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Major Tax-Exempt Multifamily Housing Debt Executions in an Era of Rising Interest Rates[*]

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As 2018 unfolds, all industry players involved in affordable multifamily housing finance are still giving thanks that tax-exempt private activity bonds and the related 4% LIHTC survived the passage of the Tax Cut and Jobs Act (the "TCJA") in late December, and did so with very limited adverse collateral impacts as compared to various proposals which were under consideration prior to final passage. On many of these financings, the tax-exempt debt may finance 60% of total development cost, 4% LIHTC may cover 35% or so and soft dollars perhaps 5%. Various estimates suggest that the dramatic reduction in the marginal corporate tax rate from 35% to 21% and certain other changes may have had a slight adverse impact on the demand for tax-exempt bonds, thus raising bond yields and lowering proceeds and may have lowered 4% LIHTC pricing by around 15 cents on the dollar[**]. The overall impact of these changes may be to have lowered the total available financing proceeds from the debt and equity side of a financing by 5 – 8% on a typical transaction. This is a different solar system in terms of adverse impact (and one much closer to earth) than the 40 – 45% loss of proceeds we were facing until just before Christmas. Have you thanked your U.S. Senator yet?

Recent annual studies by the Harvard Joint Center for the Housing Studies have indicated that the affordable rental housing crisis in the United States has grown more critical and widespread since 2011, notwithstanding a surge in affordable unit production (under 9% LIHTC plus tax-exempt bonds and 4% LIHTC) from about 90,000 units per year several years ago to an estimated 135,000 units in 2016 (including an estimated 75,000 to 80,000 from tax-exempt bonds and 4% LIHTC). Thus, the demand side of the equation grows stronger every year, and is likely to continue to do so in 2018 and beyond.

This is not to say that all is smooth sailing now. There are, however, storm clouds on the supply side. These mainly take the form of potentially rising interest rates. Though no one can reliably forecast future interest rates, recent developments seem to suggest that after peaking in 1981, the 35+-year down

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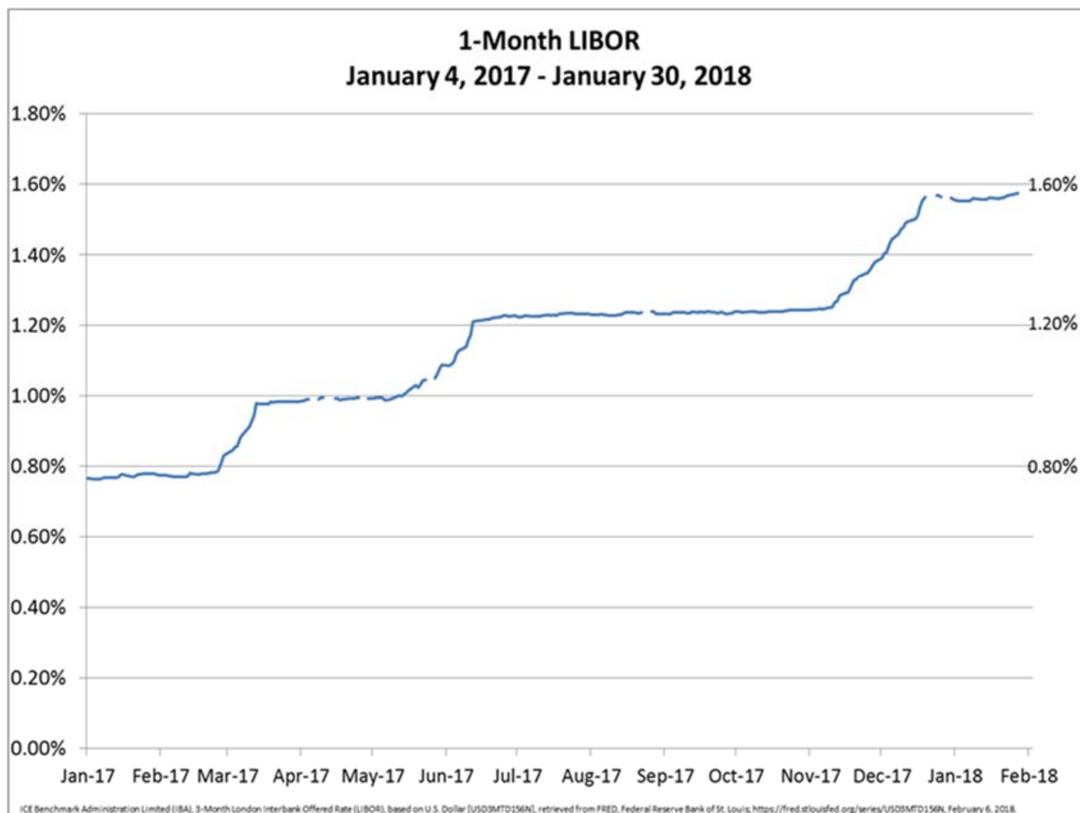
[**] Some sources estimate that 4% LIHTC syndication proceeds dropped an average 10-12 cents after the fall election when the market generally modeled a 25% corporate tax rate and another 4-5 cents when the final 21% rate was adopted in the TCJA.

cycle in interest rates MAY be plateauing and indeed perhaps finally reversing to what has long been viewed as more "normal", and higher, levels. If that is true, it will have a significant potential adverse effect on the financing of long-term capital assets, such as apartments, with a 50-year average life, where, unlike purchases of shorter duration assets like washing machines and automobiles, financing costs generally comprise a very high percentage of the purchase price.

What sort of overall impact do rising interest rates have on loan proceeds for an affordable apartment financing? At current rates – say mid to high 4% or low 5% all-in borrowing rates (see below), on a 35-year level amortization debt service constrained affordable apartment loan, for every 7-10 basis points increase in rate, we lose about 1% of loan proceeds. While this ratio declines as interest rates go higher, at current levels this means a 100 basis point increase in the all-in borrowing rate can shrink loan proceeds about 10-14% - a major hole in most financing budgets.

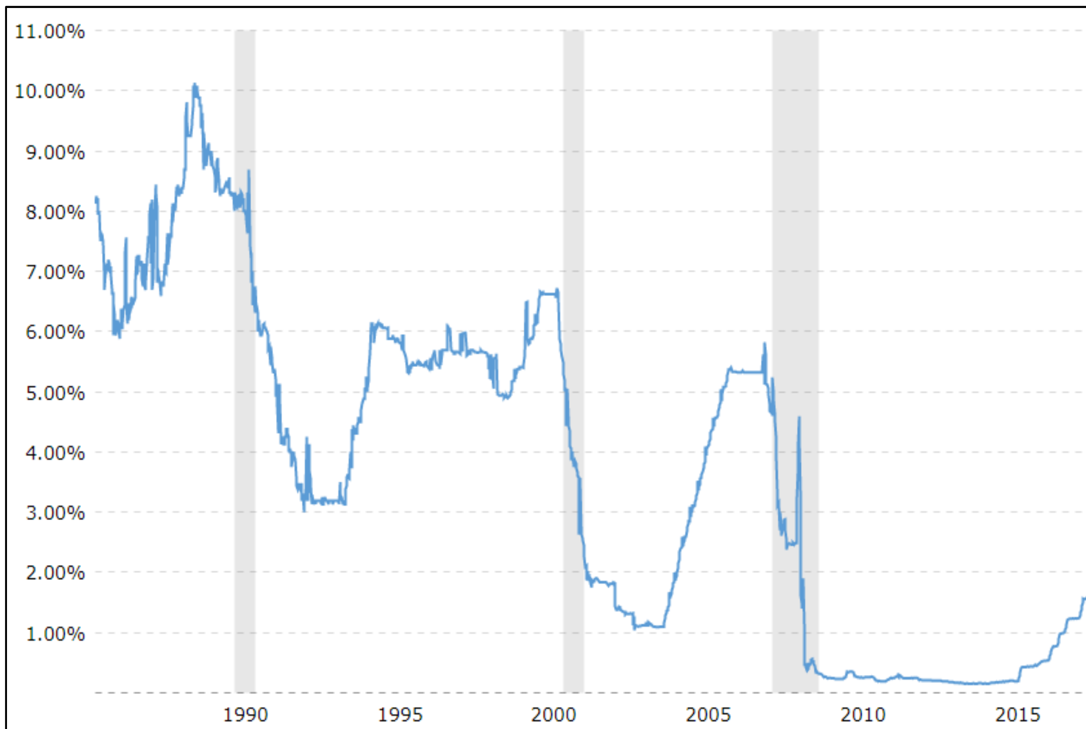
Where have short term and long-term interest rates, which underlie the borrowing rates on affordable apartment loans, gone over the last year? The two most widely followed indexes of short-term floating rates are the SIFMA and one-month LIBOR indexes. Of the two, one-month LIBOR is generally viewed as the broader, less volatile index of very short-term rates. The most widely followed measure of long-term borrowing rates is the 10-year U.S. Treasury Bond.

Short-term Rates. The following charts show the level of one-month LIBOR over the past year and the past 35 years.



As shown in the chart above, one-month LIBOR is around 1.60% today, or 40 basis points above last fall's 1.20% rate and 80 basis points above the rate in early 2017.

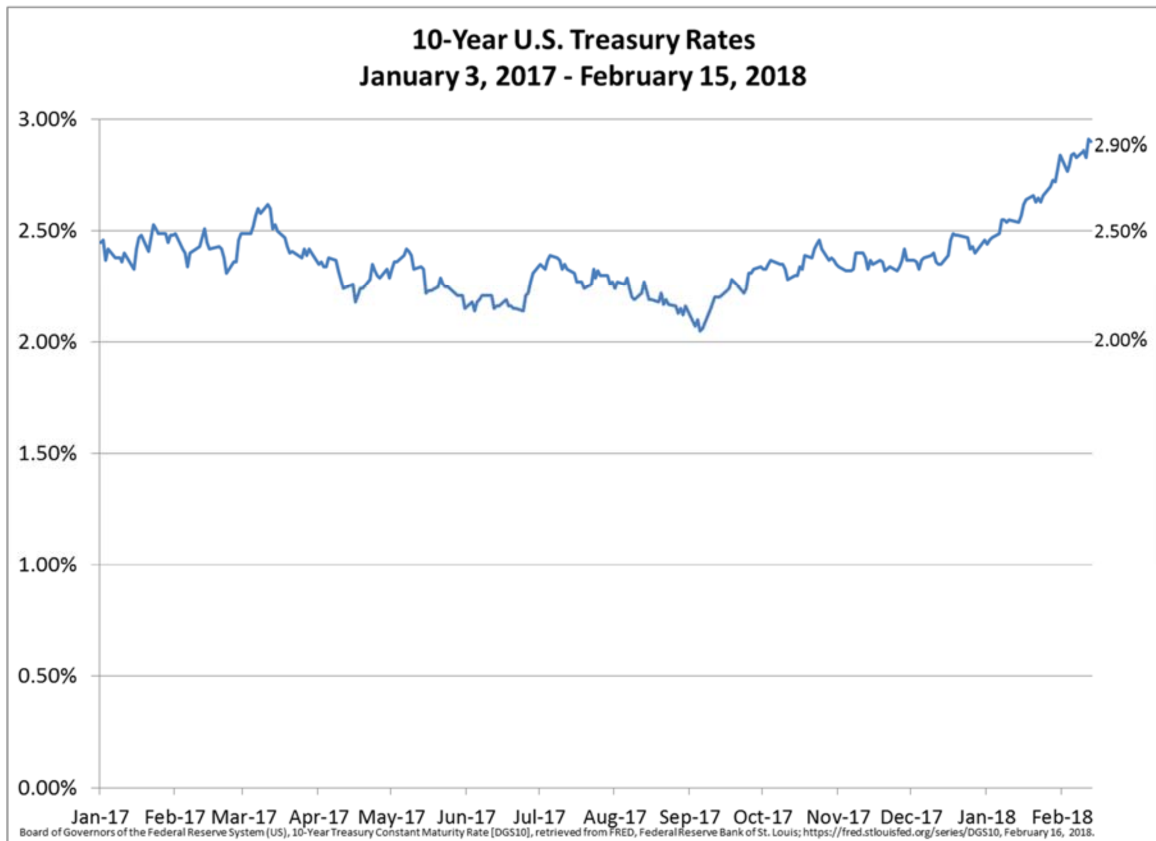
1-Month LIBOR
1985 - 2018



Source: http://www.macrotrends.net/2518/1-month-libor-rate-historical-chart

As shown in the chart above, one-month LIBOR held at around 20 basis points for seven years from the fall of 2009 following the financial crisis in 2008 until it began to rise in 2015 to its present level of approximately 1.60%. While there have been major peaks and troughs, the general trend was down from a high of almost 10.0% in 1988 to the very low 20+ basis point level which prevailed from 2009 through 2015.

Long-term Rates. The following charts show the yields on the 10-year U.S. Treasury Bond over the past year and over the past 54 years.



As the preceding chart shows, the 10-year U.S. Treasury yield is now at 2.90%, up from a low of about 2.00% in September last year, and versus 2.20 – 2.30% for most of 2017 – a 55 to 65 basis point increase over most of the past year.

10-Year U.S. Treasury
1964 - 2018

Source: http://www.macrotrends.net/2016/10-year-treasury-bond-rate-yield-chart

The preceding chart above shows the same long-term downturn in long-term rates as the second chart on one-month LIBOR shows in short-term rates. The 10-year Treasury yield peaked at a rate just under 15.0% in September of 1981 to a low of around 1.65% in late June of 2012. We are now over 100 basis points above that level, and the Fed has announced that it may raise the discount rates 3 or 4 more times in 2018, and twice in 2019, which would be expected to raise both short-term and long-term rates. As the long-term interest rate charts demonstrate, if the right conditions emerge, there is a lot of room for interest rates to move up from the historically low levels we have seen since 2008.

Interest Rates for Bank and Freddie Mac TEL Draw Down Private Placements*

In a bank private placement, the Bank, often called the "Funding Lender", extends a floating rate draw-down construction loan through the municipal entity (often called the "Governmental Lender") to the Borrower. The Bank also commits to hold the permanent component of the loan following "Conversion" to a stabilized loan, during the permanent loan phase ending about 16 years after the placed-in-service date, at a permanent lending rate committed at closing. In a Freddie Mac Tax-exempt Loan or "TEL" financing, a bank serves as the "Initial Funding Lender" during the pre-Conversion phase, and a Freddie Mac Targeted Affordable Lender and Freddie Mac serve as the permanent "Funding Lender." Underwriting and other

* In 1998, the author helped pioneer what has become one of the country's leading bank private placement platforms, and in 2001, the leading securitization structure for these issues through Freddie Mac. The author and his partner, Ryan George, also led the development of documentation for the tax-exempt loan (versus) bond format for these executions when the regulatory environment dramatically changed in 2008. Our Norris George & Ostrow PLLC colleague, Kim Griffith, was a principal architect and developer of the Freddie Mac TEL structure when he served as Vice President of Sales and Investment in Freddie Mac's Multifamily Housing Division from 2003-2015. The author and his partner Ryan George served as special outside counsel to Freddie Mac in the development of program memoranda, model documentation and other materials for the Freddie Mac TEL structure.

terms under these executions are similar and very favorable (e.g., 1.15:1 DSCR; 85 – 90% LTV, 35-year loan amortization to a 16-18 year balloon). These financings now constitute probably 80 to 85% of the tax-exempt debt on Section 142(d)/4% LIHTC financings.

In the past year, both the Pre-Conversion ("Construction") and Post-Conversion ("Permanent") interest rates on private placements have generally moved up, with the general increase in short-term and long-term rates shown in the one-month LIBOR rate charts above.

Pre-Conversion interest rates on bank draw down loans and Freddie Mac TEL private placements are generally set as a spread above SIFMA or, more often above one-month LIBOR (e.g., 175 to 250 basis points above one-month LIBOR). The permanent lending rate in these financings is generally locked at a spread of above the 16-18-year LIBOR Swap index, now about 2.95%. The permanent loan spread might be in the low 200 basis point range if the financing is a moderate rehab financing or if that rate applies to the permanent component of the loan from closing versus following conversion. The spread would typically be more in the 230-250 basis point range where it applies only following conversion and/or for certain substantial rehab and new construction financings.

The bank serving during the Pre-Conversion (or "Construction Phase") as the "Funding Lender" on a Bank private placement or as the "Initial Funding Lender" on a Freddie Mac TEL financing, and the Bank serving as the Funding Lender in the Permanent Loan period of a Bank private placement (or Freddie Mac in a TEL financing), will lock the **Pre-Conversion spread** as well as the Post-Conversion or **"Permanent Loan" spread** when a loan application is filed. These Lenders will generally hold the **spread** for some time while the loan is underwritten, **but Lenders generally will not lock the Permanent *Index* Level** on which the Permanent Lending rate will be based (the Construction Loan Index, as described above, is a floating index and thus is not locked) **until about a week before closing.**

Pre-Conversion ("Construction") Borrowing Rates	January 2017	July-Nov. 2017	Early February, 2018	
1-mo LIBOR	0.80%	1.20%	1.60%	
Spread (typically,	1.75-2.50%	1.75-2.50%	1.75-2.50%	**Up about 80 Basis**
175-250)	2.55-3.30%	2.95-3.70%	3.35-4.10%	Points in the Last Year

Post-Conversion ("Permanent") Borrowing Rates	January 2017	October 2017	Early February, 2018	
17-year LIBOR	2.50%	2.10%	2.95%	
Spread (typically,	2.00-2.50%	2.00-2.50%	2.00-2.50%	**Up about 85 Basis**
200 to 250)	4.50-5.00%	4.10-4.60%	4.95-5.45%	Points from Fall 2017

While these rates are higher now than recently, the combination of relatively low costs of issuance versus a public offering, low rate construction period floating rates, draw down funding (which eliminates negative arbitrage) and low permanent interest rates with the favorable underwriting terms described above, make these executions, as noted above, the primary tax-exempt debt funding source in the vast majority of affordable multifamily rental housing financings. Bank private placements probably account for an estimated $5 to $8 billion per year or more of the tax-exempt debt financing for these projects, and the volume under the Freddie Mac "TEL" program now exceeds $3.0 billion.

Fannie Mae M.TEBs[*]

The relatively new Fannie Mae M.TEBs product lowers long-term borrowing rates by combining very attractive bond rates from publicly offered monthly pay MBS-backed tax-exempt bonds with a competitive guaranty/servicing spread. This product has really taken off over the past three years. Fannie Mae has now closed over 20 M.TEBs type financings in nine states having an aggregate dollar amount of over $300 million, and has another $650 million of M.TEBs financings in its pipeline.

Moderate Rehab M.TEBs. The initial Fannie Mae M.TEBS structure involved a 16-year tax-exempt monthly MBS pass-through bond for mod rehab projects. The rehab may be as high as $40,000 or $50,000 or a bit more per door, so long as there are no substantial tenant relocation or re-tenanting issues. The Fannie Mae mod rehab DUS loan is funded by the DUS Lender at closing of the Bonds and commences amortization almost simultaneously with the issuance of the Bonds. No separate construction loan is involved under this structure.

New "Forwards" M.TEBs. Fannie Mae's new "forwards" M.TEBs product is for new construction/sub rehab projects. This product is just emerging and is rapidly gaining wide acceptance. This product not only offers very competitive rates and other underwriting terms, but Fannie Mae has shown great flexibility in permitting earn-out and/or other supplemental loan funding. The structure combines a 17- to 18-year fixed rate tax-exempt MBS monthly pass-through Bond with a taxable draw down construction loan from a bank or other construction lender. It entails 2-2.5 points of construction period negative arbitrage, but for many projects this disadvantage is more than offset by the favorable terms and flexibility on supplemental funding.

Both versions of M.TEBs (mod rehab and "forwards") combine very low all-in borrowing rates and attractive loan terms (35-year loan amortization to balloon 15 to 16 years after placed-in-service/1.15 DSCR/85 to 90% LTV).

	Moderate Rehab Loan	"Forwards" M.TEB (New Construction/Sub Rehab)
10-Year Treasury	2.90%	2.90%
Spread	.70	.80
Tax-Exempt Bond Coupon/ MBS-Pass-Through Rate	3.60%	3.70%
Guaranty/Servicing	1.00	1.10
All-in Borrowing Rate*	4.60%	4.80%*

*Excluding ongoing issuer, trustee, rebate fees and about 2.5 to 3.5 points of construction period negative arbitrage in the "Forwards" M.TEBS structure. Taking into account about 3.0 points of negative arbitrage, the equivalent permanent rate would be **comparable to about a 5.00% permanent rate on the "Forwards" structure** when compared to other draw down executions such as (i) Bank and Freddie Mac TEL draw down private placements and (ii) FHA/RD Loans combined with short-term, cash backed tax-exempt Bonds, both of which structures in today's markets typically involve no or only a very small amount of negative arbitrage.

[*] The author and his partner, Ethan Ostrow, together with their prior colleague, Ad Eichner, worked with Fannie Mae and other participants for over two years to develop the structure and documentation for the Fannie Mae M.TEBs product. This led to the closing of the first M.TEBs financing in February, 2015. Messrs. Norris and Ostrow then served as underwriter's counsel on the first seven M.TEBs financings which closed over the next two years, and on a number of subsequent M.TEBs financings.

FHA or RD/GNMA Taxable Loans and Short-Term Tax-Exempt Cash-Backed Bonds*

As interest rates move higher, we may ultimately return to a "right side up" interest rate environment which existed for decades before the 2008 financial crisis, when putting highly rated credit (like that of GNMA) behind long-term municipal bonds produced the lowest all-in borrowing costs for all executions. But for now, selling long-term GNMA's in the taxable institutional markets still produces a significantly lower borrowing cost than selling long-term tax-exempt municipal bonds backed by GNMA. In addition, on new construction/sub rehab projects, the forward delivery structure available in the taxable GNMA markets eliminates a potential 6-8 point negative arbitrage deposit associated with fully-funded long-term municipal bond financings – a huge advantage of using short-term cash-backed bonds on these financings versus the fully-funded long-term GNMA-backed municipal bonds structure used to fund these loans prior to 2008. Finally, in financings with issuers that charge substantial ongoing fees, the short-term cash-backed bond structure can reduce all-in borrowing costs by as much as 25 to 40 basis points per year in some cases by terminating ongoing issuer fees when the short-term bonds are retired.

	§223f (Mod Rehab)	§221(d)(4) (Sub Rehab/ New Construction)
10-Year Treasury	2.90%	2.90%
GNMA to 10-Year Treasury spread	.75	1.20
Taxable GNMA Pass-Through Rate	3.65%	4.10%
Servicing/GNMA Guaranty Fee	.25	.25
Stated Mortgage Loan Rate	3.90%	4.35%
Mortgage Insurance Premium (Affordable)	.25	.25
All-in Borrowing Rate	4.15%	4.60%

As most industry participants are aware, over the past five years HUD **has quintupled** its FHA loan volume on affordable housing loans to over $2.6 billion in the last fiscal year ended September 30, 2017 and has dramatically improved its processing times and reliability on these loans. From the initial pre-app meeting and submission of a full loan application, even on new construction/sub rehab loans under Section 221(d)(4), in most HUD offices a firm commitment can be obtained and the loan can be priced in three to five months or less, not the six to eight months or more which was required in the "old days". Loan terms continue to be very attractive (35-40 year level amortization (no balloon); 1.11 to 1.17 DSCR; 85% loan-to-value (223f); or 90+% loan-to-cost (221(d)(4)). While supplemental financing can be more challenging with HUD than under other platforms and Davis Bacon wages can be a barrier on Section 221(d)(4) loans in some markets, for developers who understand FHA and can take the extra time which FHA loan processing requires, FHA can offer a very attractive debt side execution, including non-recourse construction terms.

Rural development ("RD") loans can require even longer to process than FHA, but in light of the willingness of USDA to subordinate existing Section 515 financing, to provide additional financing under Section 538, the subsidies which are available, the unique focus USDA brings to rural projects, and the ability to wrap the permanent loan component with GNMA securities which can be sold at very low rates

* The author, working with other industry colleagues, played a major role in introducing the use of short-term cash backed financing with FHA insured, rural development and other taxable loans in 2009, and in recent years he and his partner, Ethan Ostrow, have helped pioneer a number of the innovations which have lessened or eliminated negative arbitrage and dramatically improved the efficiency of these executions.

in today's market, this execution now provides a uniquely effective loan platform for pools of these small project loans throughout the United States.

Recent Developments on Short-Term Cash Backed Tax-Exempt Bonds. As is now well understood, to meet the critically important "50% Test" necessary to trigger the 4% LIHTC which funds 35% or more of total development costs in these financings, we now use short-term cash-backed tax-exempt bonds. The good news here is that for such bonds combined with all forms of moderate rehab loans (e.g., FHA §223f, Fannie Mae, RD), market conditions and creative structuring techniques now enable us to eliminate or almost eliminate the bond-side negative arbitrage on almost all of these bond issues. The same is now true with bonds issued in connection with new construction/sub rehab FHA 221(d)(4) and RD loans, with all but a handful of issuers and bond counsel firms. The result is that the Borrower pays usually one to three points for cost of issuance (as it would do in any tax-exempt debt financing) and closes the short-term cash-backed bonds which remain outstanding until the project's placed-in-service date (or until a slightly later mandatory tender or maturity date) - **without any out-of-pocket for negative arbitrage** - and the 50% Test is satisfied.

In new construction/sub rehab FHA and RD projects, it continues to be **critically important** for the Borrower to speak with its Bond Underwriter and Underwriter's counsel **at the very outset** of these financings (**i.e., before applying for bond volume**) so that its reinvestment options can be maximized. This **can save hundreds of thousands of dollars** on FHA and RD new construction/sub rehab financings with short-term cash-backed bonds in some jurisdictions where reinvestment options may be limited.

Where Are Interest Rates Headed Now and How Can Affordable Housing Borrowers Prepare for Further Potential Interest Rate Increases?

As noted above, virtually no one can reliably predict the future direction of interest rates. Today's interest rate levels undoubtedly incorporate factors, such as the Fed's announced intended 2018 – 2019 discount rate increases, continued strong employment, a slightly faster rate of economic growth here and abroad, increased inflationary pressures and other factors. However, the convergence of these factors with other recent developments discussed below seem to suggest that the entire Treasury yield curve, both the short end and the long end, may now be moving higher, and in the next 12 to 24 months could be as much as 50 to 100 basis points higher than today's levels. As Dr. Martin Feldstein, Chairman of the Council of Economic Advisors in the Reagan years, observed in the January 17, 2018 edition of Wall Street Journal (p. A17), four other factors suggest a higher yield curve in the near term:

1. Real Interest Rates are Still Low. The current rate on the 10-year Treasury of 2.90% is 90 basis points over the 2.0% approximate expected level of inflation over the next decade – a very low "real" rate of interest. According to Dr. Feldstein, "Historically, the real yield on 10-year Treasuries was about 2.0%" [i.e., about 200 basis points] above the rate of inflation". Thus, a return to normal interest rates could, in and of itself, support a 110 basis points rise in 10-year Treasury yields to 4.0%.

   The long-term interest rate charts set forth above should be a wake-up call, while there is no assurance where interest rates will go, if fundamental factors are indeed now shifting, they could move up to levels **much higher** than even the recently elevated levels we now have.

2. A Planned Massive 10-Year Deleveraging of the Fed's Balance Sheet Has Just Begun. To prevent the 2008 financial crisis from ripening into the next Great Depression, from 2009 to 2011, the Fed more than **quadrupled** its balance sheet, by increasing its holdings of U.S. Treasury and Agency

(mainly MBS) securities from about $1.0 trillion (slightly over 5% of GDP) to over $4.0 trillion (about 25% of GDP), a level not seen since World War II. It did this primarily by buying federal agency/MBS Securities and continuing to purchase new paper of this type as these securities prepaid or matured. These days are now over. The Fed has just commenced a 10-year planned deleveraging pursuant to which it will allow as much as $300 billion per year of this paper to amortize or mature without new purchases. This could materially reduce the demand for such paper and thus contribute to a rise in long-term rates on such paper, by some estimates of 20 – 30 basis points or more.

3. Increased Federal Deficits Will Require Increased Issuance of Treasuries. A basic law of economics is that if one dramatically increases the supply of an item, in the face of constant demand, the price will go down to enable markets to clear. In the case of U.S. Treasuries, this means one would expect that the yield will go up. An article in the February 1, 2018 Wall Street Journal (p. A1), cites an estimate that the recent $1.5 trillion tax cut implemented by the TCJA and other factors will drive the Treasury's borrowing needs from $519 billion in the fiscal year ended September 30, 2017 to $955 billion in the fiscal year ending September 30, 2018 – **an 85% increase** - and to $1.083 trillion and $1.128 trillion in the two fiscal years thereafter. It seems inevitable that this dramatically increased level of Treasury borrowing, which is only now becoming clear, will put additional upward pressure on interest rates.*

4. Borrowers with Poor Credit Generally Pay More. As Dr. Feldstein observes in the article cited above, the United States debt-to-GDP ratio now stands at about 77%. This is expected to rise to about 100% by 2027. The projected continuing decline in U.S. Credit generally is expected to exact a further upward influence on Treasury Rates.

What would be the impact of rising interest rates on affordable housing financing? Let's assume that 12-18 months from now, the rate on the 10-year U.S. Treasury has moved up only 50 basis points from today's level at about 2.90%. If the debt side funds 60% of the total development cost and we lose one point in loan proceeds on a 35-year level amortization, debt service constrained loan per 7-10 basis points increase in rates, we've lost about 5-7 points of loan proceeds or roughly 3-4% of total development cost on the debt side. Of course, 4% LIHTC buyers are also yield driven to a certain degree. If a 50 basis points higher rate reduces 4% LIHTC proceeds by say several cents, that's another point or two, so let's assume 5-6% of our debt and equity funding proceeds have gone away as a result of a 50 basis points rise in rates.

* It is hard to escape the unsettling conclusion that we may be laying the foundation for a pattern similar to that which emerged in the 1960's, when the country spent massively on the Vietnam War and the Great Society programs without raising taxes; then endured 8-10% per year inflation in the 1970's, which was only curbed by the historic spike in interest rates shown in the chart on page 5 engineered by the Federal Reserve in 1979-1981. Congress spent almost two months in November and December debating the TCJA, which is projected to widen the federal deficit by $1.5 trillion (about 8% of current U.S. GDP) (or more!) over the next decade. Then, in **only several days last week** (after the Treasury borrowing estimates outlined above were released) Congress agreed to almost **$500 million** of **additional** military and domestic **spending** and disaster relief which is projected to widen the federal deficit by $265 billion in the next two years alone. Then, only a day or two later, the President abandoned a long-stated Republican goal to balance the federal budget in ten years. This pattern, combined with the massive increase in underfunded Social Security, Medicare and Medicaid entitlements which are projected to emerge in the next 10-15 years as the post-WWII baby boom generation moves into its 80's, paints a very troubling financial picture which our government in the current political environment seems unable to address. If this trend continues, harkening back to the 60's and 70's, the phrase "I think I've seen this movie before" sadly comes to mind.

If the Treasury rate is 100 basis points higher in 12 to 18 months, we may have lost 10-12% or so of our total funding on a typical deal.*

Some knowledgeable industry sources have recently stated that they believe the recent run-up in interest rates has already taken most of these factors into account, and that additional substantial increases in interest rates may not be immediately forthcoming. These sources include Citigroup and the Bank Credit Analyst, who project a yield on the 10-year U.S. Treasury around 3.0% at the end of this year. On the other hand, in light of everything going on, with seemingly unrestrained spending on both sides of the aisle in Congress and a new fiscally frightening headline every day, there may be more room for rates to continue to increase and some sources, including RBC Capital, project a yield as high as 3.35% on the 10-year U.S. Treasury at year-end. Of course, a host of unpredictable developments could alter any forecast for the better or worse, but these "guestimates" are one way to try to assess the potential adverse impact if we are headed, after over three decades, into a world of higher interest rates. If higher rates do emerge and are accompanied by higher inflation and decreased production, rents will ultimately rise and costs should decline, but there is typically a substantial lag before these trends can help ameliorate the adverse impact of higher interest rates, which is immediate in the case of long-term highly leveraged capital assets like apartments.

What Can An Affordable Housing Developer Do?

Let's say I am an affordable housing developer and I have a project in the planning stages where I hope to close the financing by the end of 2018. Is there an effective, economical way to hedge my borrowing costs? Unfortunately, according to Jim Moore and Charlie Jacobs at Kensington Capital Advisors, LLC, many products used to hedge interest rate and other risks in large commercial transactions are not easily applied to the average affordable multifamily developer. This is due in part to the fact that the average affordable housing developer does not have the balance sheet to guarantee the performance by the Borrower of its obligations (to make a termination payment, to post collateral and other obligations) under a swap or other derivative instrument. Moreover, the pricing of non-binding alternatives for the duration of a Qualified Project Period lasting 15+ years which the 4% LIHTC buy side will need, tends to be prohibitively high as compared to the more normal 3-5 year duration for these instruments.

The hedging structures that might be available to the typical affordable housing developer are not cheap and provide much less than a perfect hedge. Let's say to cover the loss I might suffer from the long-term LIBOR swap rate rising above today's implied forward LIBOR swap levels over the next nine months, I decide to purchase an option that grants the holder the right to pay fixed on a 17-year LIBOR Swap, exercisable 9 months from now in a "notional" amount equal to the principal amount of my expected

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* On the "potential good news" side of the ledger is the Affordable Housing Credit Improvement Act (S. 548/H.R. 1661) legislation proposed by Senators Maria Cantwell and Orrin Hatch and others (the "Cantwell/Hatch Bill"). If adopted as currently proposed, this legislation would, among other things, expand 9% LIHTC volume by as much as 50% (providing an estimated additional 400,000 affordable rental housing units over 10 years). It would also set the 4% LIHTC at an actual 4% rate versus about 3.2% currently – a 20% increase in the value of the 4% credit. Furthermore, it would give state allocating agencies the ability to apply a 1.3 basis adjustment for certain bond financed projects in Qualified Census Tracts ("QCT's") or Difficult to Develop Areas ("DDA's") or where the agency otherwise concludes additional resources are needed – a potential 62.5% increase in the volume of the credits for certain of these projects. If, on the average bond financed affordable project, the 4% LIHTC funds roughly 35% of total development cost, these changes in the 4% LIHTC, if enacted, could make up a gap in funding sources used by the TCJA, rising interest rates or other factors, equal to 7% to 15% of total development cost. This would be a **huge boost** in affordable rental housing resources! Of course, it remains to be seen whether Congress will take up and pass some or all of this proposed legislation.

permanent loan. According to Kensington, the upfront premium today for the purchase of this option would be about 5% of the notional amount – a cost which most developers would likely consider prohibitive.

For a preservation project which has not yet reached Year 15, the following strategy may now be one a borrower should consider. The existing owner can refinance at today's rates – e.g., an FHA 223(f) loan at all-in 4.15% rate, 35-year level amortization. At year 15, the existing owner does a transfer of physical assets (TPA) with HUD or other lender at no premium or fee and transfers the project and today's "low rate" refi loan to a new borrower affiliate it has established to recapitalize the project. The new borrower has short-term tax-exempt cash-backed bonds[*] issued in Year 15 to prime 50% Test and syndicates 4% LIHTC. Several approaches can be used to avoid tax issues if the amount of the assumed loan is too large. This immediate refinance followed by loan assignment can lock in today's rates for most of the debt two or three or more years in advance. The time to act on this type of preservation opportunity may be now!

In states where the demand for private activity bond volume essential to these deals has now risen to levels which exceed supply, it may be especially important to move early in the year on planned financings. These states have for several years included Massachusetts, New York, New Jersey, Minnesota, Tennessee, Arizona, Utah and Washington State. In the past year, Texas and Virginia may have joined that list. Applying for volume and otherwise starting the financing process early may now be more important than ever in these states. And if we are entering an era of increasing interest rates, moving as quickly as circumstances permit to price and close pending financings addresses that issue as well.

General Conclusions in an Uncertain World

Perhaps the best general takeaway, if we are entering an era of continued rapidly rising interest rates is this – time is now your enemy, not your friend. I am senior enough in this industry to have lived through the meteoric run-ups in rates from the summer of 1979 to the fall of 1981, when rates on the 10-year Treasury soared from 8.76% in July, 1979 to 15.84% in September, 1981. We would rob from the equity to subsidize the debt, shorten the debt duration (finance down the yield curve) and use every other device we could conceive to develop a feasible financing plan, only to discover that in the 5 – 6 months it took us to obtain the agreement of all parties to the proposed execution, it no longer worked! We felt like that donkey, who could just never catch that carrot which the driver of the wagon we were pulling was dangling in front of us from a long stick.

It seems highly unlikely that we are entering an era nearly that dramatic. However, the factors discussed above would seem to suggest that interest rates – both short-term and long-term, may rise further in the months and years ahead and, if this occurs, each increase will have an adverse impact on financing sources. As noted, the long-term charts make it clear there is a lot of room for rates to run higher if the right underlying conditions, such as a substantial increase in the inflation rate, emerge. We at least seem to be entering a period when pushing to close sooner may well be better than "waiting for circumstances to improve." For the immediate future, certainty and timeliness of execution may become the most important hallmarks of a successful project financing.

[*] The rates on these AA+ rated, short-term bonds are not terribly volatile and tend to be offset by reinvestment rates which may move up or down in the same general direction as the tax-exempt coupon.