National Housing & Rehabilitation Association

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DAVID LETTERMAN'S LIGHTNING ROUND BIG TOP FOUR DEVELOPMENTS ON TAX EXEMPT BONDS

Presented by:

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1. RECENT IRS PRONOUNCEMENT CLARIFIES THAT TAX EXEMPT FINANCED PROJECTS MAY GIVE PREFERENCE TO VETERANS

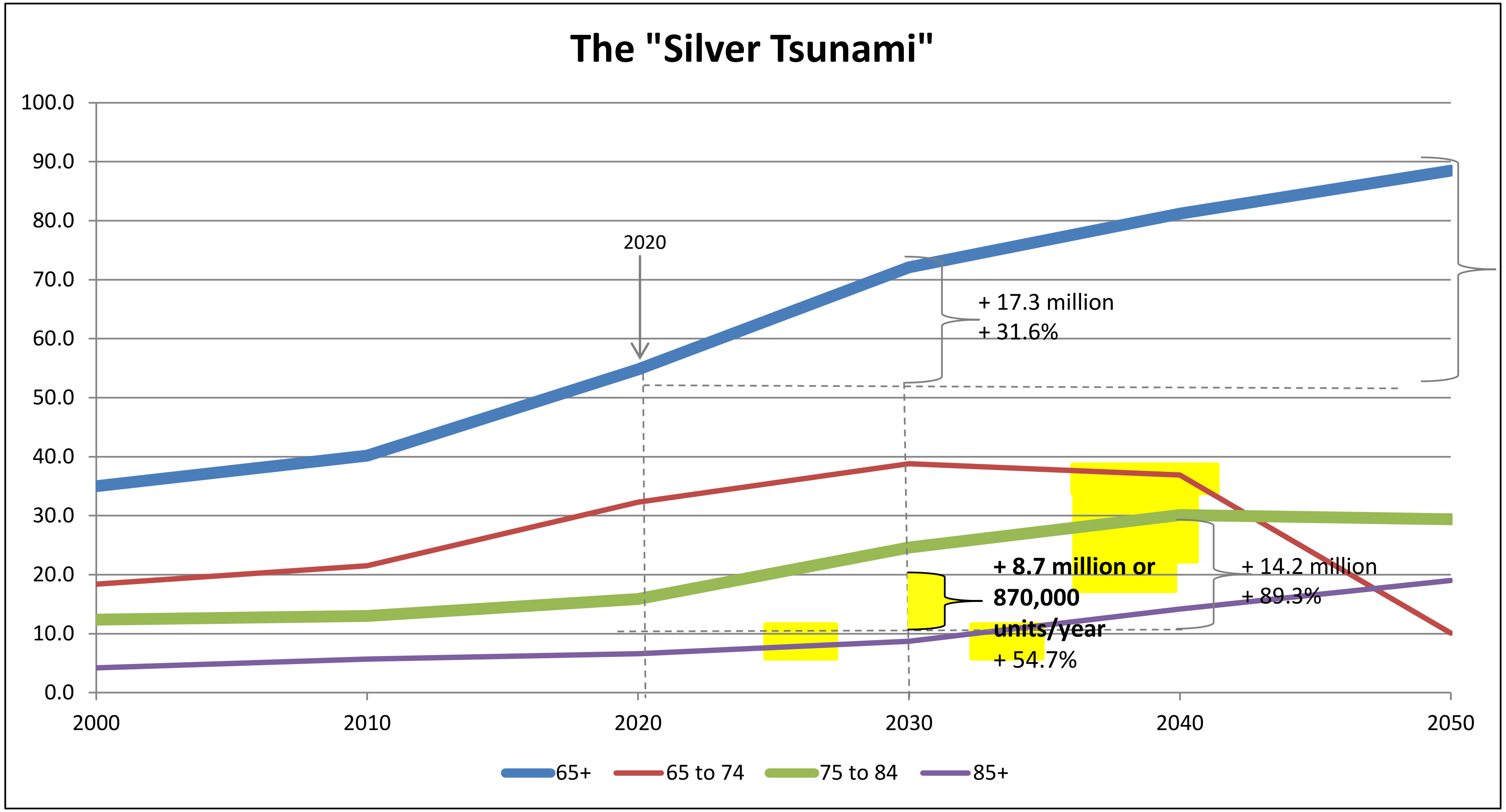
- An announcement last fall by the **IRS questioned whether setting aside units for veterans**, as a number of projects now do, **is consistent with** the requirement under Section 142(d) that units be **available for occupancy by the general public.**

- Section 42(g)(9) of the Code, relating to the LIHTC, treats Group Preferences, including those for veterans, as meeting the public use requirement for purposes of the LIHTC, **but Congress did not address Group Preferences in the Section 142(d) Multifamily Bond provisions.** This fall the Office of Chief Counsel of the **IRS publicly stated that they could not give comfort** that such a preference satisfies Section 142(d).

- In **Rev. Proc. 2019-17**, released on **April 3, 2019**, the Service clarified that **a qualified residential rental project** (as defined in Section 142(d)) **does not fail to meet the general public use requirement** applicable to exempt facilities **solely because of occupancy restrictions or preferences that favor** tenants described in Section 42(g)(9) (for example, certain housing preferences for **military veterans**). This revenue procedure applies to bonds **sold before, on, or after** April 3, 2019.

2. THE COMING TSUNAMI OF ASSISTED LIVING/MEMORY CARE FINANCINGS – INCREASING USE OF 4% LIHTC; DEFINITION OF "COMPLETE LIVING UNIT"

- We are seeing a **rapidly accelerating interest** in the use of **tax exempt debt to finance affordable rental housing for seniors. A growing number of these are assisted living facilities**, including assisted living facilities with **memory care units**. Why?



THIS IS A HUGE DEMONGRAPHIC SURGE!

- Over the **past decade, the surge in the post WWII "Baby Boom Echo", or "Millennial" generation** entering the workforce and seeking housing, at a rate of about **400,000 additional units per year**, was **one of three major drivers of surging apartment demand**. **That trend** is now **almost spent.***

- **Note the above statistics** – the **Baby Boom Generation** is **much bigger** – the **870,000 additional units per year of senior rental housing demand over the next decade** is **over twice** the 400,000 units per year addition to **rental housing demand over the past decade from millennials**.

- Conclusion: Over the **next decade**, the **huge new driver of multifamily rental housing demand**, with much of it being assisted living, **will be the Silver Tsunami**.

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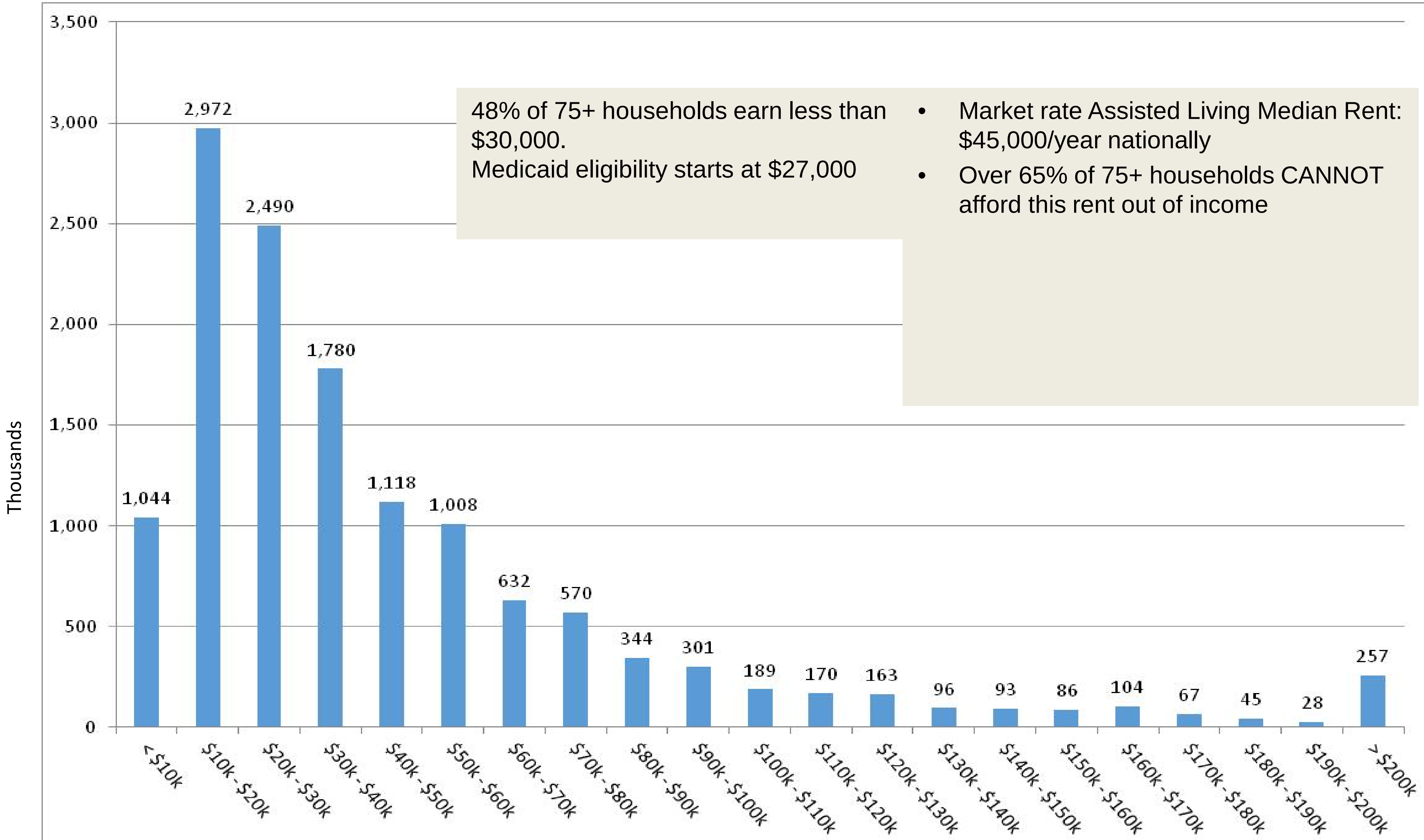
* The **other two** major factors were (i) **continuing decline in single family home ownership** from 69% at peak in 2007 to about 64.4% today, which **appears to have bottomed** out for now, and (ii) **continued net immigration** (immigrants rent for 10 years before buying), **which continues**.

- Emerging medical issues and physical limitations combined with **low income levels and limited net worth will force many 75-85 year old seniors into an affordable assisted living alternative.**



48% of 75+ households earn less than $30,000.
Medicaid eligibility starts at $27,000

- Market rate Assisted Living Median Rent: $45,000/year nationally
- Over 65% of 75+ households CANNOT afford this rent out of income

Source: US Census, https://www.census.gov/data/tables/time-series/demo/income-poverty/cps-hinc/hinc-02.2016.html

- A rapidly **increasing number of these assisted living projects** are **now financed with tax exempt bonds under Section 142(d)**.

- There are **now several major syndicators who will buy the 4% LIHTC** on these financings where an **experienced operator** is on board; this adds **25-40% of additional proceeds**.

- We are **now pledging Medicaid payments and Social Security housing allowances**, in facilities targeted to this growing population **to secure tax exempt bonds** to finance these facilities, and we are also **exploring the use of Medicare Advantage Plan payments** in these financings.

- For **memory care units** included in some of these facilities, there is a question of **whether the kitchens can be configured to meet the "complete living unit" standards** of Section 142(d).

  - Some bond counsel will allow a **half refrigerator, microwave and sink, with the microwave activated only when supervision is present.**

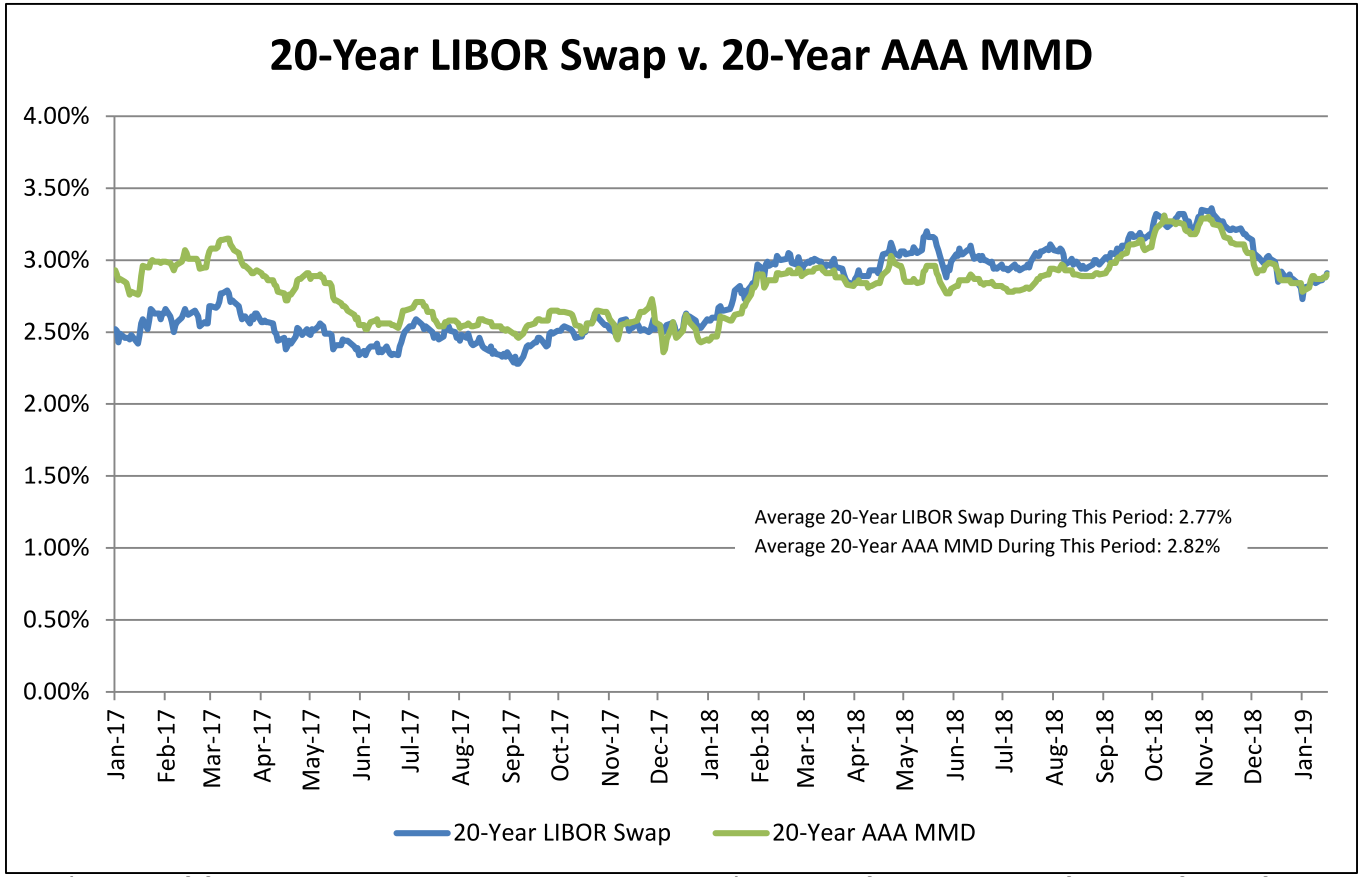
  - Some **assistance in taking medications, etc., is permitted**, including by nurses, but **one cannot have 24/7 licensed nursing care** or other arrangements which would constitute **"continual or frequent nursing, medical, or psychiatric care"** that would disqualify units from Section 142(d) financing (and 4% LIHTC).

3. FHA AND RD FINANCINGS AND SHORT TERM CASH BACKED TAX EXMPT BONDS – MR. LETTERMAN HAS GOOD NEWS AND BAD NEWS

- **Good News:**
  - **HUD affordable volume continues to grow – up $500 million or 18.5%** in **FY 18** v. FY 17 – $3.2 billion v. $2.7 billion.
  - HUD has introduced its **new §221(d)(4) Pilot program** to speed loan underwriting.
  - **Negative arbitrage** on the bond side **has all but disappeared**.
    - Short term taxable **U.S. Treasury rates** are **40-50 basis points higher** than **short-term tax exempt bond coupons**.
    - **Almost all bond counsel firms will now give a clean "reallocation opinion" permitting investment in a fixed portfolio of U.S. Treasuries** and reallocation of ownership from the Project Fund to the Collateral Fund **without liquidation** on **Section 221(d)(4) FHA** and similar RD financings..
    - **If in doubt, ask before selecting an issuer** and applying for bond volume. **Can be $100,000's of losses** if no reallocation opinion is available on an FHA §221(d)(4) or comparable RD deal.
- **Bad News:**
  - The GNMA buy side is scared of rising rates – **GNMA spreads have risen** and **all-in borrowing rates now closer to those on other executions** – **4.35%** (223(f)) **to 4.65%** (221(d)(4)).

4. PUBLICLY OFFERED TAX EXEMPT BONDS, INCLUDING FANNIE MAE M.TEBS, CONTINUE TO GAIN MOMENTUM

- The following chart shows the relationship over the **past two years** 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:



- 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.

FANNIE MAE M.TEBS CONTINUE TO GAIN MOMENTUM

- M.TEBs bond coupons are **still 70 to 80 bps over the 10-year** U.S. Treasury.

- **All-in borrowing rates of 4.50% to 4.60%.**

- **"Forwards" M.TEBs** structure for new construction/sub rehab entails about **2.0 to 2.5% of negative arbitrage. But, having two sets of debt outstanding** during the construction period on a "Forwards" M.TEB **can increase tax credit basis and thus 4% LIHTC syndication proceeds. This offsets almost 80% of the negative arbitrage deposit** required. **Adds about 5 basis points to the effective permanent rate.**

- **Net result is – a permanent lending rate equivalent of about 4.65-4.70% –** a very competitive rate in the current market when compared to other executions.

- We can now save costs by **combining short term cash backed tax exempt bonds with M.TEBs in one Indenture and OS** where extra tax exempt bonds needed to meet the 50% Test.

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)	**4.65 to 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, about 80% of which is offset by a bump in tax credit basis and 4% LIHTC proceeds from having two sets of construction period debt outstanding.