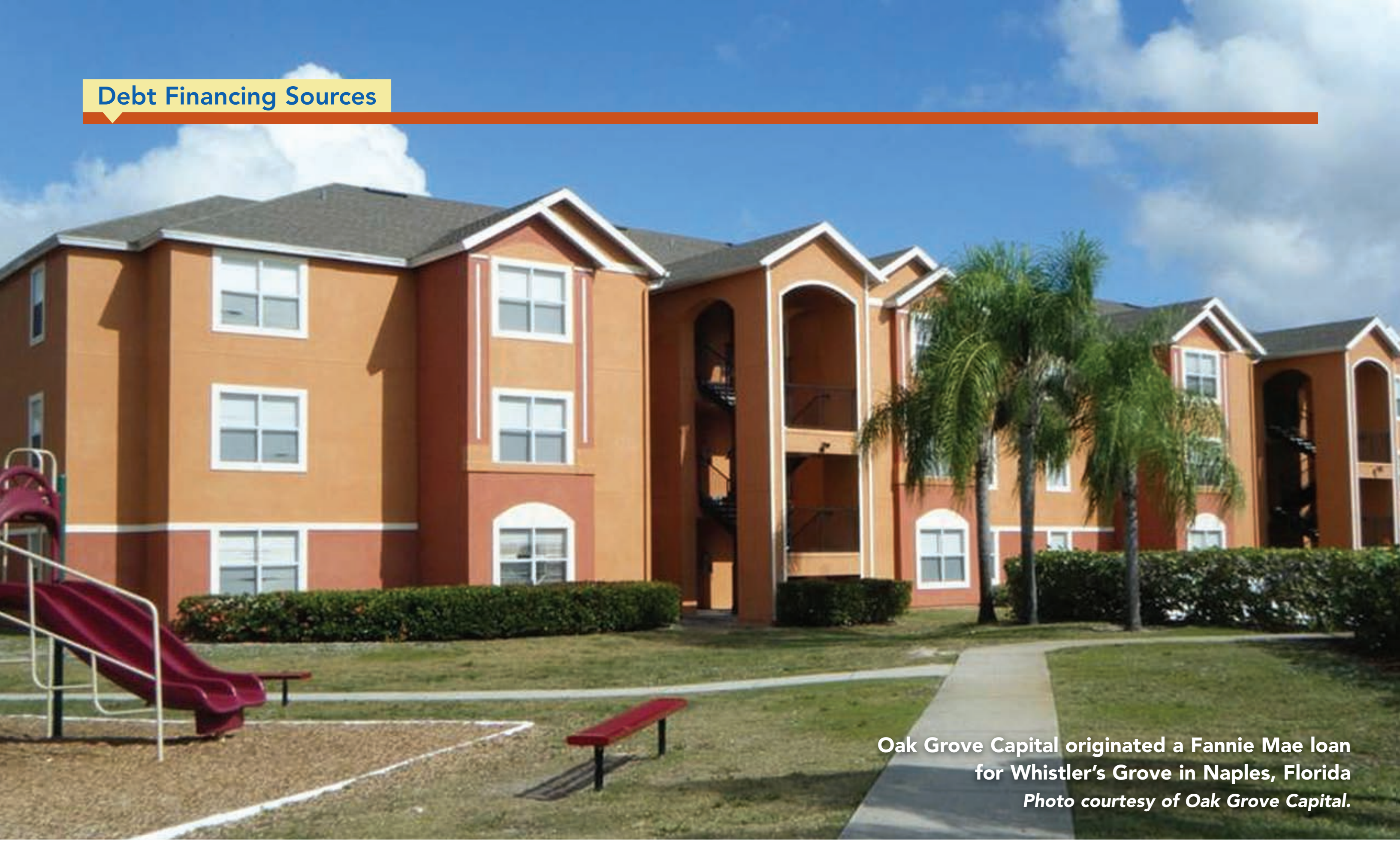

Oak Grove Capital originated a Fannie Mae loan for Whistler's Grove in Naples, Florida
Photo courtesy of Oak Grove Capital.

Prime Time

Low Rates, Variety of Debt Products Are Available to Affordable Housing Developers and Owners

With interest rates at or near historical lows, it's an opportune time for affordable multifamily housing developers and owners to secure permanent debt for new low-income housing tax credit (LIHTC) projects or to refinance existing properties.

With shrinking amounts of gap financing available at the federal, state, and local level, developers may need to consider more debt on new LIHTC projects to make them pencil out.

The primary options are programs of Fannie Mae, Freddie Mac, and the U.S. Department of Housing and Urban Development's Federal Housing Administration (FHA), though banks are a traditional source of construction financing and sometimes also permanent loans. Some major syndicators also have affiliates or partners that offer debt financing. For rural projects, USDA's Rural Development (RD) Section 538 guaranteed loans are a possibility for new LIHTC projects.

For tax-exempt bond-financed deals, Fannie Mae, Freddie Mac, and FHA are credit enhancement options, and there are also some private placement and other bond executions.

Factors Driving the Decision

Factors determining the available debt options and best fit for a particular project include:

- The type of transaction (new construction, acquisition/rehabilitation, acquisition only, refinance);
- The property's size and location;
- Competition in the state for 9% housing credits;
- The availability of gap financing;
- The time needed to close (i.e., any pressing deadlines); and,
- The developer's financial strength and track record.

The most options are available for projects in large

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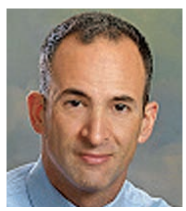
metropolitan areas – higher demand "CRA" markets where major banks compete aggressively to buy the housing credits and provide loans for new LIHTC projects, especially 9% deals, to receive consideration under the Community Reinvestment Act. In these markets, major banks, besides buying the tax credits, will often provide construction and sometimes permanent loans.

Regional and local banks can also be a source of construction and permanent debt, particularly in secondary and smaller markets.

Tom Maxwell of LIHTC syndicator WNC & Associates, Inc. said quasi-public entities are a potential debt source in some states, such as the Massachusetts Housing Partnership.

HUD Programs



Alex Viorst

The mainstays for LIHTC deals are the products of HUD/FHA, Fannie Mae, and Freddie Mac. Their products "are all equally popular" today with affordable housing developers and owners, according to Alex Viorst of Prudential Mortgage Capital Company, a FHA, Fannie Mae, and Freddie Mac lender.

FHA mortgages – Section 221(d)(4) for new construction or acquisition/substantial rehab projects, or Section 223(f) for acquisition or refinancing with or without moderate rehab – are attractive for borrowers not facing pressing deadlines, he notes. Advantages are that they are non-recourse loans, are assumable, provide construction and permanent financing, have terms and amortization periods up to 40 years, and generally boast lower all-in borrowing rates than Fannie Mae or Freddie Mac loans.

The drawback is the potential long processing time by HUD offices. Viorst estimated that processing times generally range anywhere from 3 to 4 months to 8 to 10 months. The length of processing time will vary, though, depending on the particular HUD office, its volume of applications, and the size and complexity of the transaction. Some HUD offices – with staff experienced in underwriting LIHTC projects – have much quicker processing times. Also, 221(d)(4) loans tend to have longer processing times than 223(f) loans.

FHA is launching a LIHTC pilot program designed to cut the processing time for Section 223(f) mortgages for tax credit projects to 90 to 120 days. It will initially be available through only about a dozen Multifamily Accelerated Processing (MAP) lenders for Section 223(f) loans on projects within the jurisdiction of HUD "Hub" offices in Boston, Chicago, Detroit, and Los Angeles. Likely up and running in the second quarter, the pilot is expected to be expanded later geographically and to 221(d)(4) loans. *(For details, see* Tax Credit Advisor*, March 2012, p. 8.)*

Jeffrey Banker

Jeffrey Banker of Lancaster Pollard, a FHA, Fannie Mae, and RD lender, expects the FHA pilot to stimulate more demand for Section 223(f) mortgages. "It will help capture some of the deals that probably don't need to be 221(d)(4)s but get kicked into that category," he notes. "It will be a real boon to production, streamline the process, and leverage these programs."

Fannie, Freddie Programs

Fannie Mae and Freddie Mac, through their approved lenders, offer much quicker execution while being competitive on rate and mortgage proceeds. Their debt products, though, generally don't provide construction financing and have shorter loan terms than FHA loans (although amortization up to 30-35 years). For 4% credit deals, the two government-sponsored enterprises provide credit enhancement for fixed-rate tax-exempt multifamily housing bonds floated by state or local housing agencies. Freddie Mac also credit enhances variable-rate bonds hedged for interest rate and remarketing risk, but these are usually for "80/20" projects.

Timothy R. Leonhard

Timothy Leonhard of Oak Grove Capital, a Fannie Mae, Freddie Mac, and FHA lender, said with Fannie Mae and Freddie Mac executions developers can close within 45 to 60 days on acquisition or refinancing loans. For moderate rehab loans, the closing timeframe is 30 to 45 days from the time that the developer submits complete plans and specs.

"Our most popular product today in the low-income housing tax credit financing world is credit enhancement for fixed-rate bonds," says Freddie Mac executive Kim Griffith.

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Griffith said that Freddie Mac is providing credit enhancement of bonds and is funding loans for some new construction projects. But he indicated that most of its current affordable housing business, for both 4% and 9% credit projects, involves existing properties, such as acquisition/rehab transactions.

"Many of these acquisition/rehabs are tenant-in-place rehabs," he notes. "The borrower immediately knows the income stream they're working with, and will continue to have that income stream during the rehab period. From their side there's less market exposure."

Industry participants indicated that many transactions they are seeing today involve existing properties, as opposed to new construction or acquisition/substantial rehab projects. "I'm seeing a lot of activity on existing properties," notes CPA David Reznick of Reznick Group. These deals are using programs of FHA, Fannie Mae, Freddie Mac, and other debt sources.


Bob Simpson

Griffith and Fannie Mae executive Bob Simpson said much of their current business is funding loans or providing credit enhancement for bonds for the acquisition or refinancing of existing affordable rental housing properties (e.g., LIHTC, Section 8); for acquisition/rehab transactions; and for moderate rehabilitation of existing properties. The pair and the lenders noted that some of the current activity involves LIHTC properties in Years 10 to 15 of the 15-year tax credit compliance period, such as instances where the existing general partner is buying out their limited partner with an eye to re-syndicate with new tax credits after Year 15, or non-LIHTC properties being acquired for an acquisition/rehab transaction with tax credits. "I'm seeing a lot of activity in properties anywhere from Year 8 to 15," says Reznick, "not necessarily waiting for Year 15 before activity takes place."

Leonhard noted, "Fannie and Freddie are very competitive on acquisition/rehabs, both taxable and tax-exempt."

Simpson said Fannie Mae's 7-year adjustable rate mortgage product (ARM 7-6) is popular with borrowers acquiring LIHTC properties during Years 10-15 who anticipate doing a new tax credit transaction after Year 15, and with existing owners refinancing their properties. Freddie Mac also has an ARM product, with a greater variety of options in term, rate cap, etc. Benefits from these ARMs include a very low floating interest rate and prepayment flexibility. Prepayment is permitted after one year for a 1% fee. *(For details, see* Tax Credit Advisor, *January 2012, p. 26.)*

Simpson said Fannie Mae's most popular debt product currently for affordable rental/LIHTC properties is its standard fixed-rate mortgage, typically with a 10-year term. In addition to this and the ARM, he noted the com-

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Current FHA, Fannie Mae, Freddie Mac Financing Options

Program	DSCR	LTC/LTV	Rate	Loan term	Amortization
FHA/HUD – Taxable New Construction or Sub Rehab Loan Parameters [Section 221(d)(4)]	1.11 to 1.20	LTC: 83% to 90%	3.80% (plus MIP)	Up to 40 years	40 years
FHA/HUD – Taxable Acquisition or Refinancing Loan Sizing Parameters [Section 223(a)(7), 223(f)]	1.15 to 1.20	LTV: 85%	3.30% (plus MIP)	Up to 35 years	35 years
Fannie Mae/Freddie Mac Taxable Acquisition or Refinancing Loan Parameters (without new LIHTC)	1.20 to 1.25	LTV: 75% to 80%	3.75% to 4.50%	5 to 10 years	30 years
Fannie Mae/Freddie Mac Taxable Acquisition or Refinancing Loan Parameters (with new LIHTC)	1.15	LTV: 90%	5.35% to 5.95%	15 to 30 years	35 years
Fannie Mae/Freddie Mac Taxable Adjustable Rate Acquisition or Refinancing Loan Parameters (without new LIHTC)	1.20 to 1.25	LTV: 75% to 80%	2.30% to 3.10% over 30-day LIBOR	5 to 10 years	30 years

Source: Timothy R. Leonhard, Oak Grove Capital, Dallas, Texas, 817-310-5800; as of mid-March 2012

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pany is seeing more demand for its Green Refinance Plus product. This 10-year loan allows borrowers up to an additional 5% in loan proceeds to fund renovations to existing affordable properties at least 10 years old that make them more energy efficient.

Simpson also noted that Fannie Mae's credit enhancement of tax-exempt bonds for moderate rehabilitation 4% credit projects "has become very, very popular."

Bond Financing

Over the past two years, most tax-exempt bonds for 4% LIHTC projects were those issued under the federal New Issue Bond Program (NIBP). Under this, the U.S. Treasury bought fixed-rate housing bonds floated by state and local issuers. The bonds were mostly credit enhanced by Freddie Mac and Fannie Mae, and the bond proceeds disbursed in stages as needed.

Freddie Mac and Fannie Mae are still seeing some NIBP issues in 2012 but much fewer. The companies are credit enhancing more standard fixed-rate multifamily bond issues instead.

Another option for developers is private placements – direct purchases of rated or unrated tax-exempt multifamily housing bonds by banks or by specialized buyers such as funds.

For example, New York-based Red Stone Partners buys unrated tax-exempt multifamily housing bonds issued to refinance existing multifamily bonds or to fund new housing projects, and places them in funds that have institutional investors. "The demand for this kind of financing has recovered to a place where I would say it's modestly robust," says James Spound, president of Red Stone Tax Exempt Funding. He noted the primary driver of the greater demand has been an increased appetite among LIHTC investors for 4% tax credits. "The recovery of that demand has allowed developers to explore tax-exempt financing as a vehicle for financing their projects," he said, adding that Red Stone's program offers developers quick execution and very favorable borrowing rates.

James Spound

Standard & Poor's Corporation has a program under which it rates tax-exempt multifamily housing bonds that do not have credit enhancement.

A common type of tax-exempt bond execution today, though, seems to be cash-collateralized transactions. Under a complex structure, triple-A rated short-term tax-exempt bonds (generally 18 months) are issued to qualify a project for 4% credits and the bonds are retired after construction is completed. The project enjoys very low-rate long-term financing because of the favorable taxable rates on Ginnie Mae securities. The lender sells a taxable Ginnie Mae at the outset, and U.S. Treasuries bought with the bond proceeds collateralize the bonds during the construction period. In addition to a lower interest rate than possible with a standard tax-exempt issue of fixed-rate long-term bonds, another advantage of the structure is much lower negative arbitrage costs. In these transactions, the debt on the project is typically a HUD-insured Section 221(d)(4) or 223(f) mortgage that is exchanged for a modified Ginnie Mae mortgage-backed security.

Mike Sturges of The Sturges Company, a Dublin, Ohio-based investment bank that only underwrites tax-exempt multifamily housing bond issues, said more than 80% of his firm's current business is cash-collateralized bond transactions, which it has been doing for two years.

Sturges has also closed cash-collateralized tax-exempt bond transactions utilizing short-term tax-exempt bonds (mostly rated and publicly marketed) for (1) new HUD Section 202 elderly supportive housing projects that utilize a HUD Section 202 grant for long-term financing after construction completion; (2) LIHTC projects in which the long-term soft debt is from federal Neighborhood Stabilization Program (NSP) dollars; (3) the major rehabilitation of existing older 202 projects using a new 221(d)(4) or 223(f) mortgage and tax credits; and (4) acquisition/rehab projects using 221(d)(4), 223(f), or USDA Rural Development Section 538 mortgages for permanent financing.

Sturges, a CPA as well as an investment banker, said another opportunity for existing general partners in LIHTC properties wishing to buy out their limited partners and re-syndicate with 4% tax credits is to structure the purchase as an installment sale and issue a tax-exempt note to the limited for part of the purchase amount. Advantages to the limited include tax-free interest on the note and recognizing profit at a more favorable capital gains tax rate spread over the term of the note rather than an ordinary income tax rate on the entire amount of profit in the first year. TCA