Virginia
Housing Alliance
Expanding Housing Opportunity and Ending Homelessness

2017 Housing Credit Conference
September 26, 2017

Tax-Exempt Bonds and 4% Credits

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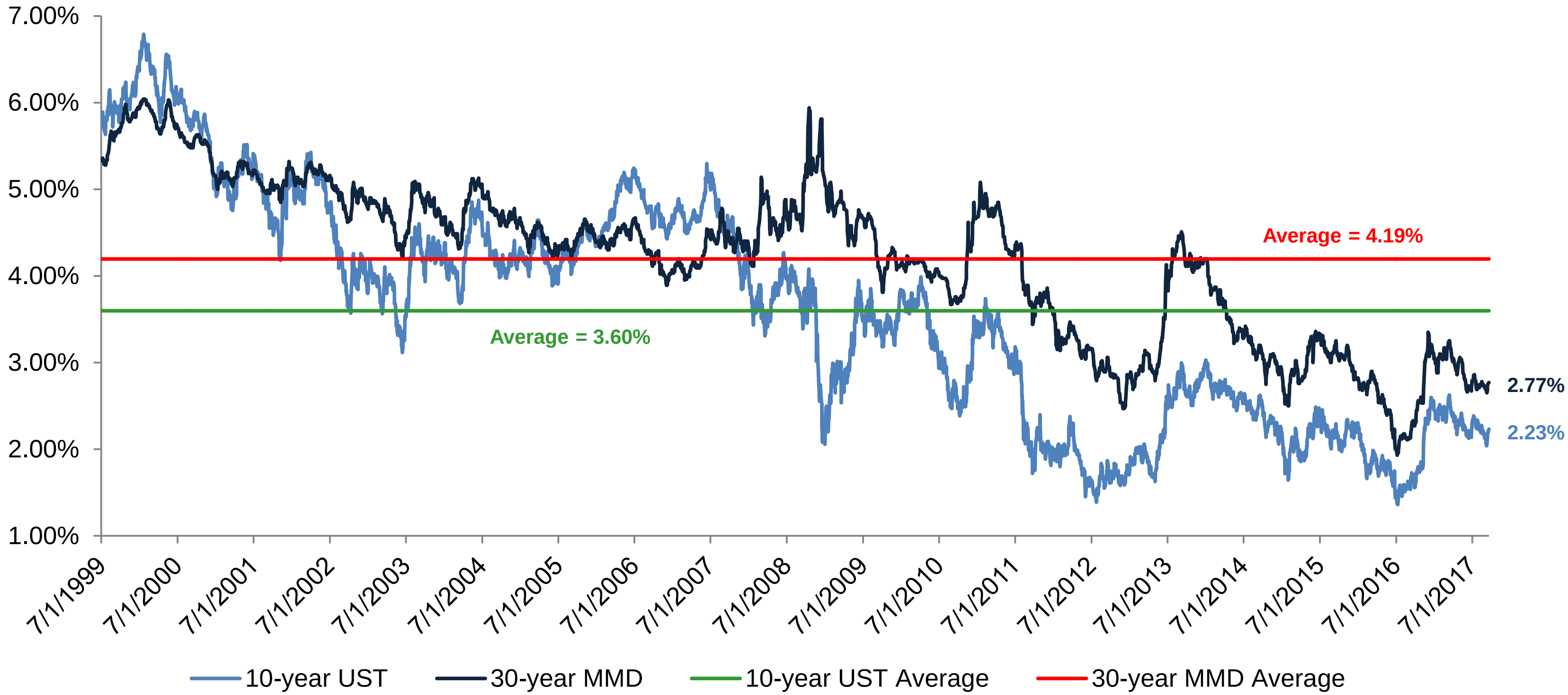
Both taxable and tax-exempt rates remain well below historical averages.

Historical Performance of 10-year UST and 30-year MMD



Source: Bloomberg. Thomson Reuters
Reflects market conditions as of September 26, 2017
Thomson Reuters Municipal Market Data (MMD) AAA curve is a proprietary yield curve that provides the offer-side of AAA rated state general obligation bonds

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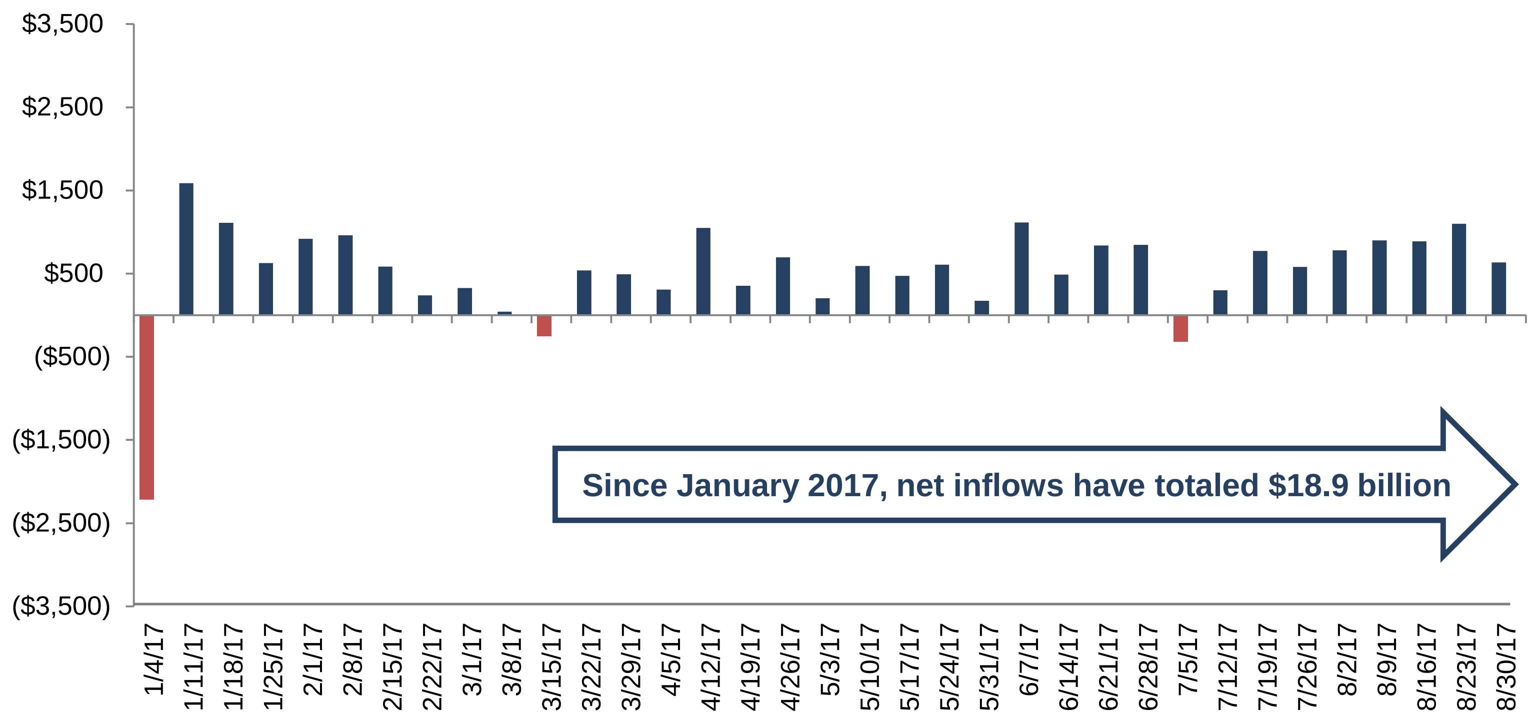
Despite the threat of higher interest rates, long-term municipal bond fund flows have been positive in 2017.

Long-Term Tax-Exempt Mutual Fund Flows



Source: ICI Group
Numbers in millions
Reflects market conditions as of September 26, 2017

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Overview

- When structuring a tax-exempt bond transaction, the Fannie Mae DUS lender has the following three executions:
  1. Bond Credit Enhancement
     - — Fannie Mae provides credit enhancement for tax-exempt bonds
  2. Fannie Mae MBS combined with tax-exempt bonds
     - — A Fannie Mae MBS is issued simultaneously with short-term cash collateralized tax-exempt bonds
     - — The short-term cash collateralized tax-exempt bonds are issued to achieve compliance with the 50% Rule[1]
  3. M.TEB
     - — A Fannie Mae MBS is issued as collateral for tax-exempt bonds
- Stifel recently developed its own version of M.TEB called M-TEMS (Multifamily Tax-Exempt Mortgage-backed Securities).
- The M-TEMS structure is very similar to the M.TEB structure with the following modifications:
  - — M-TEMS do not require a credit rating[2]
  - — M-TEMS are priced off a different index
  - — M-TEMS have an optional exchange feature[3]

Notes:

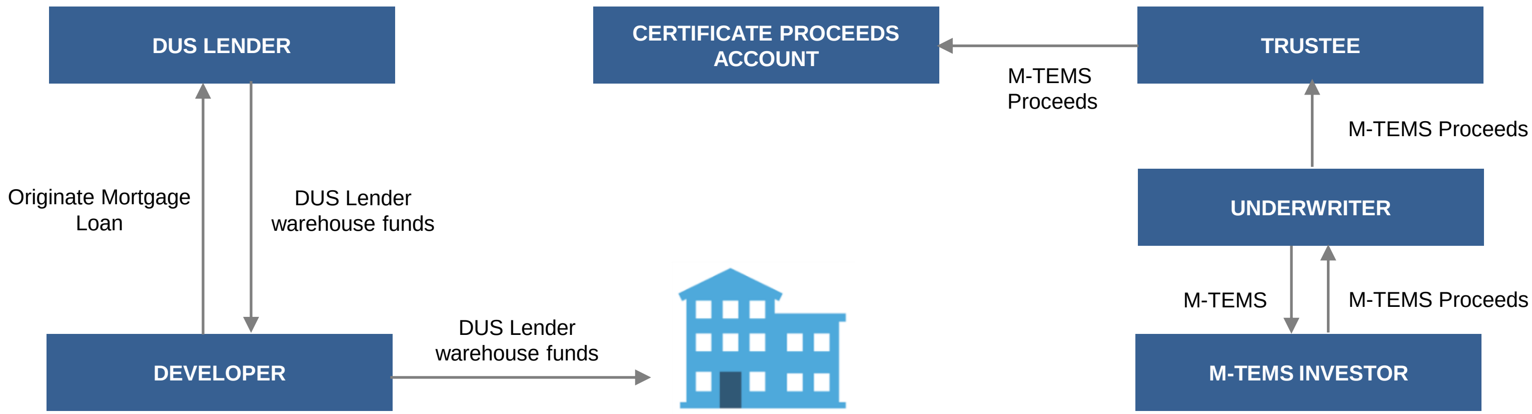
1 The developer must finance 50% of project costs with tax-exempt bonds and keep those bonds outstanding until the project's placed-in-service date in order to get full value for the 4% low income housing tax credit equity

2 M-TEMS investors do not require a credit rating. However, the issuer may require a credit rating

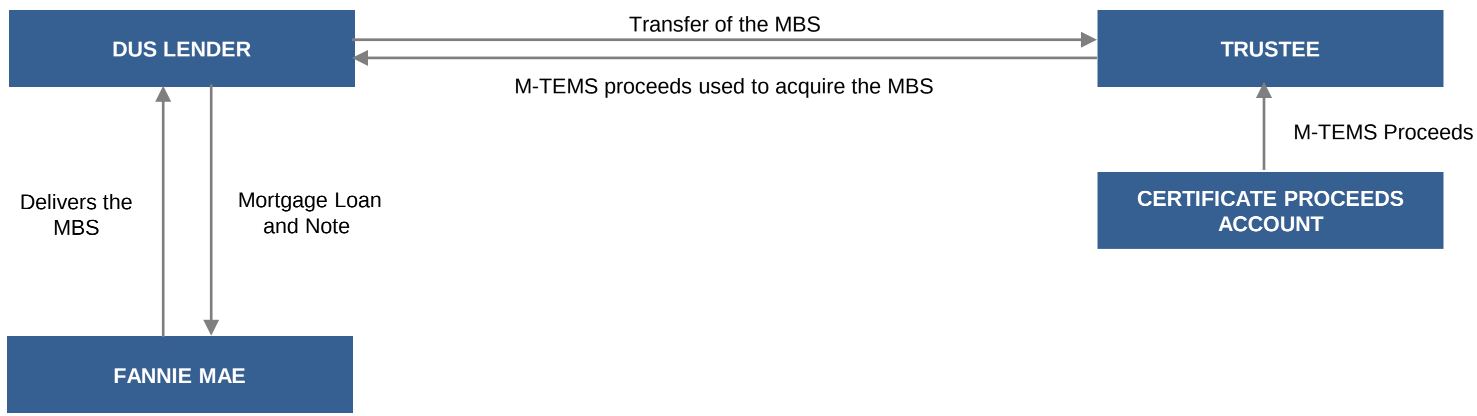
3 The M-TEMS has the risk weight of a municipal revenue bond (50%) before the project is placed in service (i.e., before the exchange feature becomes active) and has an adjusted risk-weight (26.9%) after the project is placed in service (i.e., after the exchange feature becomes active)

M-TEMS Structural Overview

STEP 1 – The Fannie Mae DUS Lender originates loan with Developer and Underwriter prices M-TEMS



STEP 2 – Fannie Mae securities the loan with MBS which is purchased by the trustee with M-TEMS proceeds

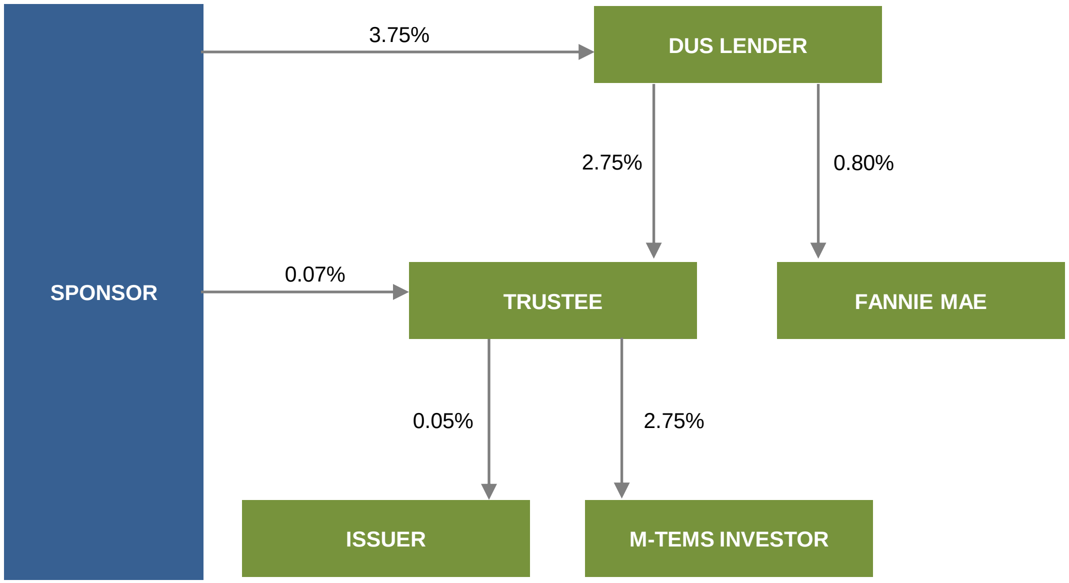


M-TEMS Payment Flow of Funds

Financing Assumptions[1]

Par Amount	$15,000,000
M-TEMS Rate	2.75%
Servicing Fee	0.20%
Guaranty Fee	0.80%
Issuer Fee	0.05%
Trustee Fee	0.02%

M-TEMS Payment Flow of Funds



Notes:
1 The figures presented above are for illustrative purposes only. The annual issuer fee and trustee fee are paid outside of the capital stack

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Case Study – Maple House Apartments

$26,528,000

County of Westchester Industrial Development Agency

Multifamily Tax-Exempt Mortgage-backed Securities (M-TEMS) (Maple House Apartments) Series 2017 (FN)

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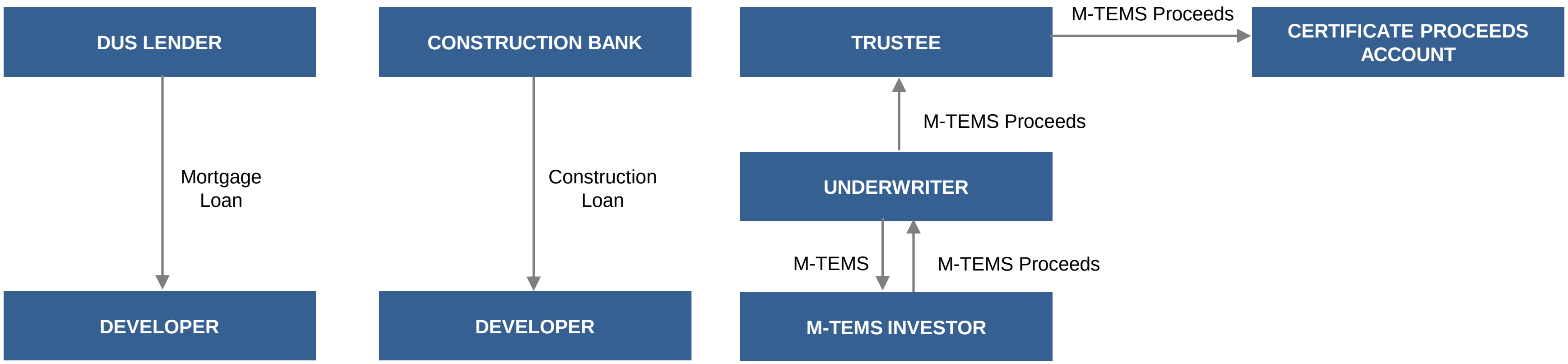
September 29, 2017

Transction Overview

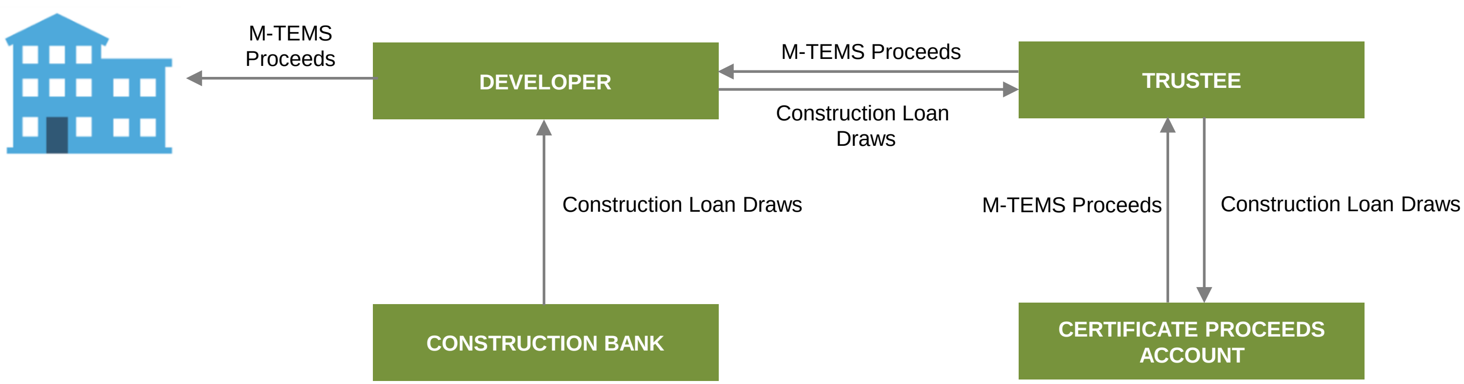
Issuer	County of Westchester Industrial Development Agency
State	New York
Project Name	Maple House Apartments
Number of Units	105
Subsidy	Project-based Section 8
Bond Counsel	Nixon Peabody LLP
Loan Purpose	Acquisition and Rehabilitation
Rating	Standard & Poor’s: “AA+”
Credit	Fannie Mae MBS
Par Amount	$26,528,000
Structure	17-year term / 35-year amortization
Underwriting	1.15x DSCR / 90% LTV
I/O Period	2 years
Bond Rate	2.85%
Pricing Spread	+83 swaps / +79 UST

M-TEMS can also be used to provide financing for new construction projects.

CONSTRUCTION PHASE



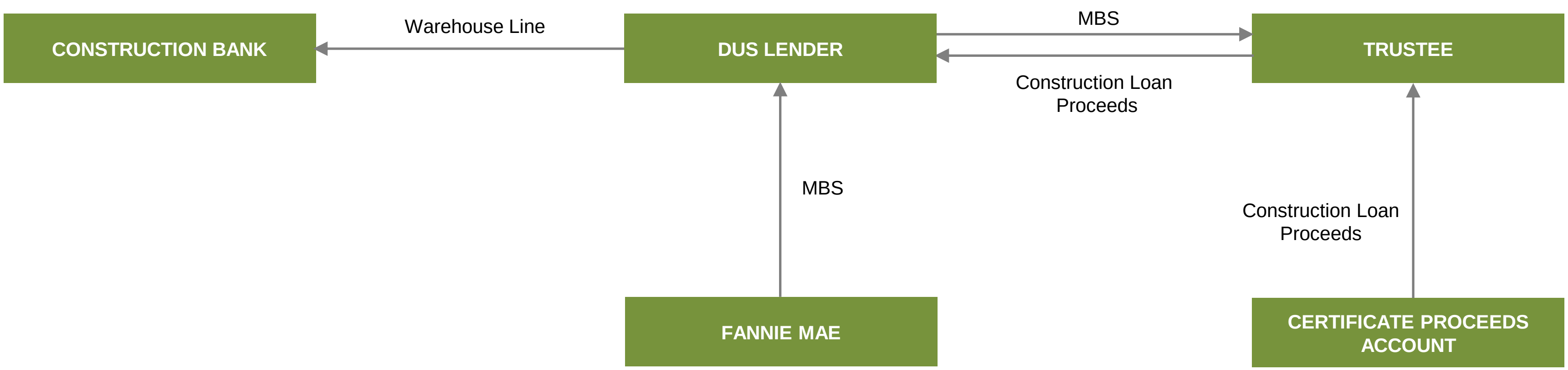
CONSTRUCTION PHASE – FLOW OF FUNDS



M-TEMS can also be used to provide financing for new construction projects (cont'd).

PERMANENT PHASE

The Project is placed in service, all approvals are received and Fannie Mae confirms final loan sizing



- The DUS Lender warehouse line is used to pay off the construction loan
- The construction loan proceeds in the Certificate Proceeds Account are used to acquire the MBS from the DUS Lender

Cutting Edge Financing Options for Affordable Housing:

FHA/GNMA

September 2017

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COMBINED TAXABLE GNMA SALE WITH SHORT TERM TAX EXEMPT BONDS AND 4% LIHTC – FAQ/ISSUES

Bond Amount to meet 50% test > Taxable FHA Loan Amount:

- Other (bankruptcy remote) sources of funds (i.e. bridge equity, subordinate loan proceeds, etc.) are needed to cover the differential. Timing of funding is critical. Seller Take-Back loan can often be used to collateralize bonds (see applicable slides)

Investment and other options to reduce cost:

- Although short term rates have gone up, taxable investment options have gone up also: Ex.1.25% bond rate **less** 1.25% investment rate = **<u>0.00% net interest cost per year on bonds.</u>**
- Seller Take-Back Bonds can sometimes be used to help reduce costs further (see applicable slides)
- Multiple loans/projects can be **<u>pooled</u>** into a single bond issuance to spread out fixed closing costs – all deals need to be in a position to close within the same timeframe.

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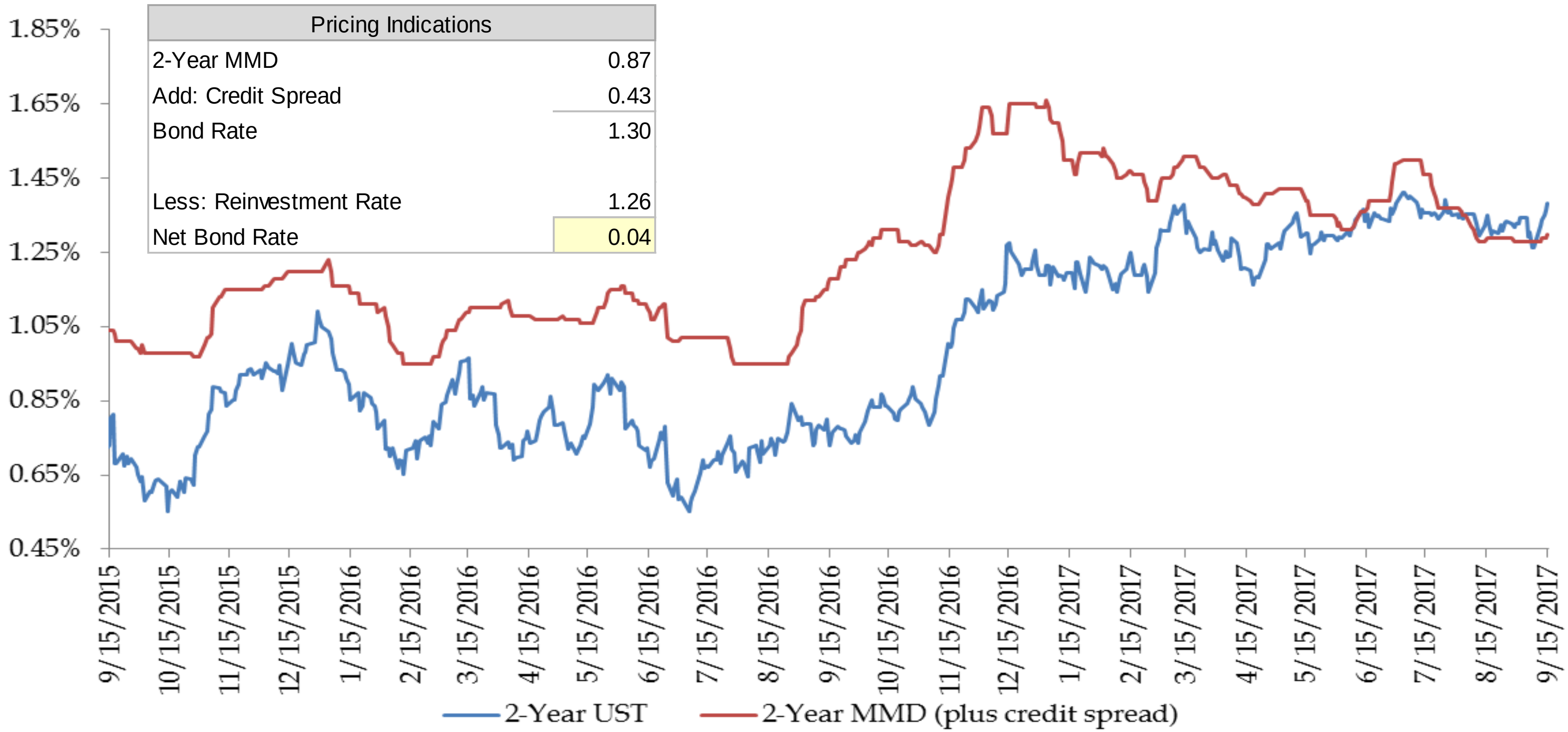
Despite the recent increase in short-term, tax-exempt rates, the negative arbitrage deposit can still be significantly reduced.

Historical Performance for 2-Year MMD (plus credit spread) and 2-Year UST



Pricing Indications	
2-Year MMD	0.87
Add: Credit Spread	0.43
Bond Rate	1.30
Less: Reinvestment Rate	1.26
Net Bond Rate	0.04

Source: Bloomberg. Thomson Reuters
Reflects market conditions as of September 26, 2017
Thomson Reuters Municipal Market Data (MMD) AAA curve is a proprietary yield curve that provides the offer-side of AAA rated state general obligation bonds

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COMBINED TAXABLE GNMA SALE WITH SHORT TERM TAX EXEMPT BONDS AND 4% LIHTC – FAQ/ISSUES

Publically Offered vs. Privately Placed:

- Potential tax implications if Bond Purchaser is “related” to the Borrower (see §1.148 program investment regulations)
- Costs of issuance are very close. Interest and investment options can vary.

Issuer considerations:

- Possible limitation on Issuer Fees due to short maturity and Loan Yield limitations
- Some states have very limited private activity volume cap – although this structure does use the minimum amount of bonds to meet the 50% test
- A few Issuers do not allow the structure due to limitations on fees.

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Tax-Exempt Seller “take back” Note & Bonds

- **Many 4% preservation deals and affordable transaction located in high cost areas require subordinate gap and/or “soft” funds to get the financing to work. This can often include seller financing in the form of a subordinate “take-back” note for deals with a “friendly” seller. This is very common in RAD transactions.**

- **These deals will have higher eligible basis for tax credits (generating more tax credit proceeds) but no significant impact the size of the permanent loan.**

- **Due to the LIHTC 50% test, tax-exempt bonds <u>in excess</u> of the permanent financing are often required in these deals.**

Tax-Exempt Seller "take back" Note & Bonds (con't)

- **Option 1: Instead of allocating the seller note to a reduction of the purchase price of the Project, Bond proceeds can often be "allocated" for the full purchase price of the Project and the seller can "allocate" the note as new funds to the deal – which can be used to collateralize that portion of bonds.**

- **Makes it much easier to meet the 50% test (equity or other soft funds are no longer needed for collateral.**

- **Often results in saving from additional investment opportunities and eliminating the need for bridging of other collateral funds.**

Tax-Exempt Seller "take back" Note & Bonds (con't)

- **<u>Option 2</u>: Instead of issuing additional short-term tax-exempt bonds that will be sold to 3rd party, it is often possible to convert some of the subordinate debt to tax-exempt through the project's "placed-in-service" and then convert it to taxable debt thereafter.**

- **By running the surplus cash note from the Borrower to the municipal bond issuer, creating a corresponding note from the Issuer to the Seller and allocating the corresponding amount of tax exempt bond volume cap to the acquisition of the project, the note would apply towards meeting the 50% test – even though no cash is actually moving.**

- **Results in significant interest saving from the reduction of debt service on the "take back" Bonds.**

- **Note that tax-exempt private activity volume cap and any upfront/ongoing issuer fees would still be applicable.**

FHA Refinancing to Resyndication (R2R) Program for Affordable Projects

GOAL: Lock in today's low financing rates for future tax credit deals.

Applicable for existing affordable housing projects still in 15-year tax credit compliance period (target: years 9-14) or otherwise not yet ready for tax credit syndication.

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NEW FHA Refinancing to Resyndication (R2R) Program for Affordable Projects

- **NEW LOAN**: Current owner (or new purchaser) can use a taxable fha loan (223f or 223(a)(7)) to refinance existing debt or purchase an affordable project.
- Goal is to keep rehab to a minimum (preserve as much as possible for future tax credit deal).
- Highlights of 223f loan:
  - Exempt from LIHTC 10-year rule (Section 42(d)(6))
  - 35+ year full amortization and term
  - 80-90% LTV / 1.11 DSCR
  - **~3.50%** all in mortgage rate including 25bps MIP for affordable deals
  - Possible exemption from Davis Bacon wages; Non-recourse

FHA Refinancing to Resyndication (R2R)

WHEN READY TO INTEGRATE TAX CREDITS (Upon Year 15 or otherwise): Owner would simultaneously take 3 steps…

Step 1: Sell project to new tax credit borrower at full appraised value - **<u>with ~3.50% fha debt in place</u>** (not prepaid) pursuant to HUD's **TPA** (transfer of physical asset) process.

- TPA can take 90-120 days
- Remaining term of fha loan would be 30+ years
- No prepayment fees or substantial transfer fees are applicable for TPA

FHA Refinancing to Resyndication (R2R)

Step 2: Close on a new supplemental **FHA 241(a)** loan equal to the lower of (a) 90% of rehabilitation and related construction costs or (b) 1.11 dscr for total fha debt.

241(a) loan highlights:

- Designed as a supplemental loan in second position behind a senior fha loan.
- Is a construction loan program (clc/plc) and not limited to 223(f) pilot rehab limits.
- Loan term/amortization can be up to 40 years although default is for it to match the remaining term on the senior fha loan.
- Possible exemption of Davis Bacon wage requirements (depends on senior fha loan in place).

FHA Refinancing to Resyndication (R2R)

Step 3. Use tax exempt bonds in an amount necessary to meet the 50% test to qualify for 4% tax credits (generating ~35% of additional sources of funds).

- Need to issue bonds in excess of 50% of aggregate basis to qualify for 4% low income housing tax credits
- 95% Bonds need to be spent on "good" costs of project – excluding existing assumed fha debt in senior position
- If not enough "good" costs to spend all bonds, a portion of the existing fha loan may need to be repaid just enough to free up additional "good" costs. Original 223(f) loan can be structured to allow for this flexibility. Could also allow for increased 241(a) sizing depending on constraint.

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Refinancing to Resyndication (R2R) with FHA

- **Results:**
  - **<u>Locks in today's low rates</u>** for **~70%** or more of the total debt
  - Avoids prepayment fees/costs on fha loan (~5-9% of loan balance)
- **Compare:**

Loan	Amount	Rate	Annual Pmt	Tax Credit Year
223(f)	$7,000,000	3.25%	$335,100	10
241(a)	$3,000,000	5.25%	$187,464	15
Total:	$10,000,000	3.825%	**$522,564**	

vs.

Loan	Amount	Rate	Annual Pmt	Tax Credit Year
223(f)	$10,000,000	5.25%	**$624,888**	15

→ **Over $100,000 in annual debt service savings and eliminates ~$500,000 in potential prepayment fees.**

Refinancing to Resyndication (R2R) with FHA

- Although this is a very streamlined/ state-of-the-art execution, it does have a lot of moving and inter-related parts. Many assumptions are required in order to demine future sizing of the transaction. As such, it is very important to work closely with the borrower as well as Bond and 4% tax credit experts to model deals with conservative assumptions. These include:
- Purchase price (subject to appraisal)
- Scope of rehab and related costs
- Tax credit equity pricing
- Aggregate basis calculation (for bond sizing)
- Mortgage rate/term on 241 loan

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Bond Transactions

September, 2017

Transaction – *December, 2016*
814 Units

Funding Sources & Uses	Total Amount	Per Unit
Bond Issuance	27,539,000	33,800
Senior Debt (USDA 538 Loan)	20,276,000	24,900
Existing Subordinate Debt	17,438,557	21,400
TC Equity (Net Pricing $0.97)	17,436,806	21,400
Interest Income and Surplus Reserves	701,390	900
Deferred Developer Fee	1,543,557	1,900
Total Sources	**84,935,310**	**104,300**
Acquisition	21,540,725	26,500
Pre Development / Arch. / Eng.	1,202,187	1,400
Construction	23,454,501	28,800
Contingency	1,641,824	2,000
Financing & Legal (Includes COI)	2,824,595	3,500
Soft Costs	5,548,022	6,800
Reserves	1,184,456	1,500
Bond Redemption	27,539,000	33,800
Total Uses	**84,935,310**	**104,300**

Conditions for Equity Placement

1. **Getting better…..**

2. **Reality is lack of clarity for setting expectations.**

3. **Result is pricing drop and increase differentials from property to property**

4. **State HFA's, Lenders, Syndicators and Developers. The common narrative "*what do I control and what can I do*" to maximize creation / preservation of affordable housing.**

Transaction – ***February, 2017***
676 Units

Funding Sources & Uses	Total Amount	Per Unit
Bond Issuance	22,362,000	33,100
Senior Debt (USDA 538 Loan)	18,758,000	27,700
Existing Subordinate Debt	13.550,674	20,000
TC Equity (Net Pricing $0.85)	12,405,034	18,400
Interest Income and Surplus Reserves	514,620	800
Deferred Developer Fee	1,548,981	2,300
Total Sources	**69,139,309**	**102,300**
Acquisition	17,064,813	25,200
Pre Development / Arch. / Eng.	969,539	1,400
Construction	19,395,325	28,700
Contingency	1,357,680	2,000
Financing & Legal (Includes COI)	2,442,247	3,600
Soft Costs	4,559,069	6,700
Reserves	988,636	1,500
Bond Redemption	22,362,000	33,100
Total Uses	**69,139,309**	**102,300**

Comparison 12/16 to 2/17
Portfolio of 18 vs. 14 Properties and 814 vs. 676 Units

Funding Sources & Uses	**Per Unit - 2016**	**Per Unit-2017**
Bond Issuance	33,800	33,100
Senior Debt (USDA 538 Loan)	24,900	27,700
Existing Subordinate Debt	21,400	20,000
TC Equity ($0.97 / $0.85)	21,400	18,400
Interest Income and Surplus Reserves	900	800
Deferred Developer Fee	1,900	2,300
Total Sources	**104,300**	**102,300**
Acquisition	26,500	25,200
Pre Development / Arch. / Eng.	1,400	1,400
Construction	28,800	28,700
Contingency	2,000	2,000
Financing & Legal (Includes COI)	3,500	3,600
Soft Costs	6,800	6,700
Reserves	1,500	1,500
Bond Redemption	33,800	33,100
Total Uses	**104,300**	**102,300**

What Changed from the 2016 Project to the 2017 Project

1. Properties with the higher credit pricing were removed from transaction.
2. Per unit mortgage proceeds increased (properties with higher tax credit pricing have less capacity for new debt).
3. Lowest property credit pricing reduced from $0.35 to $0.20.
4. Deferred Developer increased to maximum amount that could be repaid within a reasonable time frame.
5. New funding sources not required, but, Portfolio unit count was reduced by 17%

This type of analysis is achievable only if modeling tools are designed to test multiple scenarios with limited input.

How can stakeholders work together

- **Allocating Agencies**

  - 1. Minimum Design Standards – Is there any ability to waive certain requirements that were “nice to have at $1.00 pricing but not essential at $0.80. Consider how removal of any construction work impacts the capital need assessment and replacement reserve amount; removal may increase funding gap that is met by DDF.

  - Non basis items – reserves, bond fees, land costs. Are there any savings that can be realized in how these amounts are determined while maintaining and meeting the agency’s compliance and underwriting parameters.

  - Items that impact potential mortgage amount. Required trending assumptions and associated debt service coverage requirements. Operating Expense floors and mandatory rental rate cushions between maximum TC rent and proforma rent.

How can stakeholders work together

- **Syndicators –**
  - Communication on property locations where investment interest exists and at what price.
  - Impact of delaying property closing to maximizing first year credit delivery and tying equity pay-in more closely to when benefits are received.
  - What is the require pay-in schedule during the construction period. Work with Lender’s requirements and detail a payment schedule that does not overfund or underfund
  - Early discussion of financial variances and related mitigants

- **Developers –**
  - Cost containment. A Bond deal is a leveraged investment with certain fixed costs. Where can savings be realized, what savings can be modeled and what savings are only realized post-closing. Most costs associated with TIME – schedule is critical to understand and maintain.
  - All line items in Development Budget can be reviewed, reconsidered and discussed with vendors and financial analysts (modeling).

The Development Budget and related schedules

- **1. Prepare the development budget so each line has only one payee or one funding source**
- **2. From this schedule create all additional schedules that will be needed; limit input, all data pulls from one source worksheet.**
  - a) Eligible Basis (have cost cert CPA approve methodology 3-6 months before closing)
  - b) Aggregate Basis (50% test) and Good Cost / Bad cost (95/5 test). CPA / Bond counsel approve methodology.
  - c) Allocation of specific Funding Sources to Each Costs (timing)
  - d) Draw schedule from Initial Close to Perm Loan conversion to final Equity Payment
  - e) Closing draw - follow Indenture

3. With timely and accurate data - decisions on allocation of resources and management of development team are simplified.

Cash *Developer Fee is scorecard - all transaction numbers impact it - track it, keep it in line with projections and your project will meet expectations of all vested parties.*

CAHEC Footprint – Tax Credit Investments in LIHTC, Historic, New Markets and Renewable Energy Programs. Loan programs and Community Investments available for Development Partners.

- Pennsylvania
- Maryland
- West Virginia
- Virginia
- Kentucky
- Tennessee
- North Carolina
- South Carolina
- Alabama
- Georgia
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