Major Tax-Exempt Bond and Loan Executions for 100% Affordable and Mixed Income/Mixed Use Apartment Projects*

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I: THE BASICS: MAJOR INTERNAL REVENUE CODE PROVISIONS SUPPORTING AFFORDABLE RENTAL HOUSING IN THE UNITED STATES

- **Section 42** of the Internal Revenue Code provides **two forms of tax credits to support affordable rental housing:**

  A. **The 9% Low Income Housing Tax Credit ("9% LIHTC")**, which the Borrower can generally syndicate for an amount sufficient to **cover 70 – 75% of total development cost.** Very **powerful** subsidy, the Borrower simply obtains a small taxable loan from a bank and potentially other subordinate loans to cover the other 25%, and the financing package is complete.

Real Estate Developer Recipient of 9% LIHTC

  B. **Combination of 4%* Low Income Housing Tax Credits ("4% LIHTC") under Section 42 and tax exempt private activity bonds under Section 142(d)** on the debt side of the financing. **In some cases using tax exempt debt lowers the mortgage interest rate** versus comparable taxable rates.

Still Happy Developer Pursuing
TE Bonds +4% LIHTC

* The actual percentage is lower – about 3.2% at this time.

- **These two programs** account for a roughly equal amount of affordable rental housing units each year in the United States – 9% LIHTC ≈ 60,000 units in 2016; **tax exempt bonds + 4% LIHTC ≈ 75,000 units** in 2016. Together they **fund about one third of annual rental apartment production** in the United States, or about 400,000 units in 2016.
- The **9% LIHTC** is a much **more powerful** subsidy, **but** is often **over subscribed** by a factor of **4 or 5:1**, and is **generally allocated in small amounts** to **non-profit sponsors** for small to medium size 100% affordable housing projects.
- This means that **other Borrowers will use a combination of 4% LIHTC under Section 42 and tax exempt debt under Section 142(d)** to finance these projects.

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- **Tax Exempt Bond + 4% LIHTC Projects** fall into **two distinct** and very different **categories**.

  1. **"100% Affordable" Projects** where **all (or substantially all)** of the units in the Project are rented to tenants whose incomes do not exceed **60% of** Area Median Income **("AMI")** (for a family of four, adjusted up or down for family size).

     - To qualify for 4% LIHTC, the Borrower must also agree to **cap rents at 30%** of that amount.

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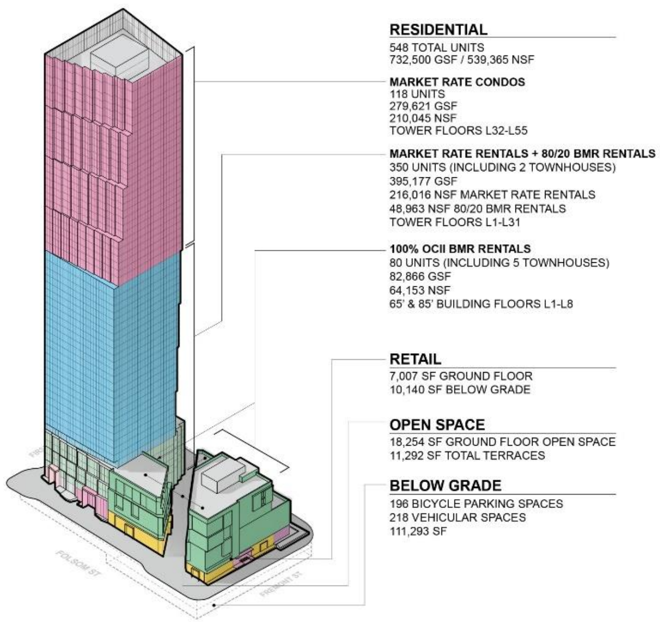
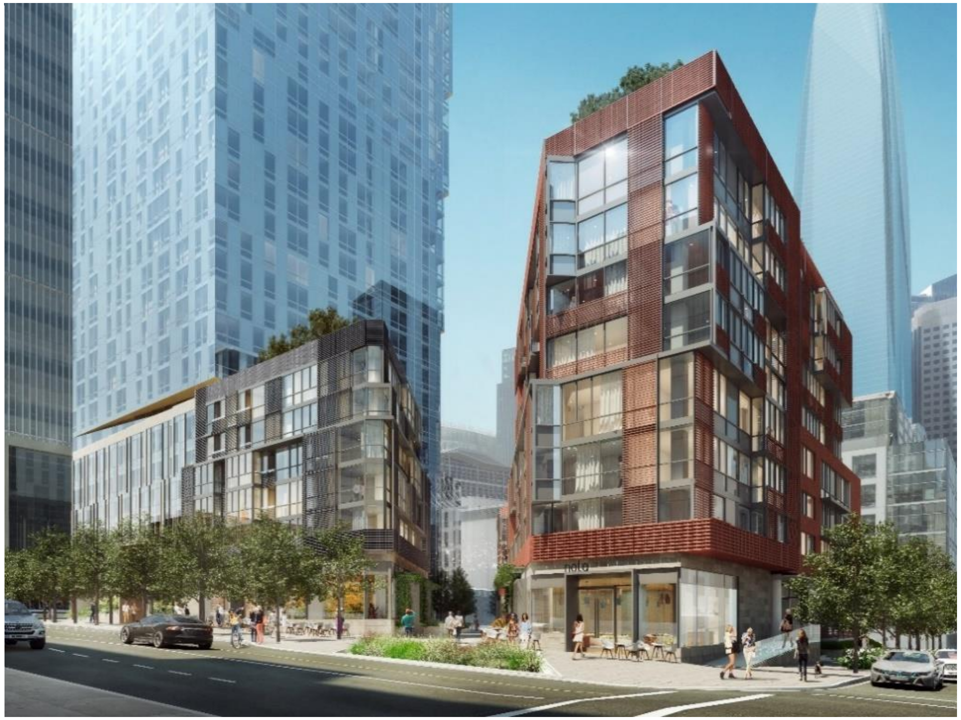
- This obviously depresses revenues versus revenues based on market rate rents that the Borrower could otherwise charge, and the project has to remain an **affordable rental** project for a **qualified project period** of **15 years beyond 50% occupancy or longer (almost always 30+ years).**
  - **Developer incentives are very different from most conventional real estate,** where developer buys and rehabs on builds, stabilizes, and then sells the property to long-term owner, takes out his or her profit, and moves on.
  - Here, the developer works for **upfront developer fee** of 8 – 12 %, possible contractor profit, possible **ongoing management fees** and **very slow, long-term appreciation** in value.
- **BUT**, the foregoing restrictions enable the Borrower to **syndicate 4% LIHTC (and maybe state tax credits)**, to finance **25% to 45% of total development cost** with **little give-up** by general partner **of cash flow or residual** – the investors are buying the tax credits and certain losses and perhaps getting CRA credit.

2. "Mixed Use" and/or "Mixed Income" Projects – usually **very large, complex urban projects** (which may involve for sale units, commercial and other components), where **80% of the apartment units** are market rate and **20% of the units** are **reserved** for persons whose income do not exceed **50% of AMI** (for a family of four, adjusted up or down for family size).

PROJECT OVERVIEW
KEY STATISTICS

Transbay 8
San Francisco, California
Related Companies (National Development Partner)





- Since **LIHTC** is **only available on the affordable units** – in this case **4% LIHTC** will account for **only 4-6% of total development cost; much less important.**
- These financings entail the same requirements for the property to remain a long-term rental with 20% of units affordable, but these projects present **greater appreciation opportunities since 80% of rental units are market rate.**
- The principal financing structures used for “100% Affordable” Housing Projects are discussed in Section IV of this outline; the two major tax exempt debt financing structures often used for “Mixed Use” projects are discussed in Section VII.

II. THE 50% TEST

- **The 50% Test:** To be eligible for the full value of the 4% LIHTC on the affordable units in either of these two types of projects, the Borrower **must finance at least 50% of basis in the building and land with volume limited tax-exempt private activity bonds** under Section 142(d) and **keep these bonds outstanding until the project's placed-in-service date** (receipt of a certificate of occupancy for new construction or completion of rehab for acq/rehab financings).

- **Why the 50% Test?**: Congress wanted projects receiving the 4% LIHTC subsidy to pass the **same hurdles one has to pass to be eligible for private activity bonds.**

  - The Project must **score high enough on public merit with state bond volume allocators** to receive a private activity bond volume award.

  - The Project must also have the **support of a municipal bond issuer like a state or local HFA**, a city or county who will apply for the volume.

  - The project must also have the **support of a governmental entity where the project is located** through a **TEFRA hearing and governmental approval.**

- In short, the 50% Test assures that these projects receive a **thorough, local vetting and approval of public purpose** and that they will address local needs of the community where the project is located.

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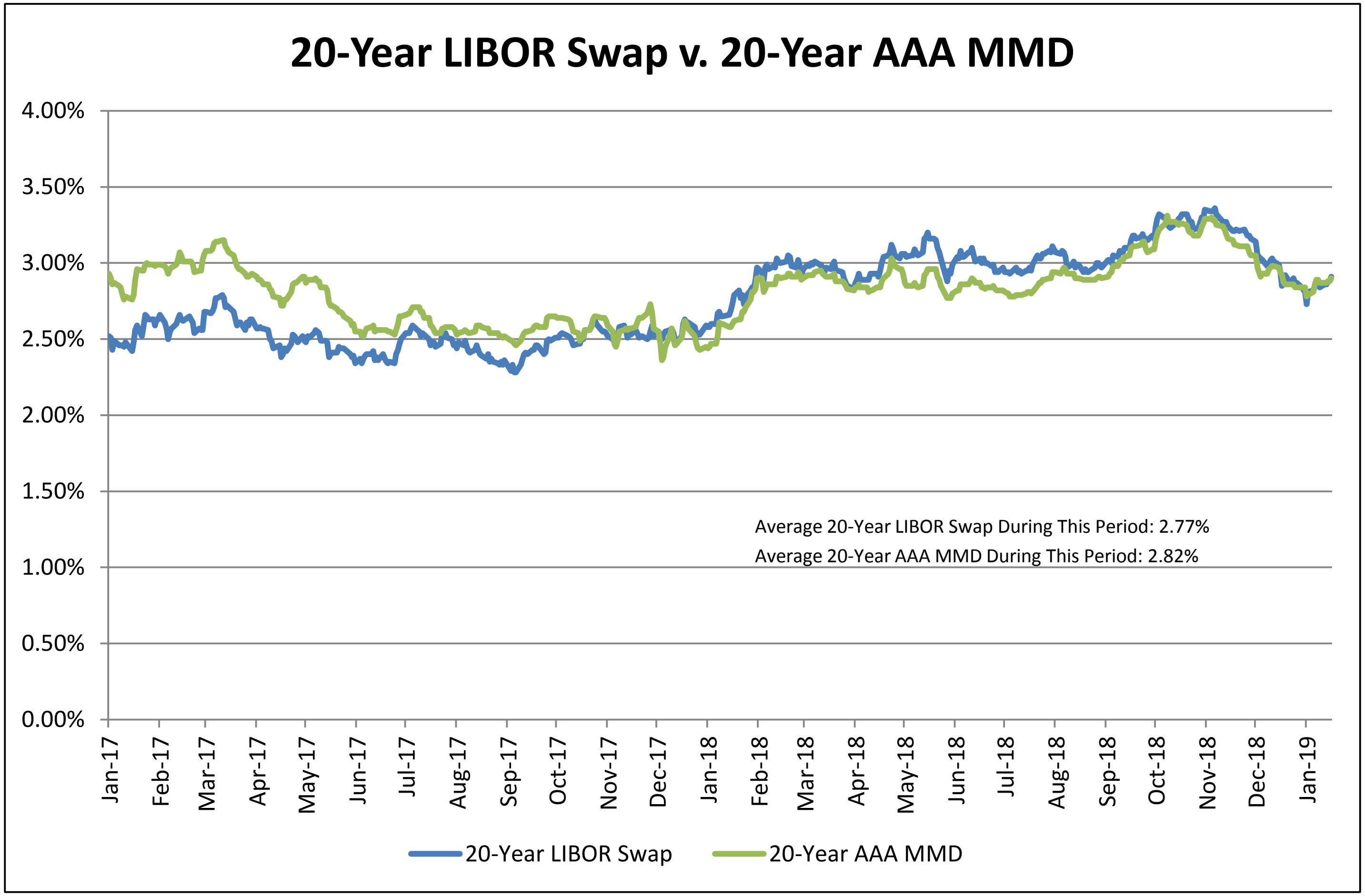
III: POSSIBLE ADDED BENEFIT OF LOWER TAX EXEMPT VERSUS TAXABLE LONG TERM DEBT FINANCING RATES

- **Until the 2008 financial crisis**, a major advantage of combining 4% LIHTC with tax exempt bonds or loans on the debt side of the financing was that, given the same rating and underlying credit, **debt purchasers would accept a lower interest rate** on **tax exempt** bonds. Why? Because they do not pay federal (and often state) income tax on the interest they receive. If a **taxable long term rate was 6.0%**, the **tax exempt rate might be 5.0%** or a little above.

- Since the **financial crisis in 2008**, that **relationship has flipped "upside down" for certain governmental credits** (like GNMAs versus long-term tax exempt municipal bonds backed by GNMAs), as discussed further below. However, under the **most frequently used debt structures** – tax exempt debt in the form of **bonds or loans** acquired or funded **by banks** in **drawn down private placement programs** and by Freddie Mac under its very similar **"TEL" structure** (See Part IV. A. and B. Below) – the **tax exemption still provides a lower mortgage rate by 25-50 basis points or more.**

- As interest rates have generally began to rise over the past two years, **the interest rate advantage of the tax exempt debt financing versus taxable financing has began to reemerge**, including on publicly offered municipal bonds such as those used in the M.TEBs structure discussed in IV.C. below.

- The following chart shows the relationship of the 20-year LIBOR swap rate, a widely used index of highly rated taxable rates, to the 20-year MMD – the most widely used index for highly rated publicly offered 20-year tax exempt municipal bonds:



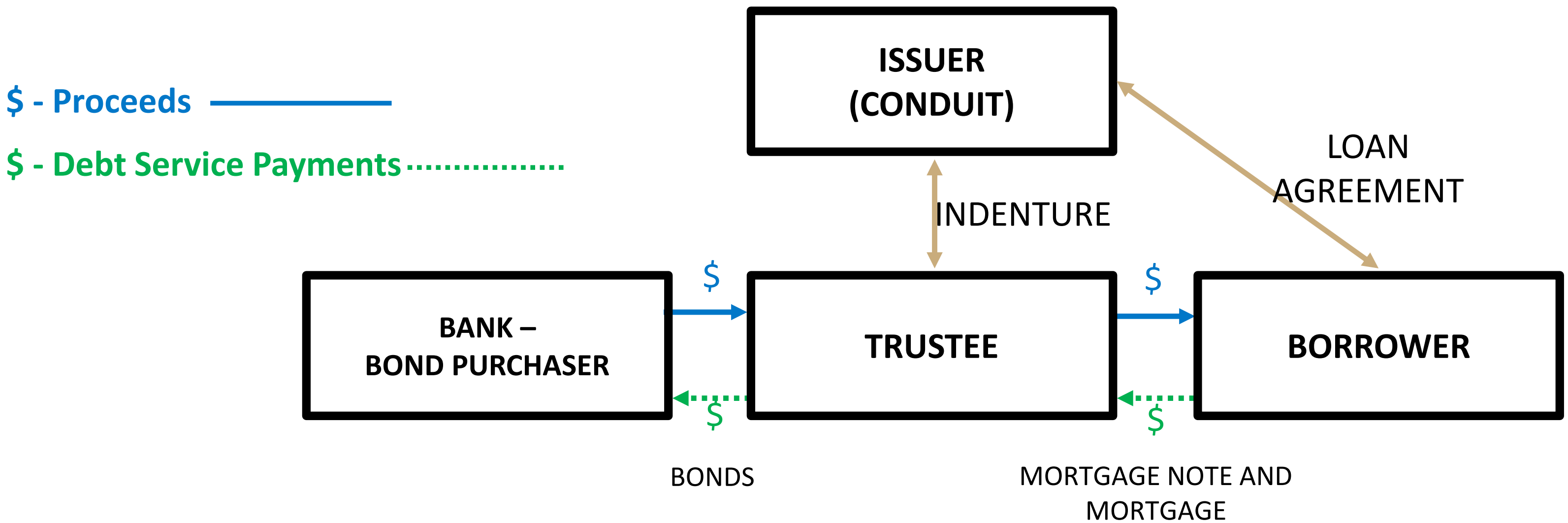
- As can be seen above, **two years ago** at the beginning of 2017, the **taxable 20-year LIBOR swap rate** was about **40 basis points lower** than the 20-year MMD (LIBOR at 2.50% versus the MMD at 2.90%); **today they are virtually the same**, at about 2.90%. If rates continue to rise and this trend continues, we expect to see an **increasing use of publicly offered tax exempt bonds** in affordable multifamily rental housing financings.

IV. MAJOR TAX-EXEMPT BOND OR TAX-EXEMPT LOAN EXECUTIONS FOR AFFORDABLE HOUSING

A. BANK PRIVATE PLACEMENT PROGRAMS

- Starting in **the late 1990's**, in part to satisfy CRA goals, banks began to buy **non credit enhanced bonds, backed only by a first deed of trust and certain pre-"Conversion" general partner guaranties** (e.g., completion, payment) in private placement financings.* For the reasons described below, this has become **by far the dominant tax exempt debt financing structure** for affordable rental housing projects in **major urban markets** (e.g., Boston, New York, Washington D.C., Miami, Chicago, San Francisco, Los Angeles, Seattle). **These programs, together with the Freddie Mac "TEL" structure described in IV. B. below,** comprise the **substantial majority (75% to 85%) of tax exempt debt side executions** (by number of financings and dollar volume) **for 100% affordable projects.**

BANK PRIVATE PLACEMENT BOND STRUCTURE



*In 1998, **Wade Norris** helped pioneer what has become one of the country's leading private placement platforms, and in the early 2000's, the leading securitization structure for these issues through Freddie Mac, in which **Kim Griffith**, as Vice President of Affordable Sales and Investments in Freddie Mac's Multifamily Division, also played a major role. **Wade Norris** and **Ryan George**, led the development of documentation for the tax exempt loan (versus) bond format for these executions when the regulatory environment dramatically changed in 2008.

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BACKGROUND ON PRIVATE PLACEMENTS FOR AFFORDABLE MULTIFAMILY HOUSING PROJECTS

- These private placement programs have the **advantages** of:
  - **Lower financing costs** – No rating fees and other costs associated with a public offering.
  - **Flexibility** – Terms could be modified as agreed by the Issuer, the Borrower and the Bank or other program sponsor.
  - **Speed** – Faster loan underwriting in some cases and no delays associated with rating and public offering.
- More recently, **additional major advantages** have been added, including:
  - **Draw-down Funding**: Tax-exempt debt is funded as loan advances are made – **eliminates construction period negative arbitrage** on new construction sub-rehab deals – can be **up to 2-4 points or more of savings** on new construction/sub rehab versus "fully-funded" publicly offered bonds.
  - **Low variable rate during construction**/rehab/rent-up – e.g., 1-Month LIBOR (2.50%) plus spread of ~1.60% to 2.00% = **4.10% to 4.50% "pre-Conversion" rate.**
  - **Locks in very low permanent rate** (e.g., 16 to 18-year LIBOR swap (2.90%) plus ~1.60%-2.20% or around **4.50% to 5.10% perm rate**) at initial loan closing.

BANK PRIVATE PLACEMENTS

- **"Built-in" Tax Exempt Bridge Loan between Closing and Conversion.** Since the bank funding the loan has a first deed of trust on the project and other guarantees, these programs also allow the pre-conversion phase of the tax exempt loan to be "upsized" to fund project costs incurred prior to the receipt of tax credit equity, subordinate loans, and other permanent funding sources, which may not be available until after the related costs have been incurred.
- **Underwriting Terms Very Attractive**
  - **35-year loan amortization** to a 16 – 18 year balloon
  - **Very large (85 – 90%) loan-to-value,** and
  - **Very low debt service coverage (1.15).**

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TAX-EXEMPT BANK DRAW DOWN **PRIVATE PLACEMENT** BOND OR LOAN FINANCING STRUCTURE **– MOD REHAB, SUB REHAB, NEW CONS**

	Sample Interest Rates*
Bond Rate – Construction: One-Month LIBOR	2.50%
Plus: Spread	1.60%
= Bond/Loan Interest Rate	**4.10% Floating***
Bond Rate – Permanent: 16 to 18-year LIBOR Swap	2.90%
Plus: Spread	2.00%
Credit Enhancement	N/A
Servicing Fees	N/A
Total Permanent Mortgage Rate** **(Underwriting Rate and Actual Permanent Borrowing Rate)**	**4.90% Fixed**

Upfront Fees (est.)

Origination	1.0 - 1.5%
App.	0.25
Bond Costs of Issuance	0.75 – 1.50
	2.00 – 3.25%

***Add 15 basis point fee stack below for all-in construction period borrowing rate.**

**** Most bond private placements funded on "draw down" basis, which eliminates construction period negative arbitrage.**

Estimated Rates as of 02/01/2019; 35-year loan amort.; 1.15 - 1.20 DSCR; 80 - 90% LTV. If the Project is not in a part of a Bank's CRA footprint, this type of product may only be available at somewhat higher rates and somewhat tighter underwriting terms from the Bank or perhaps from a non-bank provider.

***Actual rates may vary depending on various factors, including mod rehab/stabilized versus sub rehab/new construction, project; borrower; CRA or non-CRA market; and other factors. LIBOR rates set when bond or loan is priced. Spreads set at pricing (1-2 weeks before closing) and vary depending on market conditions at pricing.**

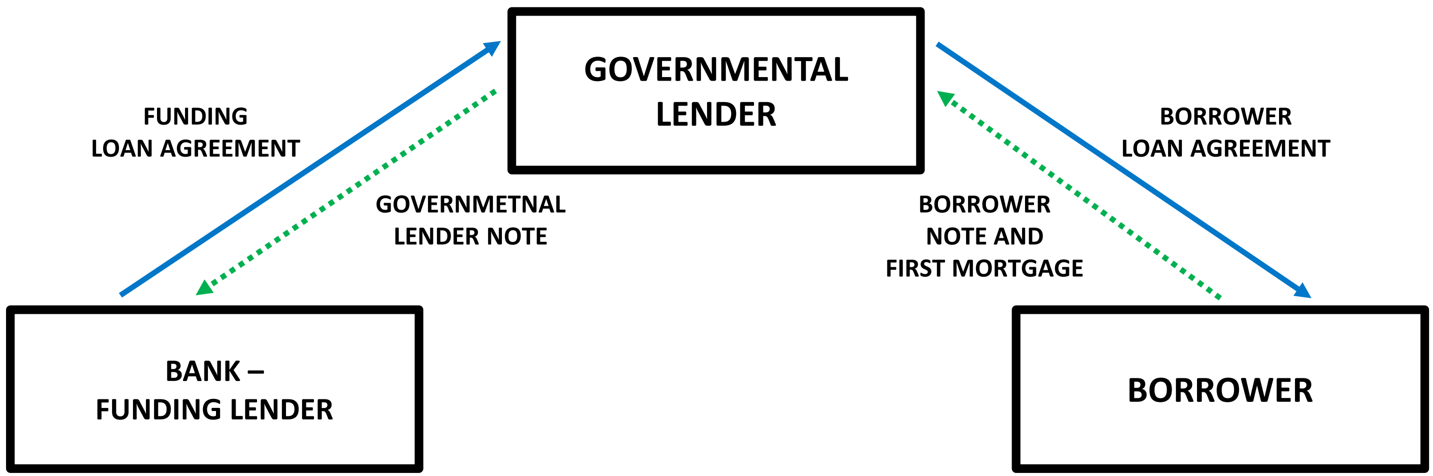
****Excluding ongoing third party fees such as issuer, trustee, and rebate analyst, which can add 10-15 basis points or more.**

BANK PRIVATE PLACEMENTS

- **CRA Impact on Affordable Housing Finance**. Large banks are required under the **Community Reinvestment Act ("CRA")** to do a certain dollar volume of public benefit **"lending" activities** and a certain dollar volume of **"investment" activities** in the markets where they have a presence, or they risk severe limitations on their future activities (e.g., new products, mergers, etc.). Thus, **large banks are huge buyers of both tax exempt bonds and funders of tax exempt loans** (and buyers of both 9% and 4% LIHTC) in markets where they have a presence. **This substantially lowers tax exempt all-in borrowing rates** (as well as tax credit yields) **in CRA driven markets**.

- Emergence of **Tax Exempt "Loan" Alternative**. The regulatory environment for banks changed dramatically following the financial crisis in 2008. To achieve **"lending" treatment**, which is **generally more favorable**, for CRA accounting, reserve, and other regulatory purposes, many **banks developed tax exempt loan (versus bond) versions** of their private placement programs. Freddie Mac's draw down private placement program – its Tax Exempt Loan or "TEL" program described in section IV.B. below– is also structured as a tax exempt loan. **There is little difference in substance between tax exempt "bond" and "loan" programs**; it is almost totally a **difference in terminology**, albeit one with important regulatory consequences.

Alternative Bank Private Placement "Tax-Exempt Loan" Structure



$ - Proceeds

$ - Debt Service Payments

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B. FREDDIE MAC TAX-EXEMPT LOAN OR "TEL" STRUCTURE

- In 2014, **Freddie Mac** introduced its **Tax Exempt Loan or "TEL"** structure with **many of the same features and terms as bank private placements**. This structure also offers very low fixed perm rates and is potentially available in a broader range of markets (not just CRA driven).
- **Loan terms are 16 years (mod rehab) up to 18 years (new cons/sub rehab), a 35-year loan amortization, 1.15 debt service coverage and a 85% - 90% maximum LTV.**
- The TEL structure was **expanded in 2015 to include sub rehab/new construction with a bank taking the risk on the tax exempt loan during the pre-Conversion phase**, and a **forward commitment from a Freddie Mac Targeted Affordable Lender and Freddie Mac to acquire the permanent phase component of the tax-exempt loan** at an agreed upon fixed rate at Conversion.*
- **The "forwards" TEL structure does require a separate bank (probably with separate counsel) to take pre-Conversion risk** on the tax exempt loan versus most other private placements, thus perhaps entails slightly higher costs.
- **Terms** are quite comparable to **those of bank private placements** (discussed above).

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*__Kim Griffith lead the development of the Freddie Mac TEL structure__ in his role as **Vice President of Affordable Sales and Investments in Freddie Mac's Multifamily Division**, a position he held from 2003 through 2015. **Wade Norris** and **Ryan George**, as **special outside counsel** to Freddie Mac, assisted in the drafting of program memoranda, model documents and other materials relating to the development and implementation of the Freddie Mac TEL structure.

C. FANNIE MAE "M.TEBs" STRUCTURE

- Over the past 6-7 years, **over $3.0 billion** of agency backed (Ginnie Mae, Freddie Mac, Fannie Mae) **tax exempt monthly pass-through bonds** have been sold in the **single family mortgage revenue bond market, lowering coupons by 25-35 basis points** versus traditional semi-annual pay long-term tax exempt bonds. Buyers want the security of an **immediate, monthly agency MBS pass-through**.

- In 2015, Fannie Mae pioneered a new, **16-year fixed rate tax exempt Fannie Mae MBS pass-through** structure initially for **mod rehab** multifamily affordable rental projects.*

- **Under this structure, the Trustee on these monthly-pay fixed-rate bonds simply passes through the monthly Fannie Mae MBS payment** to the Bondholder on **next business day** on a **tax exempt basis**.

- The **savings** in bond rate **versus** a **taxable Fannie Mae MBS** has ranged from **5 to 10 basis points**, while the savings **versus** a **semi-annual pay Fannie Mae credit enhanced tax-exempt bond** has been **closer to 25-30 basis points**.

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*__Wade Norris__ and **Ethan Ostrow**, together with their prior colleague, **Ad Eichner**, worked with Fannie Mae and other participants to develop the structure and documentation for the Fannie Mae M.TEBs product. This led to the closing of the first M.TEBs financing in February, 2015. Messrs. Norris and Ostrow then served as underwriter's counsel on the first seven M.TEBs financings which closed over the next two years, and have served as underwriter's counsel on a substantial portion of these financings closed since that time.

Fannie Mae M.TEBs

- **Bond coupon rates are around the 10-year U.S. Treasury rate plus 70 or 80 basis points: 2.75% + 0.80 = 3.55% in today's market.** This, like private placement and Freddie TEL, is another example where borrowing on a tax exempt basis provides at least a small interest rate advantage over taxable.
- **Fannie Mae is also offering very low guaranty and servicing fees of roughly 100 basis points to promote this program.**
- **Result: All-in borrowing rates as low as 4.50% to 4.60% on mod rehab (before ongoing issuer's, trustee's, and rebate analyst's fees); roughly the same rate on "Forwards," but 2 to 2.5 points of negative arbitrage on "Forwards" version,** suggesting **effective borrowing rates in the high – 4.0% range for the forward executions.**
- On the other hand, **having two sets of debt outstanding** during the construction period **can increase tax credit basis and thus 4% LIHTC syndication proceeds**, as discussed in section IV.D. below. In the case of the Fannie Mae "forwards" M.TEBs, **this can come close to offsetting the negative arbitrage deposit** required. The **net result may be a permanent lending rate equivalent of about 4.70%** in the current market when compared to other executions.
- **35-year loan amortization to 16 to 18-year balloon, 1.15 DSCR; 85-90% LTV. Mod-rehab and forwards** (sub rehab/new construction) executions.

Fannie Mae M.TEBs

- **Fannie Mae will include an allowance of 0.75% within Fannie Mae DUS Loan for issuance costs to compete with private placements –** Raises guaranty/servicing fee spread but lowers out-of-pocket expense of execution to better compete with bank private placements and Freddie TEL.

- The product is be most likely to be used in **markets where tax-exempt bond volume is available through issuers who charge very low (e.g., 5-10 basis points per year) or no ongoing fees. Short-term cash backed tax exempt bonds plus taxable Fannie Mae MBS sale** (discussed below) may be continue to be a **better option** for **moderate rehab Fannie Mae backed deals** where **ongoing Issuer fees are very high (e.g., 25 – 50 basis points).**

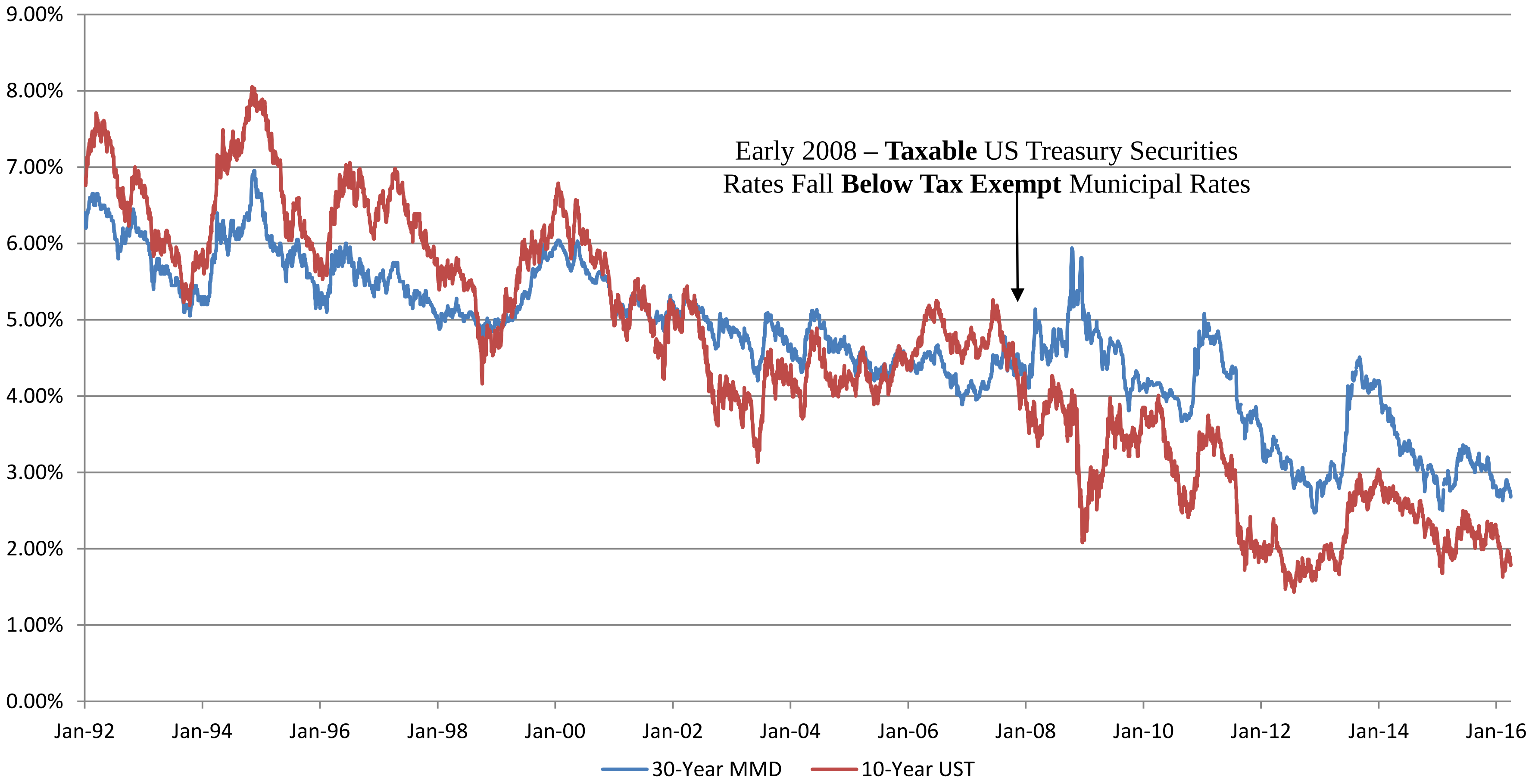
- For sophisticated developers, this **structure allows potentially more flexible prepayment options; yield maintenance** through 10 or 15.5 years to par call **versus** absolute **10-year lock-out** associated with traditional municipal bonds and **15+ year absolute lock-out under private placements**.

- The program **may allow more lenient waivers** for certain loan underwriting criteria such as larger rehab per door for mod rehab loans with low tenant relocation risk, the potential for **earn-out provisions for certain loans** and other features typically associated with Fannie Mae DUS loans.

D. SHORT TERM CASH BACKED TAX-EXEMPT BONDS

- For many years on **FHA Insured or RD financings,** we would **pledge the GNMAs to secure long-term tax exempt muni bonds** to get the lowest borrowing rate – left side of chart.
- This all changed in the **2008 financial crisis**, when **taxable rates like those on GNMAs fell *below*** the rates on **long term tax exempt muni bonds** – right side of chart.

LONG-TERM RATE COMPARISON: 30-YEAR MMD (TAX-EXEMPT) VERSUS 10-YEAR CONSTANT MATURITY TREASURY (TAXABLE)



SHORT TERM CASH BACKED TAX-EXEMPT BONDS*

- Since the 2008 financial crisis, **in some government or quasi-governmental debt markets, taxable rates are lower than tax-exempt muni rates**. For example, **rates on taxable GNMA securities**, which are used to wrap **FHA insured and certain Rural Development loans**, **are lower by 50 basis points ("bps") or more** than rates on long-term municipal bonds rated AA+ or Aaa backed by **the same** GNMAs.

- **"That's Crazy!!!"** you say. You pay federal and state income tax on the interest on Ginnies (40+% of your return if you are a high bracket tax payer), which, you keep if you instead purchase the long-term municipal bond backed by the Ginnie. How can the rates on the **taxable** Ginnies be lower?

- **We live in a crazy world.** Since 2008, **the world trusts U.S. Treasury Bonds, and GNMAs, and to a degree, Fannie Mae and Freddie Mac long-term debt securities, and not much else** (relatively), including even AA+ and Aaa-rated municipal bonds. To an extent, the world still questions that the reliability of the rating agencies; if they were that reliable they would have never rated hundreds of billions of dollars of AA and Aaa rated paper prior to 2008, which became worth 10 or 15¢ or nothing, these major disruptions in the financing markets take a generation or more to correct.

***Wade Norris**, working with other industry colleagues, played a major role in introducing the use of short-term cash backed financing with FHA insured loans in 2009, and in recent years he and **Ethan Ostrow** have helped pioneer a number of the innovations, including those described below, which have dramatically improved the efficiency of these executions.

THE ALL-IMPORTANT 50% RULE

- “So if I can do a simple taxable conventional FHA loan at a lower rate, **why** would I **use muni bonds?**”
- As described under II. above, to be sure your project is worthy of the subsidy inherent in 4% LIHTC, **Congress piggy-backed on the states’ private activity bond volume allocation systems**.
- Thus, **the 50% Rule**: Again, to be eligible for 4% LIHTC, **you have to finance at least 50% of “aggregate basis” of the building(s) plus land with volume limited tax-exempt private activity bonds** under Section 142(d) of the Code **and keep them outstanding until the project’s placed-in-service date** (roughly, completion of rehab for a mod-rehab project or certificate of occupancy for a new construction/sub-rehab project).
- So, if your project is affordable, **you will be using at least some tax-exempt private activity bonds!** (Remember: **No tax exempt bonds or tax exempt loan = No 4% LIHTC = No affordable rental housing project.**)

SHORT-TERM CASH-BACKED TAX-EXEMPT BONDS
- HOW IT WORKS

- Issue **short-term tax exempt bonds equal to 50% of the project's aggregate basis of the building(s) plus land* priced to a mandatory tender date 6-12 months following the targeted placed-in-service date** (to provide for construction delays)**. **Stated maturity will be 6-12 months** later, **allowing a remarketing** of bonds if more time is needed to place project in service.
- **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 FHA lender advances or GNMA or Fannie Mae MBS proceeds are deposited.
- 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 principal of the Bond issue thus remains 100% cash collateralized**.

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*Note: This may be greater than or lower than the taxable loan amount. Most developers aim for 52-55% of such aggregate basis to provide a cushion. The **short-term cash backed bond structure often produces a lower bond amount than other executions**, which lowers bond financing costs.

**For example, on 221(d)(4) new construction projects where the project is expected to be placed in service in 18-20 months, we would normally set a 36-month bond maturity, but price to a 24-month mandatory tender date to minimize interest costs.

SHORT-TERM CASH-BACKED TAX-EXEMPT BONDS
- HOW IT WORKS

- **As noted above, the structure also works well with rural development loans** (or loan pools) where the RD lender funds a taxable loan to the borrower and ultimately issues a GNMA security with respect to the stabilized Section 538 loan which is sold in the taxable GNMA marketplace. It **also works** where a **Fannie moderate rehabilitation DUS loan** is funded through the sale of the Fannie Mae MBS in the taxable markets.

- **In today's market**, the interest expense and upfront deposit **can often be almost totally offset or eliminated** through **investing** some or all **Indenture funds in U.S. Treasury securities or SLGS, at yields which are currently 40-60 basis points higher than the tax exempt bond coupon*.**

- This cash collateralization of principal plus interest enables the financing to obtain an **AA+ rating** on the short-term Bonds from S&P Global Ratings, based on the rating of the underlying investments (often a highly rated money market fund and/or U.S. government securities), **without other credit enhancement**.

- **When** the project loan has been fully funded, rehabilitation or construction has been completed and **the project has been placed in service, the tax exempt bonds are redeemed** on the mandatory tender date.

- The **Project's only remaining debt** (except for certain subordinate loans often used for affordable housing projects) is **the taxable loan.**

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*The excess earnings go to the U.S. Treasury in the form of a yield reduction payment or through investment in U.S. Treasury State Local Government Securities (SLGS) at the Bond yield.

SHORT-TERM CASH-BACKED TAX-EXEMPT BONDS
SUMMARY OF ALL-IN BORROWING RATES

	§223(f) (Mod Rehab)*	§221(d)(4) (Sub Rehab/ New Construction)*
10-Year Treasury	2.75%	2.75%
GNMA to 10-Yr TSY Spread	1.10	1.40
Taxable GNMA Pass-Through Rate	3.85%	4.15%
Servicing/GNMA Guaranty Fee	.25	.25
Stated Mortgage Loan Rate	4.10%	4.40%
Mortgage Insurance Premium (Affordable)	.25	.25
All-In Borrowing Rate	**4.35%**	**4.65%**

*All in borrowing rates on mod rehab and sub rehab/new construction Rural Development loans are very similar since they are also based on taxable GNMA sales. On a taxable Fannie Mae **mod rehab** DUS loan combined with short-term tax exempt cash backed bonds, the all-in borrowing rates in the current market through the sale of the Fannie Mae MBS in the taxable market would be about 10 basis points higher than the comparable tax exempt M.TEBs rate described above (i.e., 3.55%), producing an all-in borrowing loan rate of about 4.65%, roughly equal to the 4.65% rate above for a §221(d)(4) loan.

SHORT-TERM CASH-BACKED TAX-EXEMPT BONDS
OTHER ADVANTAGES

- **Total issuance costs** are **lower on short-term cash backed bonds** than on long-term municipal bond financings backed by these FHA/GNMA and Fannie Mae credits, and **Bond issues are sized to the 50% Test**, which may be much lower than the taxable long-term loan amount, thus **lowering issuance costs**.

- **Another potential major advantage of short-term cash backed tax exempt bonds** is **elimination of ongoing administrative issuer fees after Bonds are redeemed. Where ongoing issuer fees are high** (e.g. issuer fees of 25 to 40 or 50 basis points per year), this **can be a major advantage**. These issues involve an **average of 18 or 24 months of ongoing fees** or slightly more **versus 15 years** of ongoing fees for a long-term bond execution.

- **Two sets of construction period interest** may **increase tax credit basis and thus 4% LIHTC proceeds**. Under this structure, the borrower incurs **two sets of construction period interest**: (i) **interest on the fully funded short term tax exempt cash backed bonds** (which is almost always more than covered by earnings on the U.S. Treasury securities securing those bonds), and (ii) **interest on the taxable loan. Many Section 42 lawyers will allow both sets of interest to be included in tax credit basis.** The inclusion of interest on the short-term cash backed tax exempt bonds in basis may provide an **additional 3-4% bump in tax credit basis** and an **additional 1 – 1.25 points of proceeds on the syndication of the 4% LIHTC**.

- **Major Advantages of Tax Exempt Short-Term Cash Backed Bonds:**
  1. **Qualifies the Project for 4% LIHTC.**
  2. **Still lowers Mortgage Rate by 50 basis points or more.**
  3. **Avoids huge (4-8%) negative arbitrage deposit** on new construction/sub rehab (§221(d)(4)) deals.
  4. **Eliminates on-going issuer/administrative fees after 1-3 years; huge benefit** where issuers charge major (25-50 basis points) ongoing fees as long as bonds are outstanding.
  5. **Flexible Financing Alternatives:** Can sell bonds in public offering or private placement and can finance multiple loans in one tax exempt bond issue as long as loans close at the same time.
  6. **Slight bump in 4% LIHTC Proceeds – See above.**
- Major Disadvantages:

  0. **None** (ok, in an extremely small percentage of cases, a material cap i deposit).

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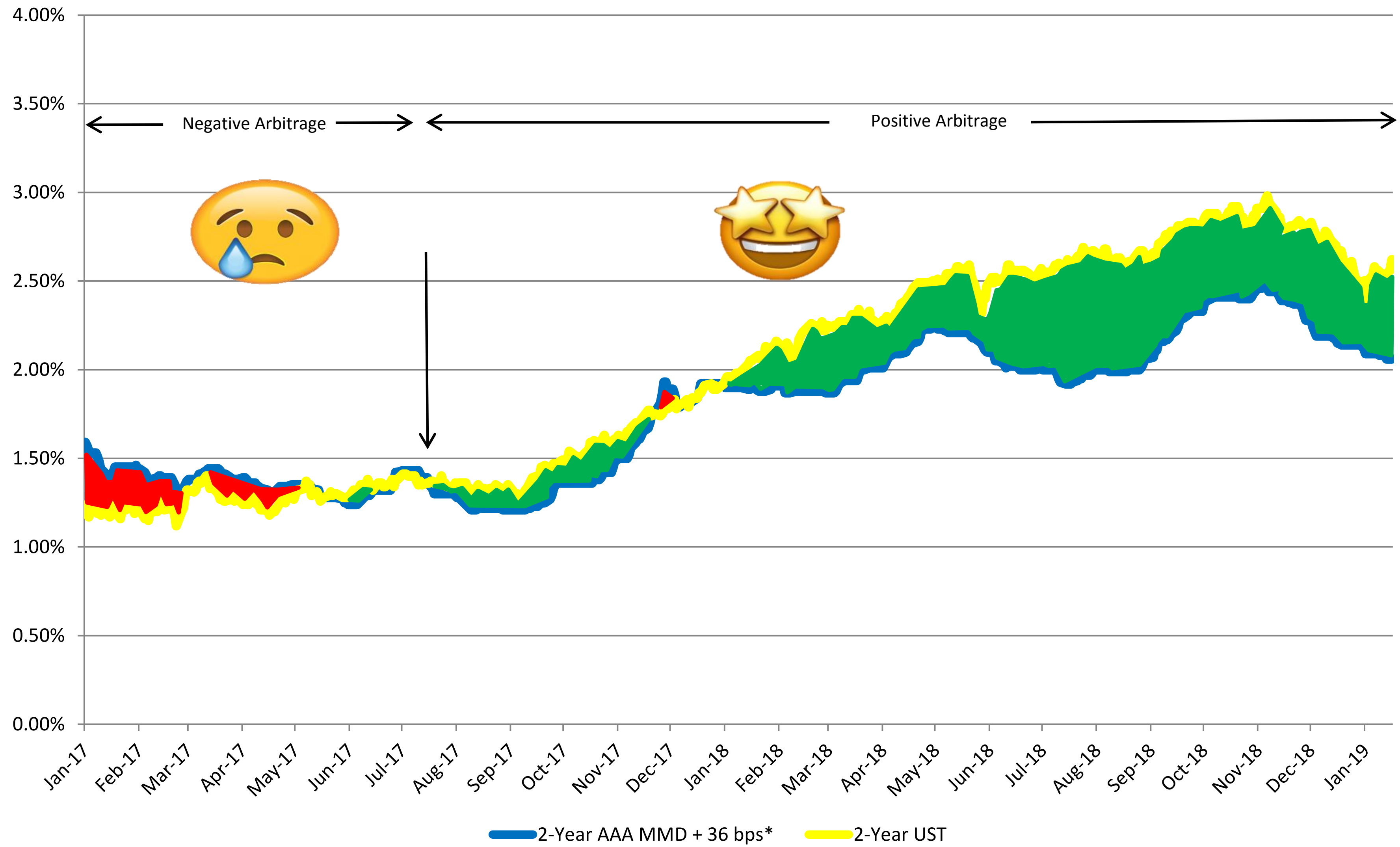
Short-Term **Tax Exempt** Interest **Rates Have Begun to Move Up**

But

SHORT-TERM **TAXABLE RATES HAVE RISEN EVEN MORE**!!! → **POSITIVE**, NOT NEGATIVE, **ARBITRAGE**

2-Year AAA MMD + 36 bps* v. 2-Year U.S. Treasury



*Spread of actual tax exempt bond coupons over 2-year MMD in one recent study.

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This means… **NO NEGATIVE ARBITRAGE!!!**
ON DEALS INVOLVING §223(f) AND **MOST §221(d)(4) LOANS**

	§223(f)	§221(d)(4)
Expected Placed in Service Date	12 Months	18 Months
Recommended Tax Exempt Bond Maturity	18 Months	36 Months
Mandatory Tender Date*	N/A	24 Months
Invest Collateral Fund in 18/24-Month U.S. Treasury	2.65%	2.70%
Tax Exempt Bond Coupon (18/24-Months)	2.15%	2.25%
POSITIVE!!! (Not Negative) **Arbitrage**	**+0.50%**	**+0.45%**

* Bonds will be priced to the mandatory tender date and redeemed on that date if the project has been placed in service; otherwise, will be remarketed on that date for 6-12 months, as needed.

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No Negative Arbitrage Deposit

- **Net Defeasance:** Moreover, if the Borrower makes arrangements for the U.S. Treasuries to be bid and purchased for delivery to the Trustee at closing, **NO DEPOSIT to cover capitalized interest is required** since the investment earnings are locked in at closing!*
- The Trustee, on behalf of the Borrower, simply makes a small yield reduction payment to the U.S. Treasury from the locked-in positive arbitrage (Sorry! Since 1986, you can't keep the positive arbitrage ☹) and you are done!**
- **Only cost on Bond side is** 2-3 points of **costs of issuance**.
- **The best conditions we have had since we helped pioneer the structure in 2008!!!**

---

*Or invest in SLGS issued by the U.S. Treasury equal to the bond yield.

**Not needed with SLGS investment.

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The Key to No Negative Arbitrage on Bond Issues with **§221(d)(4) Loans**: A Clean **Bond Counsel "Reallocation Opinion"**

- **Almost all Bond Counsel firms (well over 20-30) will allow us to invest moneys in** Project Fund and Collateral Fund – i.e., an amount equal to the Bond issue – **in a fixed portfolio of 24-month U.S. Treasuries.***

- **As the FHA Lender presents monthly FHA Lender advances to Trustee** for deposit to Collateral Fund against disbursement of an equal amount of tax exempt Bond proceeds from the Project Fund to the Borrower/FHA Lender to cover project costs, we **reallocate** ownership of this **fixed portfolio** of Treasuries* **from the Project Fund to the Collateral Fund without liquidating the investments**.

*Or invest in SLGS issued by the U.S. Treasury equal to the bond yield, which has the same effect.

Where a Reallocation Opinion is available…
NO NEGATIVE ARBITRAGE

- We call this a **"Reallocation with No Liquidation" opinion,** or, for short, a **"Reallocation Opinion."***
- Bond Counsel's willingness to give a **Reallocation Opinion** allows us to lock our reinvestment rate and thus is **critical to eliminating negative arbitrage on issues involving §221(d)(4) loans**, **especially** for **new construction**.
- In the last two years, we have worked to get over a dozen major bond counsel firms to give a clean Reallocation Opinion. The **savings on five bond financings** totaling $115 million in late 2017 and early 2018 **were $5.1 million**.

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*This relates to the "approving opinion" of bond counsel – that the bonds are legal valid and binding obligations of the issuer and that interest on the Bonds is tax exempt, not the opinion which bond counsel gives to HUD regarding consistency with HUD requirements.

POTENTIAL NEGATIVE ARBITRAGE ON
A VERY SMALL NUMBER OF DEALS INVOLVING **§221(d)(4) LOANS**

- There are now **only a handful of bond counsel firms who have not gotten comfortable** rendering a clean Reallocation Opinion.
- This can **force** the **investment** of a substantial portion of the cash securing the bonds **into liquid taxable government backed money market funds** which currently **yield only** about **130 basis points versus 265 – 270 basis points above.**
- Moreover, **this yield cannot be locked in at closing**.
- **Gross Funding of Capitalized Interest:** As a result, instead of making no upfront deposit and making **no** negative arbitrage deposit at closing, on these transactions a substantial portion of the full capitalized interest – **as much as 2.0 or 3.0 points or more** – **must be deposited in bankruptcy remote funds at closing** (i.e., the capitalized interest must be "gross funded," assuming 0% investment earnings).

SUBSTANTIAL NEGATIVE ARBITRAGE ON **A SMALL NUMBER OF DEALS** INVOLVING **§221(d)(4) LOANS**

- **On a $20.0 million bond issue, this is a $500,000 or $600,000 or greater negative arbitrage deposit at closing!**
- On a **substantial rehab loan with a large first draw** to cover project purchase price and other upfront costs, the amount of this negative arbitrage and the size of the upfront deposit **can be dramatically reduced**.
- Even on a new construction loan, **with creative steps**, we can structure the issue so that much of this deposit can be reduced.
- But the **expected negative arbitrage may still be in the hundreds of thousands under this scenario – versus - $0 above, with a clean reallocation opinion**.

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Conclusion:

On a §221(d)(4) financing, at the very outset – i.e., before selecting the issuer and applying for bond volume – the **Borrower must determine:**

Will bond counsel render a clean Reallocation Opinion?

<u>If Yes;</u>

No problem… Party on, Dude!”

Will bond counsel render a clean Reallocation Opinion?

<u>If No,</u>

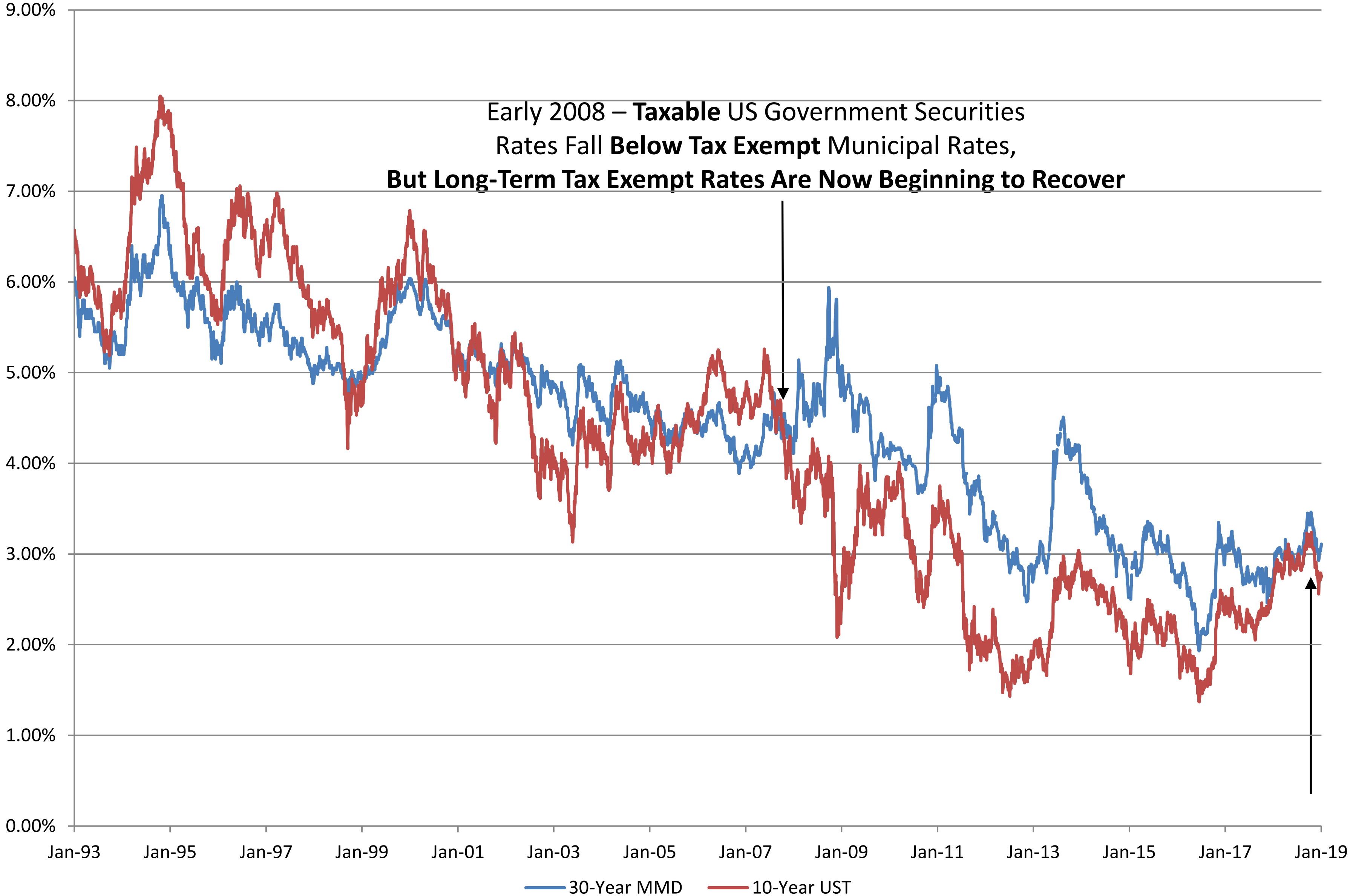
AT VERY OUTSET OF DEAL – BEFORE APPLYING FOR BOND VOLUME!!!

Shop Around!!!

- **Can you work with a different bond counsel firm** that will render a clean Reallocation Opinion? Some issuers allow the borrower to choose among several bond counsel firms – shop around!
- If not, **can you** obtain your bond volume and **have the tax-exempt bonds issued by another issuer**, whose bond counsel will give a clean Reallocation Opinion? In many cases there may be multiple issuer choices (1 or 2 local, regional, and/or state issuers).

Again, **on a Section 221(d)(4) FHA or new construction/sub rehab RD financing, in the very few cases where a clean reallocation opinion is not available, shop around before applying for bond volume - the savings can be hundreds of thousands of dollars.**

ARE LONG-TERM TAX EXEMPT RATES FINALLY GOING "RIGHT SIDE UP" VERSUS TAXABLES?



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BACK TO LONG TERM MUNI BONDS?

- It has taken 10 years, but **long-term tax exempt rates may finally be dropping to levels roughly equal to those on long term GNMA's.**
- Does this mean we will **go back to financing the debt side with long-term tax exempt muni bonds** backed by GNMA's? **Answer: Probably not quite yet.**
- **Long term muni bonds** are **fully funded** at closing → **huge (up to 6% – 8%) potential negative arbitrage** on **§221(d)(4) new construction / sub rehab deals** – v – $0 on short-term cash backed tax exempt bonds.
- **Ongoing issuer / trustee / rebate fees** (often **15 to 30 basis points** or more) are eliminated on short-term cash backed bonds after 2-3 years.
- **Upfront costs are lower on short-term cash backed tax exempt bonds.**
  - **Underwriting fees are lower** on short-term municipal bonds (0.50% to 0.70% on many deals v 1.0% to 1.25% for long-term)
  - **Other fees are lower too:** rating agency ($5,000 v $16,000 or more), etc.
- **We only issue tax exempt bonds in an amount up to the 50% test** → this further lowers underwriting fees and other costs of issuance.

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ADVANTAGES OF BANK AND FREDDIE "TEL" PRIVATE PLACEMENT STRUCTURES – v – FHA

- As noted above, especially in high cost markets, **many projects require a construction loan** that is **much larger than** the supportable **permanent debt**. A portion of the larger **construction loan often provides critical "bridge" financing** to later tax credit equity installments and subordinate loan pay-ins.

- **As noted above, private placement sponsors and bank construction lenders on Fannie/Freddie sub rehab or new construction financings will readily provide such a larger construction loan** since the entire construction loan is secured by a first deed of trust; **with FHA**, on the other hand, **no lien on real estate is permitted to secure a tax credit or other bridge loan**.

- Instead, **on FHA loans the bridge loan** (either taxable or in the form of subordinate tax exempt bonds if needed to satisfy the 50% rule) must be **secured by a pledge of tax credit equity installments, deep pocket general partner guarantees of completion and payment and/or possibly a pledge of general and/or limited partnership interests**. Such debt may be more difficult to place.

ADVANTAGES OF BANK AND FREDDIE "TEL" PRIVATE PLACEMENT STRUCTURES – v – FHA

- While all-in permanent borrowing rates on private placements may be somewhat higher than FHA all-in rates, and most such loans do not offer the 40-year loan amortization available on Section 221(d)(4) loans, **private placements do offer very low perm rates described above** that are **locked at closing**; and, as noted above, **the structure readily accommodates a loan pay-down at Conversion** from other funding sources.

- **Private placements and Fannie and Freddie deals also avoid Davis Bacon wages** required for sub rehab (very generally > $40,000 per unit)/new construction FHA Section 221(d)(4) loans, and generally offer more flexible/quicker loan underwriting.

- Private placements **may also be available from non-bank financial institution sponsors** and may be especially attractive in non-CRA driven markets.

SUMMARY OF BORROWING/ UNDERWRITING RATES
PRINCIPAL TAX EXEMPT DEBT PRODUCTS FOR 100% AFFORDABLE PROJECTS

	Estd. Actual All-In Borrowing and Underwriting Rate
1. Bank Private Placement	
-Mod Rehab	**4.10% to 4.50%**
-Sub Rehab/New Cons	
Cons Period	**4.10% to 4.50% Floating**
Perm Period	**4.50% to 5.10%**
2. Freddie Mac "TEL" Program (Mod Rehab, Sub Rehab, New Cons)	**Similar to Bank Private Placements above**
3. Fannie Mae "M.TEBS" Structure – mod rehab	**4.55%**
or "Forwards" (new cons / sub rehab)	**4.70%***
4. Short-Term Cash Backed Tax Exempt Bonds with Taxable Loan Sale	
FHA/ GNMA §223f (Mod Rehab)	**4.35%**
FHA/ GNMA §221(d)(4) (Sub Rehab / New Cons)	**4.65%**
Fannie Mae Mod Rehab	**4.65%**

*Taking into account 2-2.5 years of negative arbitrage during the pre-conversion phase, which is typically almost offset by a bump in tax credit basis and 4% LIHTC proceeds from two sets of construction period debt under the Fannie Mae Forwards M.TEB structure.

V. COMBINING MAJOR TAX EXEMPT DEBT STRUCTURES

1. Short-Term Cash Backed Tax Exempt Bonds + Fannie Mae M.TEBs

- Because the Fannie Mae DUS Loan is sized to the permanent, stabilized loan amount, especially in high cost areas where other permanent financing sources play a major role in funding, **the M.TEBs issue may be less than the 50% amount.**

- In some cases, this can be addressed by using one or more of the other debt structuring techniques described in section V.B. below; in other cases, those **other funding sources are flowed into the deal by a separate series of short-term tax exempt cash backed bonds.**

- We now **combine these two sources of tax exempt debt in one Indenture**, and offer them in **one Official Statement**, which can **further lower documentation and financing costs**.

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2. Short-Term Cash Backed Tax Exempt Bonds + Freddie TEL

- The **same technique** can be used to **satisfy the 50% Test on a Freddie Mac Mod Rehab TEL debt structure**; though the debt will typically be **structured as two separate issues (slightly increasing costs)**.

- In addition, for a **new construction/sub rehab project**, it is possible to **combine an issue of publicly offered short term tax exempt cash backed bonds with a Freddie Mac unfunded forward commitment** in which the **permanent component of the loan is structured and documented as a Freddie Mac TEL execution**. As with the "Forwards" M.TEBs structure, the pre-Conversion funding occurs through the exchange of the short term cash backed tax exempt bond proceeds and the proceeds of **a taxable draw down construction loan from a bank**, which is paid off when Conversion to the permanent phase occurs after the placed-in-service date from the closing of the TEL financing. For tax purposes the permanent Freddie TEL financing is structured as a tax exempt current refunding.*

- Such an execution can **be especially effective when state law (e.g., Texas) or other limitations prevent the structuring of the draw down loan as the tax exempt debt**, since it **satisfies the 50% Test** while **eliminating the construction period negative arbitrage** associated with a fully funded tax exempt long-term bond or loan issue.

- **The interest paid on the separate issue of short-term cash backed tax exempt bonds can also slightly enhance the tax credit basis and 4% LIHTC proceeds** as described in IV.D. above.

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*Which is a "reissuance" that imposes a tax risk under this structure, if a law, like HR1 proposed in 2017, were to pass which eliminates tax exempt current refundings.

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VI. THREE OTHER DEBT STRUCTURING TECHNIQUES

- **Three other debt structuring techniques** can be used to close funding gaps and/or to help satisfy the 50% Test:
  1. Taxable and Tax Exempt **Tax Credit Equity Backed Bridge Loans**
  2. Taxable and Tax Exempt **Seller Take Back Debt**
  3. Tax Exempt **Cash Surplus Backed Bonds**

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1. TAXABLE AND TAX EXEMPT **TAX CREDIT EQUITY BACKED BRIDGE LOANS AND BONDS**

- **Especially on** financings involving an **FHA loan, any bridge loan** must be **secured by a pledge of tax credit equity installments, deep pocket general partner guarantees of completion and payment and/or possibly a pledge of general and/or limited partnership interests**. Such debt can have no claim on the Project and is subordinate to the FHA Loan and payable only from the sources described above.
- Such tax credit equity bridge loans may take one of **two forms**:

a. Taxable Bridge Loan

- A taxable bridge loan is sometimes provided by the **tax credit syndicator,** backed by the collateral described above.

b. Tax Exempt Tax Credit Equity Backed Subordinate Bonds

- **A Tax Exempt** Tax Credit Equity Backed Subordinate Bond issue, secured by the collateral described above can also be used.
  - If meeting the 50% test is a challenge, Tax Exempt Tax Credit Equity Backed Subordinate Bonds can sometimes be **delivered to the syndicator** to help meet that test*.
  - A number of our underwriter clients can also structure a **Publically Offered** Tax Exempt Tax Credit Equity Backed Subordinate Bond issue to provide this type of bridge financing on relatively attractive terms.
  - Such a separate series of tax exempt bonds can involve **additional documentation costs** and, if publically offered, will not reduce selling costs, but in the **few cases** where a short-term cash backed tax exempt issue involves **negative arbitrage**, **such an issue can substantially lower the amount of tax exempt cash backed bonds needed and thus substantially lower the negative arbitrage**.

*These bonds may be taxable to the syndicator, but they will nonetheless count for purposes of meeting meet the 50% test.

2. TAXABLE AND TAX EXEMPT **SELLER TAKE BACK DEBT**

The **need for** taxable or tax exempt **bridge loan** financing can often be **eliminated or reduced,** and other financing gaps can be closed, through the use of **"Seller Take-Back Debt."**

a. Taxable Seller Take Back Note

- Under this approach, a simple "**Taxable Seller Take Back Note**" is executed by the Borrower and **delivered to the Seller** in lieu of cash, in payment of a portion of the project purchase price. This is often used to **maximize the purchase price** on **RAD transactions and other preservation deals,** where the **new borrower** has been set up by or **has a close relationship with the housing authority or profit-motivated project seller**.
- A **robust purchase price** also **increases the** federal and state **tax credits** available to the purchaser.
- A **simple Taxable Seller Take Back Note** can **dramatically reduce the need for cash at closing.**
- The **proceeds** of a simple taxable Seller Note **may sometimes be escrowed and delivered to the Bond trustee at closing to immediately collateralize part of a short-term cash backed tax exempt bond issue and reduce both selling costs and, in the small number of cases where negative arbitrage is an issue, negative arbitrage**.

b. Tax Exempt Subordinate Seller Take-Back Bonds

- As an **alternative**, the seller take-back note or a portion thereof can also be effectively **converted to tax exempt debt by having** the **issuer** of the other tax exempt bonds issued to meet the 50% test also **issue Tax Exempt Subordinate Seller Take-Back Bonds,** backed by a surplus cash note from the Borrower. **Disadvantage: 2 sets of tax-exempt bond documents. Advantage: No underwriting or origination fee on these tax-exempt bonds** since they are acquired by the seller.

- Especially **if the Seller is a for-profit entity**, this also **makes the seller take-back terms more attractive** to the Seller (interest is tax exempt), and these Bonds count as tax exempt debt for **satisfying the 50% Test**, if needed. This **can reduce the size of a Series A Tax Exempt Cash Backed Bonds**, lowering the associated costs and reducing negative arbitrage on those bonds if that is an issue.

- Moreover, the subordinate tax exempt bonds can be **delivered to the Seller** as partial consideration of the transfer of the project **without cash changing hands,** reducing or eliminating the need for bridge financing and putting the FHA execution on a more even footing with private placements and other competitive executions.

3. TAX EXEMPT **CASH SURPLUS BACKED BONDS**

- With both construction costs and interest rates rising in 2018, and tax credit equity pricing being impaired by lower corporate tax rates adopted in the recent Tax Cuts and Jobs Act, a number of **affordable housing developers are seeking additional funding sources** to plug the gaps left in their financing plans.
- To address these gaps it is possible to structure and sell **tax exempt subordinate bonds secured by a pledge of surplus cash from the Project** as defined in the FHA Regulatory Agreement. Such bonds typically also entail a debt service reserve fund typically sized to cover the maximum annual debt service on the bonds and/or a guaranty of the bonds by a deep pocket general partner of the Borrower.
- **Such bonds are generally structured as term bonds** set to mature, depending on the availability of moneys available from surplus cash term bonds, after the FHA insured loan has been fully amortized. In today's market, they might be expected to bear interest at tax exempt rates of 6.0 to 10.0%. While these rates are higher than most tax exempt bond rates, they are much lower than the yields which would be required to fill these gaps from equity funding sources.

VII: MAJOR TAX EXEMPT DEBT EXECUTIONS FOR "MIXED INCOME" AND/OR "MIXED USE" PROJECTS

- As noted above, **"mixed income" and/or "mixed use" projects** are usually very **large, complex urban projects** (which often involve a combination of for sale residential, commercial, and other components, combined with a rental apartment component where 20% of the units are rented to tenants where incomes do not exceed 50% of AMI (for a family of four, adjusted for family size at rents ≤ 30% of that amount). Usually, 80% of the units are rented to tenants at any income level at market rates.
- The developers of such projects tend to be **very large or national development firms**, who have the capability of using their **large, liquid balance sheets** to achieve, when desired, very high leverage and/ or the lowest possible borrowing rate.

ALTERNATIVE A. TAX-EXEMPT 7-DAY DEMAND VARIABLE RATE BONDS BACKED BY LARGE BANK DIRECT PAY LETTER OF CREDIT.

- Structure large tax exempt and, in some cases, taxable bond issues as **7-day demand "lower floater" bonds** backed by a **direct pay letter of credit** from a **large** foreign or domestic highly rated **bank**.
- In some cases, this debt may comprise as much as 85 – 90% LTV, when combined with a pledge of other collateral and/or completion, payment (or other guarantees for some portion of the exposure) by strong, liquid corporate guarantors.

- Major Advantage:
  - Allows developer to **borrow at the very shortest end of the traditionally steep tax exempt yield curve** (e.g., SIFMA = ~1.3%) and/or shortest end of taxable yield curve (e.g., one-month LIBOR = ~2.5%).
  - Add letter of credit fees of 150 – 200 basis points, and **all-in borrowing cost is 3.0 to 4.0%** versus much higher long-term tax exempt and taxable rates (5.0% to 6.0%).
- Disadvantages:
  - **Variable rate risk,** but this can be limited with caps or swaps, and bonds are multi-modal; the borrower can trigger a mandatory tender and go into alternate interest rate modes.
  - **Limited duration.** These letters of credit typically expire in 4-6 years, and the borrower must then extend or arrange an alternate credit and/or liquidity from another facility at then applicable market rates.

ALTERNATIVE B. COMBINED WITH TOTAL RETURN SWAP PRIVATE PLACEMENT FIXED RATE BOND STRUCTURE

- Under a "total return swap" structure **bonds are typically structured as fixed rate (e.g., 6.0%) unrated, non-credit enhanced tax exempt bonds** sold to a **bank in a private placement.** The Bonds are issued in large minimum denominations (e.g., $100,000 or higher), and are subject to transfer restrictions.
  - The Borrower also enters into a separate **swap transaction** with the Bank which effectively **converts the Borrower's fixed rate borrowing into an extremely very low variable rate borrowing** as follows:

  1. *The Swap Counterparty (the Bank) makes fixed rate payments to the Borrower at a fixed rate equal to the fixed rate on the Bonds, generally on the same Notional Amount. This offsets the payments due from the Borrower to the Bank on the Bonds.*
  2. ***The Borrower makes floating rate payments to the Bank on the swap** based upon a stated notional amount which is equal to the outstanding principal amount of the fixed rate Bonds**, based upon the 7-day SIFMA or 1-month LIBOR index plus a spread** of a fixed number (e.g., 150) of basis points..*

  - The **net effective borrowing rate in this example is** what the Borrower pays on the floating rate leg of the swap – in this example the SIFMA index (≈ 0.90) + 1.50% = **2.40%, an extremely low borrowing rate**.

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- **Considerations: The Borrower will be required to post additional collateral** to the Bank to the extent the Notional Amount of the swap exceeds some percentage (e.g., 75%) of the market value of the Bonds or the underlying Project, as determined by the Bank on a periodic basis. **A termination payment may also be required** if the value of the bonds declines below the notional amount of the swap at termination and the swap is not excluded or the Bonds are not otherwise refinanced. Finally, the **Borrower** will also be **exposed to increases in the index on which the variable rate is based on unless a cap on other hedge is bought.**
- **Limited Duration.** The **swap generally expires on a date 5-8 years** from the initial effective date, so this structure entails the same need to restructure debt in the near term as with most letter of credit backed financings.
- **Result**: This structure provides an **extremely low borrowing rate**, but only for a limited term (usually 5-8 years, which **may or may not be rolled forward**). Thus, it is only attractive to and available to **experienced large balance sheet borrowers** who can post additional collateral if required and/or make any required termination payment.
- **Tax considerations** require the terms of the bonds and the Swap to be kept separate, which can introduce some **timing and other risks.**

VIII. CONCLUSIONS

- The techniques described above represent an **array of effective structures and programs** which are being using in financings today to meet the debt-side funding requirements and satisfy the all-important 50% Test on today's affordable multifamily rental housing financings.
- It **is critical** for the borrower and its attorneys and advisers and other trusted industry colleagues **at the very earliest planning stages** for such a project – **well in advance of applying for bond volume** – to **develop an overall financing plan** which will represent the optimal combination of these structures and techniques for a particular project.
- A **Note of Caution on Proposed New Structures and Techniques**:
  - All of us in the industry work continuously to develop **new financing structures and programs**, which in some cases, become mainstream, effective, debt executions.

- **But remember…**
  - **This can take time.** Our lawyers worked for **3-5** years to move **short-term cash backed tax exempt bonds** into the mainstream. We worked for the better part of **3 years** before closing the first **Fannie Mae M.TEBs** financing, and the **Freddie Mac TEL program,** in which our lawyers played a central role in creating at Freddie Mac, also **evolved over several years**.
  - **Tax law uncertainties. New structures often trigger tax questions** with respect to which **different bond counsel firms** – who have to render unqualified opinions – **may disagree.** This may trigger **tax issues which have not been identified until a number of deals have closed**.
  - New structures may trigger **other issues** – bankruptcy, real estate, rating agency, securities law, local law, HUD or GNMA policies or other issues **which can side track a deal and which may not surface until a product has become mainstream**.

- All of this suggests…**if your deal has to close, you may not want to bet your upcoming cross country trip on a brand new model.**
- It's great to expand the envelope, but **if you are a test pilot or a guinea pig you need to know that and agree to that role!** ☺

Are you…

– or –

- Both are great, but **on your project, if it has to close, who do you want to be?**
- Industry players promoting new structures owe it to the developer to **candidly discuss these risks on the front end of the proposed financing.**

- **Notes of Optimism for Affordable Multifamily Rental Housing Finance**

    - The **HR1 Meteor did not strike the earth**, and **tax exempt multifamily volume rose** from $7.0 billion in 2015 to $14.0 billion in 2016 **to $15.3 billion in 2017**, according to CDFA data.* Data is not in for 2018, but it appears to have been a very solid year.

    - The **demand for affordable multifamily rental housing grows more acute each year**, and **state and local governments are providing increasing funds to close funding gaps**.

    - **The recent rise in interest rates seems to be ameliorating**, and a slowdown in market rate apartment construction may provide **some relief from increasing construction costs.**

    - **Tax credit equity pricing appears to have firmed up** following the uncertainties in 2017 and early 2018, and there is a reasonable **prospect that the 4% LIHTC will become a real 4%**, not 3.2% – a **20% increase in this funding source**.

    - **Times may not always be this good**. This appears to be a **time to continue to use** the techniques described above and other **existing and new techniques to meet the nation's need for affordable multifamily rental housing, which continues to become increasingly critical each year.**

* CDFA Annual Volume Cap Report, An Analysis of 207 Private Activity Bond & Volume Cap Trends, released September, 2018.

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