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Major Tax-Exempt Multifamily Rental Housing Debt Executions in the Post-Covid 19 Interest Rate World*

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The financial markets, including the market for tax-exempt multifamily housing bonds and loans, have just gone through a market tumult which rivaled and in certain respects surpassed the market chaos seen during the financial crisis in the fall of 2008 and the first quarter of 2009. While dramatically more sudden and less anticipated than the 2008-2009 disruption, the adverse impact on rates has now largely abated, and we have yet to see anything like the adverse impact on low income housing tax credits which occurred in that earlier period, when 65% of the buy side (Fannie Mae and Freddie Mac at 40% and the commercial banks at 25%) became unprofitable and dropped out of the tax credit market. This article analyses this spring's dramatic interest rate run-up in the tax-exempt multifamily rental housing debt markets, assesses where we stand today on the major product types and offers some thoughts on how markets may evolve this fall and next winter if the Pandemic resurges in the United States, as currently appears to be happening.

Recent Short-Term Rates

The short-term index which forms the base index for the pre-Conversion variable rates on many tax-exempt affordable multifamily rental borrowings through bank private placements and Freddie Mac TEL financings is one-month LIBOR**. As shown in the chart below, after reaching a recent peak of about 2.50% in the fall of 2018, one-month LIBOR had fallen to about 1.80% on January 7 of this year and had declined another 120 basis points to a low of 0.60% by the second week of March – **a 190 basis point decline!** Interest rates were low and getting lower; it seemed like a golden age of tax-exempt debt financing. In addition to this dramatic drop in interest rates, the economy was strong, the stock market was high, tax credits were selling well, there was a surge in additional state and local subordinate funding for affordable

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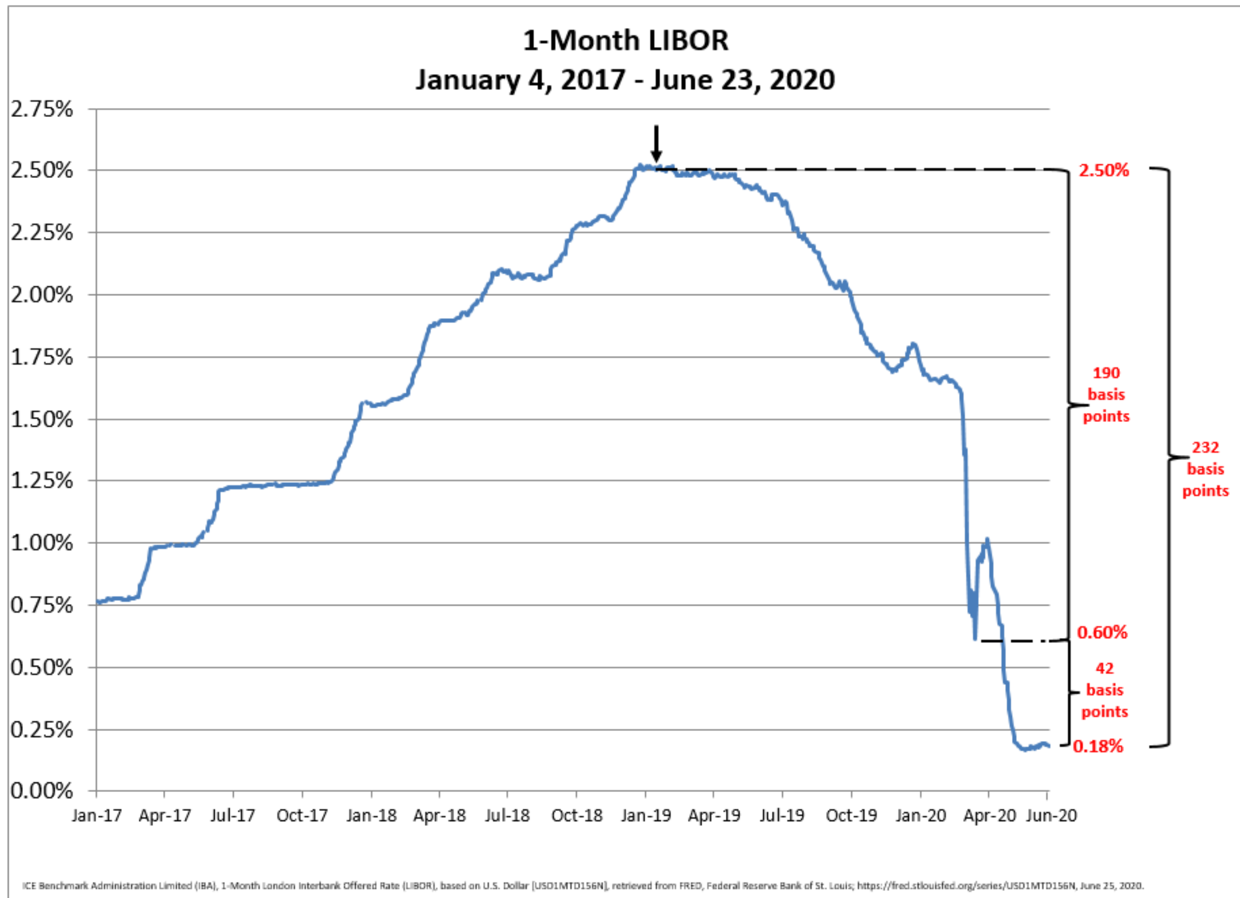
** Bank and other draw down private placement and their "first cousin," Freddie Mac TEL private placement financings, probably account for two thirds to three quarters of the roughly $15.0 billion annual tax-exempt multifamily rental housing bond financings. Publicly offered bonds, including short-term cash backed tax-exempt bonds used with low rate taxable FHA and rural development loans, Fannie Mae M.TEBs offerings and other long-term tax-exempt bond offerings account for the balance.

rental housing, and although construction and other costs were rising, as long as private activity bond volume was available, may financings worked well.

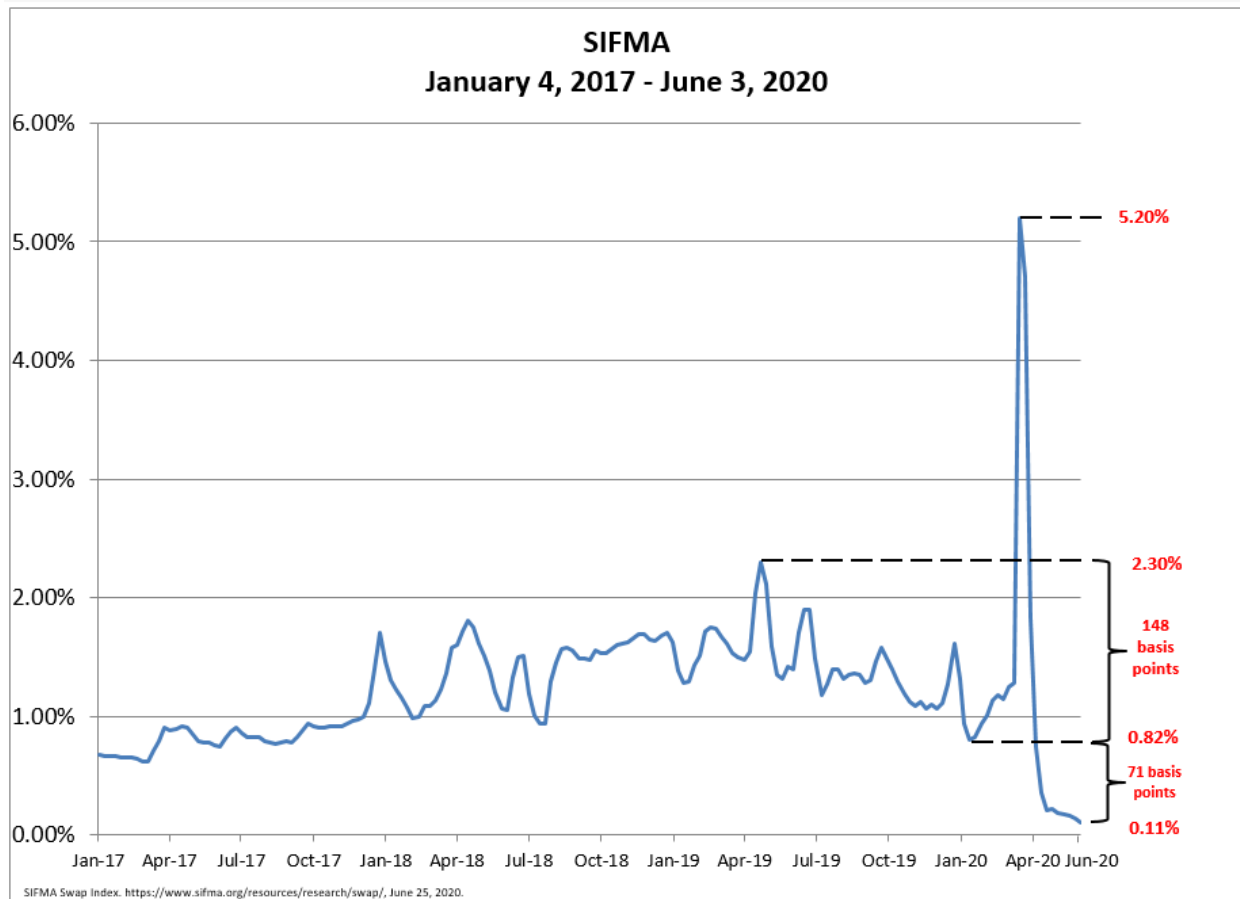
Of course, the realization that the Covid 19 Pandemic presented a major challenge for the United States economy caused the S&P 500 Index to drop from a high of almost 3400 in early March by 1200 points or about 35% to a low of about 2200 in the third week of March. This stock market panic triggered a mass liquidation of all types of debt securities, including short and long-term municipal bonds, as investors scrambled for liquidity. This resulted in a corresponding surge in interest rates, as the demand for short and long-term debt securities plummeted and was overwhelmed by a massive surge in supply on the sell side.

One-month LIBOR spiked about 40 basis points in late March (much less than other indexes), but recovered quickly and now stands at 18 basis points, down another 42 basis points since early March and 232 basis point since its fall 2019 recent peak. Short-term rates on private placements are now back to prior market lows.

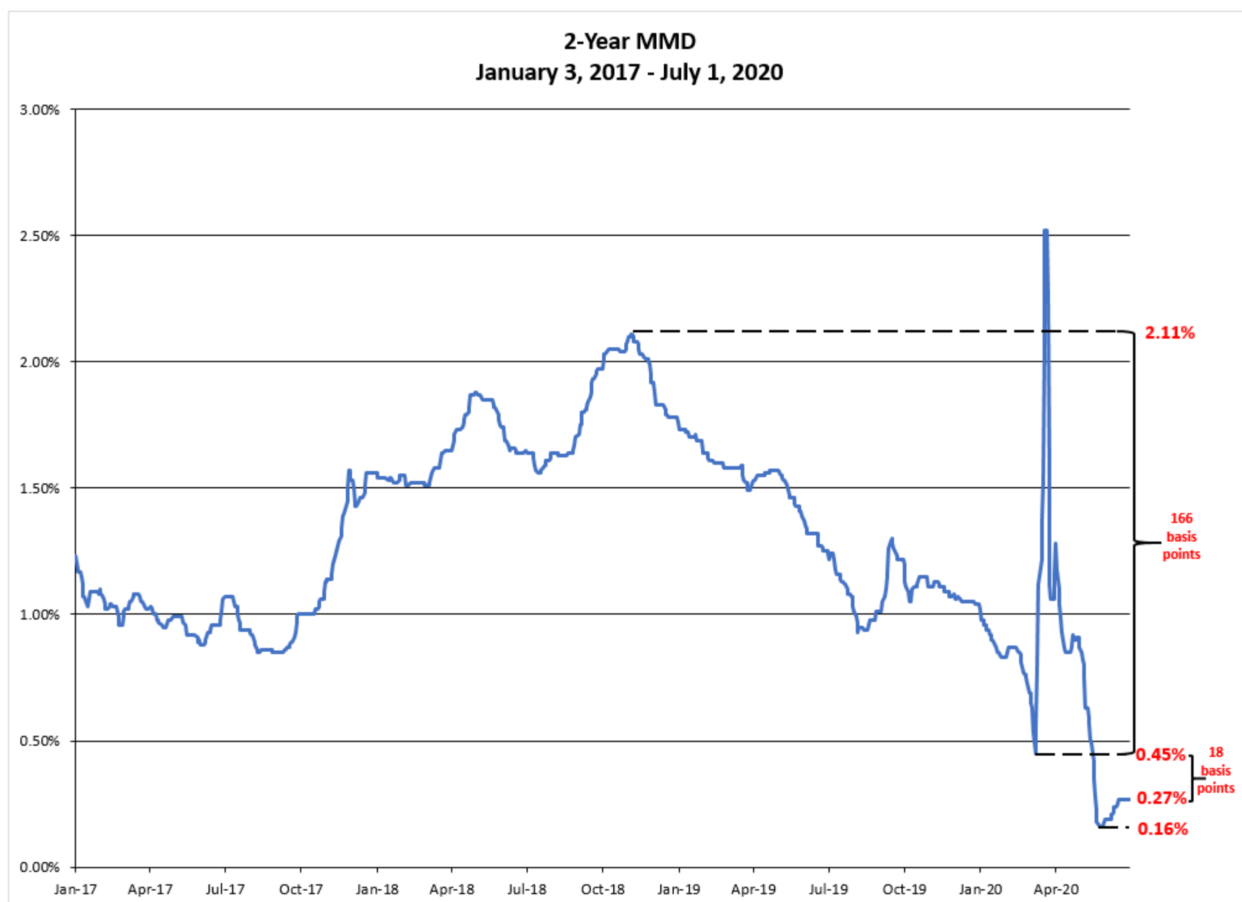


ICE Benchmark Administration Limited (IBA), 1-Month London Interbank Offered Rate (LIBOR), based on U.S. Dollar [USD1MTD156N], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/USD1MTD156N, June 25, 2020.

The SIMFA 7-day demand tax-exempt index, which is a much narrower index and more volatile than one-month LIBOR, serves as a proxy for the interest rates on many tax-exempt multifamily housing variable rate letter of credit backed and some other variable rate borrowings. The SIMFA index had fallen 198 basis points from a recent year high of 2.30% in April 2019 to 0.82% in early March, 2020. When the markets froze in mid-March, SIFMA spiked over 400 basis points to a high of 5.30%, but then plunged as fast as it had spiked. It now stands at 0.11% – 71 basis points lower than the early March level.



The short-term cash backed tax-exempt bonds we use to satisfy the 50% test for affordable multifamily rental housing projects using FHA insured, rural development and other low rate taxable loans are generally marketed to a mandatory tender date roughly 2 years after bond and loan closing. These bonds usually price at roughly 40 basis point spread over the 2-year tax-exempt AAA rated MMD index. Early in 2020, the 2-year MMD had declined from a recent year high of 2.11% on November 16-17, 2018 to a low of 0.45% on March 9, 2020 – a 166 basis point decline!!! Following the market freeze in mid-March, the 2-year MMD spiked over 200 basis points to a high of 2.52% on March 20-23, before then falling to a low of 0.16% on May 26. Today it stands at 0.27%, or 18 basis points below its pre-spike low on March 9 and 219 basis points below the November, 2018 high.



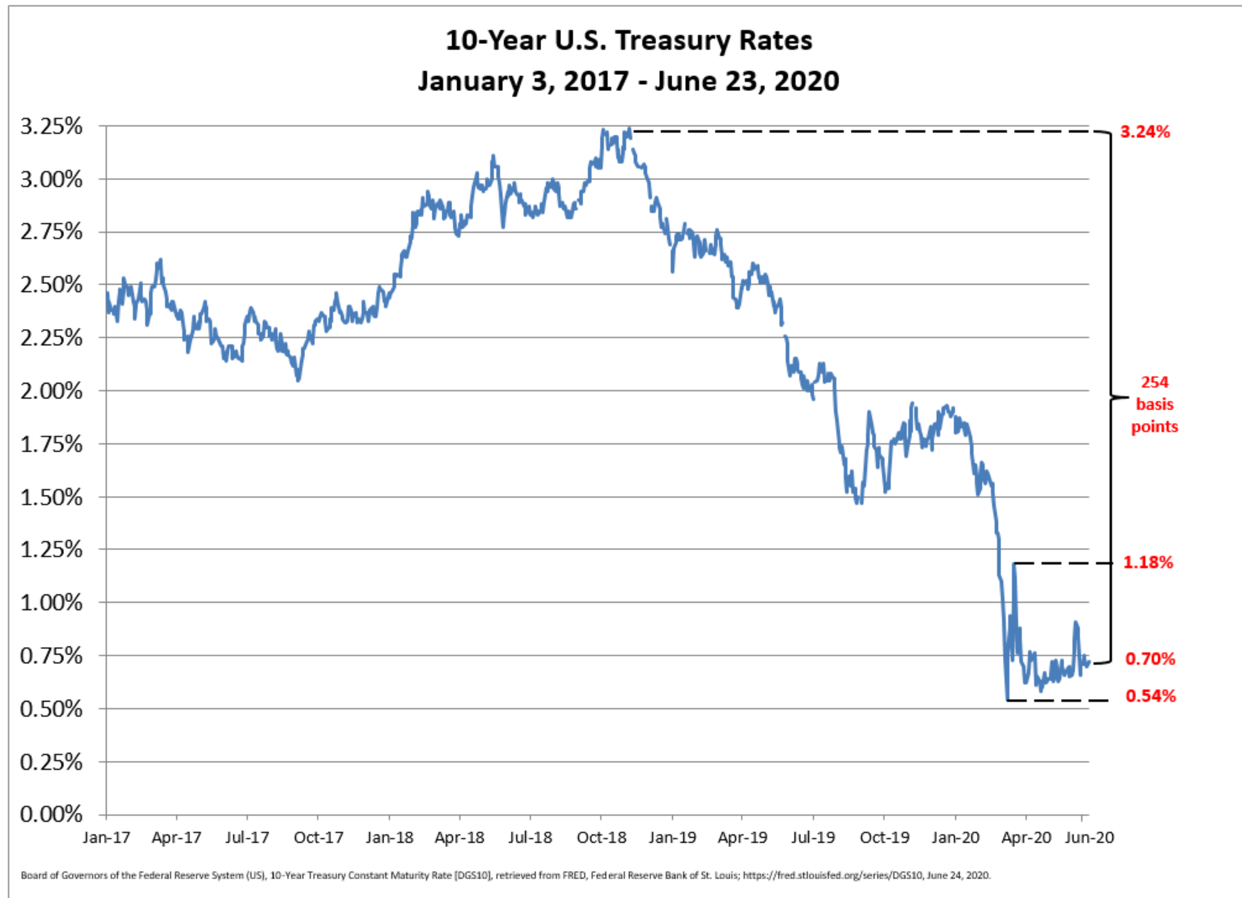
Of course, the important variable on these financings is not the level of the short-term cash backed tax-exempt bond coupons, but it is their relationship to the rates on 2-year U.S. Treasury securities in which these bond proceeds are invested. That relationship went seriously "upside down" in mid-March, creating a substantial negative arbitrage problem, which has now largely subsided, as is further discussed below.

A recent article in the Wall Street Journal suggested that the growing recession triggered by the Pandemic is projected to exceed the 2008-09 downturn and to be the deepest recession the country has faced since the Great Depression. To provide market liquidity to spur recovery from this historical downturn, the Fed is expected to manage the issuance of short-term Treasuries so as to keep short-term rates at today's extremely low levels for the next two to three years.

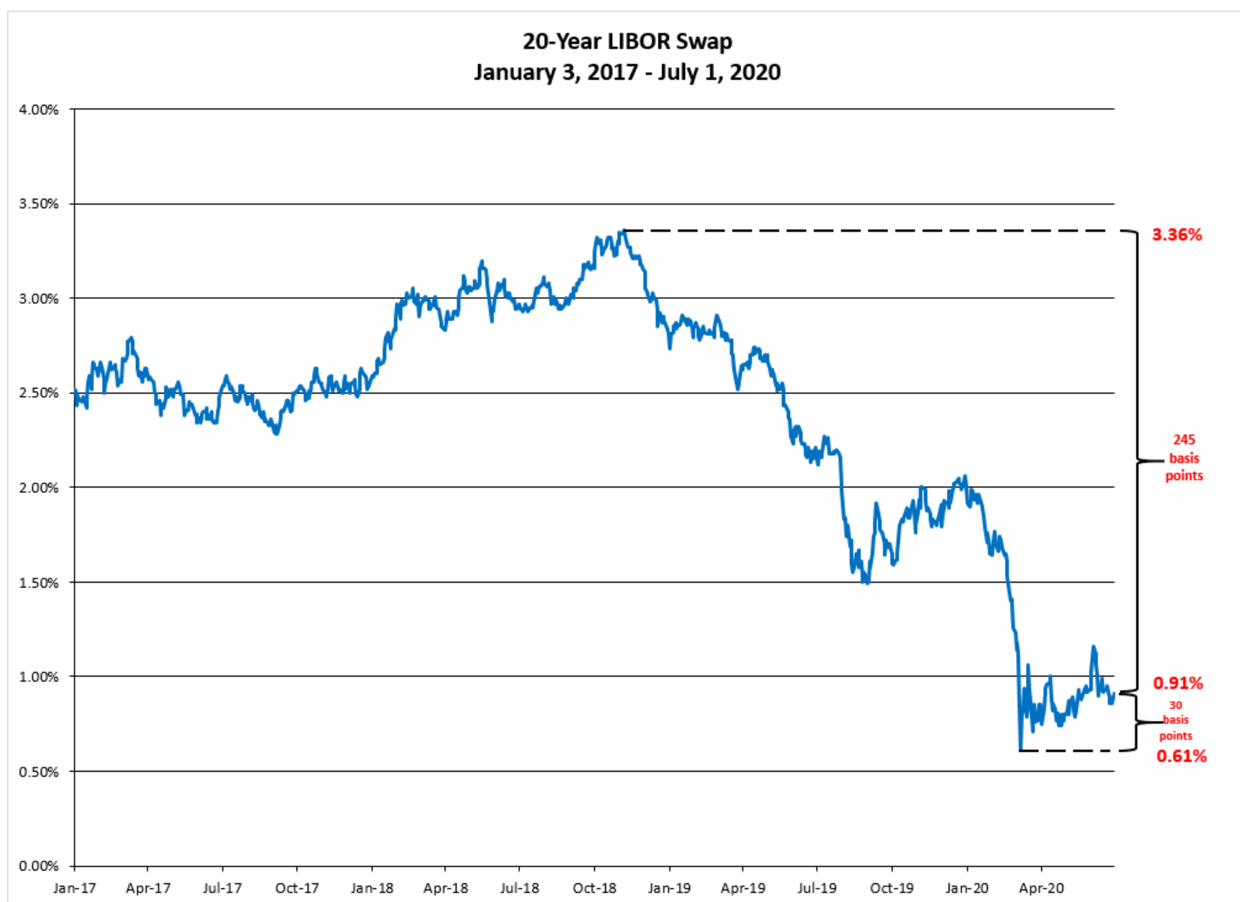
Recent Long-Term Rates

Many long-term borrowing rates for taxable loans such as FHA insured and rural development loans, and to a certain extent, the tax-exempt Fannie Mae M.TEBs product, trade at spreads to the 10-year U.S. Treasury Bond. Many draw-down bank private placements trade at a spread to the 17-19 year LIBOR swaps index; we've used the more widely available 20-year LIBOR swaps index in the charts below as a proxy for these rates.

From January 1, 2017 through early March, 2020, the rates on the 10-year U.S. Treasury Bond had declined from a recent year high of 3.24% in October, 2019 to a low of just over 0.54% on March 9 – **a 270 basis point drop!!!** The 10-year Treasury rate then spiked up to 1.18% during the mid-March market freeze but subsequently declined to a level of 0.70% – only 16 basis points above its March 9 low.



As shown in the chart below, the 20-year LIBOR swap index showed a trend similar to that of the 10-year U.S. Treasury rates, dropping from a recent year high of 3.36% on November 18, 2018 to a low of 0.61% on March 9 – **a 275 basis point decline!!!** The permanent loan rate on many bank and other private placements and Freddie Mac TEL financings is set at an agreed upon spread above the LIBOR swap index most closely corresponding to the agreed upon balloon date on the debt – often the 17, 18 or 19-year LIBOR index. As noted, because it is more widely available, we have used the 20-year LIBOR swap index as a proxy for these rates. During the mid-March market freeze, the 20-year LIBOR swap index moved up only about 60 basis points to just above 1.0%. It has since declined to .91%, just 30 basis points above the recent March 9 low.



Sales of long-term high yield non-credit enhanced tax-exempt multifamily housing bonds, which may have traded at yields of 4.00% to 5.00% before the March market freeze, simply dried up for weeks following the market freeze. These yields have only recently begun to decline to levels in the 5.0% to 6.0% range, which are the rate levels required for financial feasability in many of these financings.

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" and stabilization for a permanent loan period of about 16 years following Conversion 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

* 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.

and Freddie Mac serve as the permanent "Funding Lender." Underwriting and other terms under these executions are similar and very favorable (e.g., 1.15:1 DSCR; 85 – 90% LTV, 35 to 40-year loan amortization to a 16-18 year balloon). As noted above, these financings now constitute probably two thirds to three quarters of all tax-exempt debt on Section 142(d)/4% LIHTC financings.

Pre-Conversion interest rates on bank draw down loans and Freddie Mac TEL private placements are generally set as a spread above one-month LIBOR (e.g., most recently 200 to 225 basis points above one-month LIBOR, subject to floors given today's rock-bottom rates). The permanent lending rate in these financings is generally locked at a spread above the 16-18-year LIBOR Swap index or in the case of Freddie TEL financings the 10-year U.S. Treasury. The permanent loan spread is affected by whether the financing is an "immediate funding" vs. a commitment to an interest rate following Conversion. The permanent loan spread on bank private placements might be in the 190 to 225 basis point range over the 17 or 18-year LIBOR swap in today's low-rate world if the financing is a moderate rehab financing or if that rate applies from initial loan closing through the pre-Conversion and post-Conversion phases of the financing. The spread would typically be more in the 225 to 250 basis point range or slightly higher where it applies only following Conversion and/or for certain substantial rehab and new construction financings. It might also be in the high end of this range or slightly higher where the lender is providing financing only during the permanent phase.

The bank serving during the Pre-Conversion (or "Construction Phase") as the "Funding Lender" in a Bank or other 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 or other private placement (or Freddie Mac in a TEL financing), **will almost always lock** not only the Pre-Conversion spread but also the Post-Conversion or "Permanent Loan" **spread** when a loan application is filed. These lenders will generally hold the **permanent rate spread** for some time while the loan is underwritten, but lenders generally will not lock the **permanent lending rate** until about a week before closing.

As the table below demonstrates, both short-term and long-term all in borrowing rates on private placements are dramatically lower today than they were at their recent year highs in 2018 or 2019. These lower borrowing rates primarily reflect the dramatically lower index rates we have today, as compared to two years ago. The lower borrowing rates also reflect some competitive contraction in spreads; however, spreads have broadened a bit in the last quarter and have been combined with index floors required by the funding lender, as interest rate indexes have hit new lows.

Pre-Conversion (“**Construction**”) Borrowing **Rates***	Jan. 2019	Feb. 2020	June, 2020	
1-mo LIBOR	2.50%	0.60%	0.50(floor)**%	
Spread	1.70-2.50%	1.70-2.25%	2.00-2.25%	• **Down about 200 Basis Points since Jan. 2019**
	4.20-5. 00%	2.30-2.85%	**2.50-2.75%**	• **About level with February, 2020**

Post-Conversion (“**Permanent**”) Borrowing **Rates***	Fall 2018	Feb. 2020	June, 2020	
17-year LIBOR	2.80%	1.80%	0.85(floor)***%	• **Down about 200 basis points since Fall 2018.**
Spread	2.00-2.50%	1.70-2.00%	1.90-2.75%	• **Down about 25 Basis Points since February, 2020**
	4.80-5.50%	3.50-3.85%	**2.75-3.60%**	

The combination of relatively low costs of issuance versus a public offering, today’s extremely 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.

* **Cautionary Note:** The interest rates, spreads and other data set forth in this article, including tables which follow, are **estimates only. These interest rates, spreads, fees and other variables can vary dramatically** depending on state, timing, market conditions, the project, the developer, whether mod rehab or new construction/sub rehab, whether immediate or forward starting, CRA demand in the market where the Project is located, GSE volume constraints and other factors. Borrowers should check with their bank or other lender, investment banker or financial advisor before conducting a detailed assessment of any of these structures or programs.

** 1 Month LIBOR = 0.18%; assume 0.50% floor; one month LIBOR is lower in June than in February; but we are now seeing floors applied and spreads slightly higher since February.

*** 17-Year LIBOR = 0.80%; assume 0.85% floor; 17-year LIBOR is down 100 basis points since February, but we are also seeing floors here and spreads slightly higher since February.

Fannie Mae M.TEBs

The Fannie Mae M.TEBs structure is now five and one half years old since we closed the first M.TEBs financing*. This 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. In the past four years alone, Fannie Mae has now closed over 90 M.TEBs financings having an aggregate dollar amount of over $1.2 billion, and has another $500+ 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 "forwards" M.TEBs product is for new construction/sub rehab projects. This product has now also gained 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. In the current market, it entails 3-4 points of construction period negative arbitrage, but after taking into account an increase in 4% tax credit basis due to two sets of construction period interest which the structure entails, the net-negative arbitrage effect is generally 2 points or less. In addition, 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 to 40-year loan amortization to balloon 15 to 17 or 18 years after placed-in-service/1.15 DSCR/85 to 90% LTV).

10-Year Treasury	0.65%
Spread	1.60
Tax-Exempt Bond Coupon/MBS-Pass-Through Rate	2.25%
Guaranty/Servicing	1.20-1.40
All-in Borrowing Rate	**3.45-3.65%**

Taking into account about 2.0 points of net negative arbitrage (after increase in 4% LIHTC basis), the equivalent permanent rate would be comparable to about a 3.60-3.80% 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, the late 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 January, 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 large number of subsequent M.TEBs financings.

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

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	0.65%	0.65%
GNMA to 10-Year Treasury spread	1.35**	2.10**
Taxable GNMA Pass-Through Rate	2.00%	2.75%
Servicing/GNMA Guaranty Fee	.25	.25
Stated Mortgage Loan Rate	2.25%	3.00%
Mortgage Insurance Premium (Affordable)	.25	.25
All-in Borrowing Rate	**2.50%**	**3.25%**

As most industry participants are aware, in recent years HUD significantly increased its FHA loan volume on affordable housing loans and has 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 four to six months or less, not the eight to twelve 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, no balloon, ad no reunderwriting of the loan at stabilization.

* 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, including investing tax-exempt bond proceeds in fixed rate U.S. Treasury securities instead of money market funds, which eliminated or resulted in a major reduction in the negative arbitrage which was previously associated with this execution. These innovations have dramatically improved the efficiency of this structure over the past several years.

** The spreads between the 10-year Treasury and the stated mortgage loan rates above – 160 basis points for mod rehab (e.g. FHA 223f) loans and 245 basis points for new construction/sub rehab (e.g. FHA 221(d)(4)) loans are much higher than normal. These spreads would typically be closer to 115 to 125 basis points for mod rehab loans and 165 to 175 for new construction/sub rehab loans. While the above all-in rates are extremely low, the GNMA buy side has learned in previous downturns in 10-year treasury yields, such as that which occurred in the summer of 2012, not to follow those yields to extremely low levels and get caught holding steeply discounted long-term paper when yields later rise, as occurred late in 2012. As a result, when 10-year Treasury yields drop to record lows, the GNMA spreads widen as they have recently done.

Rural development ("RD") loans can require even longer to process than FHA, but have considerable advantages. These include the willingness of USDA to subordinate existing Section 515 financing, to provide additional financing under Section 538, the subsidies which are available and the unique focus USDA brings to rural projects. In addition, the ability to wrap the permanent loan component with GNMA securities which can be sold at very low rates in today's market, results in this execution now providing 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 low rate taxable loans (e.g., FHA insured, Fannie Mae, RD), market conditions and creative structuring techniques now enable us, under recent market conditions, to eliminate all or almost all of the bond-side negative arbitrage on these bond issues. Prior to March market freeze, the coupon on a short-term cash backed tax-exempt bond sold to a 24-month mandatory tender would generally trade roughly 40 basis points above the 2-year MMD. With the 2-year MMD at 0.45%, as shown in the chart on page 4, the tax-exempt bond coupon might have been, say 0.85%. Two year U.S. Treasuries then yielded around 0.75%, so that there might have been roughly ¼ of a point of negative arbitrage that the borrower would need to deposit in addition to covering cost of issuance.

During the market freeze in mid-March, the 2-year MMD rocketed to a 2.50% yield, and short-term cash backed bond coupons soared upwards with it; while 2-year U.S. Treasury yields plummeted from 70 basis points to 20 basis points, leaving over 4 points of gross negative arbitrage on many deals. While we dramatically reduced this negative arbitrage on a number of deals by investing in other AAA-rated short-term municipals, which yielded 80 or 90 basis points or more, as the chart on page 4 shows, this upward spike in the 2-year MMD and in short-term tax-exempt cash backed bond yields was very short lived. With coupons now once again about 40 basis points above 2-year MMD or about 0.65%, through creative structuring, net negative arbitrage on these financings can be reduced to ½ a point or less. 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) – with an additional ½ point or less for negative arbitrage, and the 50% Test is satisfied.

Current State of the Tax-Exempt Affordable Rural Housing Debt Markets

With the breathtakingly negative news which has accompanied virtually every day of the Covid 19 Pandemic for the past three months and its potential recently unprecedented adverse impact on our lives and our economy, as well as the shocking rate spike during the market freeze late March, it is not surprising that one would think that the tax-exempt debt markets are also in terrible shape. There is no question that all of the major lending platforms are imposing additional reserves and adjusting underwriting criteria to account for the potential impact of the pandemic and are increasingly focusing their originations on developers with proven track records. However, at the moment, the pace of closings and new loan applications has remained remarkably strong. California, which accounted for 30% of multifamily private activity bond volume in 2018, continues to be oversubscribed by about 2:1 for multifamily. Thus far in 2020, the Texas Bond Review Board received 126 applications for private activity bond volume (of all types) for *the first half* of 2020, as compared to 119 applications for *all* of 2019. With long-term all-in borrowing rates ranging from about 2.75% to 3.50% across most major affordable multifamily rental housing debt platforms, combined with 35 to 40-year loan amortizations and 1.15 or lower debt service

coverage ratios, conditions on the tax-exempt debt side of these financings seem to be stronger than at any time in the recent past, substantially supported by today's record low interest rates.

In addition, while the 4% LIHTC side of these financings has tightened, and some developers report prices falling from the mid or high 90's to the low 90's; or even mid to low 80's, a loss of even 10% on 35% of funding is a 3.5 point hit on overall financing proceeds. Increased state and local subordinate funds in a number of markets and early signs of decreasing labor costs, as well as increased tax-exempt debt proceeds, have offset a good portion of these losses or a number of recent deals. For now, in many markets, financing conditions continue to be remarkably robust in light of the Pandemic.

The Road Ahead

In addition, HR2, recently adopted by the U.S. House of Representative, is replete with provisions which would provide major support for affordable multifamily rental housing finance, including tax-exempt debt financed deals using 4% LIHTC. Not the least of these is reducing the 50% test to a 25% test for most projects closing before 2022, which would provide immediate significant relief from volume constraints in states like New York, Massachusetts, and Minnesota, and high growth states like Washington State, California, Colorado, Texas, Georgia, Tennessee and others, where private activity bond volume has become competitive. In addition, making the 4% LIHTC equal to a true 4% (versus 3.2% or lower) would increase proceeds from this vital financing source by as much as 20%, and the bill would add an additional 30% basis boosts in a wide range of financings. Of course, it is impossible to predict the extent to which any of these provisions will survive the Republican Senate.

Many of us lived through what has been described as "the nuclear winter of affordable multifamily rental housing finance" in the second half of 2008 and almost all of 2009, when two thirds of the tax credit market disappeared and major losses at banks caused construction loan availability to all but disappear. Total apartment starts in the United States dropped from about 400,000 units per year to 90,000. Thus, it is important not to celebrate too early. With the U.S. economy facing what many believe to be the greatest downturn since the Great Depression, there are many things that can go wrong.

Perhaps the greatest threat is that the major U.S. banks become unprofitable. Interest margins are under pressure with low rates, and the major banks are building loan loss reserves for Covid 19 Pandemic risks. An article in the July 15, 2020 Wall Street Journal entitled "This Is Not a Normal Recession: Banks Ready for Wave of Coronavirus Defaults" reveals that J.P. Morgan Chase, Citigroup and Wells Fargo added $28 billion or an average of about $9.3 billion per bank for loans loss reserves in the second quarter ended June 30, 2020. This is almost **seven times** the average quarterly loan loss reserve of $1.33 per bank for these three banks in each of the last three quarters of 2019. Quarterly earnings after these loss reserves were, respectively, just over $4.0 billion for J.P. Morgan Chase, just over $1.0 billion for Citigroup and a loss of $2.7 billion for Wells Fargo in the second quarter. Syndicators report that insurance companies are also recently increasing reserves due to a number of factors. While the major banks and insurance companies are in a much stronger capital position than they were in 2008, the Fed is actively admonishing banks to limit dividend increases and, if necessary, to cut dividends to maintain federally mandated capital levels.

We learned in 2009 what can happen if the major buyers of tax credit equity cannot project profitable operations over the next 2-12 years when low-income housing tax credits will be realized. It took the equity markets several years to recover from the exit of two thirds of the equity buy side in 2009. While no one currently projects this sudden and massive exit of LIHTC investors, an exit of any significant percentage of these buyers would eliminate much of the demand for the equity which funds 35 to 40% or

more of the total development cost of these projects. In addition, declining bank profitability or loses could substantially curtail the attractiveness of tax-exempt debt to banks and other major providers of debt capital in these financings.

We face a lot of uncertainties in the months and quarters ahead. These include the re-opening of the economy and schools as Covid 19 cases increase in numbers during the summer 2020 and the election in November 2020 for the White House, all the U.S. House of Representatives and a third of the U.S. Senate. With respect to the Covid 19 Pandemic, the Great Influenza in 1917-18 lasted 18 months in three waves and resulted in the death of roughly 675,000 Americans or 0.7% of the U.S. population of roughly 103 million at the time.[*] Of course, medical science was just beginning to develop into a science at that time, and World War I threw the segments of the population most vulnerable to that virus – young soldiers and other young adults – into conditions ideal for the transmission of a highly infectious disease. Development of vaccines and more effective treatments, as well as a social distancing, the use of masks, and testing and contact tracing will hopefully cause the Covid 19 Pandemic to be of a much more limited duration and less severe impact on the nation's physical and economic health. But no one really knows at this time.

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 2020. Perhaps the best general takeaway, given the recently challenges we now face, time is now your enemy, not your friend. Many developers seem to be following this strategy, even accepting reduced tax credit equity and lower or deferred developer's fees to assure that deals stay on track to close.

For now, conditions in the tax-exempt market are remarkably strong and the equity markets are also functioning reasonably well, tenants have in large part been able to pay their rents and deals are closing. There may come an extended period of two or three or four quarters or more where this will not be the case to nearly the extent it is today. For the immediate future, certainty and timeliness of execution may become the most important hallmarks of a successful project financing.

Of course, the increasingly unmet demand for affordable rental housing in the United States continues to grow. As we saw in the spring of 2009 when the federally mandated infusion of additional equity in the major banks broke the downwardly spiraling financial panic which arose in the fall of 2008, the current major uncertainties could quickly and dramatically abate. The key over the next six to twelve to eighteen months may be managing exposures and financings to be in a position to meet the challenges and opportunities which this will present when it occurs.

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[*] The Great Influenza is estimated to have taken 50 million lives or 2.8% of the world's 1.8 billion population in 1918. By comparison, the Bubonic Plague or "Black Death" is estimated to have resulted in the deaths of 50% of Europe's population between 1347 and 1351. If the United States loses 250,000 people to the Covid 19 Pandemic, while horrific, it would be just over one-third the number of the U.S. deaths in the Great Influenza out of a population, at 330 million, over three times the size. Of course, we all fervently hope the losses will be much lower. A compelling and informative narrative of the 1917-18 pandemic is The Great Influenza by John M. Barry, first published in 2010 and widely available in paperback.