Tax Exempt Bond Financing For Affordable Housing Projects

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The Basics

Bond: What Is It?

Bond: A debt investment in which an investor loans money to an entity (corporate or governmental) that borrows the funds for a defined period of time at a fixed or variable interest rate. Bonds are used by companies, municipalities, states and U.S. and foreign governments to finance a variety of projects and activities**.**

Bond: Government and Conduit Bonds

Government Bonds: Bonds that is issued by a government to provide funding for governmental projects. For example, water and sewer bonds.

Conduit Bonds: A bond issued by a government issuer in order to loan the bond proceeds to a third party authorized by law to use the municipal bond proceeds for an eligible use (e.g. affordable multifamily housing). There are two kinds of conduit bonds – Private Activity Bonds (For-Profits) and Qualified 501(c)(3) Bonds (Non-Profits)

Typical Participants of a Bond Deal

- Owner
- Issuer
- Underwriter
- Trustee
- Credit Enhancer
- Rating Agency
- Tax Credit Syndicator
- Bond Counsel
- Underwriter’s Council
- Owner’s Council

Typical Participants of a Bond Deal (cont.)

Owner

- Develops, builds, owns and often manages the project
- In some cases, may be a Section 501(c)(3) corporation

Issuer

- In the state of Georgia, housing authorities and development authorities are the primary issuers. There are certain national issuers that are also available.

Typical Participants of a Bond Deal (cont.)

Underwriter

- A municipal securities dealer who assists the owner in choosing optimal financing structure (including credit enhancement, if any), coordinates financing participants, obtains rating, if any and sells the bonds

Trustee

- Administers the trust indenture and makes payments to bondholders
- Also serves as dissemination agent under the Continuing Disclosure Agreement on most fixed rate financings

Typical Participants of a Bond Deal (cont.)

Credit Enhancer:

- A government sponsored enterprise, federal agency, bank, or insurance company that enters into a formal and legally binding pledge of financial support to strengthen the credit of a lower-rated bond issue. The Credit Enhancer assures repayment of the bonds – this normally is what gives most bond issues their AA or AAA rating.

Typical Participants of a Bond Deal (cont.)

Rating Agency:

- Most credit enhanced bonds are rated “AAA” or “AA” (Standard & Poor’s) or “Aaa” or “Aa” (Moody’s) – the top two categories which produce lowest interest rates for an issue of a given maturity

Tax Credit Syndicator

- Sell credits to investors to generate equity for the project

Typical Participants of a Bond Deal (cont.)

Bond Counsel

- Provides a legal opinion to the bondholders as to the validity of bonds under state law and the tax-exempt status of bonds under federal and state law.
- Drafts the main financing documents such as Indenture, Financing Agreement, Regulatory Agreement, and closing papers.

Typical Participants of a Bond Deal (cont.)

Underwriter's Counsel

- A lawyer or firm acting on of behalf of the Underwriter in conducting a due diligence analysis of the Issuer (or conduit borrower) while also drafting the Official Statement, Bond Purchase Agreement, Continuing Disclosure Agreement and if applicable, the Remarketing Agreement.

Typical Bond Documents

Trust Indenture (between Issuer and Trustee)

- The Trust Indenture establishes the “trust estate” which serves as the security for a bond transaction. The “trust estate” may consist of payments made by the borrower under the loan agreement, revenues pledged to the payment of the bonds or any other collateral pledged to the payment of the bonds.
- The Trust Indenture also provides the terms of the bonds, including payment dates, maturities, interest rates, redemption provisions, registration, transfer and exchange. and other basic financial terms.

Typical Bond Documents (cont.)

Tax Regulatory Agreement (between Issuer, Trustee and Owner)

- Prepared by Bond Counsel
- Details certain provisions of the Internal Revenue Code and regulations applicable to tax-exempt multifamily housing revenue bonds
- May include certain certificates required by the Internal Revenue Code

Typical Bond Documents (cont.)

Official Statement (between Underwriter and potential buyers of the bonds)

- Normally prepared by Underwriter’s Counsel and signed by the Issuer and/or the Owner
- Provides disclosure to investors and potential investors regarding the terms of the bonds, security, risk factors and financial and operating information concerning the Owner (similar to a stock prospectus)
- The Official Statement is used by the Underwriter to sell the bonds

Typical Bond Documents (cont.)

Bond Purchase Agreement (between Issuer, Underwriter and Owner)

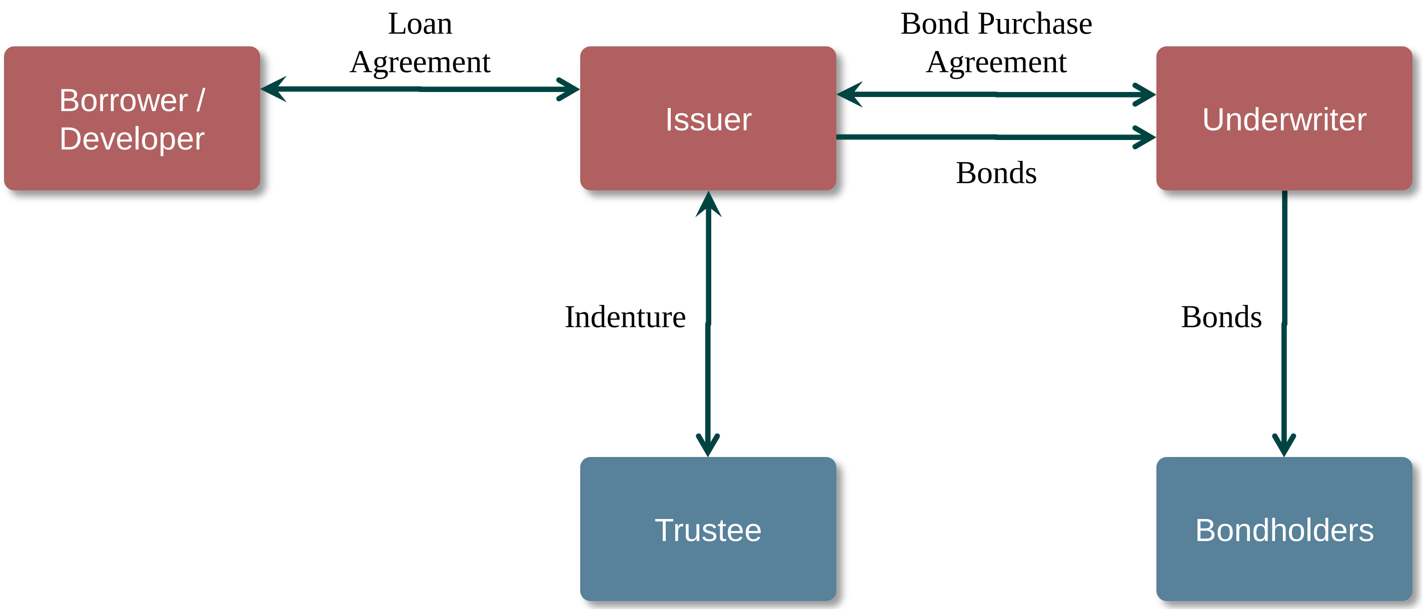
- Prepared by Underwriter's Counsel
- Provides that, upon the satisfaction of certain requirements, the Issuer will agree to issue the bonds following the pricing of the bonds and the execution of the Bond Purchase Agreement

Continuing Disclosure Agreement (between Owner and Dissemination Agent)

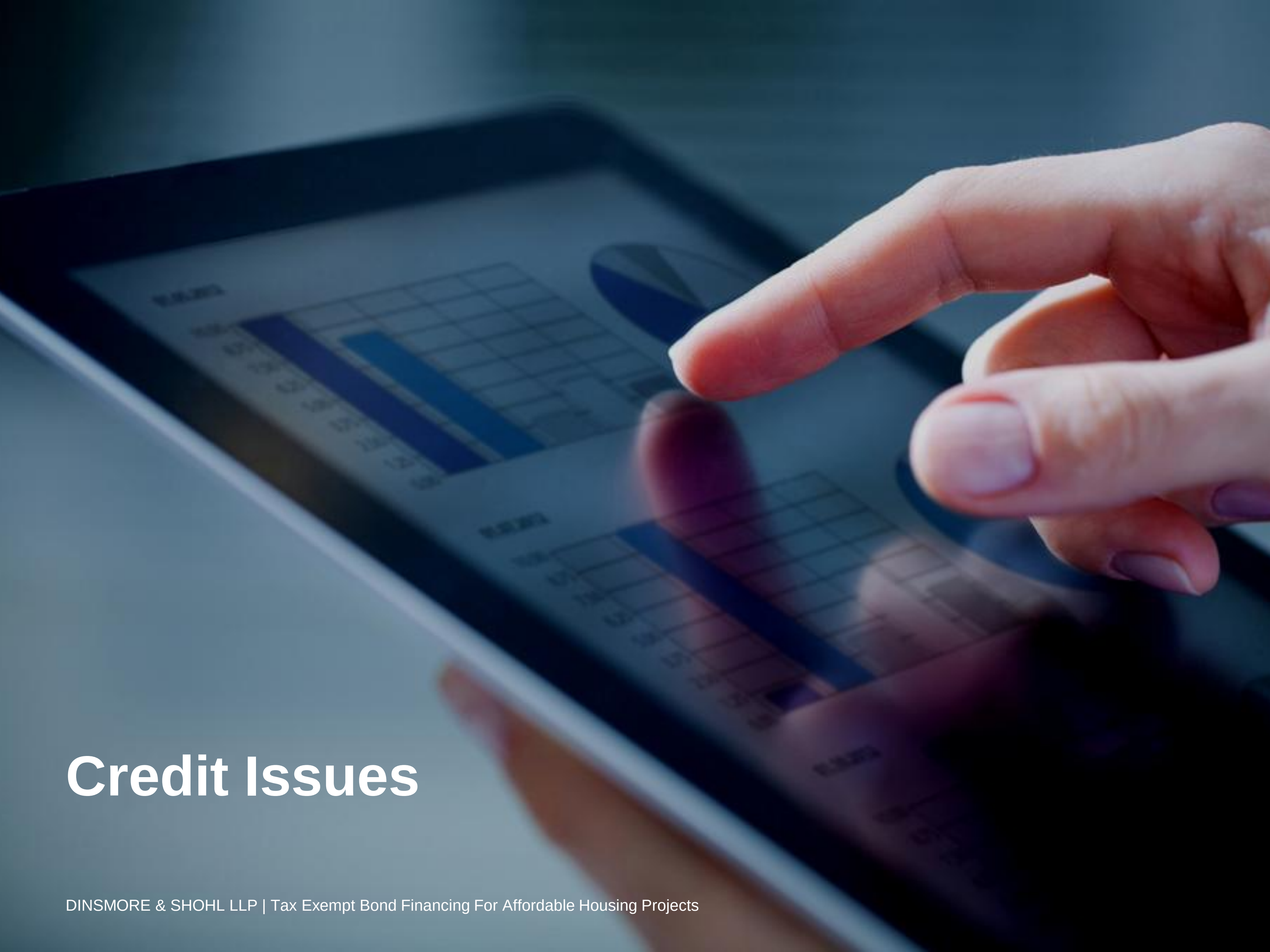
Typical Bond Documents (cont.)

Other Common Documents

- Mortgage or Deed to Secure Debt
- Credit Enhancement Facility
- Reimbursement Agreement
- Intercreditor Agreement
- Continuing Disclosure Agreement
- Remarketing Agreement
- Various closing certificates



The Documents



Credit Issues

Credit Issues

- Generally, without appropriate security investors will not buy bonds
- Underwriters do not have a legal obligation with respect to the creditworthiness of the bonds – they can buy and sell bonds regardless of the credit
- Most conduit multifamily housing bonds are “publicly offered” and rated by the national rating agencies, or sold on a “private placement” basis with sophisticated investors (principally mutual funds or insurance companies) which do their own analysis.

Credit Issues: Private Placements

Private Placement: A private placement is essentially a real-estate loan by the bondholder. The Owner borrows money from a bank or other lender, just as if no bonds were issued, but the debt takes the form of a bond transaction in which the lender holds the bonds.

Private Placement Lenders

- Commercial Banks
- Non-bank Financial Institutions

Credit Issues: Private Placements

Benefits

- Private placements transactions can be put together and closed more quickly than public sales
- Some deals are too small to justify the cost of a public offering
- Private Placement Lenders may be willing to invest in deals that the public market would not.

Credit Issues: Publicly Offered Transactions

Publicly Offered Bonds - Forms of Credit Enhancement

- FHA/RD Mortgage Insurance & GNMA wrap
- Direct-pay letter of credit
- Standby letter of credit
- Developer Guarantees
- Bond Insurance
- Fannie Mae/Freddie Mac credit agreement

Publicly Offered Transaction: FHA/GNMA

- **FHA – Federal Housing Administration (HUD), through approved lenders, provides insured mortgages to finance new construction or acquisition and rehabilitation. These programs insure the lenders against mortgage default.**

- **GNMA – Government National Mortgage Association is a wholly owned corporate instrumentality of the United States.**

    - GNMA is authorized by law to guarantee the timely payment of the principal and interest on securities which are backed by pools of FHA mortgages.

    - GNMA's guarantee is backed by the full faith and credit of the United States.

Additional Fees

- GNMA 13 basis points | FHA 45 basis points | Fees are included in the loan rate

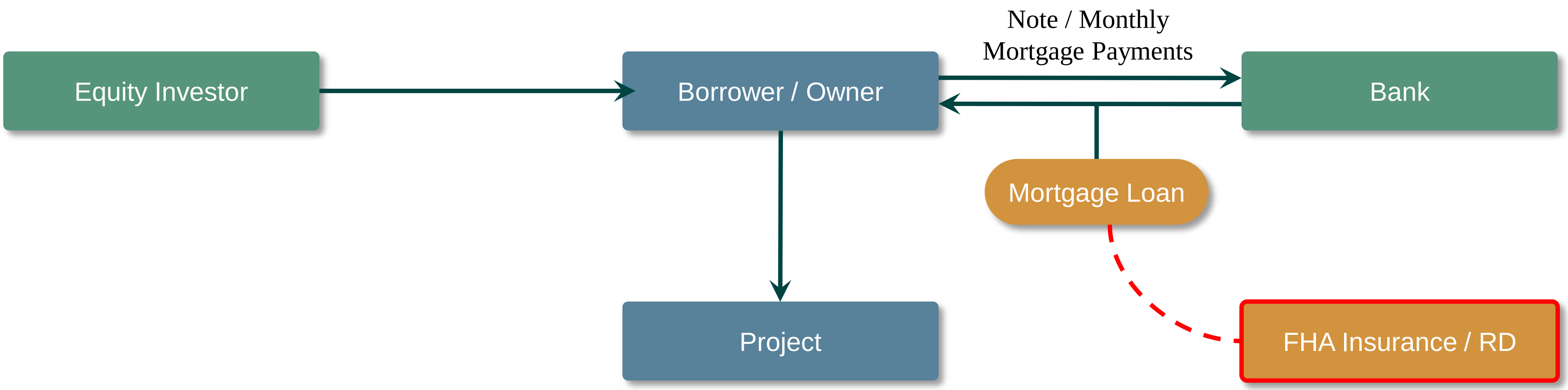
Publicly Offered Transaction: USDA/GNMA

- USDA Section 538 Guaranteed Rental Housing Program ("Section 538 Program")

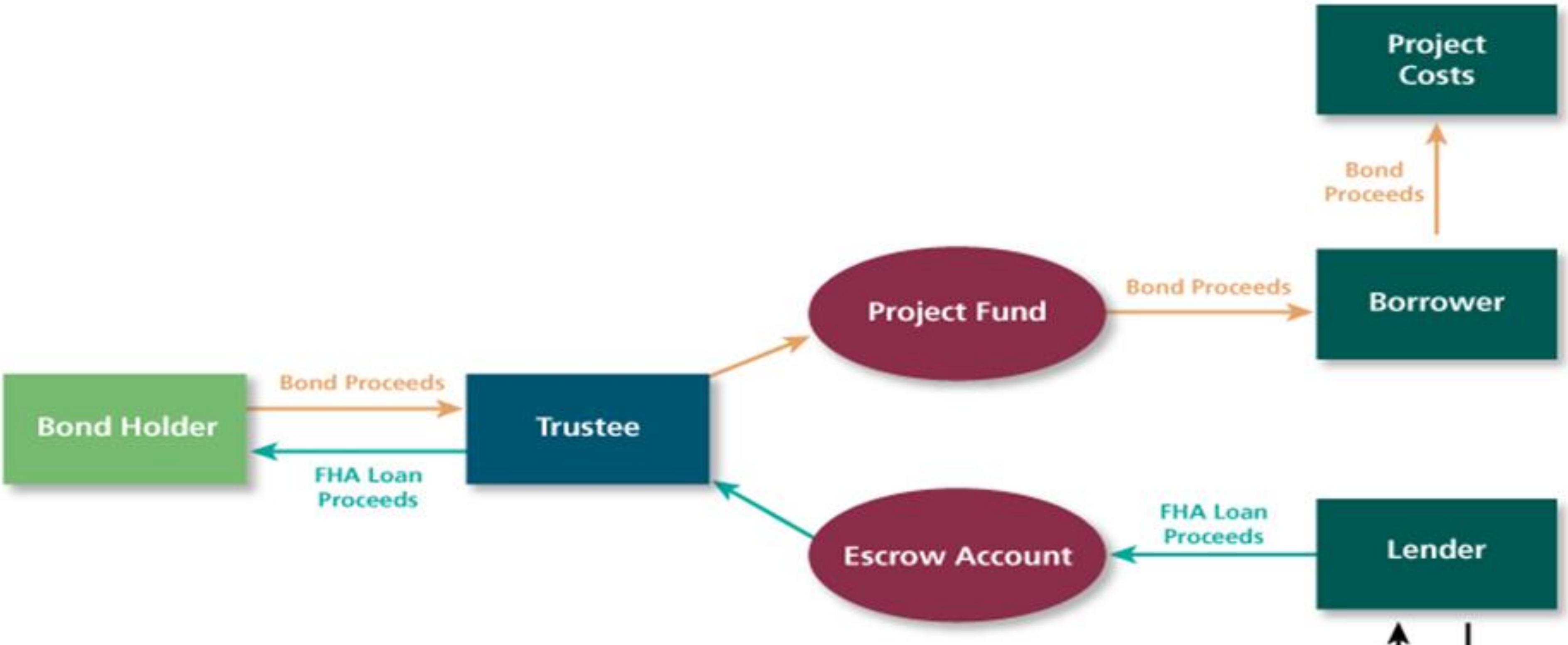
- Bond proceeds are used to fund a mortgage loan that is partially guaranteed by USDA from a USDA approved lender.

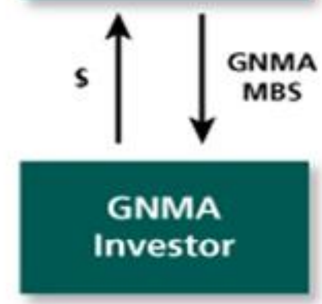
Publicly Offered Transaction: Letter of Credit

- Letters of Credit as Credit Enhancement
  - Direct Pay Letter of Credit
  - Standby Letter of Credit
- Federal Home Confirming Letters of Credit

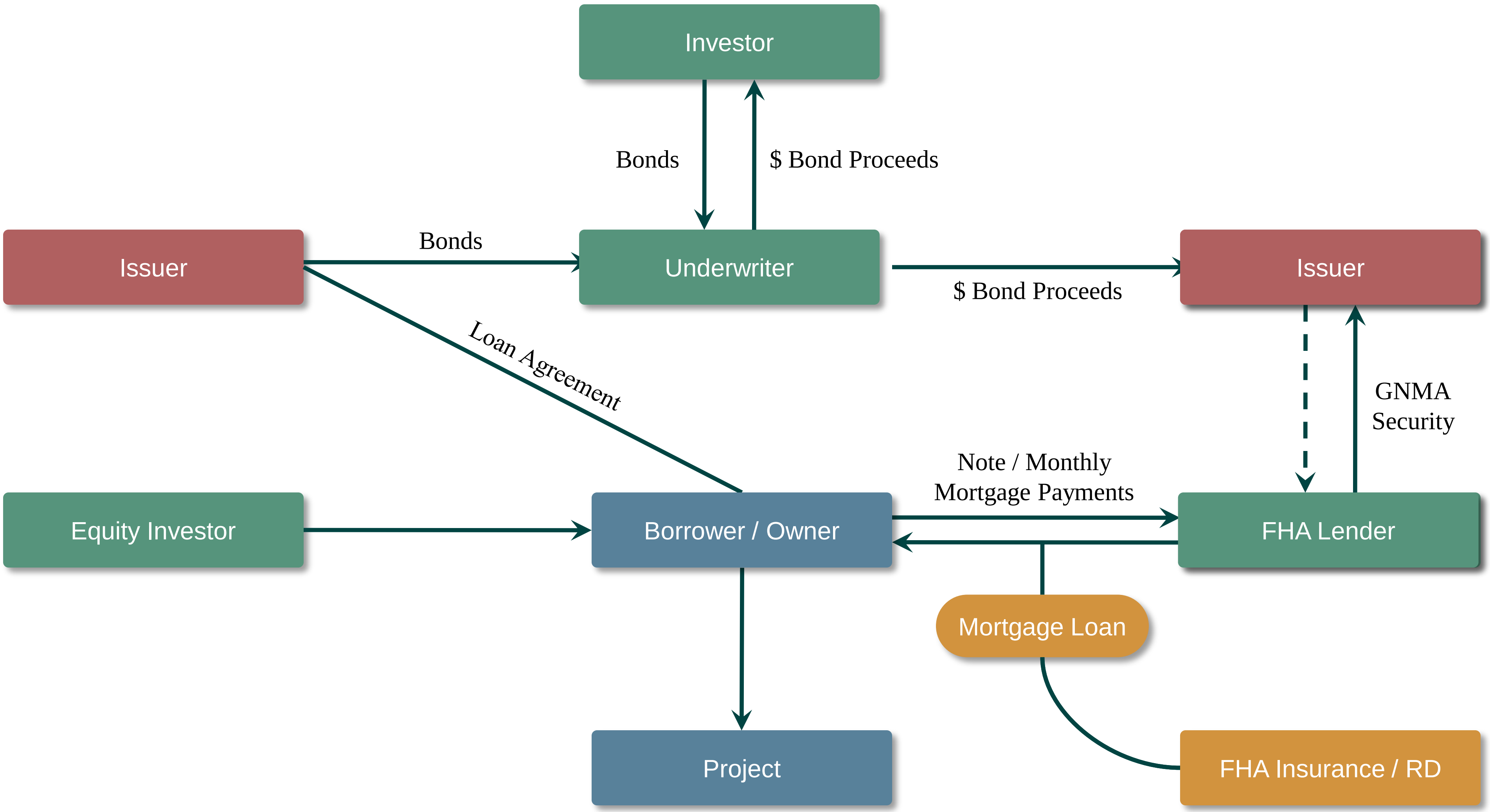


Credit Issues –
General LIHTC Transaction





Taxable FHA/GNMA Financing Combined with Tax Exempt “50% Test” Bonds



Credit Issues – Publicly Offered (FHA / GNMA)

Tax-Exempt Multifamily Housing Bonds & LIHTCs

Tax-Exempt Multifamily Housing Bonds & LIHTCs

- State Tax Credit Ceiling – if 50% or more of the aggregate basis of any building and the land on which the building is located is financed with proceeds from the sale of tax-exempt "private-activity" bonds, the regular state tax credit ceiling will not apply and ALL of the qualified project costs will be entitled to the 4% credit.
- LIHTC Calculations (Call an accountant)

Tax-Exempt Multifamily Housing Bonds & LIHTCs (cont.)

- Qualified Costs include those costs associated with the acquisition of the Improvements (excludes cost allocated to land) and the cost of rehabilitation
  - Third Party Reports (Market Study, Phase I, Appraisal, Title Insurance and Surveys) are generally qualified costs
  - Generally, a 4% LIHTC allocation will raise about 50% of the equity that a 9% LIHTC allocation would raise

Requirements Applicable to Tax-Exempt Multifamily Housing Bonds

Requirements Applicable to Tax-Exempt Multifamily Housing Bonds

General Project Rules

- Must provide residential rental housing
  - No transient housing, hotels, motels, dormitories, frat houses, etc.
  - Separate and complete facilities for living, sleeping, eating, cooking, and sanitation
- Low income occupancy requirements (i.e. 20/50 or 40/60)

Requirements Applicable to Tax-Exempt Multifamily Housing Bonds

General Project Rules (cont.)

- Low income tenants are deemed to continue to be low-income until their income exceeds 140% of the AMI

  - Annual income certifications

  - Next available unit rule

- Qualified Project Period – Generally 15 Years

- Students – Single Parents and married taxpayers (are not “students” and

Requirements Applicable to Tax-Exempt Multifamily Housing Bonds

General Bond Financing Rules

- 95% of the bond proceeds must be used for qualified costs (land or depreciable property)
- Not more than 25% of the bond proceeds may be allocated to the cost of land
- 15% rehab requirement on acquisition financings
- 2% Costs of Issuance Limitation (e.g. legal fees, title insurance and underwriter's fees)

Requirements Applicable to Tax-Exempt Multifamily Housing Bonds

General Bond Financing Rules (cont.)

- The average maturity of the tax-exempt bonds cannot exceed 120% of the average reasonably expected economic life of the facilities being financed
- **Reimbursements** – Bond proceeds may be used to “reimburse” the Owner for expenses that were paid by the Owner prior to the bonds being issued. The Issuer must adopt an inducement resolution and only those qualified expenditure paid no up to 60 prior to the date of the resolution may be reimbursed
- **Arbitrage** – You can’t borrow too much, too soon, for too long, or for a a bad purpose

Requirements Applicable to Tax-Exempt Multifamily Housing Bonds

Disclosure Requirements

- Initial Disclosure
  - SEC Rule 15c2-12, requires (unless an exception applies) that the underwriters must provide a disclosure document to potential investors an ultimate purchasers containing any information which is material to a reasonable investor's evaluation of the bonds
    - Exceptions - less than $1,000,000, or Bond denominations of $100K (or more) which are sold to 35 (or less) sophisticated investors

Requirements Applicable to Tax-Exempt Multifamily Housing Bonds

Continuing Disclosure

- In addition to the initial disclosure, absent an exception, the SEC requires that certain updated information be provided on an annual basis
    - Pertinent annual financial information and operating data
        - Material Events

Requirements Applicable to Tax-Exempt Multifamily Housing Bonds

Required Approvals

Volume Allocation – Kentucky State Volume Cap Allocation Committee (KHC)

Kentucky Housing Corporation's Board of Directors (KHC Staff & PSW)

- Inducement Resolution
- Approving Resolution

Kentucky State Legislature – Capital Projects and Bond Oversight Committee (KHC, Owner & PSW)

State Property and Building Commission (KHC & PSW)

Public approval or "TEFRA" requirement (KHC & PSW)

Secretary of the Finance and Administration Cabinet (KHC & PSW)

Attorney General (KHC & PSW)

Governor (KHC & PSW)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