for Freddie Mac's SBL (small balance loan).

Agency Lenders (Fannie Mae and Freddie Mac)	Banks (Commercial, Saving and Credit Unions)
Multifamily 5+ units	All asset types
Size: $1 million plus ($750+ for Fannie Mae Small Loans)	Size: Varies
Non-recourse (with standard "bad boy" carve-outs)	Recourse
The asset is the main source of repayment	The borrower is the main source of repayment
Leverage: Up to 80% LTV (in certain markets)	Leverage: Up to 75% LTV
Prepayment: Yield Maintenance, Defeasance, & Step-Downs • Very difficult to pay off the loans early, and even when the loan can be prepaid early there are huge prepayment penalties	Prepayment: Stepdown (5, 4, 3, 2, 1%)
Amortization: Up to 30 years	Amortization: Up to 20 years
Terms: 5, 7, and 10+ year fixed-rate options, including interest only • Hybrid ARM: 20-year term with initial 3, 5, 7, or 10 year fixed-rate period	Terms: Less than 5 years - Floating Loans
Interest Rate: Typically half to three quarter a percent lower than a bank	Interest rate: Higher interest rate
Rate Lock: Early rate-lock option available for varying durations	Rate Lock: After loan approval
Close: 60-75 days	Close: 30-45 days
Nationwide	Local

"In the beginning, someone would provide us with financials to size up a loan," he said.

To find out what type of loan and interest rate this deal works for, the person would provide a T-12 income and expense and rent roll, and Sabal will give them a soft quote.

"If they like it, we'll say, here are the things we need to produce a hard term sheet. Once we secure these, we present them with a term sheet."

When that happens, the lender will sign the term sheet and an application fee.

"From there, we assign an underwriting team internally, engage third parties, and we're on our way to processing the loan."

Once the borrower signs the application, they have 35 business days to provide Sabal all the diligence they will need on a checklist they send the borrower, Reiss said. After Sabal collects all this diligence, they conduct the appraisal and engineering report. At this point, Sabal will submit the deal to Freddie Mac.

Freddie Mac will review the file, which will generally take around 15 days. In that time they'll review Sabal's underwriting, do some of their own underwriting, and then issue Sabal a draft commitment letter, which is like their approval on the deal.

WHAT HAPPENS IF THE AGENCY DOESN'T APPROVE THE LOAN?

The agency lender may still need more information after a proposal has been submitted through a bank.

While this does happen in some instances, Reiss said the hard term sheet Sabal asks lenders to fill out helps lower the probability. Nonetheless, certain aspects are out of the lender's control. For example, tenant occupancy could tank after the application has been submitted.

There are different ways to handle situations where the unexpected can impact the deal. Rahimi said when he's dealt with clients in the past where the property dips below 90% occupancy, the borrower can consider getting a waiver exception or underwriting a bridge to agency loan with the same lender. There are different ways to handle this obstacle, but they are specific to the individual situation.

The Ideal Team the Will Help Get the Best Deal

Some buyers choose to go directly to the lenders, and others choose to go through a broker. There are pros and cons for each choice.

These are competitive federal programs, Rahimi said, and your property either qualifies for agency lending, or it doesn't. Because there are specific licensed lenders that work with Freddie Mac and Fannie Mae directly, in general, they are going to quote you an interest rate that is more or less the same. "If you show 123 Main Street in Dallas Texas to three different lenders, they're going to come back with very similar quotes," Rahimi said.

Still, a broker can be an immense help for the process.

"Brokers add a ton of value with respect to not only finding the best lender for the deal, but then also pretty much getting it done for that borrower," Reiss said. "They're going to tell you what forms you need and where to sign. They're going to guide you through it. Whereas, if you're not using a broker, it could be a little tough to get to the promised land. It just depends on what the borrower is up for and what they can tackle themselves."

There are two main ways a broker can help. The first is by figuring out the best program your deal applies for. The second is providing guidance with the paperwork involved and follow through.

"Then there's executing, and that's really the toughest part, just going through the 45 to 60 to 75 days of due diligence and making sure the agency lender doesn't retreat on you, which happens more often than it should," Rahimi said.

Rahimi added that there are many different programs available within agency lending, and these can often change the overall deal.

"For instance, if you have affordable housing, you might qualify for cheaper pricing, but you don't always get quoted, for different reasons," he explained.

Desmond Holzman-Hansen, a former Capital Markets Analyst at Lev Capital, said that when it comes to agency lending, the value of a broker boils down to how they underwrite the income of the property.

"There's a lot of different ways they can underwrite the income, like they can give credit to some things and can't give credit to other things. So at the end of the day, each lender will come up with a slightly different income for the property, and the broker's value is being able to go through the underwriting model with the agency lender," he explained. "The higher you can use the income in the eyes of an agency lender, the more money you're going to get for your client."

In general, a broker can help guide a borrower to complete the deal, navigate the required documentation and think strategically about how to underwrite a deal.

"There's a lot of paperwork, things that can go wrong, different ways to be creative," Rahimi said. "Sometimes that can make a difference of $50,000 to $100,000."

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