Private Placements Continue to Work for Affordable Multifamily

Private Placements Keep Dominating Bond Executions

By Mark Fogarty

Private placements, with their higher loan proceeds, additional flexibility and with less complexity than many other affordable housing executions, now make up more than 70 percent of the tax-exempt bond market and volumes are set to grow again this year.

According to an estimate by R. Wade Norris, partner at the Washington, DC-based law firm Norris George & Ostrow PLLC, private placements hit $15 billion out of a total $21 billion in affordable multifamily tax-exempt debt in 2020. He thinks that number will be up in 2021, although he also thinks the public offering market may notch even higher gains. Norris notes that volume data, especially on placements, is very limited. *Affordable Housing Finance* has published estimates suggesting that this volume may be substantially higher.

The Winfield Apartments in Colorado Springs, CO were financed by a private placement of $32.5 million in tax-exempt bonds.

Norris estimated that private placements from banks and other balance sheet sponsors (with Citi as the clear commercial bank leader with $7 billion of volume in 2020 according to *Affordable Housing Finance*) did an annual volume of at least $14 billion last year, with Freddie Mac's TEL structure (the acronym is for Tax Exempt Loan) doing $650 million and another $350 million or more coming in from other private sources.

Against that, the public offering market tallied an estimated $5 billion in business, with Fannie Mae Mortgage-backed securities as Tax-Exempt Bond collateral (M.TEBs) reaching $450 million, short-term cash-backed and other short-term debt and long-term debt from state and local housing agencies totaling $ 4.5 billion.

Doing away with getting a rating and their associated fees makes for lower costs and quicker underwriting, Norris says of private placements. And, there is flexibility that comes from having fewer players and moving parts in the transactions.

Jim Gillespie, executive vice president of New York City-based Bellwether Enterprise Real Estate Capital, agrees with Norris on the positives of private placements—simplicity and efficiency—although his firm refers to them as direct bond purchases.

"We're buying unenhanced, unrated bonds and placing them with an investor. It's a simpler execution," he says.

There are a variety of products that can be used in the T-E space, he says. "You can go with Freddie Mac or Fannie Mae," he says. "The Tax Exempt Loan (TEL) execution is Freddie's version of a private placement. It's a more streamlined execution relative to Fannie M.TEBs, where you're collateralizing the bonds to do a mortgage-backed security. The M.TEB is a little more complicated and requires an investment banker to publicly offer the bonds."

Bellwether uses a variety of executions, including private placements. When an opportunity comes up, Bellwether compares the different executions, obtainable from the Freddie TEL, the Fannie M.TEBs or a private placement and looks at the costs associated with each execution to come up with the net proceeds.

M.TEBs tend to have the lowest rate, TELs the highest, and private placements come in in the middle, Gillespie says. "You get a little higher proceeds with the Fannie Mae execution but there's more cost, so net proceeds come out about the same as private placements."

The Bespoke Suit

Gillespie uses a metaphor from the clothing industry, the bespoke suit, to describe how Bellwether tailors an execution. Like high-end clothiers, they fit out their customers with the best suit. Sometimes that's a private placement, and sometimes it's something else.

Bellwether thinks it has an opportunity to increase its volume in the next few years, Gillespie says, after doing its first private placement in 2019. It now has done $315.2 million worth of the product. He estimated Bellwether will do $225 to $250 million in private deals this year, and he hopes to double that in the next two to three years.

Total production of all affordable housing executions at Bellwether was $1.1 billion in 2020. "We see private placements as a nice complement to the agency products," says Gillespie.

The company's average deal size is about $20 million, he says, although it has done deals for as little as $8 million and hopes to advance into the $100 million range.

Bellwether buys the bonds directly from the issuer, which can be a state or municipality. It underwrites and originates the product and will also do the servicing. They then place the note with the investor at a fixed rate. "It's simpler," Gillespie says. "You don't need a third-party construction lender."

According to Gillespie, private placements are a good fit for acquisition/rehabs, as well as new construction. Other attractive qualities are a 40-year amortization period and the possibility of doing interest only (IOs).

While private placements are one arrow in the quiver for Bellwether, at Red Stone Tax Exempt Funding in New York City they are the sole debt execution.

President Cody Langeness says Red Stone has specialized only in private placements since 2007-2008, finding this execution easy, efficient and flexible.

"We've always used private capital to provide the loans for preservation and new construction of affordable housing. Prior to the crisis, we would use letters of credit from banks to finance the bonds," he says.

"However, after 2008-09 the regulatory requirements on letters of credit became very prohibitive. So, we started executing these private placements, which we found is a very efficient way of getting private capital in to provide

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these loans. It's got an ease of execution and the structure is very simple, which is beneficial to the borrowers and our investors," he says.

"Every deal is different. Every deal has its own nuance. Using private capital provides flexibility."

Volumes Are Doubling

Red Stone used to target $250 million a year in private placements as a benchmark. But it has seen volumes of $500 million in the last two years and hopes to execute $1 billion this year.

"Our numbers are up two-, three-, four-fold from where they were four-five years ago," he says. "I think $1 billion, $1.5 billion is where we will tap out unless there are more legislative changes. They are working on other enhancements to the program, and then it could be $2 to $3 billion."

One of the factors that allows for such expansion, he says, is many states are hitting their capital limits on tax-exempt bonds, which makes for higher volumes. In previous years, they had not been hitting those limits, leaving excess capacity in the space. Langeness believes states using their full capacities include Texas, California, Georgia, Florida, New York and Colorado.

The new "fix" setting a floor of four percent on four percent Low Income Housing Tax Credits "has been great," he says, though even in the years prior to the fix, volume has been good because rates have held steady at historically low levels, and a lot of capital has been coming from different investors.

"This is high quality housing that performs well and provides a great need," he says of affordable multifamily. "It's got a great track record. A lot of good things are going on in the industry."

There are a lot of good products in the market currently, he says. "Fannie and Freddie come out with new products all the time. FHA has the lowest interest rate possible. Each product has their benefit for certain deals. Some deals, a Fannie or Freddie product may be the best option. Some deals may need the lowest interest rate, and that's an FHA. But, I think private placements have a home for a lot of deals that have a time constraint or are complex and need a flexible partner."

The Evolution of Private Placements

In the 1970s through the mid-1990s, tax-exempt bonds issued for affordable multifamily rental projects were almost always credit enhanced by FHA/GNMA, Fannie Mae, Freddie Mac, a bank letter of credit or similar credit enhancements; were rated A to AAA by S&P or Moody's and were sold in underwritten public offerings.

The Notable (730 Simms) project in Lakewood, CO is an example of a 218-unit affordable housing development partially financed with a private placement of tax-exempt bonds.

Starting in the late 1990s, banks and other financial institutions bought non-credit enhanced, unrated tax-exempt bonds backed by real estate collateral and either held them on their balance sheets or warehoused and ultimately securitized them.

In the early 2000s, banks became even bigger players in this space, largely due to their Community Reinvestment Act obligations.

In 2008, regulatory supervisors for many banks changed, and the new regulators, based on the terminology that "bonds" issued under "indentures" with "trustees" are securities, began to require that tax-exempt bond purchases had to go into the investment bucket.

Banks and other sponsors, led by Citibank, created an alternative tax-exempt loan structure to effectively provide the debt side funding for these transactions on fundamentally the same terms and conditions, but using loan terminology throughout versus bond/securities terminology. TCA

Source: Norris George & Ostrow

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