INTRODUCTION TO TAX EXEMPT MULTI-FAMILY HOUSING BONDS AND 4% LOW-INCOME HOUSING TAX CREDITS

November 12, 2020

Presented by:

R. WADE NORRIS, ESQ.
wnorris@ngomunis.com
(202) 973-0110 (O)
(202) 744-1888 (C)

RYAN GEORGE, ESQ.
rgeorge@ngomunis.com
(502) 614-6853 (O)
(703) 867-1109 (C)

ETHAN OSTROW, ESQ.
eostrow@ngomunis.com
(202) 973-0111 (O)
(224) 216-2490 (C)

NORRIS GEORGE & OSTROW PLLC**
1627 Eye Street, N.W., Suite 1220
Washington, D.C. 20006
(202) 973-0103
www.ngomunis.com

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.

** Contact information on other NGO lawyers and other professionals is set forth on the last page.

Major Tax-Exempt Bond and Loan Executions for 100% Affordable and Mixed Income/Mixed Use Apartment Projects

I. BASICS OF MARKET RATE AND AFFORDABLE APARTMENT FINANCE

II. BONDS 101 – TAX EXEMPT MUNICIPAL BOND AND LOANS

III. 4% LOW INCOME HOUSING TAX CREDITS

IV. FEDERAL TAX LAW – THE BASICS

V. ASSEMBLING THE FINANCING TEAM

VI. FINANCING TIME TABLE

VII. REAL ESTATE FINANCE 101

VIII. BONDS 102 – ALTERNATIVE FINANCING STRUCTURES

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

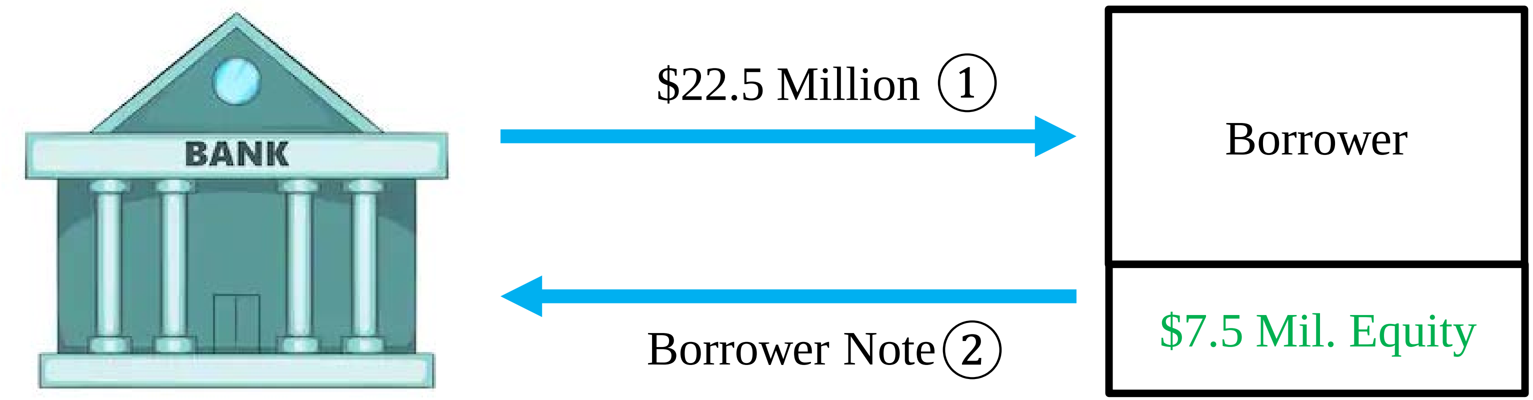
Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

I. BASICS OF MARKET RATE AND AFFORDABLE APARTMENT FINANCE

MARKET RATE APARTMENTS

- Hi!
- I am a real estate developer.
- I want to develop, finance and build a $30 million **market rate** apartment building.
- I have equity of about $7.5 million (≈ 25% of Total Development Cost (“TDC”)) and I need a loan of about $22.5 million (≈ 75% of TDC).
- I borrow $22.5 million from my bank.



- Simple; quick!

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

WHAT ARE MY MARKET RATE DEVELOPER ECONOMICS?

- I build the project using my equity and my bank loan proceeds, rent it up, achieve stabilized occupancy.
- Show 2-3 years of stabilized NOI.
- In year 5-6, sell it at a nice (3.5-4%?) cap rate, get my equity out, plus a nice profit.
- What's my profit if it's a 20%/year return and 5 years? That's a profit of about $7.5 million.
- I add that profit to my $7.5 million original equity. Repeat the above; or an even larger project! Or two projects!. Keep growing my net worth.
- **Is this a great country, or what!?**

You!

Too, can succeed in America!

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

AFFORDABLE APARTMENTS
9% LIHTC AND TAX EXEMPT BONDS + 4% LIHTC

- Hi!
- I am also a real estate developer.
- I want to develop, finance and build a $30 million **affordable** apartment building.
- I will rent to tenants whose income does not exceed 60% of AMI for a family of 4, adjusted for family size*, and I will restrict the rents I charge to 30% of that amount*.
- How can I do that?

---

* I could choose to set aside **20%** of the units for tenants whose income does not exceed **50%** of AMI for a family of four, adjusted for family size, restrict rents on those units to 30% of those income levels, and rent the other 80% of the units to any tenants at unrestricted rents, but I can only sell tax credits on the affordable units. This “mixed income” financing model is most often used on large urban apartment projects with tax exempt private activity bonds and 4% LIHTC.

TWO WAYS:

A. Apply for and sell **9% Low Income Housing Tax Credits** (“9% LIHTC”) under Section 42 of the Code.

Investor Limited Partner

① $21.0 Mil (70%)

② 9% Tax Credits & Losses

Real Estate Developer
Recipient of 9% LIHTC
(Borrower)

③ $9.0 Mil

④ Borrower Note and Mortgage

Taxable Lender

9% Tax Credit Equity

Taxable Bank Loan

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

9% LIHTC (Cont'd.)

- Available for **new construction** and **acq./rehab** (rehab at least $6,000 per unit).
- **Cannot use tax exempt bonds or loans** on a "project" receiving 9% LIHTC.
- 9**% LIHTC volume allocation** required; **often oversubscribed 4 or 5:1**.
- Can't get a 9% allocation? Next best thing is…

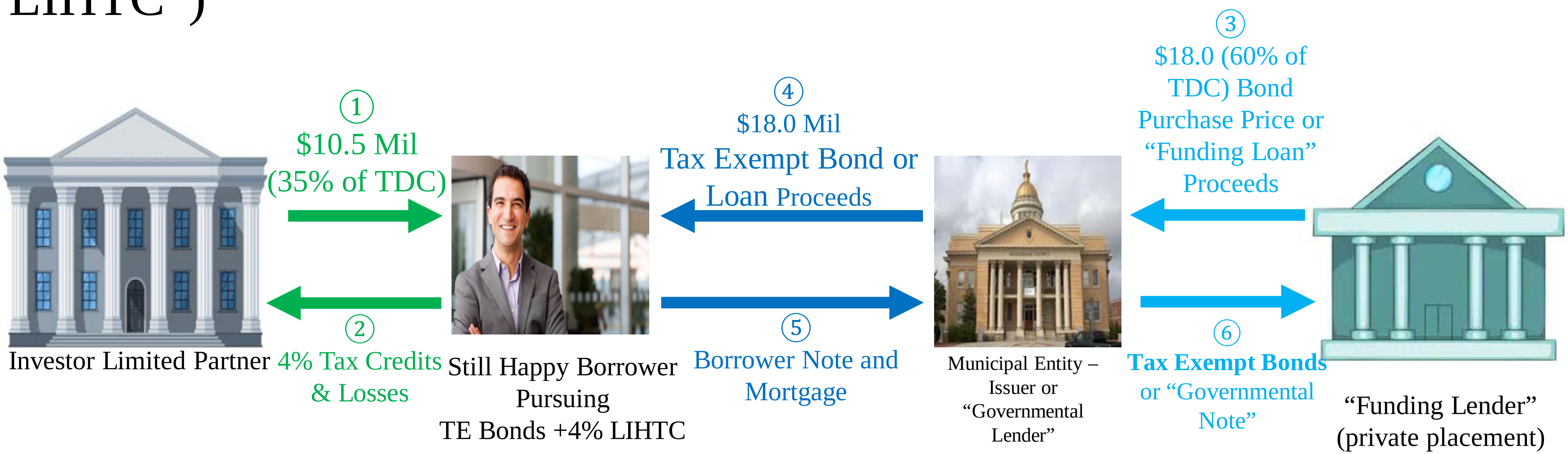
R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

4% LIHTC Combined with
Tax Exempt Bonds or Loans Under Section 142(d)

B. Apply for tax exempt private activity bond volume and issue **Tax Exempt Private Activity Bonds under Section 142(d)** of the Code; sell **4% Low Income Housing Tax Credits** under Section 42 (“4% LIHTC”)



- Not as powerful as 9% LIHTC, BUT:
  - Does finance ≈ 30-35%+ of TDC.
  - Requires more debt, but tax exemption provides a lower borrowing rate on the debt side of the deal.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

WHAT’S IN IT FOR ME,
THE **AFFORDABLE** RENTAL HOUSING DEVELOPER?

?

?

?

- **The Big Minus**:
  - Comparison to Market Rate Apartment Financing:
    - With limits on tenant income and rent, and a 15+ year regulatory period, I won’t be able to flip this in 5-6 years, get my equity out and roll that and my profit into my next deal.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

WHAT’S IN IT FOR ME,
THE **AFFORDABLE** RENTAL HOUSING DEVELOPER?

- **PLUSES:**
  - I’ll have equity ≤ 25% of TDC in the deal at closing.
  - I’ll qualify for a larger loan (lower DSCR and larger LTV) because tax credit rents are typically lower than market and lender has even more equity ahead of it.
  - I can collect a developer fee of 10-12% of TDC at closing or in 1st year or two.
  - In some cases my management company can manage for a fee.
  - In some cases my affiliated construction company can build or rehab the project.
  - These projects may not rocket in value, but do increase in value over time.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

THE BASICS

- What is a Municipal **Bond**? Step 4 on prior slide. A **debt obligation** of a **STATE**, city, county, redevelopment agency, housing authority **OR OTHER POLITICAL SUB-DIVISION** or public body or instrumentality of a state.

- It may be called a "**Bond**" in a transaction using bond terminology – **most public offerings – or** a **"Note" or "Governmental Note"** in a transaction using tax exempt "loan" terminology – **most private placements** – for Community Reinvestment Act, accounting or other reasons. Either will be **treated as a tax exempt private activity bond under Section 142(d)** and will trigger 4% LIHTC.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

SECTION 103 OF INTERNAL REVENUE CODE

- Provides that **interest on municipal bonds is excluded from gross income for federal income tax purposes**.
- Most states also **exempt** interest on bonds or loans issued for projects in that state **from state income taxation**.
- **Often, the municipal issuer uses the proceeds itself** for general public purposes, such as roads, water and sewer systems, police and fire departments, schools and other publicly owned facilities.
- These bonds are often backed by the general credit of the municipal issuer and are called **general obligation bonds** or sometimes are backed only by revenues from a certain public enterprise (e.g., water and sewer systems) and are called **revenue bonds.**

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

- In other cases, a municipal bond issuer may loan the proceeds to a **profit-motivated entity** such as a developer **or** a **Section 501(c)(3) nonprofit corporation**, which agrees to use the proceeds to finance an activity which has a specified beneficial public purpose.
- Such **approved purposes** include airports, certain educational facilities, docks and wharves, pollution control, certain privately owned water systems, industrial development, certain single-family housing and certain **multifamily rental housing facilities.**
- In 1986, these "quasi-public purpose" bonds for non-governmental were labeled "**private activity bonds**," and **Congress limited the volume of most types of private activity bonds** which could be issued by each state to stem growing a revenue drain on the federal treasury.
- If the **loan** of tax exempt bond or loan proceeds is **to** a **for-profit partnership or LLC** for affordable multifamily rental housing, then the bonds or loan will be exempt under Section 142(d) of the Code. The bonds or loan **will require a volume allocation, but can trigger 4% LIHTC**.
- If the **loan** of tax exempt bond or loan proceeds is to a **Section 501(c)(3) corporation** as borrower, then the Bonds will be exempt under **Section 145 of the Code**. **No volume allocation is required,** but not eligible for 4% LIHTC. **If** facility is **also a multifamily residential facility** under Section 142(d) and **does not involve new construction or substantial rehab**, **Section 142(d) targeting** (described below) will apply.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

- These bonds are **generally not backed by the general credit** or revenues of the municipal issuer, which serves as a mere "**conduit**" to lend the tax exempt bond proceeds to the owner of the "quasi-public purpose" facility.
- **Again, any debt of** a **state or political subdivision** of a state **can be tax exempt whether styled as a "bond" or a "loan,"** as long as the applicable statutory and regulatory provisions are satisfied.
- As noted above, **most private placements** are **styled as** "**tax exempt loans**" for CRA, accounting and other reasons; **most public offerings** are **styled as tax exempt "bonds**," but they are the **same thing (i.e., tax exempt "private activity bonds") under the Internal Revenue Code.** Both trigger 4% LIHTC when the tax exempt debt is issued under **Section 142(d)** for **profit-motivated borrowers**.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

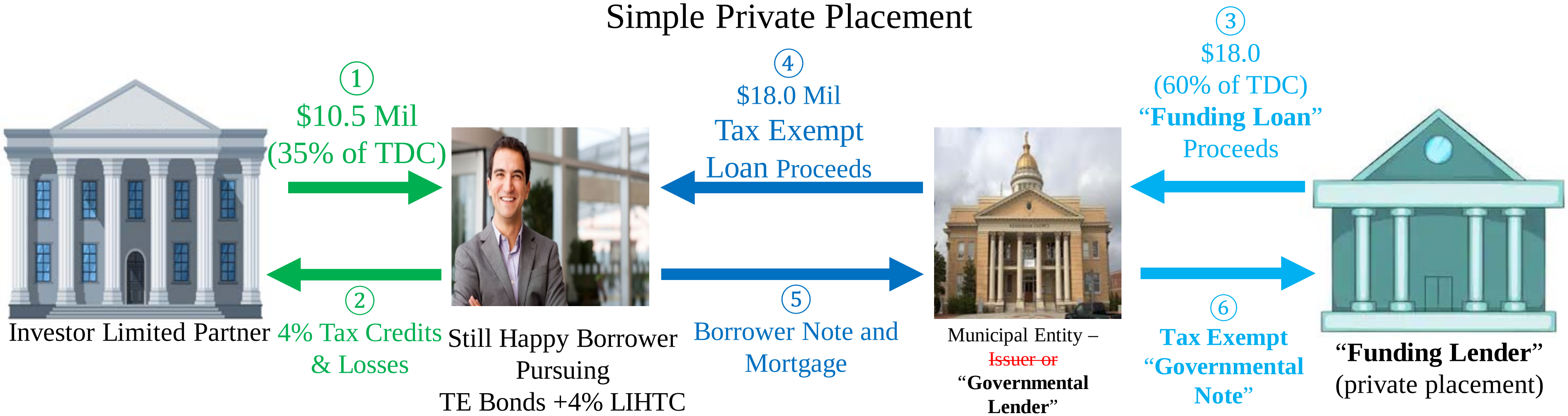
Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

Basic "Conduit" Financing Structure – Non Credit-Enhanced – Most Often Private Placement or Limited Public Offering

- The simplest private placement structure is that shown on slide 8 – a bank or other program sponsor (the "**Funding Lender**") **makes a "Funding Loan" to the** municipal entity, which we call a **Governmental Lender**, who in turn loans the money to the Borrower. The Governmental Lender issues its "**Governmental Note**" to the Funding Lender, which is payable from the **Borrower Note**.

Simple Private Placement



- Tax exempt multifamily housing bonds or loans often generally are **not backed by the Issuer***, who serves as a mere **conduit**, but in the first instance are **backed only by the project**, its special purpose **borrower** and possibly certain **general partner guarantees**.
- **Such multi-family housing bonds and loans would receive no rating or very low rating** based almost solely on the project cash flow/liquidation value.
- Such bonds or loans are generally **sold in larger minimum denominations (e.g. $100,000) to "accredited investors"** or **"qualified institutional investors"** (such as banks) in "**private placements"** or **"limited public offerings."**

---

* State Housing Finance Agencies may be an exception.

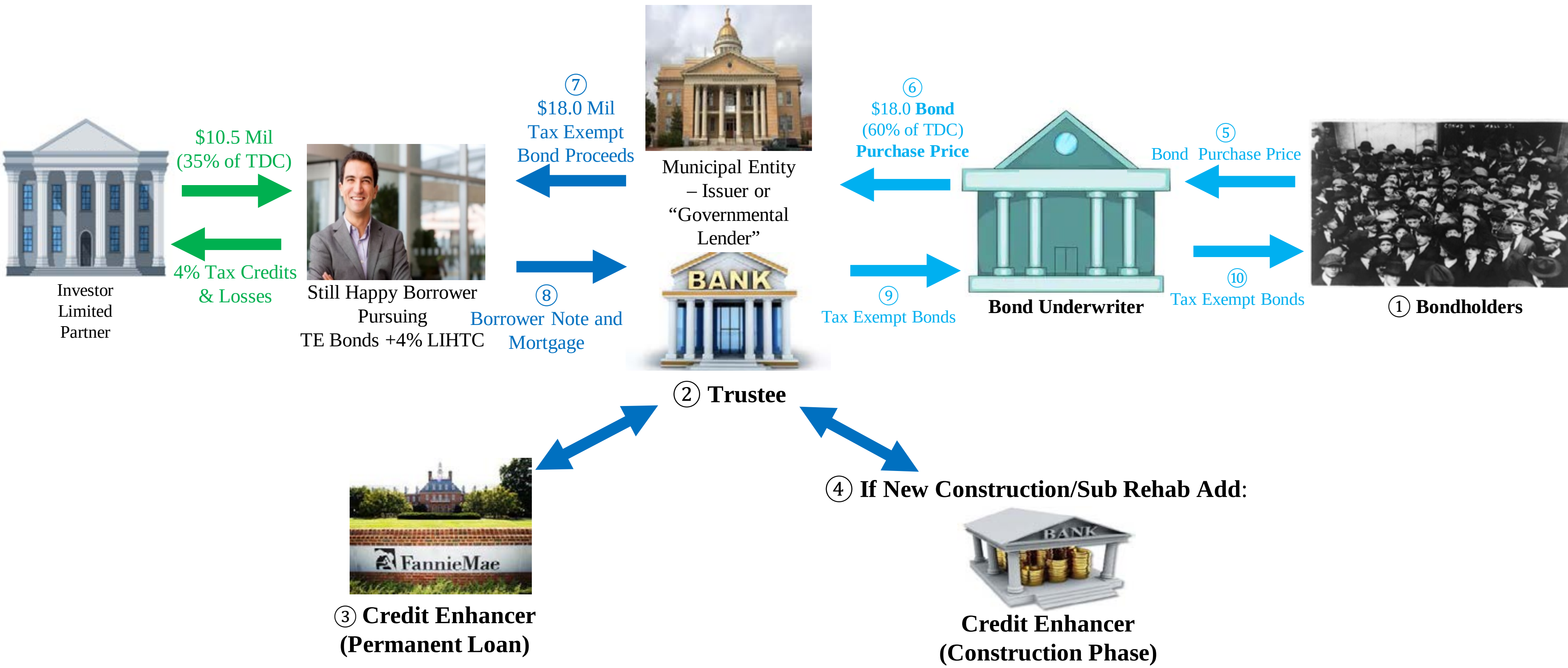
R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

Basic **"Conduit" Financing Structure** – Credit Enhanced – **Publicly Offered** and Rated A or Higher

- **Tax exempt "Bonds" may also be sold in a publicly offering.** Such bonds **will have a trustee** to act for the bondholders, and **are often "credit enhanced"** by a major **highly rated institution** such as Fannie Mae or a bank who agrees to pay timely debt service on the Bonds if the project's net operating income is insufficient.



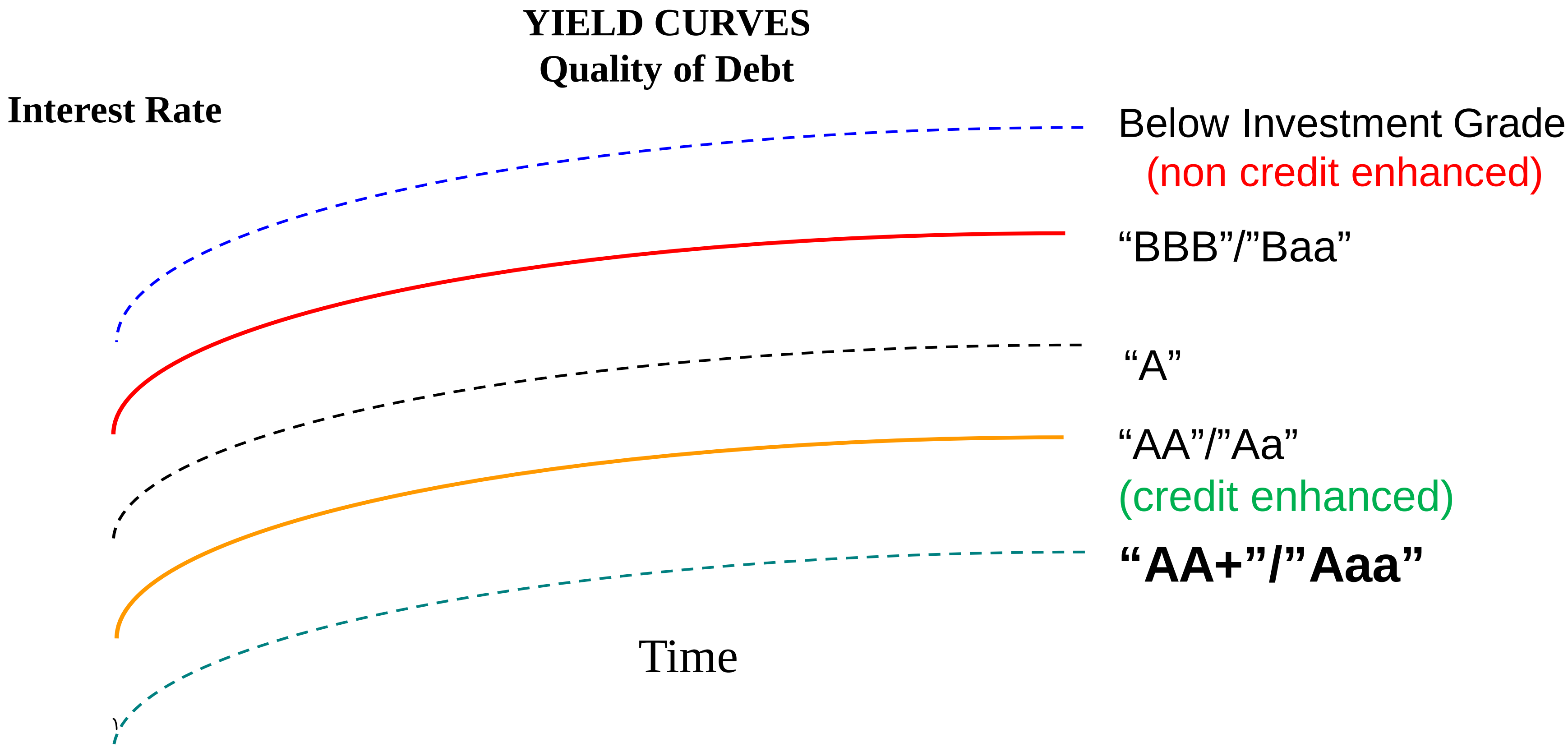
R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

Basic Publicly Offered Bond "Conduit" Financing Structure – Credit Enhanced

- Such Bonds are often **rated AA+ or Aaa**, and carry **very low interest rates** and are generally **sold in low minimum denominations (e.g. $5,000)** by an **underwriter** in a **public offering**.



- In these cases, the **lower rates generally offset the cost of the credit enhancement** to produce an all-in borrowing cost for the Borrower comparable to private placements.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

WHY FINANCE AFFORDABLE MULTI-FAMILY RENTAL HOUSING WITH TAX EXEMPT MUNICIPAL "BONDS" OR "LOANS"?

TWO BIG REASONS

1. "Automatic" **4% tax credit equity – The BIG Reason**.

   - **Available** under Section 42 of the Code **only** to **borrowers using new money private activity bonds** under **Section 142(d)** for profit motivated borrowers.

   - Can be **syndicated for 30-35% or more of total development cost** on a 100% affordable project.

2. **Lower** debt side **borrowing rates**

   - May be **50-100 basis points lower** than taxable lending rates, which can add proceeds equal to **another 8-10% of total development cost.**

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

III. 4% LOW INCOME HOUSING TAX CREDITS

How Does the 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** over a **10-year period** after placed in service is a specified percentage (e.g., approximately **4% – but really about 3.2%**) **of the "eligible basis"** of the **affordable units.**
- **"Eligible Basis"** is roughly speaking, **total development cost less land and commercial (for a 100% affordable project).**
- This is a **tax credit** – better than an income tax deduction: **Each dollar of credit offsets one dollar of tax liability**, not just 20 to 40+¢ as is the case with an income tax deduction.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

4% LIHTC – A MAJOR FUNDING SOURCE

- On 100% affordable multifamily rental projects the **4% LIHTC often funds 30, 35 or 40% of total development cost or more**.
- In 2016, it is estimated that **tax exempt bonds combined with 4% LIHTC** provided funding for roughly **75,000 units** of 135,000 estimated affordable rental apartment units in the United States*
- **The market for 4% LIHTC** on 100% affordable projects **is well established**.
  - **Prices** ranged from the $0.70 to $0.80/dollar of LIHTC through most of the 1990's.
  - **Prices climbed to a level exceeding $0.90 to $1.00** in some markets in the early 2000's and **are now in the $0.85 to $0.95/dollar range** on many executions.

---

* It is estimated that the 60,000 balance of these 135,000 affordable rental units were financed with 9% LIHTC. These 135,000 affordable rental units were about 1/3 of the estimated 400,000 rental apartment units produced in the U.S. in 2016.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

Sample Transaction - Value of 4% LIHTC

	100% Affordable, DDA*
Assume: Total Development Cost	$25.0 Million
Less: Land	($3.5 Million)
Less: Commercial Qualified Basis	$0
	$21.5 Million
Assume: Difficult to Develop Area (“DDA”) or Qualified Census Tract (“QCT”)* (e.g., entire City of LA)	x 1.3
	$27.95 Million
Assume:100% at 60% of AMI means “Applicable Fraction” of 1.0	x 1.0
	$27.95 Million
Tax Credit Rate	x 0.032
Annual Credit Amount	$894,400
Number of Years Credits Received – 10 years	x 10
Future Value of 10 Years of Credits	$8,944,000
Assume: **90¢**/$1.00 Pricing	x 0.90
Net Syndication Proceeds to Borrower	$8,049,600
	(32% of Total Development Cost)

* DDA or QCT = 30% basis boost

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

Tax Exempt Bond or Loan Financing
100% Affordable Project
Sample Sources and Uses of Funds

- Assume: Total Development Cost $25,000,000

Sources

Tax Exempt Bond or Loan Proceeds	$15,000,000	(60%)
Federal 4% Tax Credit Equity	8,000,000	(32%)
State Tax Credits and/or Subordinated Loan from City, County or State	1,250,000	(5%)
Deferred Developer Fee	750,000	(3%)
Total:	**$25,000,000**	**(100%)**

Uses

Land	$3,750,000	(15%)
Construction Costs	17,500,000	(70%)
Financing Fees (Bond Costs of Issuance; Other)	1,250,000	(5%)
Other “Soft” Costs	1,750,000	(7%)
Deferred Developer Equity	750,000	(3%)
Total:	**$25,000,000**	**(100%)**

Bond Costs of Issuance
($15,000,000 Tax Exempt Bond or Loan Issue

	Public Offering	Private Placement
Issuer Fees	$75,000	$75,000
Bond Counsel Fees	65,000	65,000
Financial Advisor to Issuer or Issuer's Counsel	25,000	25,000
Underwriting Fees	105,500	-
Underwriter's Counsel Fees	50,000	-
Rating Agency (Public Offering)	20,000	-
Construction/Permanent Origination Fee (2%)	300,000	300,000
Fees of Construction/Perm Lender's Counsel	75,000	75,000
Trustee and Counsel	5,000	5,000
Total Cost of Issuance	***$720,500 (4.8% of Bonds)***	***$545,000 (3.6% of Bonds)***

Certain of these items may vary greatly from deal to deal, including issuer fees. Does not include fees associated with 4% LIHTC, any subordinate loan and other possible loan side financing fees.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

Bond Costs of Issuance
*($15 Million Tax Exempt Bond or Loan Issue on $25 Million Project)**

Issuer	$75,000
Bond Counsel	65,000
Financial Advisor to Issuer or Issuer's Counsel	25,000
Underwriting or Origination Fees	112,500
Underwriter's (Pub. Off./Priv. Plcmt. Lender or Investor Counsel)	45,000/65,000
Rating Agency (Public Offering)	20,000
Trustee and Counsel	5,000
Other Fees of Lenders, Credit Enhancer(s)	[__________]
Total Cost of Issuance	***$347,500 (2.3% of Bonds)***

Certain of these items may vary greatly from deal to deal, including issuer fees. Does not include fees associated with 4% LIHTC.

IV. FEDERAL TAX LAW – THE BASICS

- Nature and scope of federal tax requirements depend on **type of financing**
- For tax law purposes:
  - **"New Money"** Issues (proceeds to construct or acquire and rehab the project).
    - Proceeds are used to **finance** the **construction, acquisition** and, in some cases, **rehabilitation** of a multifamily rental housing project.
    - This is where **substantially all of current multifamily bond activity** is.
    - Ninety something percent of "**New Money"** deals are **Private Activity Bond** issues under **Section 142(d)** -- for **profit motivated owner,** almost always combined with 4% LIHTC.
  - "**Tax Exempt Refundings**" of prior tax exempt bonds – **very unusual today** due to low taxable rates – very different (simpler) rules.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

Rules under Section 142(d) for "New Money" deals are very similar to those for 4% LIHTC under Section 42

- The **tax exempt bond financing rules** will be incorporated in a "**Bond Regulatory Agreement**" **or** a "Land Use Restriction Agreement" ("**LURA**") which bond counsel prepares and which will be recorded against the land*.
- **Residential Rental Housing Facility**
  - **"Rental":** Tenant must rent unit**; no condos**
  - **Complete living units** (each unit has at least a minimal kitchen and bath); "Single Room Occupancy (or "SRO's") are exempt from this requirement.
  - **No Transient use** (no hotels, rooming houses, leases of at least six months)
  - **Leased to the general public** (although restrictions to the elderly, veterans, and certain other broad groups are permitted)

---

* There will be a separate Regulatory Agreement on the 4% LIHTC §42 side.

Major Tax Exempt Bond Rules Under 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 for the **longest of (i) at least 15 years after 50% occupancy**; **(ii)** until any **Project based Section 8 subsidy expires**; or **(iii)** as long as **Bonds outstanding** (the "**Qualified Project Period**" or "**QPP**")
  - Substantial majority of deals are 100% at 60% of AMI, with 4% LIHTC on 100% of the units and effectively, a 30+-year QPP under Section 42.

Major Tax Exempt Bond Rules Under Section 142(d)

- **Private Activity Bond Volume Allocation Requirement**
  - Must **apply through issuer** for allocation.
  - **Demand** for multifamily housing volume is **now greater than the supply in at least ten states** including Massachusetts, Connecticut, New York, New Jersey, Georgia, Tennessee, Minnesota, Texas, Colorado and Washington State. Recently, the District of Columbia and Virginia have come close to being short on volume.
  - In **other states, volume is not yet a problem, but** in every state you have to **understand timing, procedures and criteria** of the allocation process and fit your transaction into this.
  - In volume limited states, it is **critical** for the developer to **ascertain the availability of private activity bond volume** for its proposed project **and** the **available issuers** through which the developer may apply for that volume **at the very outset of the financing**. **Remember: No volume = no 4% LIHTC = no affordable apartment financing**.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

Each State Has Own Allocation System

- Lottery, or
- Merit-scoring criteria, or
- Geographic allocation, perhaps collapsing mid-year into statewide pool?
- Preferred categories:
  - Preservation; other acq/rehab; new construction.
  - Rural; mixed income; general?
- Once per year or multiple application rounds?
- Different periods to use after award (e.g., 180 days) or volume may be lost.
- Remember:
  - One must **asses bond volume availability** and process **at the very outset of financing**.
  - Every state is different.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

OTHER TAX EXEMPT BOND REQUIREMENTS UNDER SECTION 142(d)

50% Change of Ownership Requirement on Acquisition Financings; No tax-exempt refinancing for existing owner

- Ownership interests representing at least 50% of profits and capital must be held by persons unrelated to prior owner of project. No tax exempt refinancing for existing owner under Section 142(d).

95/5 Good Cost/Bad Cost Test

- At least 95% of tax exempt bond proceeds must be spent on so-called “good costs” – i.e. costs paid or incurred by the borrower.
  - No earlier than the date 60 days prior to the “Inducement” or “Official Action” resolution date, except for certain permitted “preliminary expenditures.”
  - Are by their nature “capital costs” versus working capital [__________] or operating expenses.

2% Costs of Issuance Limitation

- No more than 2% of tax exempt bond or loan proceeds may be used to pay any costs of issuance. (No problem; pay any excess from 4% LIHTC proceeds or taxable debt).

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

OTHER TAX EXEMPT BOND REQUIREMENTS UNDER SECTION 142(d)

15% Rehab Requirement on Acquisition Financings

- Spend 15% of portion of depreciable cost of buildings and fixtures financed with tax exempt bonds or loan for rehab within 24 months.

Other Requirements

- Since summer of 2008, all multifamily housing bonds have not been subject to AMT.
- Public Hearing and Elected Governmental Approval or "TEFRA" requirement ("NIMBY" problems).
- No more than 25% of tax exempt bond proceeds can be used for land.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

Basic Rules for Obtaining 4% Low Income Housing Tax Credits under Section 42

- **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 assisted"** (e.g. section 8, FHA insured).

- **50% Test:** At least **50% of aggregate basis** of the building and land must be **financed from tax exempt bonds** under Section 142(d), which Bonds must **remain outstanding until** the Project's **placed-in-service-date** (generally, COO on new construction; completion of rehab on acq/rehab deals) to get full value for 4% LIHTC.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

- **Generally the same 40/60 income targeting** as Bond test under Section 142(d) of the Code (but apply building by building), but most tax credit projects are 100% affordable to maximize tax credits – **tax credits are only paid on the targeted units**.
- Unlike bond rules, **tax credit rules limit rents charged** on targeted units **to 30% of the applicable income limit** for the targeted unit.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

- Tax credit units must continue to comply with above limitations for a QPP of at least **15+ years after placed in service**, or tax credit investors subject to “recapture” of tax credits claimed.
- **If project loan defaults and the lender 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(s) in public offerings, or the bond purchaser or “funding lender” in non-credit enhanced private placements, will take various steps to minimize possibility of a loan default.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

V. ASSEMBLING THE FINANCING TEAM

- **Issuer**
- Bond Counsel
- Issuer's Counsel/Financial Advisor
- **Owner**
- Owner's Counsel
- Owner's Financial Advisor
- **Tax Credit Equity Investor Limited Partner and Counsel**
- **Senior Debt Lender and Lender's Counsel** (Fannie Mae, Freddie Mac, FHA and Rural Development Debt Structures)
- **Credit Enhancer, if applicable (public offering)**
- Credit Enhancer's Counsel, if applicable (public offering)
- Construction Phase Credit Enhancer (Fannie Mae financing) or "Initial Funding Lender" (Freddie Mac TEL financing) and Counsel
- Subordinate Loan Provider and Counsel
- **Underwriter (Public Offering) or "Funding Lender" (Bank Private Placements and Freddie TEL)**
- Underwriter's or Funding Lender's Counsel
- Trustee/Fiscal Agent and Trustee's/Fiscal Agent's Counsel
- Rating Agency, if applicable (Public Offering)

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

The Issuer

- Remember: Tax Exempt Bond or Note 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** (discussed below) – choose carefully!

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

Three major types of issuers:

1. State Housing Finance Agency (e.g. California State Housing Finance Agency)

- Can finance projects **anywhere in the state.**
- May **sometimes** control a **high percentage of state's multi-family volume**.
- May **put its credit behind bond issue or provide savings from multiple-project "combined" issues.**
- May provide **subordinate loan financing.**
- Generally **much more issuer involvement and control** and **somewhat higher fees (e.g. 25 to 50 basis points/ year vs. 10 or 12.5 or less for local or multi-jurisdictional issuers (below).**
- Often have **fixed team of participants**, including designated underwriter.
- Great if you're the designee; kiss of death of you're not.
- Often set **pooled financing structures –** reasonably competitive terms but low flexibility.
- May **bar borrower from optional prepayment** for life of loan even though the HFA can refund its bonds to the Issuer's benefit.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

2. Local County, City, Redevelopment Agency, Housing or Economic Development Authority (e.g., City of Chicago)

- Generally **allow borrower more control** over financing team, including underwriter and sometimes bond counsel (among qualified or several qualified firms).
- **More flexibility on financing structure** – perhaps limited to “A” rated or higher, unless privately placed.
- **Must have access to private activity bond volume** to be a viable choice.
- Almost **never pledge their credit**, but may make subordinated loans from their funds.
- **More flexibility** on prepayment and lower fees.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

3. Multi-Jurisdictional Authority (e.g., joint powers authority such as CMFA and CSCDA in California)

- Probably **control Bond Counsel** (or you choose among several) – **not much else.**
- Generally **greatest flexibility** on structure.
- **Always serve as conduit**, have no subordinated loan funds (but may still be available from other sources).
- **Generally “hands off”** with few, if any, extra requirements, competitive fees and little control.

Bond Counsel

- Passes on:
  - The **validity** of the Bonds under state law (Railroads example).
  - The **tax-exempt status** of the Bonds under federal and state law.
- Drafts the main financing documents such as the Indenture, Loan Agreement and Regulatory Agreement, and the closing papers.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

Owner and Owner's Counsel

- Develops, builds or renovates, owns and often manages the project.
- Responsible for complying with rules to maintain tax exempt status of bonds (use of proceeds, set-asides, rebate, etc.) and to preserve 4% tax credits, if applicable.
- **Counsel should be experienced in real estate matters, in tax exempt bond or loan financings and, if applicable, in tax credit equity.**
- May also have separate financial advisor.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

4% Low Income Housing Tax Credit Equity Provider and Counsel

- **Key player** on Section 142(d) private activity issues.
- Have separate timetable which must be coordinated with Bonds; important for Owner to **select early in the process**.
- May have separate state tax credit equity syndicator and counsel on some deals.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

Lender and Lender's Counsel

- Structures involving **Fannie Mae** and **Freddie Mac** or **FHA** insured or **USDA guaranteed rural development ("RD")** financings use lenders approved under those platforms and lender's counsel experienced in those program requirements.

Credit Enhancer and Its Counsel (Many Publicly Offered Bonds)

- Like Issuer **- Key participant** – If present, its requirements **will largely determine the basic terms of the financing.**
- **Many publically offered multifamily bond issues use some form of credit enhancement, but comprise now minority of deals** (versus private placements) **in most jurisdictions.**
- Typical Credit Enhancers include **Fannie Mae**; domestic and foreign **banks** (through letters of credit), and others. **Short-term** (often publicly offered) **tax exempt bond issues used with FHA and RD financings to satisfy the 50% Test** are now **"cash collateralized" by U.S. Treasury obligations; rated Aa+ or Aaa and no credit enhancer** is required**.**
- **Today, most bond issues** are **structured as tax exempt loans** and use no credit enhancement and are **privately placed** with **banks** (to satisfy CRA goals as well as financial returns) **or other institutional investors,** like **Freddie Mac** under its "TEL" program.
- These tax exempt loans have **higher bond or loan interest rates** but **no credit enhancement** fees, and thus often produce **competitive all in borrowing costs** and permit a **"draw down" funding which eliminates project fund negative arbitrage** on new construction and sub rehab deals.

Separate Construction Phase Credit Enhancer or Tax Exempt Loan "**Initial Funding Lender**" (e.g., a Bank) and Counsel

- Used primarily on Fannie Mae and Freddie Mac tax exempt bond and loan issues – **Fannie Mae and Freddie Mac do not take project related risk until stabilized occupancy** (e.g. $\geq$ 1.15 DSCR for 90 consecutive days).

- Not necessary in most publicly offered Bank Letter of Credit backed tax exempt bonds or tax exempt loans privately placed with a bank or other non-GSE* sponsor.

---

* GSE – Government Sponsored Enterprise; i.e. Fannie Mae and Freddie Mac.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

Underwriter (Publicly Offered) or Funding Lender (Private Placement) and its Counsel

- **Underwriter or Funding Lender serves as the Quarterback for the financing.**
- **Assembles** the **financing team.**
- On public offerings, the Underwriter assists project owner (the "Owner") **in choosing optimal financing program**, including credit enhancement, if any.
- **Develops financial structure** of bond issue (credit enhancement, if any, bonds maturities, put features, etc.) and **prepares** bond **cash flows**, if any.
- Assists Owner in assessing availability of private activity **bond volume.**

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

Underwriter or Funding Lender and its Counsel
(Continued)

- **Obtains rating on publically offered issues.**
- Together with Bond Counsel, **coordinates closing.**
- **Underwriter's or Funding Lender's Counsel** assists in above and prepares Official Statement (on public offering), Bond Purchase Agreement, Continuing Disclosure Agreement and other Underwriting or Private Placement Documents.

- **Trustee/Fiscal Agent and Trustee's/Fiscal Agent's Counsel.**
  - **Administers Trust Indenture or Funding Loan Agreement**; makes payments to Bondholders and often disburses bond proceeds.
  - May also serves as **dissemination agent** under the Continuing Disclosure Agreement on publically offered and some privately placed tax exempt loan transactions.
- **Rating Agency (public offerings).**
  - **Rates the Bonds (N/A in private placements).**
  - "Major" Rating Agencies: Generally **Standard & Poor's or Moody's.**
  - Most credit enhanced bonds are rated "AA+" or "AA" (Standard & Poor's) or "Aaa" or "Aa" (Moody's) (top 2 categories - produce lowest interest rates for an issue of a given maturity).

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

VI. FINANCING TIMETABLE

- **General Rule –** May require **4-6 months or more** from outset; some require less time
- A key role of Underwriter or Funding Lender is to coordinate the following **critical processes** to achieve a timely **pricing** of the Bonds and **closing**
  - **Volume allocation process**, if applicable
  - **Issuer approval process**
  - **Rating Agency process, if applicable**
  - **Bond or Loan Underwriting Approval** by each **Major Financing Component**
    - **Tax Credit Equity Provider**
    - Senior Bond **Permanent Credit Enhancement (if applicable) or Senior Loan Permanent Funding Lender**
    - Senior Bond **Construction Phase Credit Enhancement (if applicable) or Senior Loan "Initial" Funding Lender**
    - **Subordinate Loan Provider**
- Document production and approval
- Pricing
- Closing

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

The Goal is to avoid:

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

Sample Timetable

Month(s)

1 – **Owner selects Underwriter or Funding Lender.**

- Select Issuer, Financing Structure and Credit Enhancer if applicable.

– **Owner works with Issuer to apply for private activity Bond volume** allocation.

– **Application filed with credit enhancer or Funding Lender**, which begins loan underwriting process.

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

2 – Credit enhancer or Purchaser **begins real estate loan underwriting**

- 60-90 days for many Private Placements and structures involving Fannie Mae or Freddie Mac; 90-120 days for FHA/ §223(f); 5-8 months for FHA §221(d)(4); RD slightly longer than FHA.

3-4 – **Credit Enhancer** or **Funding Lender(s)** and counsel **on board**, **volume assured.**

– Underwriter or Funding Lender prepares and circulates initial financing **participants list**, rough financing **timetable** and basic **term sheet.**

– **"All hands" organization meeting or conference** call to review financing.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

Month(s)

4

- **Draft Documents Circulated** (starts 45-60 day drafting, revision and approval process).
  - **Bond Counsel**: Indenture or Funding Loan Agreement, Borrower Loan Agreement, Regulatory Agreement.
  - **Credit Enhancer's** or Funding Lender's **Counsel** and Construction Phase Credit Enhancer's or Initial Funding Lender's Counsel: Credit Enhancement, if applicable or Loan Commitment(s) and Documents.
  - **Underwriter's Counsel** or Purchaser's Preliminary Official Statement (public offerings), Bond Purchase Agreement, Rule 15c2-12 Continuing Disclosure Agreement, if any and Remarketing Agreement, if any (mandatory tender or variable rate transactions).
- Underwriter **submits documentation and cash flows to Rating Agency (public offering).**
- **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 (public offering).**
- **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**) or Funding Lender's commitment **received.**
- **Subordinate Loan**, if any, **approved** or finalized.
- **4% LIHTC equity commitment** delivered by Tax Credit Syndicator and Partnership or Operating Agreement final.
- **Rating received** from Rating Agency (public offering).
- **Objective/Result: Preliminary Official Statement** finalized, "deemed final" for SEC Rule 15c2-12 purposes and **mailed (public offering).**

6
- **Underwriter prices and sells Bonds;** or **Funding Lender locks Bond or Tax Exempt Loan interest rate** and commits to purchase/fund.
  - **Bond Purchase Agreement executed (public offering)**
  - 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 (public offering).
- **Transaction preclosed** one day and **closed** and funded on the following day or the second following day.
- Recording: often one day later (Gap Title Insurance).

VII. REAL ESTATE FINANCE 101

- **General partners** generally **guarantee** repayment of **debt** and project completion **during construction** or rehab **and rent-up**.
- “Non-recourse” means **guaranty falls away** after project reaches **stabilized occupancy** (sometimes called “conversion” = 1.15 debt service coverage (more later) and 90% occupancy for 90 consecutive days), **except**
  - **Fraud** (GP is still liable).
  - **Environmental** (GP is still liable).
- **Otherwise**, if project loan defaults, borrower can simply **give lender the keys.**

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

REAL ESTATE FINANCE 101

- **Very different from most corporate financings** or **municipal general obligation financings** where debt often backed by diversified income stream and large, diversified balance sheet.

- Because the real estate project is almost the only security for the loan, lenders use at least **two fundamental tests** in determining how large a loan they will make on a particular project:

  1. **Minimum Debt Service Coverage (DSCR)** test: The projected net operating income **("NOI")** from the project (rental revenues less operating expenses) **must "cover"** the **debt service** on the proposed loan (scheduled payments of principal, interest and ongoing fees) by a ratio of at least, say, **1.15 to 1.00** (e.g., DSCR $\geq$ 1.15).

  - The **purpose** of the minimum DSCR test is to **minimize** the **likelihood of default** on the loan by providing some "cushion" in projected NOI over required debt service.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

2. **Loan-to-Value ("LTV") Test**: The **largest loan** the lender will make is **no greater than** a certain **percentage** (e.g., 90%) **of** the **"value"** of the project, usually as determined by an appraisal (using cost, market comparables, projected cash flow) (e.g., LTV≤90%).

   - **Purpose** of the maximum LTV test is to **provide some cushion** to the lender **if the project is sold** after being taken back by the lender through foreclosure or deed-in-lieu of foreclosure following a default on the loan.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

REAL ESTATE FINANCE 101

3. It’s like taxpayers dealing with the IRS – the **borrower gets** the **lower** of the **loan size** indicated by the minimum DSCR test or the maximum LTV test.
4. The exact real estate underwriting tests used will depend on debt financing program chosen, project financed, borrower strength and experience and other factors.
5. On structures other than FHA loans, loan will be **re-underwritten following construction or rehabilitation and rent-up,** and must be paid down if required at this **“conversion”** to the permanent phase to satisfy these tests.

VIII. BONDS 102 –
ALTERNATIVE FINANCING STRUCTURES

- **Publicly Offering Bonds**
  - **Publicly offered bonds are generally credit enhanced and AA+ or Aaa rated.**
  - Examples include short-term cash-backed tax exempt bonds used to satisfy the 50% Test for projects using now lower rate taxable FHA and RD financing.
  - Long-term tax exempt Fannie Mae credit enhanced long-term “M.TEBs” monthly pay bonds used with Fannie Mae “DUS” loans.
  - **Some** publicly offered issues – primarily Section 145 issues for Section 501(c)(3) borrowers acquiring stabilized projects with very light rehab – may have **lower rating**, usually “BBB” or “A” (lowest two tiers of “investment grade”).
  - Some unrated bond issues backed by other stabilized projects may be **sold in limited public offerings** with some of the restrictions found in private placements.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

Alternative Financing Structures

- **Privately Placed Tax Exempt Bonds and Loans**
  - **Unrated, non-credit enhanced private placement** issues are **now predominant** especially in large urban CRA-driven markets. As described above, these issues are most often structured as **tax exempt** loans which are placed in **large minimum denominations** (e.g., $100,000 or $250,000 or higher) to sophisticated individual or institutional investors. Other restrictions:
    - Transfer limited to “Accredited Investors” under Reg D or “Qualified Institutional Buyers“ as defined in Rule 144A.
    - May have initial Investor Letter and sometimes “Traveling” Investor Letter.
    - Restrictions on Transfer.
    - Examples include the **bank draw down** tax-exempt bond or loan **private placement** structures and the closely related **Freddie Mac** tax exempt loan or **“TEL” structure**.
  - **“Senior/sub”** structure may also be used where payment of debt service on one series is made in full before any debt service is paid on the subordinated series (usually “Series B” and/or “Series C”).

Which is the Right Structure?

- Project Type and Location
- Borrower Financial Strength
- Maximum Proceeds
- Maximize Cash Flow
- Reduce Guaranties/Recourse
- Reduce Conversion/Balancing Risk
- Timeframe
- Rates

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

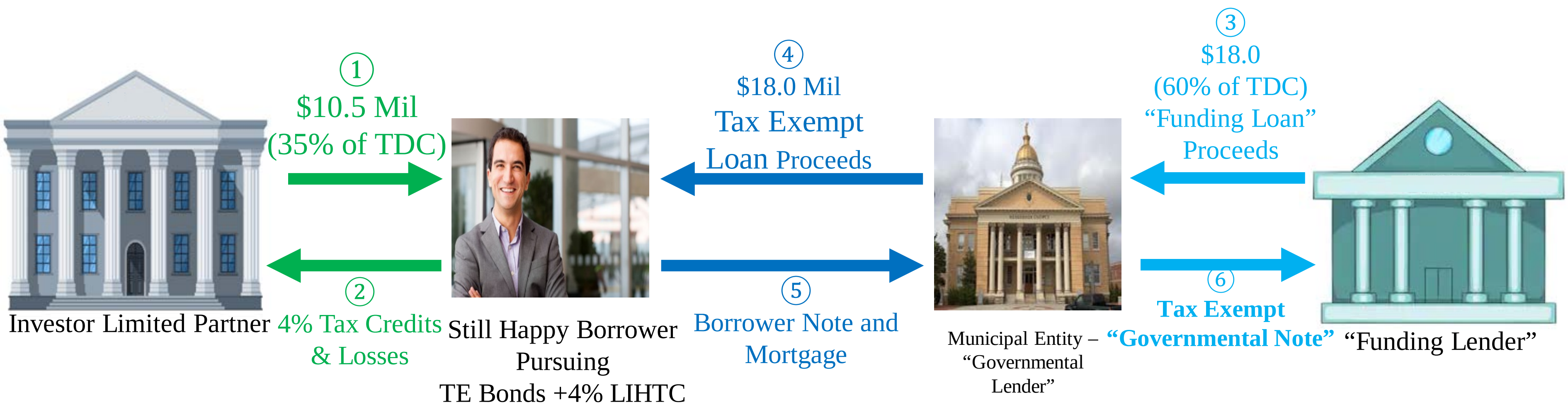
MAJOR TAX-EXEMPT BOND OR TAX-EXEMPT LOAN EXECUTIONS FOR AFFORDABLE HOUSING

A. BANK OR OTHER SPONSOR PRIVATE PLACEMENT PROGRAMS

- Starting in **the late 1990's**, in part 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). This has become **by far the dominant tax exempt debt financing structure** for affordable rental housing projects in **major urban markets** (e.g., Boston, New York, Washington D.C., Miami, Chicago, San Francisco, Los Angeles, Seattle).

- **These programs, together with the Freddie Mac "TEL" structure described below,** comprise the **substantial majority (75% to 85%) of tax exempt debt side executions** (by number of financings and dollar volume) **for 100% affordable projects.**

SIMPLEST BANK OR OTHER SPONSOR PRIVATE PLACEMENT TAX EXEMPT BOND OR LOAN STRUCTURE



R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

BACKGROUND ON PRIVATE PLACEMENTS FOR AFFORDABLE MULTIFAMILY HOUSING PROJECTS

- These private placement programs have the **advantages** of:
  - **Lower financing costs –** No rating fees and other costs associated with a public offering.
  - **Flexibility** – Terms could be modified as agreed by the Issuer, the Borrower and the Bank or other program sponsor.
  - **Speed** – Faster loan underwriting in some cases and no delays associated with rating and public offering.
- More recently, **additional major advantages** have been added, including:
  - **Draw-down Funding**: Tax-exempt debt is funded as loan advances are made – **eliminates construction period negative arbitrage** on new construction sub-rehab deals – can be **up to 2-4 points or more of savings** on new construction/sub rehab versus "fully-funded" publicly offered bonds.
  - **Low variable rate during construction**/rehab/rent-up – e.g., 1-Month LIBOR (0.50%*) plus spread of ~2.00% to 2.25% = **2.50% to 2.75% "pre-Conversion" rate.**
  - **Locks in very low permanent rate** (e.g., 16 to 18-year LIBOR swap (1.20%) plus ~2.00%-2.40% or around **3.20% to 3.60% perm rate**) at initial loan closing.

---

*One-month LIBOR is recently around 0.20%, but most sponsors apply a 0.50% floor.

BANK AND OTHER SPONSOR PRIVATE PLACEMENTS

- **"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 or 40-year loan amortization** to a 16 – 18 year balloon
  - **Very large (85 – 90%) loan-to-value,** and
  - **Very low debt service coverage (1.15).**

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

B. FREDDIE MAC TAX-EXEMPT LOAN OR "TEL" STRUCTURE

- In 2014, **Freddie Mac** introduced its **Tax Exempt Loan or "TEL"** structure. Since then, several billion dollars in loans have closed. Structure basically the same as Bank and Other Sponsor Private Placements, with a few differences.
- **Requires a separate bank (probably with separate counsel) to take pre-Conversion risk** on the tax exempt loan versus most other private placements, thus perhaps entails slightly higher costs.
- Freddie Mac also **always requires a "Fiscal Agent,"** some bank and other sponsor private placements do not, lowering expenses.
- Freddie Mac tends to agree to permanent interest rate locks further in advance than many competitors.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

C. FANNIE MAE "M.TEBs" STRUCTURE

- In 2015, Fannie Mae pioneered a new **fixed rate publicly offered tax exempt Fannie Mae monthly pay MBS pass-through** structure.
- **Under this structure, the Trustee simply passes through the monthly Fannie Mae MBS payment** securing the Bonds to the Bondholder on **next business day** on a **tax exempt basis**.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

Fannie Mae M.TEBs

- **Bond coupon rates are around the 10-year U.S. Treasury rate plus 1.10-1.20%: 0.80% + 1.20% = 2.00% bond coupon in today's market.**
- **Fannie Mae is also offering very low guaranty and servicing fees of roughly 120-140 basis points to promote this program.**
- **Result: Very attractive all-in borrowing rates as low as 3.30% to 3.50%.**
- **35 to 40-year loan amortization to 16 to 18-year balloon, 1.15 DSCR; 85-90% LTV.**

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

Fannie Mae M.TEBs

- On **new construction and sub rehab** financings, Bonds are **"cash backed" for 1st 2-3 years**.
  - Imposes **negative arbitrage** cost of **around 2 points** or so.
  - Requires a **taxable draw down construction loan**, which may carry a slightly higher rate than in a tax exempt draw down private placement.
- The program **may allow more lenient waivers** for certain loan underwriting criteria such as larger rehab per door for mod rehab loans with low tenant relocation risk, and the potential for **earn-out provisions for certain loans** and other features typically associated with Fannie Mae DUS loans.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

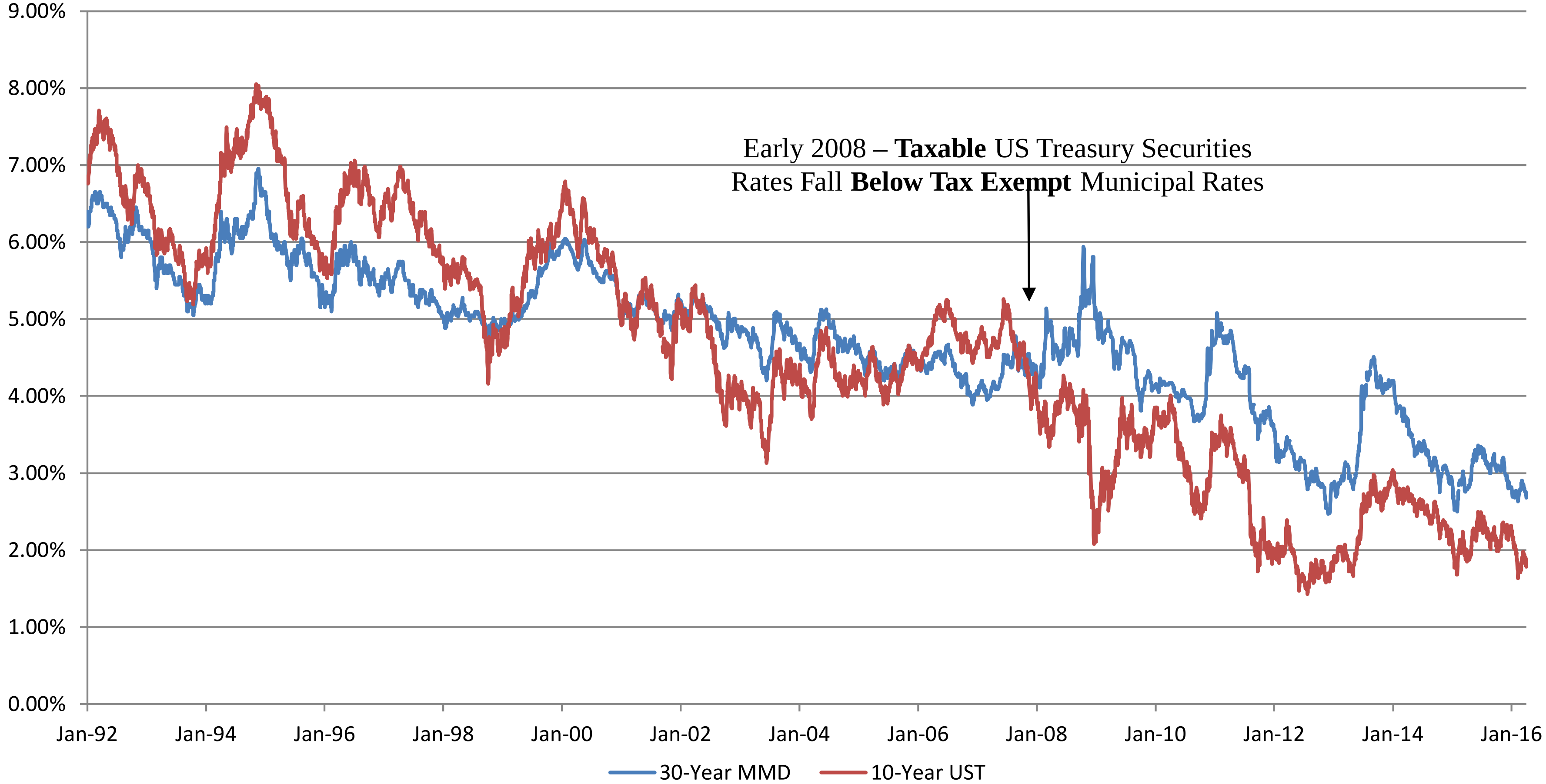
Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

D. SHORT TERM CASH BACKED TAX-EXEMPT BONDS

- For many years on **FHA Insured or RD financings,** we would **pledge the GNMAs to secure long-term tax exempt muni bonds** to get the lowest borrowing rate – left side of chart.

- This all changed in the **2008 financial crisis**, when **taxable rates like those on GNMAs fell *below*** the rates on **long term tax exempt muni bonds** by 50-100 basis points or more – right side of chart.

LONG-TERM RATE COMPARISON: 30-YEAR MMD (TAX-EXEMPT) VERSUS 10-YEAR CONSTANT MATURITY TREASURY (TAXABLE)



R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

THE ALL-IMPORTANT 50% RULE

- "So if I can do a simple taxable conventional GNMA sale on my FHA insured loan at a lower rate, **why would I use muni bonds?**"
- **The 50% Rule**: Again, to be eligible for 4% LIHTC, **you have to finance at least 50% of "aggregate basis" of the building(s) plus land with volume limited tax-exempt private activity bonds** under Section 142(d) of the Code **and keep them outstanding until the project's placed-in-service date**.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

SHORT-TERM CASH-BACKED TAX-EXEMPT BONDS - HOW IT WORKS

- Issue **short-term tax exempt bonds equal to 50% of the project's aggregate basis of the building(s) plus land priced to a mandatory tender date 6-12 months following the targeted placed-in-service date** (to provide for construction delays). **Stated maturity will be 6-12 months** later, **allowing a remarketing** of bonds if more time is needed to place project in service.

- **Two funds** established under Bond Trust Indenture and **invested in U.S. Treasury securities**:

  - A "**Project Fund**" in which all the tax exempt bond proceeds are deposited, and

  - A "**Collateral Fund**" in which FHA or RD lender taxable loan advances are deposited.

- Financings are structured so that as each dollar of tax exempt bond proceeds is disbursed from the Project Fund to pay project costs, an equal amount of taxable loan lender advances must be simultaneously deposited into the Collateral Fund. **The principal of the Bond issue thus remains 100% "cash collateralized"** with U.S. Treasuries. Receive a AA+ or Aaa rating and **no other credit enhancement is required**.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

SHORT-TERM CASH-BACKED TAX-EXEMPT BONDS

- **In today's market**, **U.S. Treasury securities** yield about 20 basis points lower than the bond coupons of 30-40 basis points, producing **about ½ point of negative arbitrage** to be funded by the borrower up front.
- **When** the project loan has been fully funded, rehabilitation or construction has been completed and **the project has been placed in service, the tax exempt bonds are redeemed**.
- The **Project's only remaining debt** is **the taxable FHA insured or RD loan.**

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

Sample Short-Term Cash Backed Tax Exempt Transaction

New Construction/Sub Rehab – 3-Year Bonds, with 24-Month Mandatory Tender

Expected Placed-In Service Date	18 Months
Initial Mandatory Tender Date	24 months*
Stated Bond Maturity	36 Months
Bond Sale	Public offering (only) of S&P AA+ rated or Moody's Aaa—rated Bonds
Interest Earnings from Eligible Investments	15 to 20 basis points per year
Initial Bond Coupon Rate	0.40%
Net Negative Arbitrage	½ point or less

* Bonds are sold to the 24-month mandatory tender date. If delays are encountered on placing project in service then bonds can be remarketed to new buyers providing up to 12 additional months before tax exempt debt goes away.

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

ALL-IN BORROWING RATES ON THE RD OR FHA INSURED LOAN
(The "Real" Construction/Permanent Loan)

		Moderate Rehab/	Sub Rehab-New Cons/
Mortgage Loan Interest Rate			
	GNMA Pass Through Rate	**2.10%**	**2.65%**
	3rd Party Fees	N/A	N/A
	Servicing + GNMA Fee	0.25%	0.25%
	Total **ML Rate**	**2.35%**	**2.90%**
	Add: MIP	**0.25%**	**0.25%**
	Total **All-in Borrowing Cost**	**2.60%****	**3.15%****

- These are the lowest borrowing rates we see on any affordable housing bond execution, and there is no re-underwriting of the loan at the permanent loan stage and no balloon on a 35 or 40-year loan amortization. On the other hand, FHA and RD take a great deal of time and Davis Bacon wage rates apply on new construction and substantial rehabilitation loans.

---

* Note: bonds are sized to 52 – 54% of Tax Credit basis; under long-term muni bond structures used before 2009, bond issue would be larger (equal to taxable loan amount) with higher costs.

SUMMARY OF BORROWING/ UNDERWRITING RATES
PRINCIPAL TAX EXEMPT DEBT PRODUCTS FOR 100% AFFORDABLE PROJECTS

	Estd. Actual All-In Borrowing and Perm Period Underwriting Rate
1. Bank Private Placement	
-Mod Rehab	**3.10% to 3.50%**
-Sub Rehab/New Cons	
Cons Period	**2.50% to 2.75% Floating**
Perm Period	**3.20% to 3.60%**
2. Freddie Mac "TEL" Program (Mod Rehab, Sub Rehab, New Cons)	**Similar to Bank Private Placements above**
3. Fannie Mae "M.TEBS" Structure	**3.30% to 3.50%**
4. Short-Term Cash Backed Tax Exempt Bonds with Taxable Loan Sale	
FHA §223f or RD Mod Rehab	**2.60%**
FHA §221(d)(4) or RD Sub Rehab / New Cons	**3.15%**

- **These long-term all-in borrowing rates are about 150 basis points or 30% lower than 2 years ago.**
- **One of the most attractive tax exempt debt markets we have seen in many years.**

R. Wade Norris
(202) 973-0110 (O)
(202) 744-1888 (C)

Ryan George
(502) 614-6853 (O)
(703) 867-1109 (C)

Ethan Ostrow
(202) 973-0111 (O)
(224) 216-2490 (C)

R. WADE NORRIS, ESQ.
wnorris@ngomunis.com
(202) 973-0110 (O)
(202) 744-1888 (C)

RYAN GEORGE, ESQ.
rgeorge@ngomunis.com
(502) 614-6853 (O)
(703) 867-1109 (C)

ETHAN OSTROW, ESQ.
eostrow@ngomunis.com
(202) 973-0111 (O)
(224) 216-2490 (C)

RANDAL S. PUTNAM, ESQ.
rputnam@ngomunis.com
(518) 729-3965 (O)
(402) 578-6205 (C)

TOM DOWNEY, ESQ.
tdowney@ngomunis.com
(415) 260-4674 (O)

KIM GRIFFTH, ESQ.
kgriffith@ngomunis.com
(202) 973-0109 (O)
(571) 243-9404 (C)

REGGIE NORRIS, ESQ.
rnorris@ngomunis.com
(202) 441-3996 (O)

MR. MATT HOOD
mhood@ngomunis.com
(407) 456-4952 (C)

MR. KEVIN EGAN
kegan@ngomunis.com
(202) 973-0123 (O)

MS. RAQUEL JONES
rjones@ngomunis.com
(202) 973-0120 (O)

NORRIS GEORGE & OSTROW PLLC

1627 Eye Street, N.W., Suite 1220
Washington, D.C. 20006
www.ngomunis.com