Combining Tax Exempt, Short-Term Bonds with Taxable GNMA Sale for Affordable Apartment Financings

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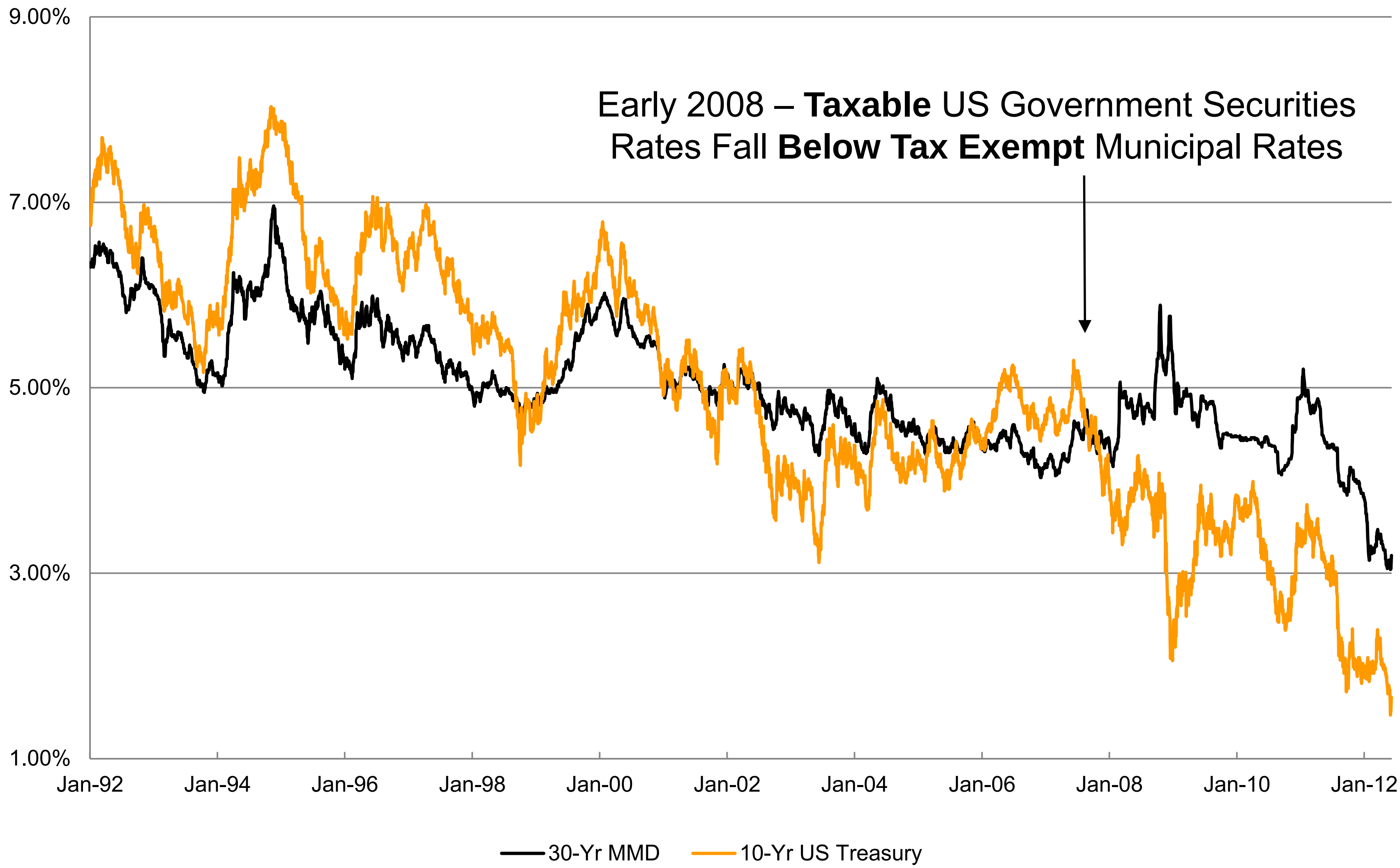
COMBINING TAXABLE GNMA SALES WITH TAX EXEMPT BONDS AND 4% LIHTC

- New Program developed by Eichner Norris & Neumann PLLC in early 2009 to **dramatically reduce the long-term borrowing rate and negative arbitrage** associated with **affordable housing projects** financed with **FHA-insured mortgage loans**. Applies where the Borrower 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% LIHTC** equity under the **"50% Rule"**.
- **Prices the permanent loan rate** in the **huge,** highly efficient "**forward delivery" market** for **taxable GNMA Securities**, rather than the much smaller, less efficient "fully funded" long-term tax-exempt multifamily housing bond market.
- Uses **short-term, "cash backed" tax-exempt bonds** to achieve compliance with the "50% Rule".
- **All-in Long Term Borrowing Rates** of approximately **3.70% (§223f) to 4.20% (§221(d)(4)) versus approximately 5.00%** for traditional long-term tax exempt bond funding; **Negative Arbitrage deposit of 1.0% or less versus** about **8 - 10%.**

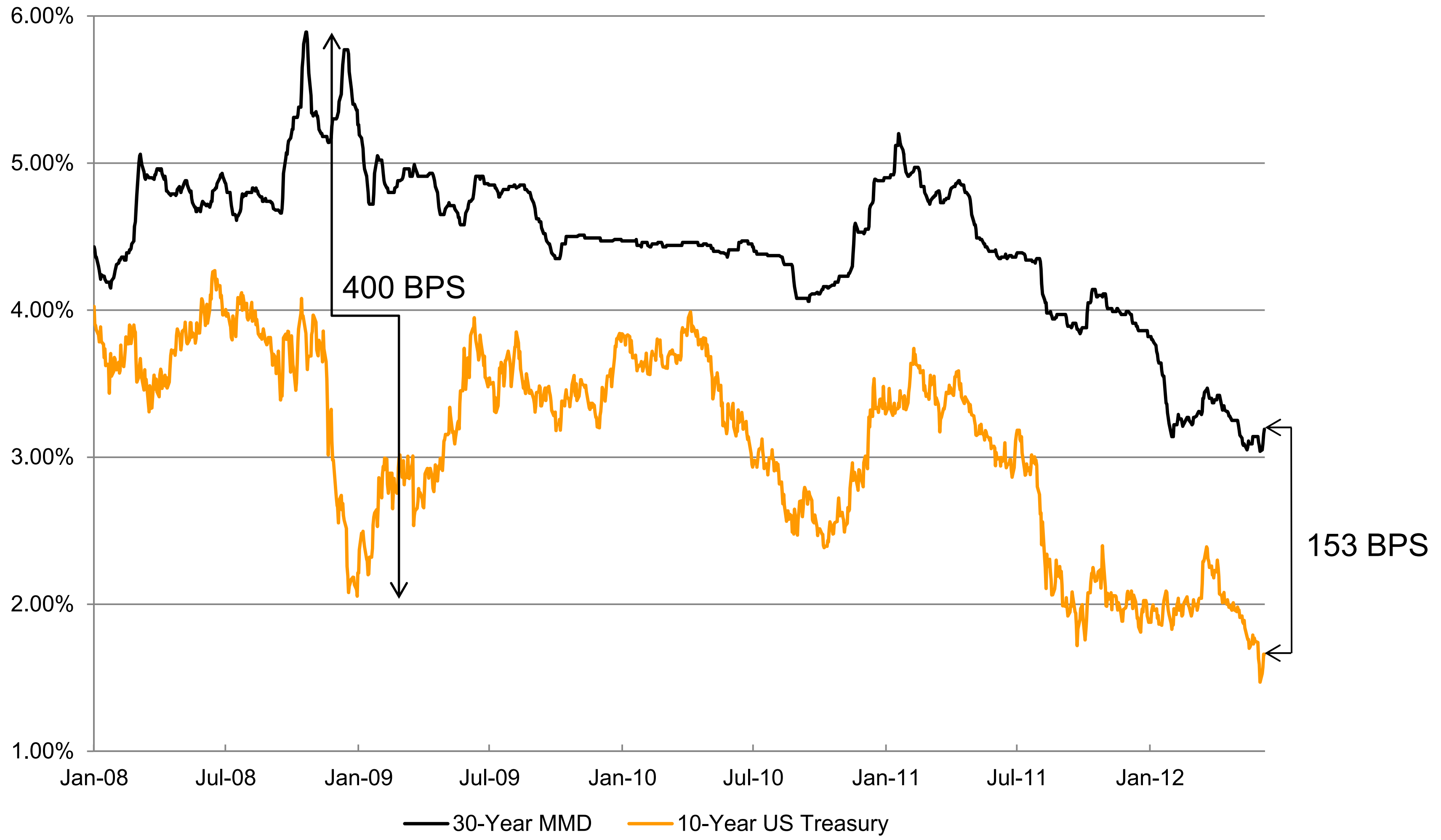
WHY TAXABLE GNMA'S? THE POST 2008 WORLD OF UPSIDE DOWN RATES

- In the **fall of 2008, numerous AAA-rated debt securities became worthless** or worth only pennies on the dollar – almost unprecedented destruction of trust in the long-term debt market.
- Result: **Long-term debt investors all over the world fled to the safety of U.S. Treasury bonds.**
- At the same time, **yields on tax exempt municipals soared to new heights** as concerns about credit quality and liquidity mounted.
- The following chart plots an **amazing development** – long-term AAA-rated **tax exempt** municipal bond **rates** soared **above** the rates on now much lower yielding **federally taxable** U.S. Treasury Bonds.
- **We still live in that upside down world today**, as continuing economic uncertainty regarding Europe and the U.S. economy and worldwide financial systems are joined by growing concerns about the tax exempt status of municipal bonds.

Long Term Rate Comparison: 30-Year MMD (Tax Exempt) Versus 10-Year Constant Maturity Treasury (Taxable)



Long Term Rate Comparison: 30-Year MMD (Tax Exempt) Versus 10-Year Constant Maturity Treasury (Taxable) January 1, 2008 - Present



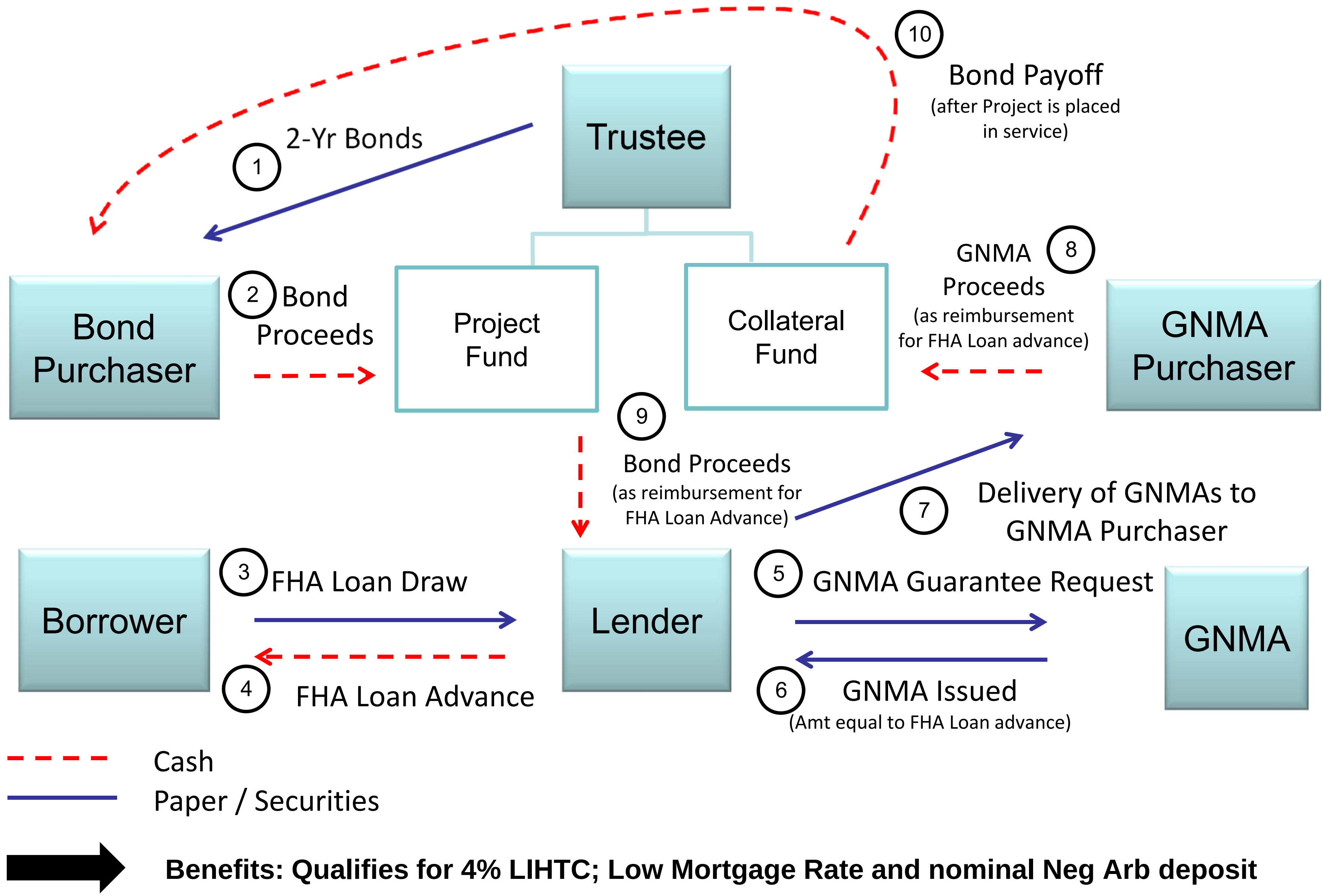
COMBINING TAXABLE GNMA SALES WITH TAX EXEMPT BONDS AND 4% LIHTC

- **Why not just borrow in the taxable markets** through the sale of Taxable GNMA securities wrapping each FHA insured loan advance?
- **Dilemma:** Owner is required to **finance 50% of project's land and depreciable basis** with **tax exempt bonds,** and keep these tax exempt bonds outstanding until Project's placed-in-service date
- **Solution:** Issue **Short-Term Cash-backed Tax Exempt Bonds**; **Sell GNMAs into taxable market**, **cross proceeds** (discussed below); **pay off TE Bonds on placed-in-service date**
- **Structure originally developed on HOPE VI Financings**, where there is no permanent debt, but short term tax-exempt bonds were issued to get full value for critically important 4% LIHTC.

CASH COLLATERALIZED BOND STRUCTURE

- Issue **short-term tax-exempt bonds equal to 50% of the project costs with a maturity roughly twice the targeted placed-in-service date** (to provide for construction delays). **Two funds** established under Bond Trust Indenture and **invested in same AA+ rated investment vehicle**:
  - a **"Project Fund"** in which all the **tax-exempt bond proceeds** are deposited, and
  - a **"Collateral Fund"** in which proceeds of sale of GNMA securities wrapping each FHA insured loan advance are deposited as the loan is funded
- Such 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 "replacement proceeds" must be simultaneously deposited into the Collateral Fund, the **Bond issue remains 100% cash collateralized**.
- Can obtain an **AA+ rating** on the short-term bonds from S&P based on the unsecured rating of the underlying investments (e.g. U.S. Treasury Bonds and/or a highly rated money market fund), **without other credit enhancement.**
- When the project loan has been fully funded, the **tax-exempt bonds are repaid after the Project's placed-in-service date** and the Project has no permanent senior debt.

COMBINED TAXABLE GNMA SALE WITH TAX EXEMPT BONDS AND 4% LIHTC



Benefits: Qualifies for 4% LIHTC; Low Mortgage Rate and nominal Neg Arb deposit

BASIC HUD INSURANCE PROGRAMS

Section 223(f)

Existing Properties – Refinance or Acquisition + Light Rehab

- Rehab no more than 2 major building systems
- Up to ~$40,000 rehab per door under Pilot Affordable Program (described below); otherwise up to $17,000 per door in high cost areas.
- 35-year level payment loan

DSCR: 1.11 for Affordable (generally 20% at 50% of AMI or 40% at 60% AMI)

LTV: ≤ 85% for Affordable

- No Davis Bacon Wages
- 0.5 to 1.5% Orig. Fees; 25 BPS Svcg/ GNMA; 45 BPS MIP
- Low Market rates on Taxable GNMA Sale ~3.00% + 25 BPS + 45 BPS% → All-in ~3.70%

BASIC HUD INSURANCE PROGRAMS

HUD Pilot 223f/ LIHTC Affordable Program

Goal: Encourage and expedite use of §223(f) loans on affordable projects & enhance compatibility with LIHTC

- Allow up to $40,000/ door rehab
- Waive 3-yr Refi prohibition; can use for perm loan
- Expected processing – Commitment 60-90 days; closing 90-120 days
- $25.0 Max Loan Amount
- Now available nationwide, loans processed through one of nine HUBS – LA, Chicago, Detroit, Boston, San Francisco, Seattle, Forth Worth, Atlanta and Denver
- Only certain pre-qualified MAP Lenders eligible
- Other requirements (eg, 6 mo DSRF) fund rehab costs in excess of normal 223(f) limit from LIHTC or other non-loan funds

BASIC HUD INSURANCE PROGRAMS

Section 221(d)(4)

New Construction or Substantial Rehab

- No separate construction lender (FHA insured advances) and no re-underwriting of loan completion (only cost certification at final endorsement)
- 40 year level amortization loan

DSCR: 1.15 for Affordable (generally 20% at 50% of AMI or 40% at 60% AMI)

Max Loan-to-Cost: 87%

Disadvantages:

- Davis Bacon Wages Apply
- Long processing times – 6 to 10 months
- 1.0 – 2.0% Orig. Fees; 25 BPS Svcg/ GNMA; 45 BPS MIP
- Low market rates on taxable GNMA Sale ~3.50% + 25 BPS + 45 BPS

  → All-in ~4.20%

RESULTS OF STRUCTURE - SUMMARY

	Traditional Long-Term Tax Exempt GNMA Backed Bonds			Short-Term Cash Back Bonds with Taxable GNMA Sale		
Tax Exempt Bonds Issued: 1 Sized to 50% test	Assume Project with **$25,000,000** Total Development Cost $18,000,000			$13,000,000[1]		
	Traditional Long-Term TE Bonds			Short-Term TE Bonds + Taxable GNMA Sale		
Tax Exempt Bond Term		223f	221(d)(4)		223f	221(d)(4)
		35 Years	42 Years		2 Years	2 Years
Mortgage Loan Interest Rate						
	Bonds	**4.15**%	**4.15**%	GNMA	**3.00**%	**3.50**%
	3rd Party Fees	0.15%	0.15%	3rd Party Fees	N/A	N/A
	Servicing + GNMA Fee	0.25%	0.25%	Servicing + GNMA Fee	0.25%	0.25%
	Total **ML Rate**	**4.55**%	**4.55**%	Total **ML Rate**	**3.25**%	**3.75**%
	Add: MIP	**0.45%**	**0.45%**	Add: MIP	**0.45%**	**0.45%**
	Total **All-in Borrowing Cost**	**5.00%**	**5.00%**	Total **All-in Borrowing Cost**	**3.70%**	**4.20%**

Result → Approximately **1.30% ML Rate Savings §223(f); 0.80% ML Rate Savings §221(d)(4)** (**~10% and 7%, respectfully of additional loan proceeds** on debt service constrained loan)

Negative Arbitrage (**Deposit**):	4.30% x $18,000,000 x 2 years $1,548,000 (**8.5%** of ML)	1.00% x $13,000,000 x 2 years $260,000 (**2.0%** ML)
Negative Arbitrage (**Actual**):	$774,000 (**4.3%** of ML)	$130,000 (**1.0%** ML)[2]

2 If Project placed in service in month 12

RESULTS OF STRUCTURE

Net Results – Borrower:

- **Approximately 80 to 130 basis points of savings** in permanent borrowing rate, resulting in a lower cost of capital over the life of the loan
  - Increased Loan Proceeds and/ or
  - Increased Cash Flow
- **Negative Arbitrage deposit reduced** from ~8 - 10 points or more to ~1 point or less
- Full syndication value of **4% LIHTC equity** on affordable units achieved

Net Results – IRS:

- **$13.0 mil. of TE Bond proceeds used to fund Qualified Project Costs –** significantly lower TE Bond amount (by $5.0 million in example) than if $18.0 million FHA loan had been funded with long-term tax exempt bond issue
- **No arbitrage "artifice or device"** - all TE Bond Proceeds (and replacement proceeds) invested at far below TE Bond yield
- **No "over issuance" of bonds or "overburdening" of market - only enough TE Bonds to meet 50% test, much lower all-in borrowing rate (<1.0% v. ~4.0%) and outstanding 2 years versus 42 years**

CONCLUSION

- **Approximately a dozen major law firms have issued or agreed to issue unqualified approving opinions** on deals using this type of cash collateralized structure for all or part of numerous tax exempt multi-family housing bond issues
- **Documents and rating agency criteria well developed**
- This is **THE NEW WAY to finance affordable housing projects backed by FHA insured loans**
- **Highly unlikely market conditions will change** in next **1-2 years** to favor traditional long-term tax exempt bond structure