Tax Exempt Bonds 101

2015 OHIO HOUSING CONFERENCE
DECEMBER 1 - 3
Lewis Diaz  
Partner  
Dinsmore & Shohl LLP  
Cincinnati, Ohio  
513-639-9264  
Lewis.diaz@dinsmore.com
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 as well as the U.S. and foreign governments to finance a variety of projects and activities.

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

- Conduit Bonds: Bonds issued by a governmental 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).
Historically Lowered the Interest Rate on Borrowing:
An investor that has a 33% marginal tax rate will essentially earn the same return with a 7% taxable bond as with a 4.69% tax-exempt bond. 
(7% multiplied by (1 minus the marginal tax rate) or .67) = 4.67
Lower Rate = More Loan Proceeds or More Project Cash Flow

Additional Equity Proceeds from 4% Low Income Housing Tax Credits
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 Qualified - Generally, a 4% LIHTC allocation will raise almost 50% of the equity that a 9% LIHTC allocation would raise
Typical Participants of a Bond Deal

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

- Trust Indenture (between Issuer and Trustee)
- Loan or Financing Agreement (between Issuer, Trustee and Owner)
- Tax Regulatory Agreement (between Issuer, Trustee and Owner)
- Official Statement (between Underwriter and potential buyers of the bonds)
- Bond Purchase Agreement (between Issuer, Underwriter and Owner)
- Continuing Disclosure Agreement
- Other Common Documents
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 underlying 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 perform their own analysis.
Taxable FHA/GNMA Financing
Combined with Tax-Exempt “50% Test” Bonds
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

- 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.
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)
  - 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”)}
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)
  - 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 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 an impermissible 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 and 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
  – 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
Players of the Tax-Exempt Bond Issuance

• Issuer & Issuer’s Counsel
• Borrower & Borrower’s Counsel
• Underwriter & Underwriter’s Counsel
• Bond Trustee
• Lender &/or Credit Enhancement
• Rating Agency
Ohio Issuers of TEBs-Non-Elderly 25 years ago-State Issue I passed by voters

• OHFA
  – 2015 Volume Cap- $100M, no application fees or ¾% deposit
    • Ohio 2014 unused Volume Cap Carried to 2015 - $3B (260+% of annual award)
  – HDAP/Bond Gap Funds – TEBs only, September application
    • 2014 10 applications, 5 awards-$4.36M
    • 2015 12 applications, 9 awards - $8.15M
Ohio Issuers of TEBs-Non-Elderly 25 years ago-State Issue I passed by voters

- Counties
  - HOME Funds, other soft money
- Cities
  - HOME Funds, other soft money
- Townships
- Port Authorities
Considerations

• Cost
• Sophistication for issuance
• Meeting schedules/timelines
• Political ramifications
• Application process
Historical TEB Perspective & Current TEB Structure

• Long-term TEBs were 1.50%-2% lower in yield than long-term taxable debt
  – Negative Arbitrage on undisbursed TEB proceeds – 5-7% deposit, about ½ spent
Historical TEB Perspective & Current TEB Structure

• 5+ years ago – long-term taxable yields now 1%-1.50% lower than long-term TEB yields
  – 2008 used Short-term Cash-collateralized TEBs on HUD 202 project
  – 2011 TSC structured & sold 1st rated Short-Term Cash Collateralized TEBs for a taxable long term FHA 221(d)(4) loan.
Historical TEB Perspective & Current TEB Structure

– Short-term Cash-Collateralized TEBs
  • 50% Test – specific tracking for LIHTC under Section 42
  • TEBs outstanding until property placed in service
  • Structure discussion
LIHTC & HUD INSURED LOANS

Tony Love, VP
Forest City Capital Corporation
Cleveland, OH
(216) 416-3503
tonylove@forestcity.net
HUD INSURED LOANS

Benefits:

• Provides construction and permanent financing
• Relatively high leverage
• Long term, self amortizing (35-40 yrs)
• Low, fixed rate, (currently 3.25% for Purchase/Acq; 4.10% for NC/SR)
• Mortgage Insurance Premium of 0.45%
• Non-recourse (standard carve out for fraud)
HUD INSURED LOANS

Drawbacks

- Protracted application process
- Inconsistent execution
- Higher up-front costs
- Higher IOD and R4R escrows
### HUD INSURED LOANS

**Section 223(f) Acquisition/Refinancing**

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<th>Refi/Acq</th>
<th>LTV</th>
<th>DSCR</th>
<th>Cost of</th>
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<tr>
<td>202 Refi</td>
<td>90%</td>
<td>1.11</td>
<td>NA</td>
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<tr>
<td>90%+ HAP</td>
<td>87%</td>
<td>1.15</td>
<td>87%</td>
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<tr>
<td>“Affordable”</td>
<td>85%</td>
<td>1.17</td>
<td>85%</td>
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<tr>
<td>“Market”</td>
<td>83.3%</td>
<td>1.20</td>
<td>83.3%</td>
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### HUD INSURED LOANS

**Section 221(d)4 NC/SR**

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223(f) LIHTC PILOT PROGRAM

- Same underwriting parameters
- Increased repairs, up to $40k/unit
- No Davis Bacon/Prevailing Wage requirements
- Reduced application paperwork
- Processed thru qualified FHA lenders
- Streamlined processing at HUD thru Chief Underwriter and HQ loan committee
RAISING THE BAR FOR BETTER COMMUNITIES

SECTION 223(f) LIHTC PILOT PROGRAM

• Plans and specs
• Arch/Cost review
• GC track record and financial review
• No interruption of income/tenant relocation
• No major environmental conditions
RAISING THE BAR FOR BETTER COMMUNITIES

SECTION 223(f) LIHTC PILOT PROGRAM

• Consistent execution, 90 days to review and close
• Ideally suited for “Preservation” projects and YR-15 re-syndication transactions
LIHTC EQUITY PAY-IN/BRIDGE LOAN

- 20% Equity (Bridge Loan) at Closing
- 50% Equity (Bridge Loan) at 65% completion
- 95% Equity (Bridge Loan) at “Stabilization”
- 100% Equity (Bridge Loan) at 8609
- Bridge Loan paid in full at 8609
Joseph R. Hague
Red Capital Markets, LLC
Columbus, Ohio
614-857-3176
jrhague@redcapitalgroup.com
Fannie Mae/Freddie Mac

- Operates with the implicit guarantee from US government

- Offers lower interest rates as compared to traditional bank loans (not as low as HUD’s)

- Offers quicker execution timeframes as compared to HUD

- Non-recourse financing except for “Bad Boy” carveouts
Fannie Mae Preservation Rehab

• Allows existing, stabilized property to undergo significant rehab ($40,000-$120,000/unit) with non-recourse financing

• Interest Only Period

• 1.15x DSC/90% LTV
Freddie Mac Tax-Exempt Loan

- Freddie Mac purchases Tax-Exempt loan from lender
- Allows for lower transaction costs due to less participants (i.e.-Bond Underwriter)
- Can allow for an Interest Only term
- 1.15x DSC/90% LTV
4% Tax Credit Transaction vs. 9% Tax Credit Transaction

- Poindexter Phase II
- Part of overall Choice Neighborhoods Project in Near Eastside Columbus
- Involved City Funds, Housing Authority Funds, tax credit equity funds, 221(d)(4) mortgage financing and HUD Choice Grant
4% Tax Credit Transaction vs. 9% Tax Credit Transaction

- Phase II involved two separate transactions
- Each phase had 87 1, 2, and 3 bedrooms units (174 units in total)
- New construction
RAISING THE BAR FOR BETTER COMMUNITIES

4% Tax Credit Transaction vs. 9% Tax Credit Transaction

#2015OHHC

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### 4% Tax Credit Transaction vs. 9% Tax Credit Transaction

<table>
<thead>
<tr>
<th>Sources</th>
<th>Phase IIA</th>
<th>Phase IIB</th>
<th>Uses</th>
<th>Phase IIA</th>
<th>Phase IIB</th>
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<tbody>
<tr>
<td>Tax Exempt Bond</td>
<td>12,600,000</td>
<td>-</td>
<td>Land</td>
<td>1,913,745</td>
<td>1,610,000</td>
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<tr>
<td>Bond Redemption</td>
<td>(12,600,000)</td>
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<td>Construction</td>
<td>14,647,255</td>
<td>14,647,255</td>
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<td>FHA 221(d)(4) Mortgage</td>
<td>3,549,000</td>
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<td>Professional</td>
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<td>1,023,500</td>
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<td>HDAP</td>
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<td>Soft Costs</td>
<td>709,153</td>
<td>890,000</td>
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<td>CHOICE</td>
<td>7,354,402</td>
<td>6,933,200</td>
<td>Financing</td>
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<tr>
<td>City of Columbus</td>
<td>6,000,000</td>
<td>875,000</td>
<td>Reserves</td>
<td>801,214</td>
<td>794,500</td>
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<td>LIHTC Equity</td>
<td>5,668,000</td>
<td>10,577,231</td>
<td>Developer Fee</td>
<td>4,320,000</td>
<td>2,940,000</td>
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<td>Deferred Developer Fee</td>
<td>1,080,000</td>
<td>934,255</td>
<td>Total</td>
<td>24,651,402</td>
<td>22,681,686</td>
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<tr>
<td>Total:</td>
<td>24,651,402</td>
<td>22,681,686</td>
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