Tax Exempt Multifamily Housing Bond Executions With FHA/GNMA and 4% LIHTC

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TIBER HUDSON

Kent Neumann, Esq.
Tiber Hudson LLC
Washington, DC
Direct: (202) 973-0107
Cell: (703) 568-0190
kent@tiberhudson.com

Impact of Tax Reform
(The Tax Cuts and Jobs Act)

- **Interest rates (short and long) are going up**
- **Corporate tax rates reduced 35% to 21%**
- **Value of tax-exemption is lower**
- **9% and 4% percent LIHTC retained (Yippy!) but pricing is lower**
- **LIHTC deals are getting squeezed on all sides**

FHA/GNMA Loan details

- Typically provides the best terms of any financing option available today in the multifamily space – **35/40-year amortization and term**.
- **Integrated construction & permanent** financing (no 3^{rd} party construction lender required).
- **Non-recourse** obligation (even during construction).
- Established forward pricing market and inherent draw-down loan structure due to insurance upon advances (resulting in no negative arbitrage).
- No new underwriting at “conversion” to permanent.
- 221(d)(4) does trigger prevailing wages/Davis Bacon.
- Although execution times are getting better, these deals can still take longer than some other structures.

FHA GNMA Loans with Tax Exempt Bonds and 4% LIHTC for affordable transactions

- **Taxable** FHA/GNMA Market continues to deliver favorable all in mortgage rates.

vs

- Long-Term Tax Exempt Bonds Backed by GNMAs are still a more costly execution.

→ **Advantages of Taxable Execution:**

- Lower mortgage rate: resulting in additional loan proceeds and/or increased ongoing project cashflow.
- Reduced Costs: Lower negative arbitrage cost.

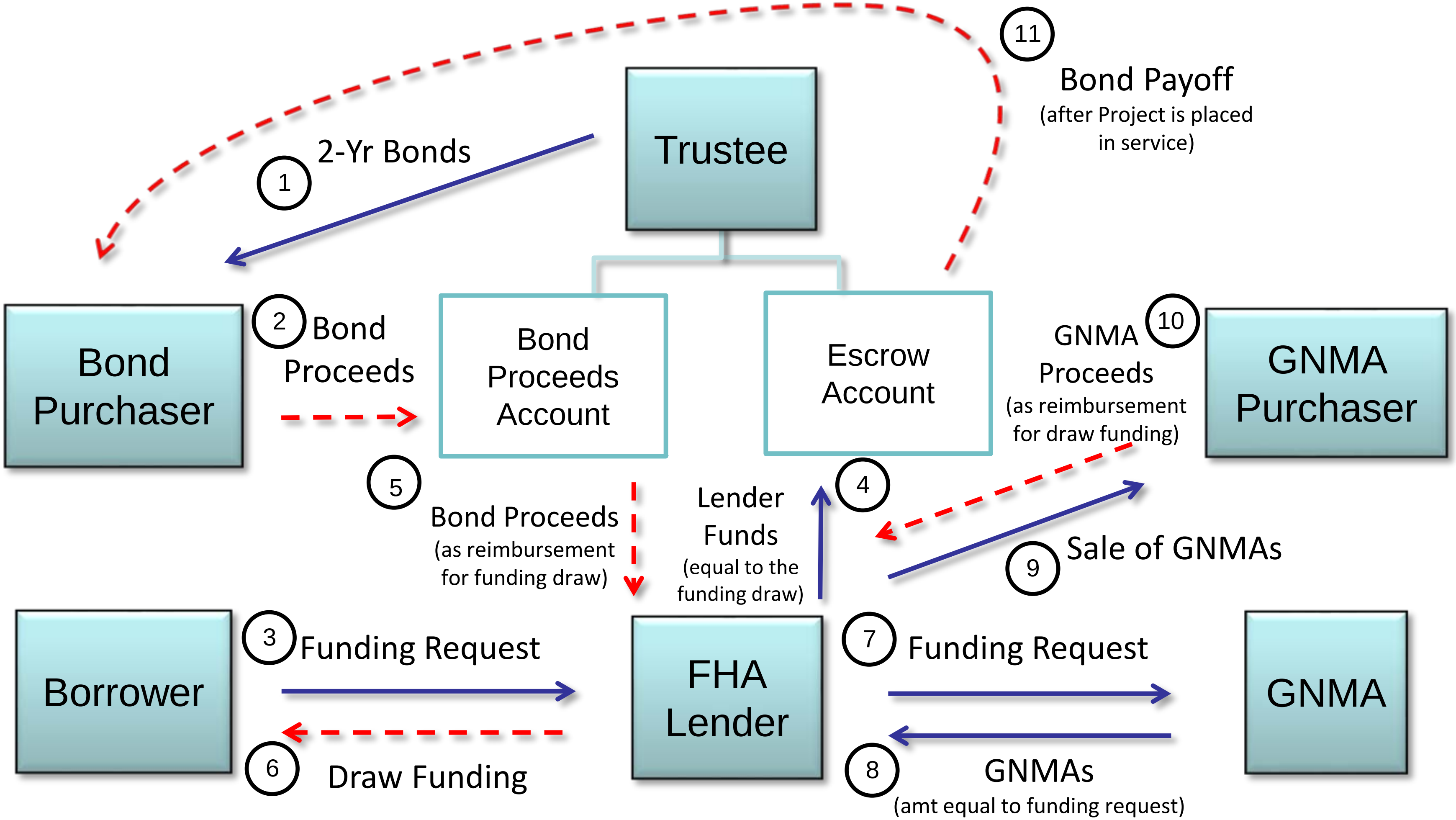
4% Low Income Housing Tax Credits: The 50% Test

With todays low taxable loan rates, why not just borrow funds in the taxable market?

Reason: Need Bonds to qualify for 4% Low Income Housing Tax Credits (**<u>at least 50%</u>** of aggregate basis of the building and land must be financed with **<u>tax exempt bond proceeds</u>).**

Benefits of 4% Tax Credits: Provides a significant (~30% or higher) additional source of funds for affordable housing transactions.

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



Qualifies for 4% Tax Credits

Low Mortgage Rate

Minimal Negative Arbitrage

Kent Neumann 202-973-0107 kent@tiberhudson.com

EXAMPLE SOURCES AND USES

Short-Term Cash-Collateralized Bonds with Taxable GNMA Sale	
Sources	
FHA Loan Funds	$9.0 M
Bond Proceeds(1)	7.0 M
4% Tax Credit Equity	3.5 M
Deferred Developer Fee	**0.0** M
Subordinate Financing	**0.5** M
Total Sources	**20.0 M**

Uses	
Redemption of Bonds	$7.0 M
Acquisition	8.0 M
Rehabilitation	3.0 M
Developer Fee	1.0 M
Financing Costs + Soft Costs + Reserves	1.0 M
Total Uses	**20.0 M**

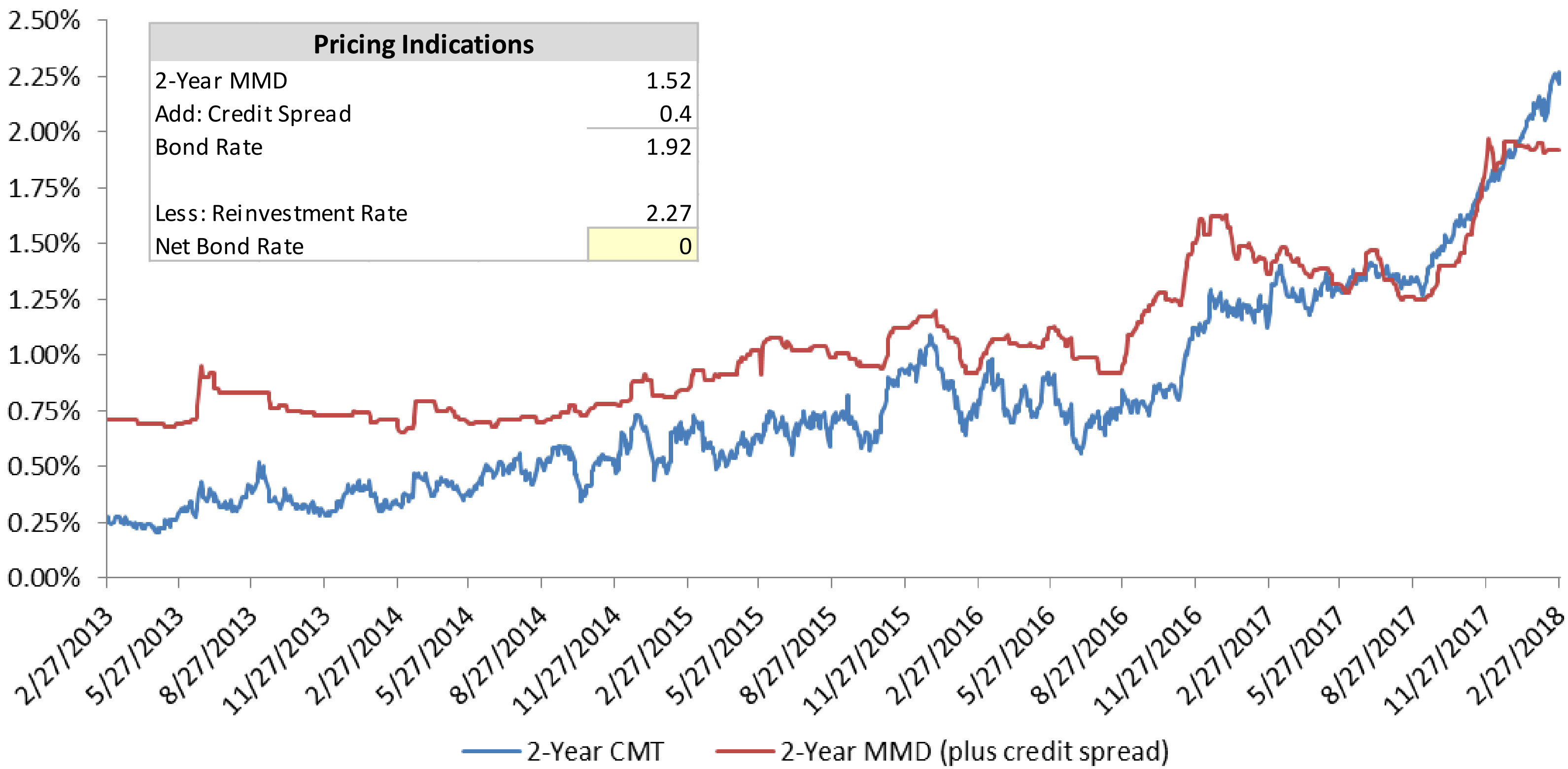
(1) $7 million sized on 50% test ($13 million total costs)

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:** Need other collateral sources of funds
- **Bond Amount to meet 50% test < Taxable FHA Loan Amount**
- **Investment and other options to reduce cost:**
  - Reduced Neg arb with investments
  - Seller Take-Back Bonds
  - Pooled financings

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 (<u>plus credit spread</u>) and 2-Year UST



Source: Bloomberg. Thomson Reuters
Reflects market conditions as of February 27, 2018
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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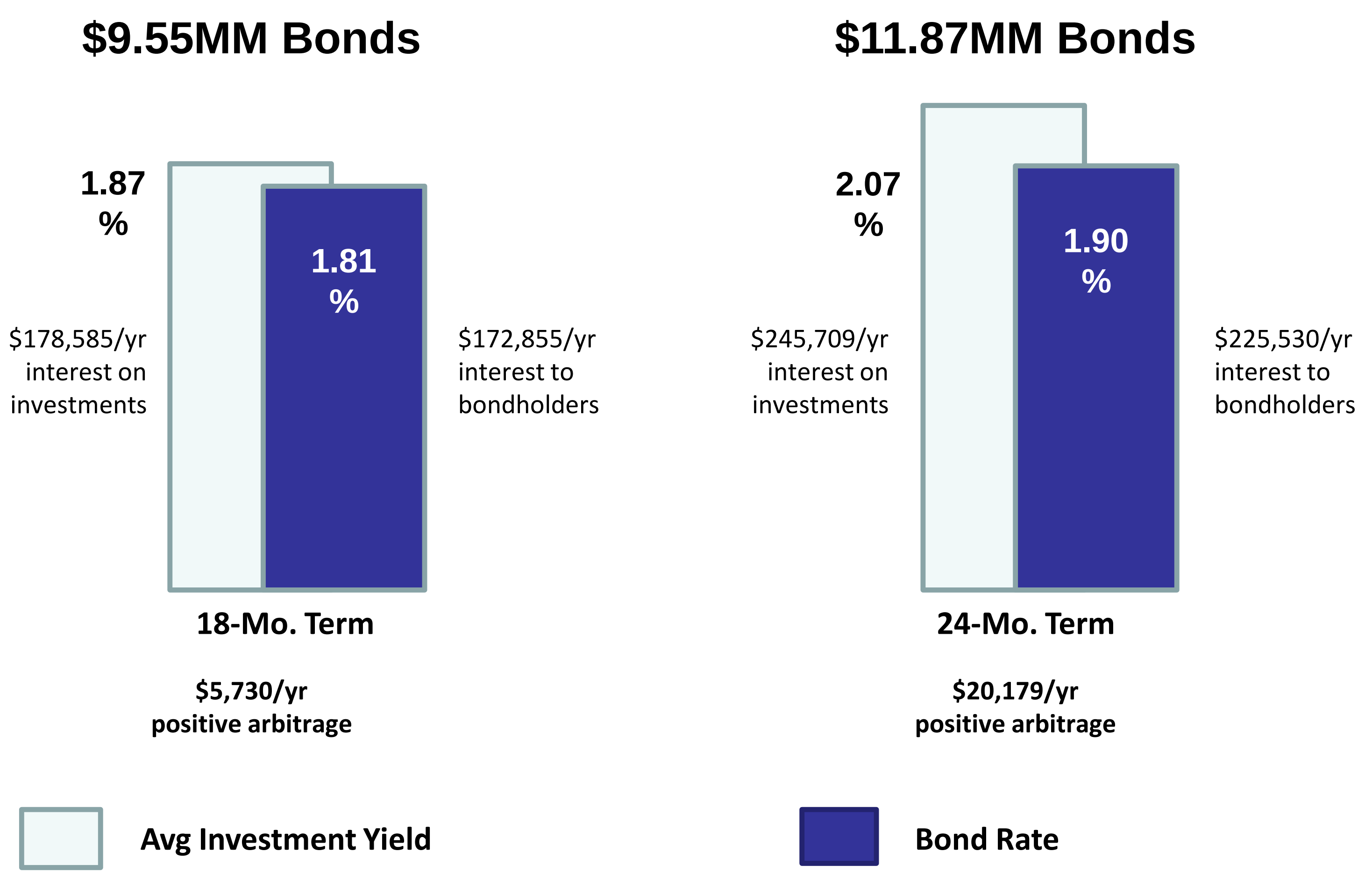
Bond Yields and Investment Rates on Recent Cash-Backed Bond Transactions with Treasury Investments



Costs of the Deal

Issuer Fees*:	0.10% - 3.00%
Bond Counsel*:	$35,000 - $100,000
Underwriter’s Fee:	0.50% - 1.00%
Underwriter’s Counsel:	$30,000 - $50,000
Miscellaneous:	$10,000 - $20,000
Negative Arbitrage*:	ZERO

Timing of the Bond Deal

- **Bond Application/Volume Cap/Initial Approval**
  - As soon as possible
- **Document Preparations and Review**
  - Around Submission of FHA Loan App
- **Bond Pricing**
  - ~2 weeks before Closing
- **Pre-close/Close**
  - Simultaneous with FHA Loan closing

Tax-Exempt Seller "Take Back" Note & Bonds

- **Many 4% preservation deals include seller financing in the form of a subordinate "take-back" note (common in RAD transactions).**
- **Due to the LIHTC 50% test, tax-exempt bonds in excess of the permanent financing are often required in these deals.**
- **Several ways to address this issue with various bond structures.**

FHA Refinancing to Resyndication (R2R) Program for Affordable Projects

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

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

- **NEW LOAN**: FHA 223(f) loan to refinance existing debt or purchase project. Keep rehab to a minimum

Highlights of 223(f) loan

- Exempt from LIHTC 10-year rule (Section 42(d)(6))
- 35+ year full amortization and term
- 80-90% LTV / 1.11 DSCR
- **~3.75%** all-in rate including 25bps MIP for affordable deals
- 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 ……

FHA Refinancing to Resyndication (R2R)

Step 1: **TPA** (transfer of physical asset) process.

<u>Highlights of TPA</u>

- Take 90-120 days
- Remaining term of FHA loan would be 30+ years
- No prepayment fees or substantial transfer fees are applicable

FHA Refinancing to Resyndication (R2R)

Step 2: Supplemental **FHA 241(a)** loan.

Highlights of 241(a)

- Second position fha loan sized to the lower of (a) 90% of rehabilitation and related construction costs or (b) 1.11 DSCR for total FHA debt.
- 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 to qualify for 4% tax credits.

Highlights of Bonds/4% Credits

- Need to pass 50% test to qualify for 4% low income housing tax credits
- 95% Bonds need to be spent on “good” costs of project
- Flexibility structured into original 223(f) loan to account for sizing

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.

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