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INTRODUCTION TO TAX EXEMPT MULTI-FAMILY HOUSING BONDS AND 4% LOW INCOME HOUSING TAX CREDITS FOR "MIXED INCOME" APARTMENT PROJECTS

Presented by:

R. Wade Norris, Esq.

wnorris@ngomunis.com

(202) 973-0110 (direct)

(202) 744-1888 (cell)

Norris George & Ostrow PLLC

The Army Navy Office Building

1627 Eye Street, N.W., Suite 1220

Washington, D.C. 20006

www.ngomunis.com

† **Cautionary Note**: The interest rates and other data set forth in this analysis are **estimates only**. **All markets today** – for bonds, tax credits, swaps, caps, investment agreements and other products – **are often thin and volatile**. These **interest rates, fees and other variables can vary dramatically** depending on state, timing, market conditions and other factors, and the other variables may vary significantly depending on project, developer and other factors. Borrowers should check with their investment banker or financial advisor before conducting a detailed assessment of any of these structures or programs.

MAJOR ADVANTAGES OF USING TAX EXEMPT MULTI-FAMILY HOUSING BONDS

- Developers may use "New Money" Tax Exempt Bonds under Section 142(d) of the Code combined with "4%" Low Income Housing Tax Credits to Construct or Acquire and Rehabilitate Apartment Projects.
    A. For 20% affordable ("Mixed Income") projects in urban areas to satisfy inclusionary zoning and other requirements.
    B. For 100% Affordable Projects.
- Many new developments in and around major urban/suburban areas are subject to inclusionary zoning requirements.
- Satisfying these requirements will obviously reduce project revenues and NOI.

- If the developer agrees to set aside **20%** of the units for families whose incomes don't exceed **50%** of area median income (or to set aside **40%** of the units for families whose income don't exceed **60%** of area median income) adjusted for family size*, under Section 142(d) of the Internal Revenue Code the project may be eligible for tax exempt bond financing and, on the affordable units, for 4% low income housing tax credits ("LIHTC").
- May be worth analyzing to see if further impact on revenues and NOI is more than offset by the advantages of Tax-Exempt Bonds and 4% LIHTC, plus real estate tax relief (on all of the units or at least on affordable units), if any.
- "Mixed income" projects are usually very **large, complex urban projects** (which often involve a combination of for sale residential, commercial, and other components, combined with a rental apartment component where 20% of the units are rented to tenants where incomes do not exceed 50% of AMI (for a family of four, adjusted for family size at rents ≥ 30% of that amount). Usually, 80% of the units are rented to tenants at any income level at market rates.
- The developers of such projects tend to be **very large or national development firms**, who have the capability of using their **large, liquid balance sheets** to achieve, when desired, very high leverage and/or the lowest possible borrowing rate.

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* The 20% at 50% test, assuming a family of 4; the maximum income level generally goes up or down about 5 percentage points for each family member above or below 4 (i.e., a couple with no children ≈ 40% of AMI).

- Advantages may include:
  - A potential 50-200 basis point reduction in effective borrowing rate on debt side through tax-exempt bond financing.
  - A lower effective borrowing rate on the debt side of the financing (depending on structure used) may equal 5-15% increase in loan proceeds.
  - The project may benefit from additional proceeds from selling a 99% limited partnership interest which entitles the limited partner to claim so called 4% low income housing tax credits ("4% LIHTC") with respect to the affordable units and depreciation deductions, without giving up substantial cashflow or residual value.

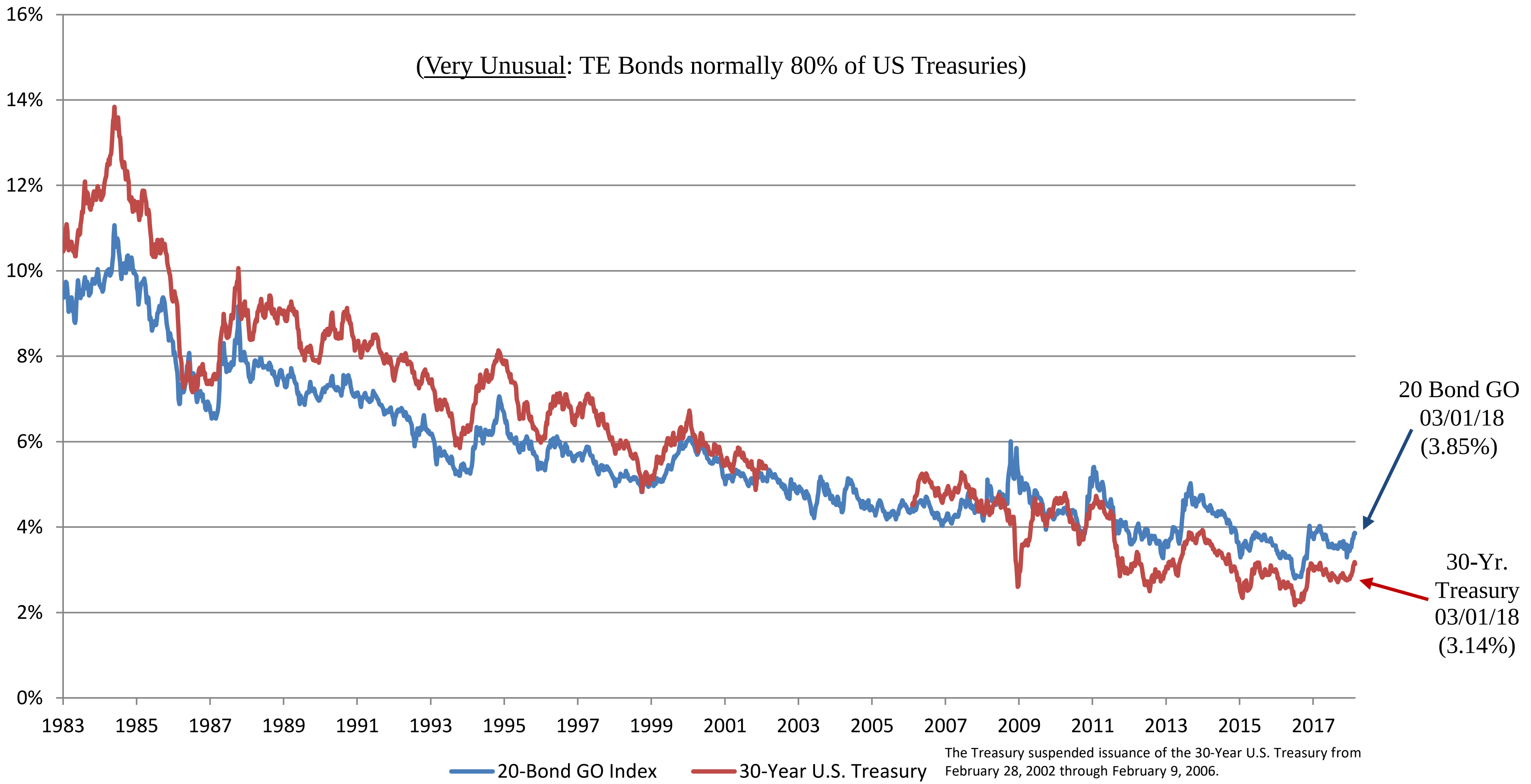
ADVANTAGES OF BONDS AND CREDITS

- LOW BORROWING RATES OF DEBT SIDE OF FINANCING

LONG TERM TAX-EXEMPT VS. TAXABLE RATES

Bond Buyer 20-Bond GO Index vs. 30-Year U.S. Treasury

January 1983 - March 2018

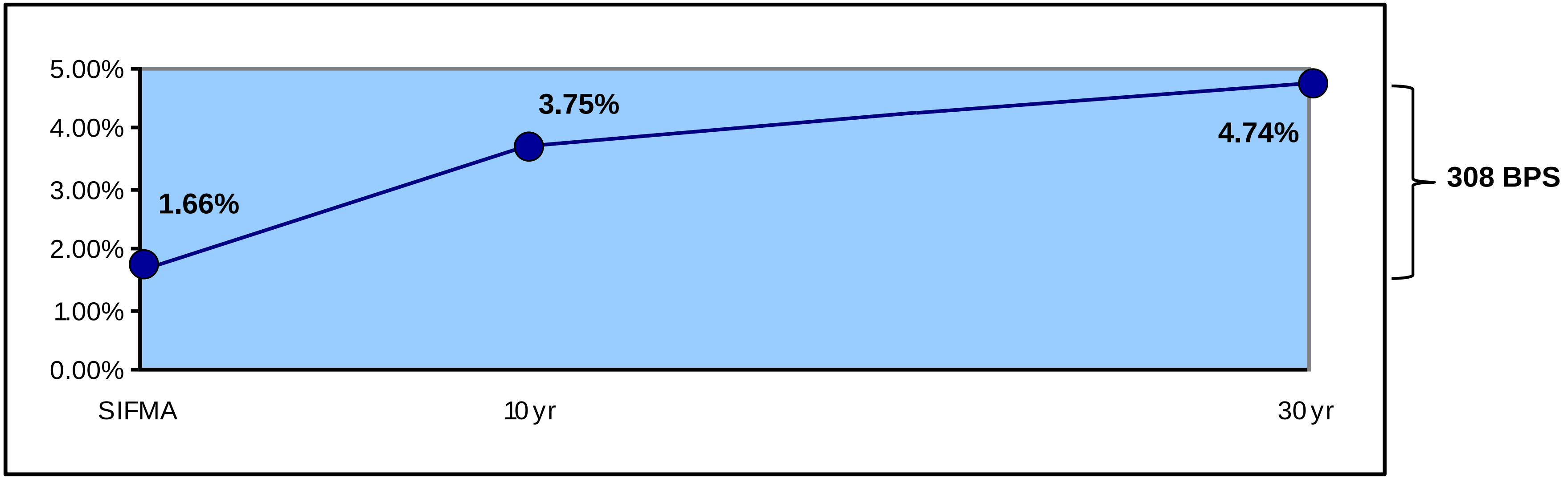


- **Preceding Chart shows** that prior to the 2008 financial crisis Long-Term **Tax Exempt Rates** were often **50-100 "basis points"** (basis point = 1/100 of 1.0%) **lower** than long-term **taxable rates**.
- Since the financial crisis much of this advantage has disappeared for general obligation bonds, but **long term tax exempt fixed rates for bank private placements on affordable multifamily housing loans and certain other executions are still 50-100 basis points lower** than they would be if these loans were made on a taxable basis.
- This reduction in rates can **increase loan proceeds** by **5% to 10%** as compared to the proceeds from a taxable fixed rate loan.

- **Tax exempt** yield curves **always have positive slope**, in part due to heavy demand for short maturities by tax exempt money market funds.

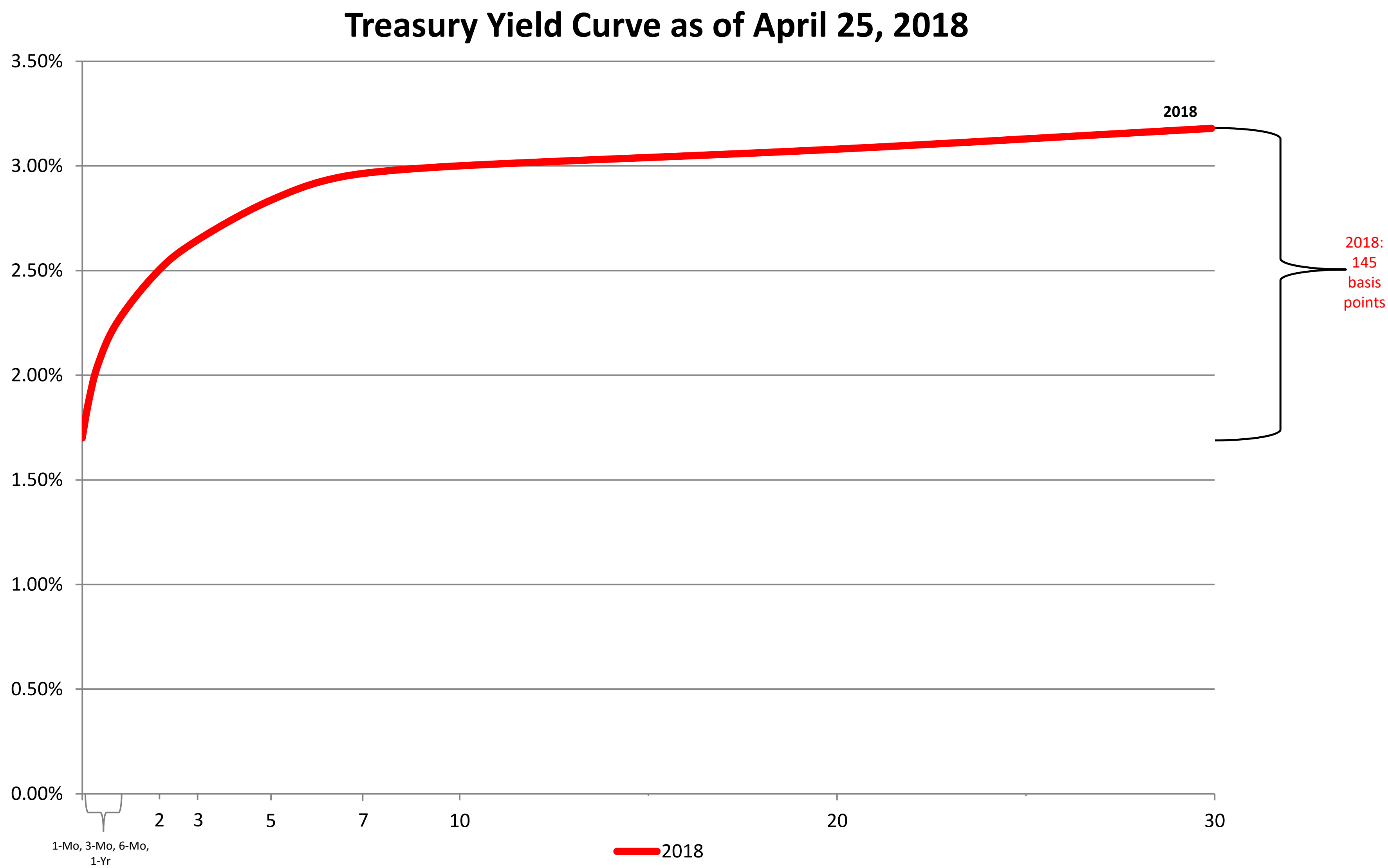
TAX EXEMPT YIELD CURVE

August 25, 2008

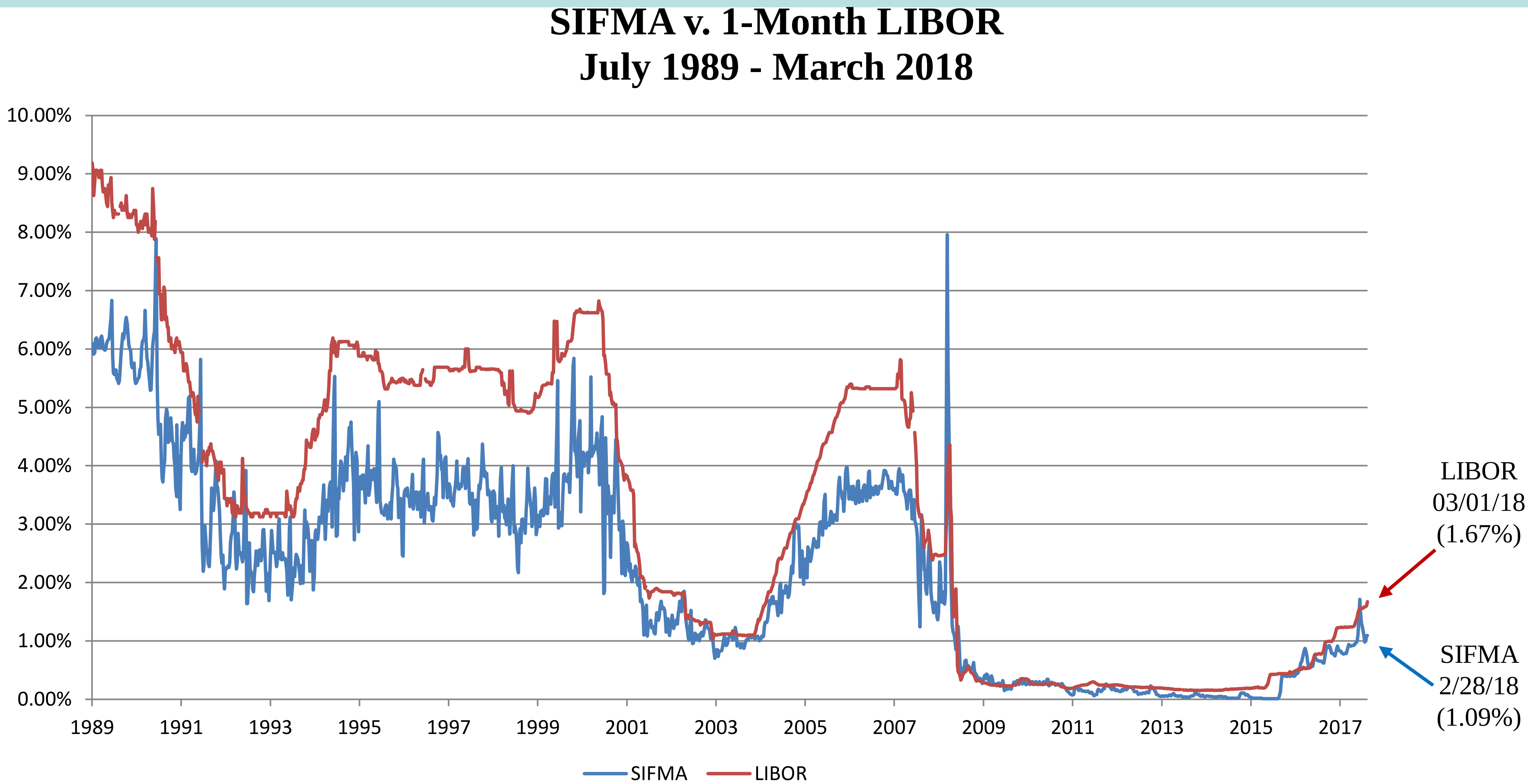


- If one can borrow through variable rate financings on the shortest end of the tax exempt yield curve, the base bond coupon will be 200-300 basis points lower (SIFMA ≈ 1.60%) versus long term fixed rate tax exempt bond coupons of 4.0% or higher.

Compare to Treasury Yield Curve Slope: 145 Basis Points



SHORT TERM
TAX-EXEMPT VS. TAXABLE RATES



Today, SIFMA = Approx. 65% of LIBOR
Normally, SIFMA = Approx. 67% of LIBOR

- **Result**: Even after **deducting** about **150 to 200 basis points** of **additional fees** for credit enhancement, liquidity and remarketing for variable rate financings, the **net effect can be to provide interest rate savings of another 100 basis points or more even versus a long term fixed tax exempt rate**, and **all-in borrowing rates in the 3.50% to 4.0% range** on the debt side of the financing, versus fixed tax exempt borrowing rates of 5.0% or more.
- This can result in an **even greater increase in loan/proceeds** and/or greater project cash flow. These savings from variable rate financings are not available to nearly the same degree on taxable financings where the yield curve is typically much flatter, especially now.

MAJOR TAX-EXEMPT BOND RULES SECTION 142(d)

- **Residential Rental Housing Facility**
  - “Rental”: Tenant must rent unit; no condos.
  - No transient use (no hotels, rooming houses).
  - Generally, complete living units (minimal kitchen and bath); but Housing Reform Act of 2008 also permits for some “SRO’s.”

MAJOR TAX-EXEMPT BOND RULES SECTION 142(d)

- **20/50 or 40/60 Income Targeting**
  - Rent 20% of units to families with incomes <50% area median, or rent 40% of units to families with income <60% area median income.
  - Above limits for family of 4; **adjust up or down for family size** (like HUD under Section 8).
  - **Annual recertification**: If income rises above **140%** of applicable income limit, next unit of equal or smaller size must be rented to qualifying tenant.
  - Lasts **at least 15 years**, or as long as Bonds outstanding (if longer).

MAJOR TAX-EXEMPT BOND RULES SECTION 142(d)

- **Private Activity Bond Volume Allocation Requirement**
  - In 1986 Congress placed volume limits (in 2017 the greater of $100 per person or minimum of $305.0 million per state) on quasi-public "private activity bonds."
  - Such bonds include wide range of uses, including pollution bonds, student loan bonds, single family mortgage revenue bonds and other categories, as well as multifamily housing bonds.
- In recent years much more private activity bond volume has become available, including more volume for multifamily housing.
  - Multifamily share in all of U.S. has grown to about 14% of volume in 2016.
  - Only a handful of States now allocate no volume to multifamily.

MAJOR TAX-EXEMPT BOND RULES SECTION 142(d)

- **In most states volume is not a major problem**, although availability of private activity bond volume has become a major issue in 8-10 jurisdictions (MA, NJ, NY, VA, TN, MN, UT, WA). Not yet a problem in California.
- But important to determine availability of bond volume for your project up front.
- States impose different systems – most are merit based, according to published criteria (e.g., California and Florida).
- Unused bond volume can be carried forward for three years, then lost (e.g. 2018 volume can be used through 2021). Many states have substantial unused carry-forward volume.

ADDITIONAL PROCEEDS FROM THE SALE OF "4%" LOW INCOME HOUSING TAX CREDIT EQUITY

- Applies only to new money private activity bonds under Section 142(d) for profit-motivated buyers.
- Eligible to receive "4%" low income housing tax credits = 35-40% more proceeds on 100% affordable project, or **5-6% more proceeds on a 20% affordable project, without giving up substantial cash flow or residual**.
- To generate tax credits, **rents** on the affordable units must also be restricted to 30% of applicable income level for that unit, which may further impact revenues and NOI.

MAJOR 4% LOW INCOME HOUSING TAX CREDIT EQUITY RULES (Section 42 of Code)

- How does 4% Low Income Housing Tax Credit Equity work?
    - Section 42 permits investors in qualified projects to claim an **annual credit against federal income tax for a 10-year period** after the project is placed in service.
    - **Amount of credit which can be taken each year** is a specified percentage (e.g., approximately **4%** (actually about 3.2%) or approximately 9%) **of the "qualified basis"** (e.g., basically depreciable cost) of the **affordable** units (i.e., excludes commercial, market rate units and land).

LIHTC PRICING; EFFECTIVE SYNDICATION

- Well established market for LIHTC on 100% affordable projects.
  - Prices ranged from the $0.70 to $0.80/dollar of LIHTC through most of the 1990's.
  - Climbed to a level exceeding $1.00 on 100% affordable deals in some markets, during 2004 – early 2007 era and again in last 4-5 years.
  - Since fall election and Tax Reform Act have declined to $0.90's in most jurisdictions; perhaps still over $1.00 in urban areas where banks have big CRA needs.

LIHTC PRICING; EFFECTIVE SYNDICATION

- LIHTC pricing for 20% affordable mixed-use deals has been less attractive, due to:
  - Perceived credit risk of market rate units.
  - “Leakage” issues.
- Prior to 2006, pricing had been $0.40-$0.50/dollar or not sold at all.
- More recently, pricing of $0.75-$0.85 or so may be obtained on some of these deals.

Sample Transaction

$50.0 Million 20% Affordable Project with Syndication of Tax Credits on Set-Aside Units

Assume: Total Development Cost	$50.0 Million
Less: Land	(7.5 Million)
Less: Commercial Qualified Basis	(2.5 Million)
	$40.0 Million
Assume: Difficult to Develop Area ("DDA") or Qualified Census Tract ("QCT")	x 1.3
	$52.0 Million
Assume: 20% Affordable	x 0.2
Eligible Basis	$10.4 Million
Tax Credit Rate	x 0.032
Annual Credit Amount	$332,800
Number of Years Credits Received – 10 years	x 10
Future Value of 10 Years of Credits	$3,328,000
Assume: 85¢/$1.00 pricing*	x 0.85
Net Syndication Proceeds to Borrower	$2,828,800 (5.7%)

* Previously, there was almost no market for tax credits on 20% affordable deals; developers were lucky to raise 40¢ to 50¢/dollar due to perceived problems of project marketability and "leakage" issues. Now structures are available which may allow tax credit equity on 20% affordable projects to be syndicated for proceeds of approximately 80-85¢/dollar.

MAJOR 4% LIHTC RULES

- **10-Year Holding Period**: Generally speaking, project must have been owned by prior owner for at least 10 years to be eligible for 4% credits, unless federal or state subsidized (e.g., §8, FHA).
- **50% Test**: At least 50% of aggregate basis of the building and land must be financed from volume limited **tax exempt** private activity bond proceeds to get full value for 4% credits.
- **Generally same 20/50 or 40/60 income targeting** as Bond test under Section 142(d) of the Code. Most tax credit projects are 100% affordable to maximize tax credits – tax credits are only paid on the targeted units.
- Unlike bond rules, **LIHTC rules limit rents charged** on targeted units **to 30% of the applicable income limit** for the targeted unit.

MAJOR 4% LIHTC RULES

- Tax credit units must continue to comply with above limitations for at least **15 years after placed in service**, or tax credit investors subject to "recapture" of tax credits claimed, and most projects are subject to an "extended use" affordable period for another 15 years. Many states, including California, impose an even longer affordable rental period.
- **If project loan defaults and credit enhancer forecloses, remaining years' credits convey with the property**, even though original tax credit investor paid for the entire stream of credits in first one or two years. Thus the tax credit investor, like the credit enhancer, will take various steps to minimize possibility of a loan default.

4% LIHTC – THE 50% TEST

- To be eligible for tax exempt bond financing of the debt on the entire project, the entire property must remain a long-term rental with 20% of the units affordable, but there are **greater appreciation opportunities where 80% of rental units are market rate**.
- Since **LIHTC** is **only available on the affordable units** – in this case **4% LIHTC** will account for **only 4-6% of total development costs**, but it can be a valuable financing source.
- **The 50% Test**: To be eligible for the full value of the 4% LIHTC on the affordable units, the Borrower **must finance at least 50% of basis in the building and land with volume limited tax-exempt private activity bonds** under Section 142(d) and **keep these bonds outstanding until the project's placed-in-service date** (receipt of certificate of occupancy for new construction or completion of rehab for acq/rehab financings).
- **Why the 50% Test?**: Congress wanted projects receiving the 4% LIHTC subsidy to pass the **same hurdles one has to pass to be eligible for private activity bonds**.

4% LIHTC – THE 50% TEST

- The Project must **score high enough on public merit with state bond volume allocators** to receive a private activity bond volume award.
- The Project must also have the **support of a municipal bond issuer like a state or local HFA**, a city or county who will apply for the volume.
- The Project must also have the **support of a governmental entity where the project is located** through a **TEFRA hearing and governmental approval**.
- In short, the 50% Test assures that these projects receive a thorough, local vetting and approval of public purpose and that they will address local needs of the community where the project is located.

ADVANTAGES AND DISADVANTAGES OF SYNDICATING 4% LIHTC

Advantages

- Additional proceeds =
  4-6% Total Development Cost
- 75-80¢ plus /$1.00 of credits

Disadvantages

- Normal Tax Credit Guarantees
- Possible corporate guarantee of yield or taking proceeds over time for maximum pricing
- Cost of putting bifurcated ownership structure in place
- Balance sheet/refinancing risk at end of moderate term (6-8 years) debt facility and/or obligation to pledge additional collateral.

Typical "New Money" Private Activity Bond Financing Sources and Uses of Funds $50.0 Million 20% Affordable Project

Sources		
Tax-Exempt Bond Proceeds	$37,500,000	(75%)
Developer Equity	6,500,000	(13%)
4% Tax Credit Equity	2,500,000	(5%)
Subordinated Loan	2,000,000	(4%)
Deferred Developer Fee	1,500,000	(3%)
Total:	**$50,000,000**	**(100%)**

Uses		
Land	$7,500,000	(15%)
Construction Costs	35,000,000	(70%)
Financing Fees	2,500,000	(5%)
Other "Soft" Costs	3,500,000	(7%)
Deferred Developer Equity	1,500,000	(3%)
Total:	**$50,000,000**	**(100%)**

BOND COSTS OF ISSUANCE*

AND OTHER ORIGINATION FEES

($50 million transaction)

Issuer	$100,000
Bond Counsel	75,000
Financial Advisor to Issuer	30,000
Underwriter	225,000
Underwriter's Counsel	50,000
Rating Agency	18,000
Printing	10,000
Trustee	12,000
Permanent Loan Origination	500,000
Permanent Lender Counsel	45,000
Mortgage Banker Counsel	35,000
Due Diligence	25,000
Construction Lender Origination	500,000
Construction Lender Counsel	35,000
TOTAL	***$1,660,000***
	(3.2%)

Certain of these items may vary greatly from deal to deal, including issuer fees. Real estate loan origination and related fees may be less if corporate credit can be used, but generally estimating cost of issuance and other loan origination fees at 3-5% is a good range.

THREE MAJOR TYPES OF TAX EXEMPT BOND EXECUTIONS
Alternative A. Bank (and Freddie Mac "TEL") Private Placement Programs

- **Dominant Tax Exempt Debt Financing Platform for most 100% Affordable and some Mixed Income Projects**. Bank private placements are **by far the dominant tax exempt debt financing structure** for 100% affordable and some Mixed Income rental housing projects in **major urban markets** (e.g., Boston, New York, Washington D.C., Miami, Chicago, San Francisco, Los Angeles).

- **These programs** comprise the **substantial majority (75% to 85%) of debt side executions** (by number of financings and dollar volume) for 100% affordable projects and **perhaps one-third of Mixed Income Projects** (see Alternatives B and C below) versus all other executions, especially in these markets.

- **CRA Impact on Affordable Housing Finance**. Large banks are required under the **Community Reinvestment Act ("CRA")** to do a certain dollar volume of public benefit **"lending" activities** and a certain dollar volume of **"investment" activities** in the markets where they have a presence, or they risk severe limitations on their future activities (e.g., new products, mergers, etc.). Thus, **large banks are huge buyers of both tax exempt bonds and funders of tax exempt loans** (and buyers of both 9% and 4% LIHTC) in markets where they have a presence. **This substantially lowers tax exempt all-in borrowing rates** (as well as tax credit yields) **in CRA driven markets**.

R. Wade Norris, Esq. wnorris@ngomunis.com (202) 973-0110 (d) (202) 744-1888 (c)

Alternative A. Bank (and Freddie Mac "TEL") Private Placement Programs

- Starting in **the late 1990's**, to satisfy CRA goals, banks began to buy **non credit enhanced bonds, backed only by a first deed of trust and certain pre-"Conversion" general partner guaranties** (e.g., completion, payment).* The regulatory environment changed dramatically following the financial crisis in 2008, and to achieve "lending" treatment, which is generally more favorable, for CRA accounting, reserve, and other regulatory purposes, many banks and more recently, Freddie Mac developed tax exempt loan (versus bond) versions of their private placement programs. **There is little difference in substance between tax exempt "bond" and "loan" programs**; it is almost totally a difference in terminology, albeit one with important regulatory consequences.

- **Draw Down Structure -** these tax exempt bonds or loans are funded **on a "draw down" basis**, as loan advances are made. This **eliminates negative arbitrage on a sub rehab or new construction loan** which is a **huge savings (1 – 3% of loan amount or more)** on these financings.

*In 1998, **Wade Norris** helped pioneer what has become one of the country's leading private placement platforms, and in 2001, the leading securitization structure for these issues through Freddie Mac. **Wade Norris** and **Ryan George**, led the development of documentation for the tax exempt loan (versus) bond format for these executions when the regulatory environment dramatically changed in 2008.

Alternative A. Bank (and Freddie Mac "TEL") Private Placement Programs

- **Low Variable All-In Pre-Conversion Borrowing Rate**. For sub rehab/new construction loans, the Banks offer **very low all-in construction/rent-up period borrowing rates (e.g., SIFMA (currently 1.60%) or 1-month LIBOR (currently 1.90%) plus 2.00 - 2.50%** – **i.e., all-in rates of 4.0 – 4.5% – until** the loan reaches **"Conversion"** or stabilized occupancy. This allows the Borrower to **access the debt markets at the very bottom end of the yield curve** (albeit with variable rate risk).

- **Low All-in Rate Permanent Rate**. This structure **also offers very low** – generally **high 4.0% to low 5.0% range - all-in tax exempt permanent rates for mod rehab as well as sub rehab/new construction loans** (at least in CRA driven markets), which is locked in at closing.

- **"Built-in" Tax Exempt Bridge Loan between Closing and Conversion**. Since the bank funding the loan has a first deed of trust on the project and other guarantees, these programs also allow the pre-conversion phase of the tax exempt loan to be "upsized" to fund project costs incurred prior to the receipt of tax credit equity, subordinate loans, and other permanent funding sources, which may not be available until after the related costs have been incurred.

- **Underwriting Terms Very Attractive**
  - **35-year loan amortization** to a 16 – 18 year balloon
  - **Very large (80 – 90%) loan-to-value**, and
  - **Very low debt service coverage (1.15 to 1.20).**

Alternative A. Bank (and Freddie Mac "TEL") Private Placement Programs

Interest Rates

	Mod Rehab	Sub Rehab/ New Cons
Bond Rate – Construction: One-Month LIBOR	N/A	1.90%
Plus: Spread		2.00% to 2.50%
= Bond/Loan Interest Rate		**3.90% to 4.40% Floating***
Bond Rate – Permanent: 16 to 18-year LIBOR Swap	3.10%	3.10%
Plus: Spread	1.80% to 2.20%	1.90% to 2.40%
= Bond/Loan Interest Rate	4.90% to 5.30%	5.00% to 5.50%
Credit Enhancement	N/A	N/A
Servicing Fees	0.00	0.00
Remarketing Agent	N/A	N/A
Issuer	0.125	0.125
Trustee	0.025	0.025
Total Fee Stack	**0.15**	**0.15**
Total Permanent Mortgage Rate (Underwriting Rate and Actual Permanent Borrowing Rate)	**5.05% to 5.45%**	**5.15% to 5.65%****

Upfront Fees (est.)

Origination	1.0 - 1.5%
App.	0.25
Bond Costs of Issuance	0.75 – 1.50
	2.00 – 3.25%

***Add 15 basis point fee stack below for all-in construction period borrowing rate.**

**** Most bond private placements funded on "draw down" basis, which eliminates construction period negative arbitrage.**

Estimated Rates as of 5/4/18; 35-year loan amort.; 1.15 - 1.20 DSCR; 80 - 90% LTV. If the Project is not in a part of a Bank's CRA footprint, this type of product may only be available at somewhat higher rates and somewhat tighter underwriting terms from the Bank or perhaps from a non-bank provider.

Freddie Mac Tax-Exempt Loan or “TEL” Structure*

- In 2014, **Freddie Mac** introduced its **Tax Exempt Loan or “TEL”** structure with **many of the same features and terms as bank private placements**. This structure also offers very low perm rates and is potentially available in a broader range of markets (not just CRA driven).
- **Loan terms are 16 years (mod rehab) up to 18 years (new cons/sub rehab), a 35-year loan amortization, 1.15 – 1.20 debt service coverage and a 85% - 90% maximum LTV.**
- The TEL structure was **expanded in 2015 to include sub rehab/new construction with a bank taking the risk on the tax exempt loan during the pre-Conversion phase**, and a **forward commitment from a Freddie Mac Targeted Affordable Lender and Freddie Mac to acquire the permanent phase component of the tax-exempt loan** at an agreed upon fixed rate at Conversion.
- **Does require separate bank (probably with separate counsel) to take pre-Conversion risk** versus most other private placements, thus perhaps slightly higher costs.
- **Terms** are quite comparable to **those of bank private placements** (discussed above).

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*__Wade Norris__ and **Ryan George**, as **special outside counsel** to Freddie Mac, assisted in the drafting of program memoranda, model documents and other materials relating to the development and implementation of the Freddie Mac TEL structure.

ALTERNATIVE B. TAX-EXEMPT 7-DAY DEMAND VARIABLE RATE BONDS BACKED BY LARGE BANK DIRECT PAY LETTER OF CREDIT.

- Structure large tax exempt and, in some cases, taxable bond issues as **7-day demand "lower floater" bonds** backed by a **direct pay letter of credit** from a **large** foreign or domestic highly rated **bank**, or by a lesser rated bank which provides a stand by letter of credit from the Federal Home Loan Bank Board (a "FHLB Wrap") if a draw down on its letter of credit is dishonored.
- In some cases, this debt may comprise as much as 85 – 90% LTV, when combined with a pledge of other collateral and/or completion, payment (or other guarantees for some portion of the exposure) strong, liquid corporate guarantors.

- Major Advantages:
  - Allows developer to **borrow at the very shortest end of the traditionally steep tax exempt yield curve** (e.g., SIFMA ≈ 1.60%) and/or shortest end of taxable yield curve (e.g., one-month LIBOR ≈1.90%).
  - Add letter of credit fees of 150 – 200 basis points, and **all-in borrowing cost today is 3.0 – 4.0%** versus much higher long-term tax exempt and taxable rates (5.0 to 6.5%).
- Disadvantages:
  - **Variable rate risk**, but this can be limited with caps or swaps, and bonds are multi-modal the borrower can trigger a mandatory tender and go into alternate interest rate modes.
  - **Limited duration**. These letters of credit typically expire in 4-6 years, and the borrower must then extend or arrange an alternate credit and/or liquidity from another facility at then applicable market rates.

Alternative C. Tax Exempt Privately Placed Bonds combined with Total Return Swap

- Under a “total return swap” structure **bonds are typically structured as fixed rate (e.g., 6.0%) unrated, non-credit enhanced tax exempt bonds** sold to a large domestic or foreign bank in a private placement. The Bonds are issued in large minimum denominations (e.g., $100,000 or higher), and are subject to transfer restrictions.
  - The Borrower then enters into a separate **swap transaction** with the Bank which effectively **converts the Borrower’s fixed rate borrowing into an extremely very low variable rate borrowing** as follows:
  - **The Borrower makes floating rate payments on the swap** based upon a stated notional amount which is generally equal to the outstanding principal amount of the fixed rate Bonds.
  - **Payments** by the Borrower **on the swap float, based upon the SIFMA 7-day index or 1-month LIBOR plus a spread** of a fixed number (e.g., 150) of basis points. That amount is paid to the Bank as the Swap Counterparty, often on a monthly or quarterly basis.
  - The Swap Counterparty in turn makes fixed rate payments at a fixed rate equal to the fixed rate on the Bonds, generally on the same Notional Amount, which offset the borrower’s payments on the bonds.
  - The **net effective borrowing rate in this example is** what the Borrower pays on the floating rate leg of the swap – in this example the SIFMA index of ≈ 1.60% + 1.50% = **3.10%, a very low borrowing rate**.

Alternative C. Tax Exempt Privately Placed Bonds combined with Total Return Swap

- **Balance Sheet Risk: The Borrower will be required to post additional collateral** to the Bank to the extent the Notional Amount of the swap exceeds some percentage (e.g., 75%) of the market value of the bonds on the underlying Project, as determined by the Bank on a periodic basis. **A termination payment may be required** if the value of the bonds decline and the bonds are not otherwise refinanced.
- **Limited Duration.** The **swap generally expires on a date 5-8 years** from the initial effective date. Same need to restructure debt in the 5-8 year term as with letter of credit backed financings.
- **Result**: This structure provides an **extremely low borrowing rate**, but only for the limited term described above, which **may or may not be rolled forward**. Thus, it is only attractive to and available to **large balance sheet sophisticated borrowers** who can post additional collateral if required and/or make any required termination payment.
- Tax considerations require the terms of the Bonds and the Swap to be separated, which can introduce some **timing and other risks.**

POWERFUL DOUBLE BARRELED EFFECT OF TAX EXEMPT BONDS AND 4% LIHTC ON 20% AFFORDABLE UNITS

- **Combine:**
  1. **5-15%** more proceeds from short-term tax exempt loan on **debt side** with
  2. **5-6%** additional proceeds from syndication of tax credit **equity**
  3. **10% to 20% increase in total proceeds!**
  4. **In return for accepting lower rents on the affordable units,** much of which may be required due to zoning and other local requirements.
- Potential real estate tax relief on all or at least the affordable units
- Lower 4% LIHTC benefits than on 100% affordable, but still **powerful debt/equity financing tool** for 20% affordable residential rental housing projects.

SUMMARY

- Use of Bonds and Credits involves:
  - **Increased time, effort and expense on front end** of financing; and
  - **Increased operating restrictions/monitoring** over substantial period of time (15+ years), **but**
- May result in:
  - **Lower all-inclusive borrowing rate on debt side of 5.0% to 5.5% (fixed rate) or 3.0% to 4.0% (variable rate or TRS)** depending on structure used;
  - **Increased proceeds from sale of 4% tax credit equity = 5-6%** of depreciable costs on Mixed Income; and
  - **Positive balance sheet impact** when corporate credit or bank letter of credit model used.

THE PLAYERS

- Issuer
- Issuer’s Counsel
- Issuer’s Financial Advisor
- Bond Counsel
- Borrower
- Borrower’s Financial Advisor
- Borrower’s Counsel
- Borrower’s Tax Credit Counsel
- Borrower’s Bond/Tax Credit Accountant
- Non-Profit
- Non-Profit’s Counsel
- Underwriter
- Underwriter’s Counsel
- Construction Lender
- Construction’s Lender Counsel
- Permanent Lender/Credit Enhancer
- Permanent Lender/Credit Enhancer’s Counsel
- Tax Credit Partner
- Tax Credit Partner’s Counsel
- Subordinate Lender
- Sub Lender’s Counsel
- Trustee
- Trustee’s Counsel
- Rating Agency
- Title Insurer

"Would everyone check to see they have an attorney? I seem to have ended up with two."

THE PLAYERS

- Issuer
- Issuer's Counsel
- Issuer's Financial Advisor

A "conduit" that issues bonds and loans the proceeds to a developer to build or acquire a project.

- **The Issuer**
  - Remember: Bond must be issued by **state or** some **political subdivision** of a state.
    - Issuer must be authorized under state constitution and some statute to issue bonds to fund the project in question.
    - There may be **different alternative issuers** available, each with its own different program, fee structure and other requirements.
    - Some of these program **requirements** (on affordability, etc.) **may exceed those of federal tax law** – choose carefully!

THE PLAYERS

- Borrower
- Borrower’s Counsel
- Borrower’s Financial Advisor
- Borrower’s Tax Credit Counsel
- Borrower’s Bond/Tax Credit Accountant
- Non-Profit
- Non-Profit’s Counsel

Partnership or other single purpose entity formed to develop or purchase and own the project for non-recourse, credit enhanced deal

THE PLAYERS

- Bond Counsel
- Underwriter/Placement Agent
- Underwriter/PA Counsel

Development of basic bond documents, and purchase and sale or placement of tax-exempt and taxable securities.

THE PLAYERS

- Construction Lender
- Construction Lender Counsel
- Permanent Lender/Credit Enhancer
- Permanent Lender/Credit Enhancer’s Counsel

Underwriting of real estate risk, and documentation of mortgage obligation, including bond enhancement facilities; Permanent Credit Enhancer is a major player.

THE PLAYERS

- Subordinate Lender
- Subordinate Lender Counsel

Gap financing in the form of MHP, Home, tax-increment set-aside, or other programmatic funds. "B" bonds, or seller carry back financing.

THE PLAYERS

- Tax Credit Partner
- Tax Credit Partner Counsel

99.9% limited partner. Takes tax benefits, certain fees, and (very small) percentage of cash flow.

THE PLAYERS

- Trustee
- Trustee Counsel

Follows directions as defined in bond indenture. Holds and invests construction funds. Receives mortgage payments, pays bondholders.

FINANCING TIMETABLE

- **General Rule** – May require **4-6 months or more** from outset; some require less time.
- Key role of Borrower's Financial Advisor is to coordinate the following **critical processes** to achieve a timely **pricing** of the Bonds and **closing**.
  - **Volume allocation process**, if applicable.
  - **Official Action Resolution and TEFRA hearing.**
  - **Issuer approval process.**
  - **Rating Agency process.**
  - **Deal Underwriting and Approval** by each **Major Financing Component.**
    - Senior Bond **Permanent Credit Enhancement**.
    - Senior Bond **Construction Phase Credit Enhancement**.
    - **Subordinate Loan Provider.**
    - **Tax Credit Equity Provider.**
- Document production and approval.
- Pricing.
- Closing.

The goal is to avoid:

Sample Timetable

Month(s)

1 – **Owner selects Financial Advisor and Financing Team.**
- Select Issuer, Financing Structure and Credit Enhancer

– **Application filed with credit enhancer**, which begins loan underwriting process

– **“Official action” or “reimbursement” resolution** passed by Issuer (for “new money” issue)

– **Owner applies for private activity Bond volume** allocation if applicable

2 – Credit enhancer **begins real estate loan underwriting**
- 45-60 days Conduits; 60-90 days for Fannie/Freddie; 90-150 FHA/GNMA

3-4 – **Credit Enhancer** and counsel **on board**, **volume assured**

– Owner’s Financial Advisor prepares and circulates initial financing **participants list**, rough financing **timetable** and basic **term sheet**

– **“All hands” organization meeting or conference** call to review financing

Month(s)

4

- **Draft Documents Circulated** (starts 45-60 day drafting, revision and approval process)
  - **Bond Counsel**: Indenture, Loan or Financing Agreement, Regulatory Agreement
  - **Credit Enhancer's Counsel** and Construction Phase Credit Enhancer's Counsel: Credit Enhancement Commitment(s) and Documents
  - **Underwriter's Counsel** Preliminary Official Statement, Bond Purchase Agreement, Rule 15c2-12 Continuing Disclosure Agreement, if any and Remarketing Agreement, if any (rare variable rate transactions)
- Underwriter **submits documentation and cash flows to Rating Agency**
- **Conference calls to obtain comments** on documents
- Draftpersons **prepare and circulate revised drafts**
- **Obtain private activity Bond volume allocation** (Generally must close in set number (e.g., 90-180) days
- **Notice** published (minimum 14 days) for **TEFRA hearing** by the Issuer
- Initial **comments** received from **Rating Agency**
- **Documents** in "substantially final form" **submitted to Issuer**

Month(s)

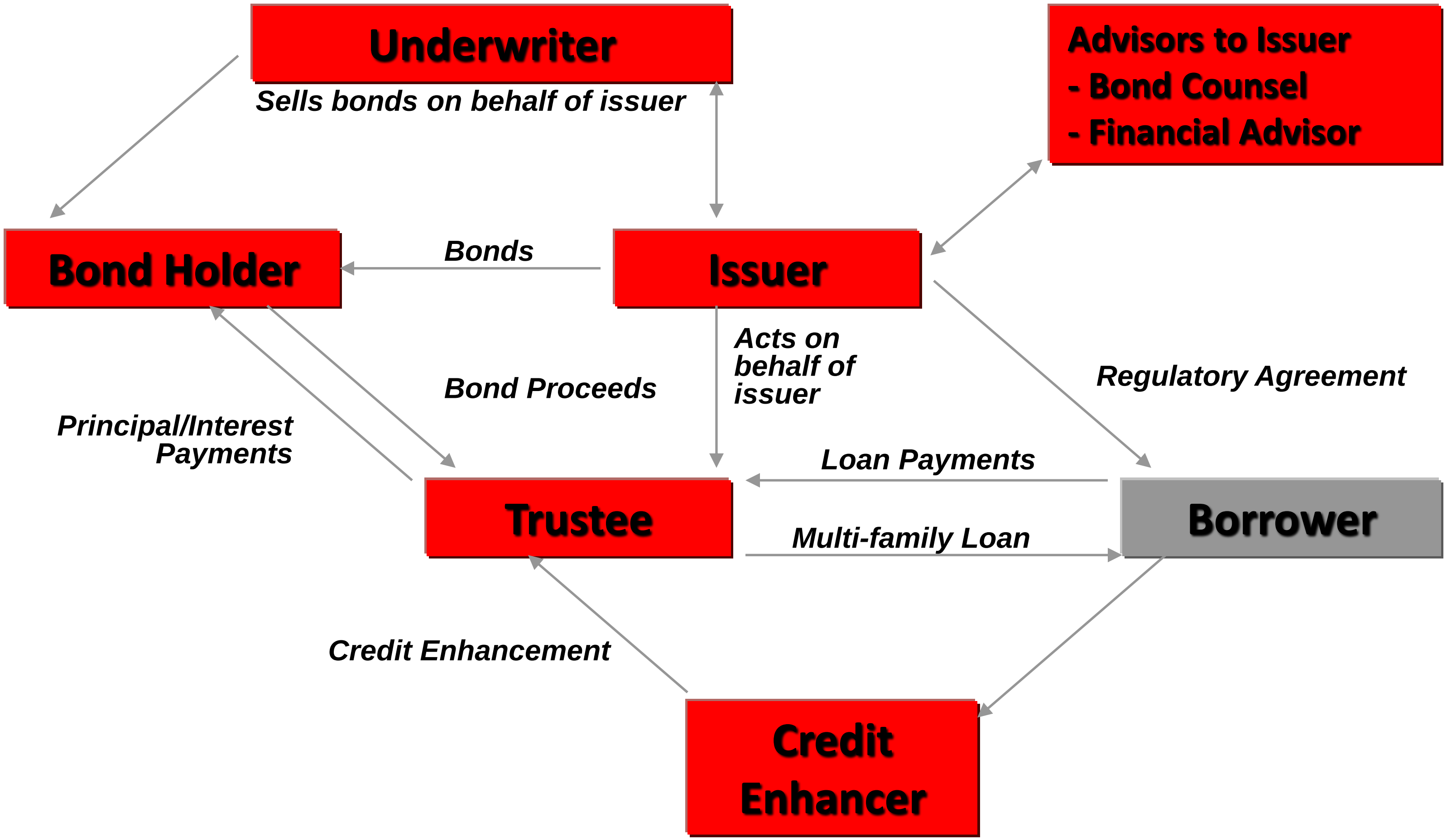
5

- **TEFRA hearing held**
- **Issuer passes Bond Resolution** and approves TEFRA hearing
- **Credit enhancement commitment** (both **permanent** and, if applicable, **construction**) **received**
- **Subordinate Loan**, if any, **approved** or finalized
- **4% LIHTC equity commitment** delivered by Tax Credit Syndicator
- **Rating received** from Rating Agency
- **Objective/Result: Preliminary Official Statement** finalized, "deemed final" for SEC Rule 15c2-12 purposes and **mailed**

6

- **Underwriter prices and sells Bonds**
  - **Bond Purchase Agreement executed**
  - Parties commence **preparation of final documents**, including pricing information
  - Bond Counsel circulates **Closing Papers**
  - **Conference call** to discuss comments on final Closing Papers and Documents prior to Closing
  - Final Official Statement printed and mailed
- **Transaction preclosed** one day and **closed** and funded on the following day or the second following day

Process (Public Offering)



Public Offering

- Agency

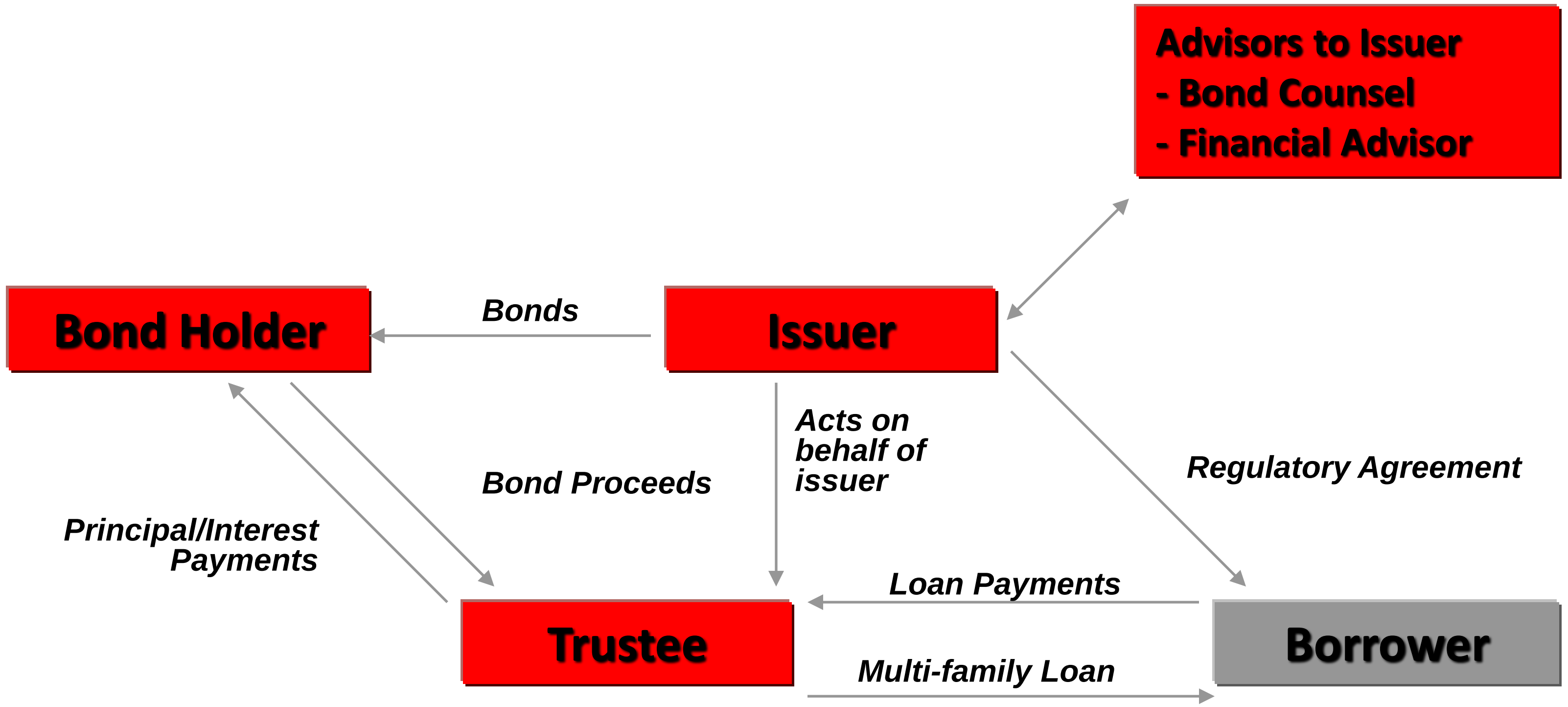
1. Forward or standby structure
2. Low rate
3. Some underwriting flexibility
4. Variable rate option; capped or swapped to fixed

Public Offering

- Letter of Credit

1. Construction or “miniperm”
2. Flexible underwriting
3. Variable rate option

Process (Private Placement)



Private Placements

- Conduit
- Institutional Purchase

1. Lower upfront cost
2. Higher rates (maybe)
3. More aggressive underwriting
4. Construction w/forward, or “miniperm”