Financing for RAD Properties

December 12, 2013

Presentation Agenda

1. Introduction to RAD program and current status
2. Using RAD to finance capital improvements
3. Benefits of combined tax-exempt bond and tax credit deals
4. Introduction to tax-exempt bond financing
5. Current state of tax-exempt bond market
6. Introduction to 4% low-income housing tax credits
7. Current state of tax credit equity market
8. Soft sources of capital
9. Issues with combined tax-exempt bond and tax credit deals
10. Case studies

City Securities Corporation

City Financial Corporation

- Diversified financial services company
- Approximately 225 employees
- Founded in 1924

City Securities

- Public finance investment bank based in Indianapolis
- Offices across the country
- Since 2000, $70 billion of tax exempt debt and 3,700 transactions

City Real Estate Advisors (CREA)

- $2.0 billion+ of LIHTC assets in syndicated funds
- 200 properties and 18,000 units across the country

Municipal Housing Division

- Established in summer of 2013 with the hiring of Marc Krasner and Matt Engler.
- Since 2005, bankers have worked on more than 125 mortgage revenue bond issuances, totaling $9.4 B of par.
- State-level and local issuers across the U.S.
- Extensive experience structuring and underwriting debt, as well as investing in LIHTC properties and raising capital for syndicated LIHTC funds.

Overview of RAD

- HUD’s Rental Assistance Demonstration (RAD) Program allows PHAs to convert Public Housing units into long-term Section 8 contracts.

- RAD was designed to preserve and rehabilitate public housing stock by leveraging private capital.

- Nationwide capital need for public housing is estimated at $25-30 B.

Current Status of RAD

- Initial round is limited to 60,000 units.
  - HUD has already received applications for more than 80,000 units.
  - Through November, 21,000 units have received awards for conversion (CHAPs).
    - Largely in the southeast
  - Many applications probably will fall out.
    - HUD has strongly encouraged demand to increase numbers.
    - A lot of properties do not have financing in place.
- HUD hopes to extend the program to 150,000 units.
  - Continuing resolution passed by the Senate extends to 120,000.

Debt Financing of RAD Properties

- Conceptually similar to the Cap Funds bonds
  - Financing against a future stream of cash flows to the project from the federal government
- Section 8 contracts are viewed favorably by both debt and equity investors and are generally very financeable.
- Investor considerations
  - Sequestration and funding levels
  - Section 8 overhang

RAD Efforts in Other States

- Other state HFAs have shown a broad range of involvement in the RAD program.
- Some have offered volume cap and 4% tax credits to RAD deals.
  - Maryland CDA and Kentucky Housing Corporation
- A number of HFAs have not looked into the program or have decided against getting involved.
  - Mostly in states where the funding levels are too low relative to operating costs
- Maine Housing is looking at ways to provide technical assistance and pooled bond financing.
- LHC is on the leading edge of active involvement.

Benefits of State HFA Involvement

- Increases the likelihood of getting a CHAP
  - Having more certain financing structure in place
- Pooled financing approach
  - Reduces transaction costs
  - May lead to lower financing rates
- Better financing rates through LHC
  - Greater market recognition and liquidity
- Access to capacity and transactional experience of LHC
- Facilitates sharing of best practices and partnering with capable developer partner

Timing for RAD Properties

- HUD has a nominal deadline for a project to close 1 year after receiving CHAP.
  - Extended for LIHTC projects

- HUD targets a 30-day response time to applications.

- In general, you should expect time from submitting proposal to closing to be roughly 15 months for LIHTC deals.

- Key Consideration: timing for pooled bond financing
  - Need to get a group of properties approved roughly at the same time.
  - HUD has preliminarily expressed willingness to coordinate.

RAD Opportunities in Louisiana

- HUD has developed a tool in Excel to estimate the amount of debt that housing authority properties could support.

- Depending on the rate, LTV , and other assumptions, the tool estimates that PHAs in Louisiana could use RAD to leverage $265-300 MM of first mortgage debt.

- The tool can be tailored to individual PHAs and properties.
  http://portal.hud.gov/huddoc/RAD1stMortgSummTool.xlsm

- ***Louisiana Housing Corporation will make tax-exempt bond volume cap available to all projects that receive a CHAP, making them also eligible for 4% low income housing tax credits.***

Benefits of Mixed-Finance Projects

- Using tax-exempt bonds generally provides the project with lower-cost debt financing than would otherwise be available.
- Using tax-exempt bonds allows developers to access 4% tax credits.
- Tax-credits provide access to a lower-cost source of equity and decrease the amount of debt and other sources required.

Example Mixed-Finance Project

Hypothetical Sources and Uses

Sources	
Tax-exempt bonds	$5,500,000
Tax equity	3,000,000
Soft sources	1,500,000
Total Sources	**$10,000,000**
Uses	
Acquisition	$1,000,000
Construction	6,450,000
Soft costs	800,000
Financing costs	900,000
Reserves	350,000
Developer fee	500,000
Total Uses	**$10,000,000**

Municipal Bond Market

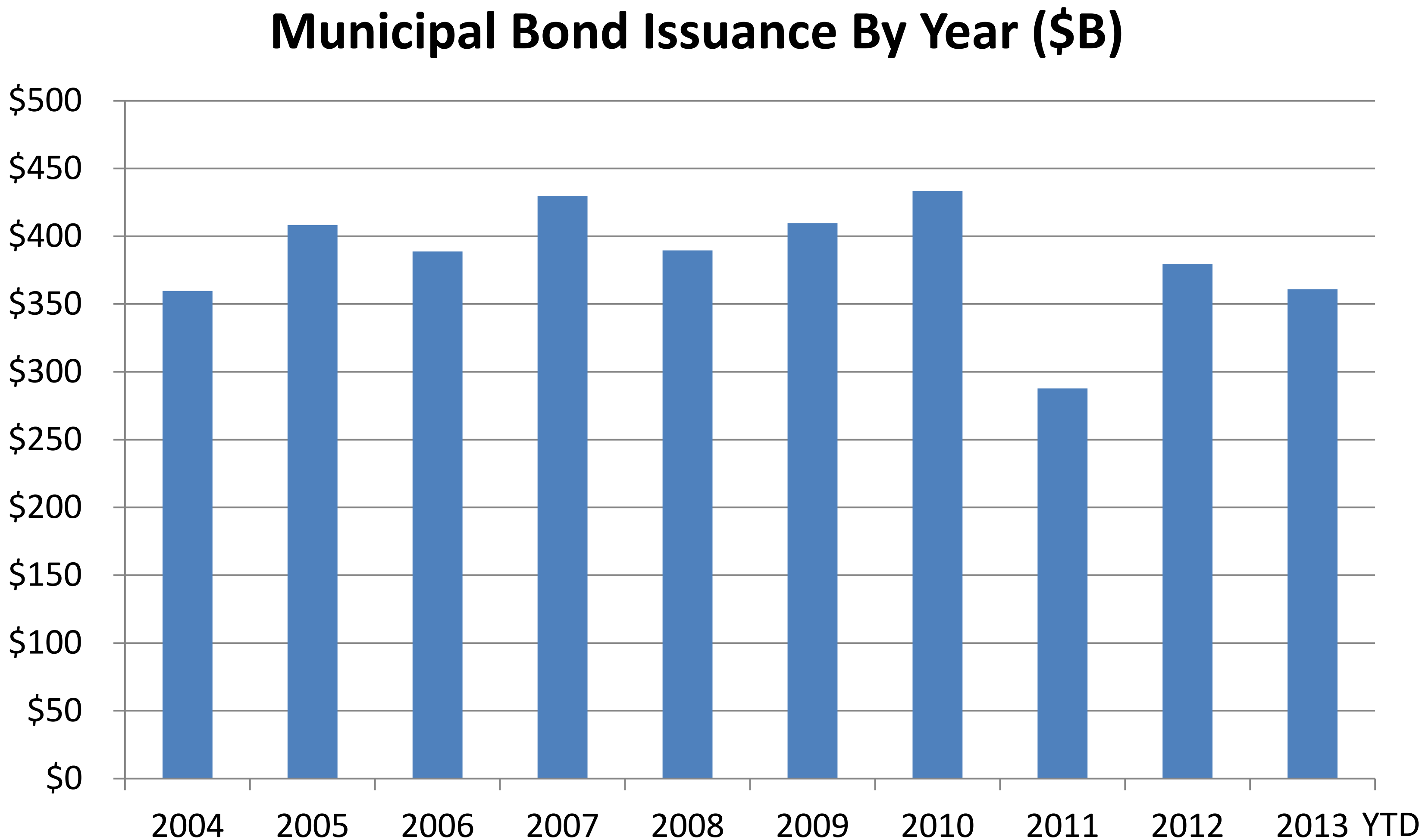
- Municipal bonds allow governments and related entities to finance a wide range of public purpose activities.

- The municipal bond market is fairly large and deep.
  - Annual issuance averages around $380 B.
  - Municipal bond par outstanding exceeds $3.7 T.

- Investors include a broad range of institutions and individuals looking for tax advantaged income.

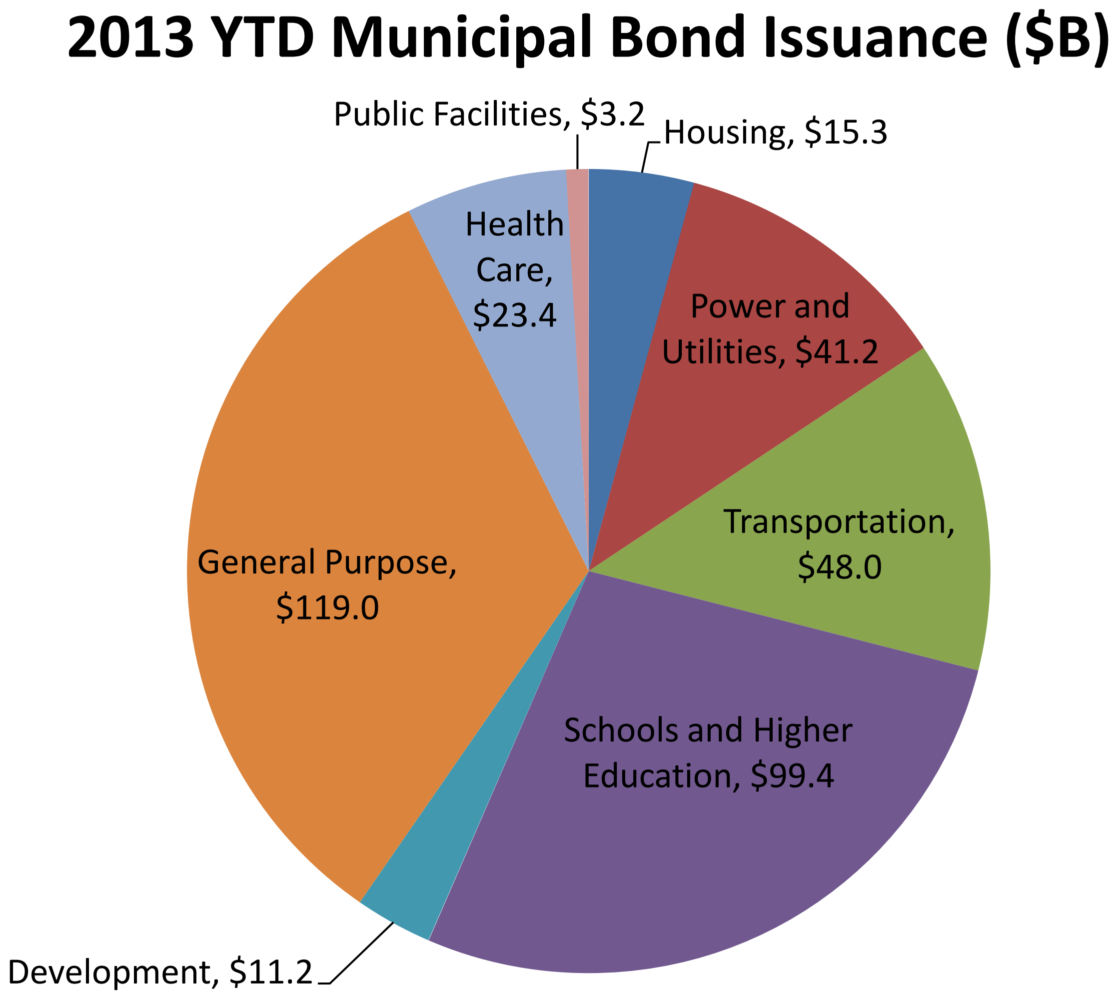
- The municipal market consists of a number of specialized sub markets based on geography, issuer type, and the purpose of the financing.

Municipal Bond Market



Source: SDC Platinum as of 12/9/2013

Municipal Bond Market



Source: SDC Platinum as of 12/9/2013

Tax-Exemption

- Tax exemption of interest provides issuers of municipal bonds with a funding advantage.
  - Investors require lower interest payments since they don't pay tax on them.

	Principal X	Coupon =	Interest X	Tax Rate	= Tax Due	**After-Tax Interest**
Taxable	$1,000	5.00%	$50.00	35%	$17.50	**$32.50**
Tax-Exempt	$1,000	3.25%	$32.50	0%	$0.00	**$32.50**

- Benefit: lower interest payments and ability to borrow more

Types of Tax-Exempt Bonds

- Two main types of municipal bonds:
  - GO: backed by full-faith and credit of state or local government, tied to taxing ability of entity
  - Revenue: tied to revenue stream from the project or asset

- Private activity bonds:
  - Issued by qualified municipal issuer on behalf of a private entity for a public-purpose project.
  - Requires an allocation of tax-exempt volume cap.
    - Multi-family mortgage revenue bonds (MRB)

Applying for Bond Volume Cap

- An allocation of private activity volume cap requires an application to the relevant allocating agency.

- Applying for volume cap is similar to applying for 9% tax credits.
  - Submit a detailed application to LHC

http://www.lhfa.state.la.us/downloads/special_programs/MFBondApplication.pdf

Multi-Family Bond Compliance

- At least 95% of the bond proceeds must be used to finance multi-family development.
- Bonds require TEFRA approval before issuance.
  - Includes public notice and a public hearing
- Income restrictions (set-asides):
  - At least 20% of households at 50% of AMI

  OR
  - At least 40% of households at 60% of AMI
- For acquisition-rehabs, rehab costs must equal at least 15% of bond proceeds used to acquire building.

Bond Indenture

- The bond indenture or resolution governs the bonds.
  - Terms, payments, covenants, events of default
- Two types of multi-family bond issuances
  - Open-indenture
    - Multiple bonds for multiple projects pooled together
    - Should generally price better
  - Conduit
    - Stand alone project
- Security for the bonds
  - Mortgage on property
    - Principal and interest payments
  - Reserve funds

Credit Enhancement

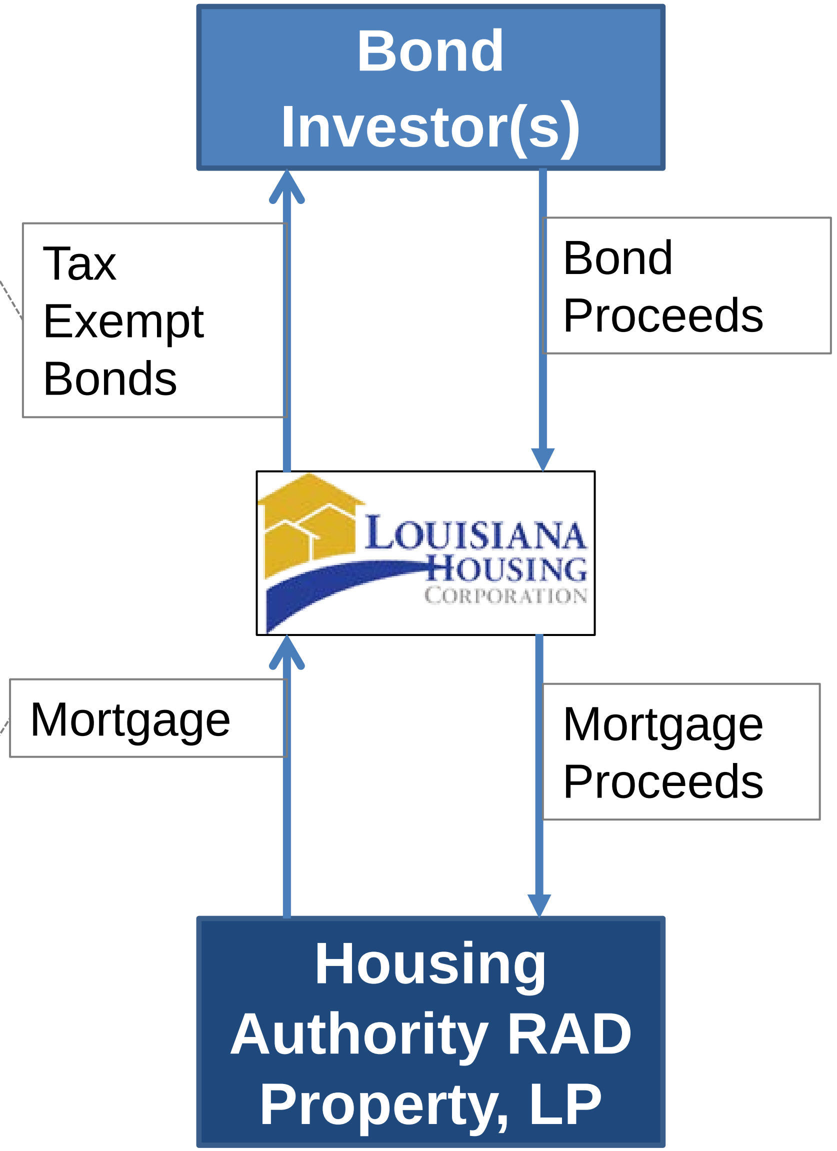
- Multi-family bonds typically involve 3rd-party credit enhancement.
  - Commercial Banks
  - Federal Housing Administration
  - Fannie Mae
  - Freddie Mac

Bond Sales and Structures

- Bonds can be sold two ways:
  - Public offering
  - Private placement
- Basic structures:
  - 17-year term bond with 35-40 year amortization
    - Match compliance period and allow for lower annual payments
  - Serial bonds and term bonds
    - Benefit from upward sloping yield curve
  - Construction versus permanent financing

Tax-Exempt Bond Mechanics

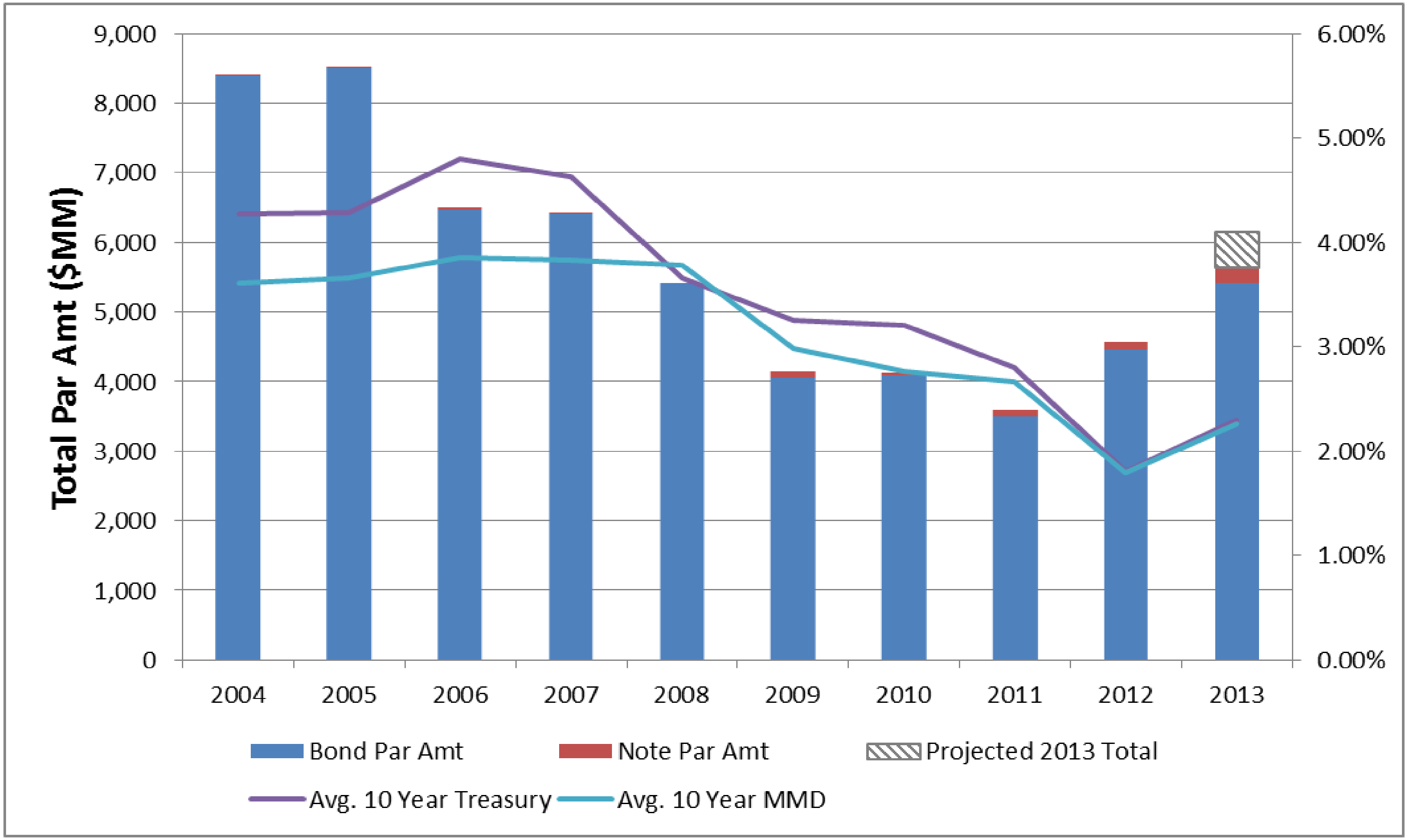
Bondholders receive payments of principal and interest over the life of the bonds.



Issuers can charge mortgage borrowers up to 1.5% annually over the bond costs.

The Multi-Family Bond Market Since 2004

Driving factors: the credit bubble, the financial crisis, disruption in the LIHTC equity market, lack of soft funds, rate compression



Source: SDC Platinum as of 12/5/2013

Current Multi-Family Bond Market

- Due to rate compression, taxable mortgages are often more attractive than long-term tax exempt bonds.

- Cash collateralized bond transactions have become a common way to use tax-exempt bonds to get the 4% LIHTC without the need of high cost long term bonds.
  - Short-term bonds that mature at placed in service
  - Long-term FHA or GSE mortgage

- For long-term bonds, demand and pricing differential exist between CRA urban markets and non-CRA areas
  - High 4% to low 5% versus high 5% to low 6% range

Recent Multi-Family Bond Issuances

Sale Date	Par ($MM)	Issuer	State	Series	Final Maturity	Coupon Range	Tax Status	Ratings
11/13/13	2.555	Missouri Housing Dev Commission	MO	2013 Series 4	01/01/45	1.0% - 5.0%	TE	AA
11/13/13	112.000	NYS Housing Fin-Mortgage Agcy	NY	2013 Series A	11/01/47	Variable	TE	Aa3
11/14/13	11.320	California Statewide Comm Dev Auth	CA	2013 Ser BB-T & CC-T	12/01/36	Variable	Taxable	AA+
11/14/13	29.520	Massachusetts Housing Fin Auth	MA	2013 Series E	12/01/54	0.5% - 5.25%	TE	AA-/Aa3/AA-
11/14/13	34.570	Massachusetts Housing Fin Auth	MA	2013 Series E	06/01/16	0.95%	TE	A2/A+
11/14/13	54.305	NYS Housing Fin-Mortgage Agcy	NY	2013 Series D	05/01/46	0.85% - 5.05%	TE	Aa2
11/14/13	6.900	New Jersey Hsg & Mtg Fin Agency	NJ	Series 2013 K	05/01/15	0.55%	TE	AA+
11/19/13	38.015	Montgomery Co-Maryland	MD	Series 2013	11/01/33	0.26% - 4.75%	Taxable	Aa1/AA+
11/20/13	11.200	California Statewide Comm Dev Auth	CA	Series 2013 T	06/01/15	0.5%	TE	AA+
11/20/13	28.000	Florida Housing Finance Corp	FL	2013 Series C	05/15/15	0.5%	TE	AA+
11/20/13	16.255	Maryland Dept of Hsg & Comm Dev	MD	Series 2013 F	07/01/55	0.7% - 5.25%	TE	AA+/Aa2
11/21/13	2.800	Buffalo Municipal Housing Authority	NY	Series 2013 A	12/01/53	5.45%	TE	NR
11/25/13	50.000	NYS Housing Fin-Mortgage Agcy	NY	2013 Series A	11/01/47	Variable	TE	Aa3
11/26/13	18.600	Utah Housing Corporation (UHC)	UT	Series 2013	11/01/16	0.65%	TE	AA+
12/02/13	3.500	Lousiana Housing Corporation (LHC)	LA	Series 2013	12/01/17	0.35%	TE	NR
12/04/13	30.000	NYS Housing Fin-Mortgage Agcy	NY	2013 Series B	11/01/46	Variable	Taxable	A2/A+
12/04/13	111.445	NYS Housing Fin-Mortgage Agcy	NY	2013 Series A	11/01/46	Variable	TE	A2/A+
12/05/13	57.000	NYS Housing Fin-Mortgage Agcy	NY	2013 Series A-2	11/01/46	Variable	TE	A/A2/A
12/05/13	65.800	NYS Housing Fin-Mortgage Agcy	NY	2013 Series A-3	11/01/46	Variable	TE	A/A2/A
12/05/13	16.950	St Anthony City-Minnesota	MN	Series 2013	12/01/30	3.1% - 6.0%	TE	NR
12/06/13	12.000	Illinois Housing Dev Authority	IL	2013 Series D	07/01/34	0.65% - 4.95%	TE	Aa3/AA
12/06/13	4.200	Lousiana Housing Corporation (LHC)	LA	Series 2013	12/01/16	0.65%	TE	NR

Low Income Housing Tax Credits

- The low income housing tax credit (LIHTC) program is designed to create and preserve affordable housing.
  - Incentives for private sector participants and capital sources
- LIHTC provides for higher levels of equity investment and lower project debt levels.
- Equity investors motivated by tax benefits and not cash flow.
- Coupling lower debt levels with tax-motivated equity makes the financial structure of LIHTC properties work.
  - Lower cash flow requirements = lower rents

4% Low Income Housing Tax Credits

- 4% Low income housing tax credits (LIHTC) are awarded in conjunction with an allocation of tax-exempt bond volume cap, subject to certain criteria
  - 50% test
  - Bonds must remain outstanding until project is placed in service.
- Unlike 9% LIHTC, not a competitive application
  - Submit a detailed application to LHC

https://webapps18.lhfa.state.la.us/login.aspx?ReturnUrl=%2f

4% LIHTC Compliance

- Same tax compliance rules as 9% credits still apply:
  - Affordability requirements
    - Rent cannot exceed 30% of tenant income
      - Exception for Section 8 rents
    - At least 20% of households at 50% of AMI

  OR

    - At least 40% of households at 60% of AMI

  - 10-year delivery of tax credits with 15-year compliance period and 15-year extended use period

4% LIHTC Mechanics

- The tax credits available to a project are calculated using a lower rate than 9% LIHTC, typically around 4%, applied to eligible basis.
  - Current tax credit rate for December 2013 is 3.25%
  - Unlike the 9% rate, was not set at a fixed number under financial-crisis era legislation

- This combination of volume cap and LIHTC was generally designed for rehab projects.
  - Equity targeting 30% of total development cost (TDC) versus 70% for 9% deals
  - Typically lower per unit TDC than 9% deals

4% LIHTC Calculation Example

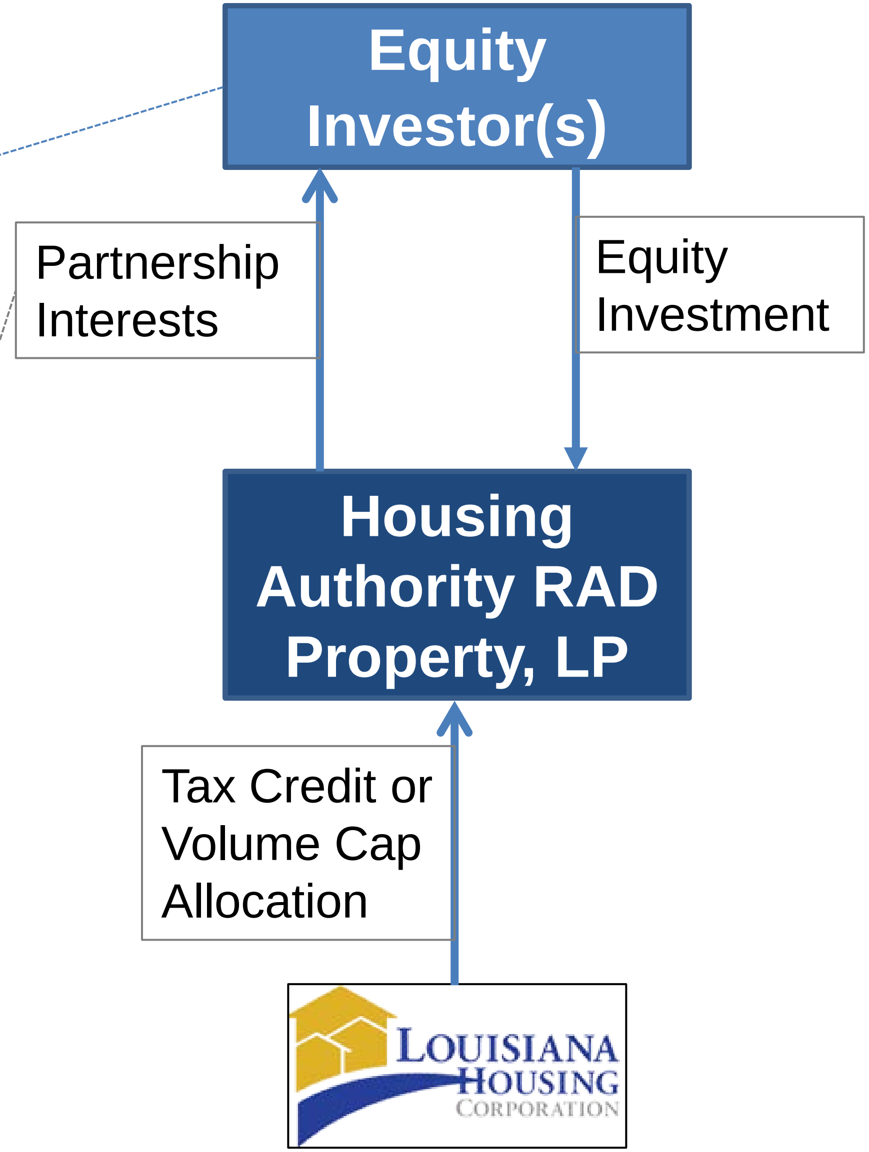
Assumptions:	
Total Development Cost	$11,000,000
Eligible Basis	$10,000,000

	9% LIHTC	4% LIHTC
Eligible Basis	$10,000,000	$10,000,000
X Tax Credit Rate	9.00%	3.25%
= Annual Tax Credits	$900,000	$325,000
X Year Stream of Credits	10	10
= Total Credits Received	$9,000,000	$3,250,000
X Price per Credit	$0.82	$0.82
= Investor Equity	$7,380,000	$2,665,000
Percent of TDC	67%	24%

LIHTC Mechanics

Equity in a property can come from a single direct investor or from a syndicated fund consisting of one or multiple investors.

Equity investors receive tax credits and tax deductions from asset depreciation.



Current Tax Equity Market

- Large differential between CRA and non-CRA markets
- Bifurcation between economic and CRA investors
  - Insurance companies and corporations vs. banks
- National, multi-investor funds are paying around $0.85 per dollar of credit to developers.
  - In CRA markets, from $0.90 to over $1.00
- A pending accounting change should make LIHTC more attractive to investors and increase prices to developer.
- Terms:
  - Developer guarantees: tax credit delivery, operating deficit, construction completion
  - Reserves: operating, replacement

Soft Sources

- LIHTC properties often need soft sources of capital as part of the capital stack.
- Typically, grants or subordinated debt
  - Federal funds
  - State or local funds
  - Foundation funds
  - Seller financing
  - Deferred developer fees

Mixed-Finance Deal Team

- Co-developer or development consultant
- Tax credit allocator
- Volume cap allocator and bond issuer
- Sources of soft funds
- General contractor
- Architect
- Consultants - environmental, market, accountant
- Property manager
- Legal counsel (transaction and tax)
- Credit enhancer
- Tax credit syndicator
- Bond investment banker
- Bond trustee
- Rating agencies
- 3rd party counsel

Considerations for Mixed-Finance Deals

- Lots of parties in the transaction
- Timing
  - More steps
  - Coordinating the different parties
  - Getting TEFRA approval for bonds
  - Layer on RAD application and approval process
- Equity investors typically prefer 9% to 4% LIHTC deals.
  - 4% deals have higher over all debt levels
  - Tax losses are higher on 4% deals
- Tax equity is the largest driver of tax-credit transactions.

RAD Case Study- Webster, MA

- 134 unit property in the town of Webster, MA
- $8.3 MM of volume cap from MassHousing
  - $6.1 MM permanent and $2.4 MM bridge
- $43 k per unit rehab cost
- Soft financing from town and 2 state sources

Sources	
Tax-exempt bonds	$6,100,000
Tax equity	$4,718,800
Subordinate debt	$6,589,185
Operating income	$282,723
Def. developer fee	$185,223
Existing reserves	134,000
Total Sources	**$18,009,931**

Uses	
Acquisition	$7,010,592
Construction	5,785,450
Development exp.	2,749,448
Reserves	888,441
Developer fee	1,400,000
Note repayment	176,000
Total Uses	**$18,009,931**

RAD Case Study- City of Baltimore

- 349 unit property in the Baltimore
- $83 k per unit rehab cost
- $36 MM of volume cap from Maryland CDA
  - Using cash collateralized bond structure
  - Bonds only outstanding until placed in service
- No soft financing other than seller note

Sources	
Taxable debt	$23,349,400
Tax equity	19,426,148
Seller note	18,034,509
Total Sources	**$60,810,057**

Uses	
Acquisition	$18,034,509
Construction	29,008,073
Soft costs	4,050,565
Financing costs	5,231,225
Developer fee	2,500,000
Reserves	1,985,686
Total Uses	**$60,810,057**

Summary

- RAD offers a good tool for preserving and improving public housing.
- LHC will offer bond volume cap and the associated 4% tax credits to properties receiving RAD approval.
  - These sources should make many RAD conversions much more financially feasible.
- Combined bond-LIHTC deals are complex, involving numerous parties, compliance issues, and negotiated terms.
- Given the complexities of the deals, it is important to partner with capable and experienced parties.

References

- RAD
  - http://portal.hud.gov/hudportal/HUD?src=/RAD
  - http://www.recapadvisors.com/services/RAD

- LIHTC and General Affordable Housing Finance
  - http://www.novoco.com/low_income_housing/
  - https://custom.cvent.com/1CAD98FA1AB943A7B1B55DA6B2E3BD7C/files/cc9561385ee040bd9415268ff09424f0.pdf
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- Multi-Family Tax Exempt Bonds
  - http://www.ipedinc.net/powerpoints/Tax-Exempt_Housing_Bond_Basics.pdf
  - http://www.orrick.com/Events-and-Publications/Documents/2709.pdf

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Disclaimer

The Municipal Securities Rulemaking Board (the “MSRB”) has adopted MSRB Rule G-23 (“G-23”). G-23 prohibits a broker, dealer or municipal securities dealer (each, a “Dealer”) from acting as a Financial Advisor or Municipal Advisor, as defined in Section 15B of the Securities Exchange Act of 1934, as amended, to an issuer of municipal securities on a particular issue of municipal securities and subsequently switching roles to act as an underwriter or placement agent with respect to the same particular issue of municipal securities. MSRB Notice 2011-29 (the “G-23 Notice”) defines “underwritings” to be both (i) the acquisition, either alone or as a participant in a syndicate or other similar account formed for purpose of acquiring an issue of municipal securities, of all or any portion of an issue of municipal securities, directly or indirectly, from the issuer, as principal and (ii) acting as an agent for the issuer in arranging the placement of such issue. Additionally, the MSRB states in the G-23 Notice, “the primary role of an underwriter is to purchase securities in an arm’s-length commercial transaction between the issuer and the underwriter” and, “the underwriter has financial and other interests that differ from those of the issuer.” Furthermore, G-23 states that an underwriter may provide advice concerning the structure, timing, terms, and other similar matters related to the issuance of municipal securities to the extent the underwriter discloses that such advice is provided with respect to the underwriting and not in relation to a financial advisory relationship, as specifically defined in G-23.

The MSRB has also adopted MSRB Rule G-17 (“G-17”). In accordance with MSRB Notice 2012-25 (the “G-17 Notice”), a Dealer, which is involved as the underwriter in the sale of municipal securities on a negotiated basis (the “Underwriter”), is required to provide to the Municipal Entities, as defined in Section 15B of the Securities Exchange Act of 1934, as amended, that are involved in the issuance of such municipal securities the following written disclosures: (a) G-17 requires the Underwriter to deal fairly at all times with both municipal issuers and investors; (b) the Underwriter’s primary role in any anticipated purchase and sale of such municipal securities is to purchase the municipal securities with a view to distribution in an arms-length commercial transaction with such Municipal Entities, and the Underwriter has financial and other interests that differ from those of such Municipal Entities; (c) unlike a Municipal Advisor, the Underwriter does not have a fiduciary duty to such Municipal Entities under the federal securities laws, and is, therefore, not required by federal law to act in the bests interests of such Municipal Entities without regard to its own financial or other interests; (d) the Underwriter has a duty to purchase such municipal securities from such Municipal Entities at a fair and reasonable price, but must balance that duty with the Underwriter’s duty to sell such municipal securities to investors at prices that are fair and reasonable; and (e) the Underwriter will review the official statement for such municipal securities in accordance with, and as a part of, its responsibilities to investors under the federal securities laws, as applied to the facts and circumstances of the Transaction. Furthermore, under G-17 the Underwriter may not recommend that such Municipal Entities not retain a Municipal Advisor.

Accordingly, and in compliance with G-17, G-23, the G-17 Notice and the G-23 Notice, City Securities Corporation (“CSC”) hereby expressly states that: (a) CSC is acting as an underwriter or placement agent under G-17 and G-23 and not as a Financial Advisor or Municipal Advisor in connection with all services proposed and/or provided with respect to any of the matters set forth in the City Securities Corporation Possible Financing Options attached to these disclaimers (the “Financial Presentation Materials”); (b) any services provided by CSC as they relate to its role as underwriter or placement agent should not be construed by anyone to be those provided by a Financial Advisor or Municipal Advisor and such notice, as required under G-23 and the G-23 Notice and described above, is hereby provided; (c) the written disclosures, as required under G-17 and the G-17 Notice and described above with respect to CSC acting as the Underwriter, are hereby provided to each recipient of the Financial Presentation Materials; and (d) it is CSC’s understanding that each Municipal Entity that is involved in the issuance of one or more of the municipal securities identified in the Financial Presentation Materials has consulted, or will consult, with such Municipal Entity’s own legal and financial advisors to the extent such Municipal Entity deemed, or will deem, appropriate in connection with the issuance and sale of any such municipal securities.