Public Offerings

Publicly Offered Tax-Exempt Housing Bonds Primed For a Great Year

By Mark Fogarty

Private placements may make up to three quarters of the affordable multifamily housing bond market, but that doesn't mean that publicly offered bonds are a weak sister. In fact, growth in tax-exempt bond public offerings may be even larger than the increase in private placements in 2021.

R. Wade Norris, partner at Washington, DC-based Norris George & Ostrow PLLC, says that while private placement volume may increase by five to ten percent this year over last, public offerings are likely to see an even greater boost this year. And public offering market share has been growing in recent years. (In the June 2021 issue of *Tax Credit Advisor*, Norris estimated that $15 billion in private placements were done in 2020, compared to $5 to $7 billion in public offerings, though he noted other estimates are higher than his.)

Helen Feinberg, managing director at RBC Capital Markets, an active participant in the market, also sees a growing share for public offerings this year.

"If the 2021 pace of multifamily bond issuance sustains, the year-end volume could exceed $11.5 billion, which would be more than a 50 percent increase in publicly offered multifamily bonds from last year to this year," she says.

"In 2020, RBC Capital Markets served as senior managing underwriter on over $915 million in multifamily public offerings. These issues included a wide variety of structures, including four percent Low Income Housing Tax Credit bonds that were short-term cash/Treasury-backed bonds, Fannie Mae M.TEBs and essential function bonds."

There are a number of factors contributing to this robust environment, Norris feels. They include proposed tax code revisions that would make tax-exempt bonds more attractive to investors, especially upper-income ones, and an increase in so-called California Joint Powers Authority (JPA) financings involving unrated public bond offerings that offer higher yields than rated bonds in return for what might be manageable risks.

Though rates have increased since last August (with the ten-year Treasury going from 53 basis points to 165 or so), "tax-exempt rates aren't up nearly as much," Norris says. Though municipal bond outflows spiked at the beginning of the pandemic, that was corrected within a few months and there is now once again strong demand for them, keeping tax-exempt rates down relative to taxable rates.

"Bond fund demand being strong has made the public offering market even stronger, vis-a-vis private placements, than they have ever been," he notes. And investors have shown themselves willing to take on a little more risk to receive a higher return in what is still a very low interest rate environment. Norris believes that continues to underpin the substantial demand for the public offering market.

Big Rise in California JPA Deals

As an example, California recently has seen robust growth in JPA deals targeting workforce housing. These are high-yield, unrated limited public offerings often in the $100 million or more range. Yields may be roughly 150 basis points higher than highly rated multifamily housing bonds.

Special authorities under state law (examples of JPAs are the California Statewide Communities Development Authority and the California Municipal Finance Authority) have teamed up with cities and towns in financings that are taken off local real estate rolls, saving tenants rental costs of as much as $100 to $200 a month in the highly expensive housing markets of the Golden State.

California JPA workforce housing financings, which have been around since the spring of 2019, typically are for stabilized apartment properties, fairly new and in very good shape, not new construction or substantial rehab, Norris says. "We're putting them into public ownership to create real estate tax relief so we can make the units affordable to first responders, teachers and others at 80 or 100 or 120 percent of area median (income)."

In return for giving up real estate taxes for 15 years, Norris says, the city or county in the JPA is able to make the units affordable at 30 or 35 percent of the renters' income levels, which they'd never be able to do on market-rate apartments. The municipalities may not want to own or operate the units themselves, he says, nor to issue the bonds. So, the JPAs issue the bonds and act as owners of the properties.

At the end of the 15 years, the city or county can require the JPA to sell the project or transfer it back to the local municipality, which might refinance the bonds if they choose to. So, the city or county has enabled workforce housing for a 15-year period and created a "significant likelihood" of value that exceeds the amount of debt that has to be repaid.

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"The combination of a dearth of non-rated tax-exempt paper in California, coupled with one of the highest combined federal and state income tax burdens, has created significant institutional demand for this product," says Ian Parker, managing director of RBC. The firm is estimating there has been $2.7 billion in California JPA workforce housing financings this year, and Parker says the California model could be exportable to other states.

"These things become possible in a strong environment like we have. That's a big part of what is supporting this," says Norris.

State Income Tax Shelters As Well

And public offerings are attractive to upper income investors because they can be used as tax shelters for federal taxes and sometimes state taxes as well, Norris says, especially in high tax states, like New York and California.

"The incredible appetite of high-net worth investors for municipal paper through tax exempt bond funds is going to drive that growth in public offerings or limited public offerings to even higher levels," Norris believes.

"There's no question that higher-income individuals are going to be paying more taxes under the current Biden proposals. If you're making more than $400,000 a year, chances are you are going to pay substantially higher federal income taxes, both on income, and if you're making more than $1 million, a much higher rate on capital gains, retroactive to last April by the way. They will go from an effective 24 percent up to 44 percent. People that are affected by that will be looking for places to shelter income. Tax exempt bonds are one big area that enables them to do that."

And even though these higher-income people constitute a very small percent of the population, "they do control massive amounts of assets," Norris points out.

And Feinberg notes, "The very low tax-exempt bond rate achieved in a public offering when paired with 35-year amortization, and in certain markets, 40-year amortization, has enabled borrowers to increase the amount of bond proceeds to pay project costs while providing a relatively quick closing process."

Norris will chair a panel on tax exempt multifamily bonds, both on the private placement and public offering niches, at the virtual Summer Institute of the National Housing & Rehabilitation Association on July 15. Examples of recent deals both on the public and private sides will be showcased. TCA

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This means the housing does not necessarily serve the lowest end of the market. In fact, the need for housing targeting the 60 to 80 percent area media income (AMI) level "has grown immensely," says Smith. Unlike some other states, Texas does not have a separate financing category known as "workforce housing;" only supportive housing (targeted at the homeless) and elderly housing have their own classification. Smith says that of the ten most populated states, Texas—which is second in the country for population growth—is the only state without any dedicated funds to assist in developing affordable housing.

Texas, given its job growth, inbound population figures and looser land-use regulation is an attractive market for LIHTC investors. The Texas Triangle, in particular, has evolved into one of the heartbeats of America; a place where low- and middle-income people migrate to live their version of the American dream.

But investors and developers should be aware that Texas is competitive, with some constraints that limit where LIHTC projects can be built. Still, investors can expect a steady revenue stream from tenants moving in to take advantage of the state's opportunities. TCA

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