The Comeback Kid

Multifamily Bond Deals Appear to Be on Upswing

After a rough period, the volume of tax-exempt multifamily housing bond transactions appears to be picking up – thanks to the fierce competition for 9% low-income housing tax credits and renewed investor demand for tax-exempt bonds, say industry professionals.

Michael Novogradac

"The tax-exempt bond market has come back a lot," said Michael Novogradac, a CPA and managing partner of the San Francisco office of Novogradac & Co., which works on affordable multifamily rental housing deals. John Mackey, a CPA with Reznick Group in its Boston office, said that while he can't quantify the increase in bond demand by investors and developers, he is handling "a pretty good flow" of pending multifamily bond transactions. In particular, Mackey is seeing increased use of tax-exempt financing for specialized projects such as HUD Section 8 project revitalizations, preservation deals, homeless shelters, and acquisition/rehab developments that use federal historic and housing tax credits and have reasonable acquisition and construction costs.

Photo by Adam Auel Photography

John Mackey

Kim Griffith, vice president of affordable sales and investments at Freddie Mac, said that while there is difficulty obtaining soft gap dollars to bridge the funding gaps in bond-financed rental housing projects, the higher prices being paid for the 4% housing credits generated by bonds is still making many deals financially feasible and allowing them to go forward.

Certainly, tax-exempt bond-financed rental projects receiving 4% housing credits are still far less popular with LIHTC syndicators and investors than 9% credit projects. They generate much less tax credit equity and thereby require more debt and gap financing as a share of total development costs, especially for new construction projects.

In 2008-2009 they became even less popular, when LIHTC equity dried up and credit prices fell. In late 2009, the federal government stepped in to prop up the ailing tax-exempt housing bond market, launching two new initiatives, one of which was the New Issue Bond Program (NIBP). Under this, the U.S. Treasury purchased about $15.3 billion in securities issued by Fannie Mae, Freddie Mac, and the Federal Home Loan Banks that were backed by new tax-exempt single-family and multifamily housing bonds floated by state and local issuers. Issuers had until the end of 2010 to disburse the escrowed bond proceeds to fund low-interest loans for home purchases or the development of affordable multifamily rental housing projects. This deadline was extended twice. Issuers now have until year-end 2012 to disburse their remaining proceeds, and may also re-channel unused single-family proceeds for multifamily loans.

Griffith estimated that there is enough remaining NIBP escrow proceeds to fund $600-$700 million in housing bond deals. He noted that about 70% of the 2011 business in Freddie Mac's targeted affordable housing division involved providing credit enhancements for tax-exempt housing bonds.

Bonds, continued on page 31

Total Tax-Exempt Private Activity Bond (PAB) Volume Cap & Issuance, Multifamily Housing Bond Issuance for 50 States and District of Columbia
(in billions)

	2007 (1)	2008 (1)	2009 (1)	2010 (1)
Aggregate Tax-Exempt Private Activity Bond Volume Cap	$28.185	$28.571	$30.252	$30.504
Total Aggregate PAB Authority Including Carryover	$48.854	$50.948	$60.989	$64.967
Aggregate Total PAB Issuance	$28.5	$13.7	$11.92	$14.6
Aggregate Multifamily Housing Bond Volume	$5.873	$1.286	$1.154	$2.388

(1) No data from certain states on carryover PAB amount or multifamily bond volume.
Source: Council of Development Finance Agencies survey

Bonds, continued from page 30

The NIBP program diminished the need and demand for regular new tax-exempt multifamily private activity bonds. Yet that was just part of the story.

In December 2010, a banking analyst predicted on "60 Minutes" that there would be hundreds of billions of dollars in municipal bond defaults in 2011 because of state and local government fiscal problems. Traditional bond investors dramatically curbed their purchases of new offerings, and interest rates for new municipal bond issues shot up. This contributed to a sharp drop-off in municipal bond volume during the first half of 2011, including of multifamily housing bonds.

Reasons for Rebound

The predicted massive wave of municipal bond defaults never materialized, and since mid-2011 municipal bond volume and investor demand has rebounded.

The volume of tax-exempt multifamily housing bond transactions has risen as well, though certainly not to the lofty levels of the 1980s. Besides greater investor appetite for tax-exempt bonds, reasons for this recent uptick include:

- **The heightened competition from developers for allocated 9% housing credits.** If 50% or more of the cost of a project, including land, is financed by tax-exempt private activity bonds, "automatic" housing credits (4%) can be obtained for the project outside of the state's annual housing credit volume cap for 9% credits. Avoiding the intense competition for 9% credits, or trying to get 4% credits for a deal after failing to get an allocation of 9% credits, is the primary driver for developers utilizing tax-exempt financing, according to investment banker John Rucker III, of Montgomery, Ala.-based Merchant Capital. (Merchant led all underwriters in the number of regular (non-NIBP) negotiated new tax-exempt multifamily housing bond issues underwritten in 2011 (29).) "I'm getting a lot of phone calls now from developers who failed to get an allocation through the 9% round," he says.

- **Low interest rates**, which mean lower borrowing rates for multifamily developers on mortgages funded with tax-exempt bond proceeds. Washington, D.C. bond attorney Wade Norris, a partner with Eichner & Norris PLLC, estimated that developers can now obtain an all-in borrowing rate – the rate on the bonds plus all fees – of around 5%, down from more than 6% in the summer and fall of 2011. "That's an attractive loan," he notes.

- **The higher prices paid to developers for housing credits.** The much larger amount of investor equity chasing after a limited supply of 9% credit projects has boosted prices sharply for housing credits, including for 4% credits. And much of this excess capital has flowed into 4% deals. Novogradac said LIHTC investors are now generally paying in excess of 90 cents per credit dollar for 4% LIHTC projects, especially those in the coastal markets, up from the 60- to 70-cent range paid during the depth of the economic downturn. The higher prices paid for 4% credits mean more equity for bond projects.

Bonds, continued on page 32

Bonds, continued from page 31

"The [multifamily bond] deals are just penciling out a little bit better now," says Rucker. He noted that the tax-exempt multifamily bond offerings that Merchant Capital has been underwriting are of fixed-rate bonds, not variable-rate bonds.

New Twists

While the recent and current multifamily housing bond issues look pretty much the same as they have traditionally, comprised of rated long-term bonds (30 or 35 years), there have been some new twists.

One is a complex new technique devised by the law firms of Eichner & Norris PLCC and Cincinnati-based Peck Shaffer LLP, and utilized by Merchant Capital in a number of transactions to date. This involves issuing a series of rated short-term tax-exempt bonds to qualify projects for "automatic" 4% credits, using the proceeds to fund a traditional HUD-insured multifamily mortgage, but utilizing taxable Ginnie Mae obligations and disbursing the proceeds in stages during the construction proceed. The tax-exempt bonds are paid off after the project is placed in service.

The lower rates available on short-term tax-exempt bonds compared to long-term bonds, the lower rates now possible on conventional (i.e. taxable) HUD-insured mortgages, and the gradual disbursement of the bond proceeds produces a lower all-in borrowing rate compared to a standard tax-exempt multifamily issue of long-term bonds, and avoids nearly all "negative arbitrage" on the bond issue. Negative arbitrage is the added cost that occurs when all of the proceeds of a tax-exempt bond issue are parked upfront in temporary investments (e.g., guaranteed investment contract) that pay lower interest than the interest rate that the issuer is paying to the bond investors.

Griffith said he is seeing more "bond swaps," transaction in which the tax-exempt bonds issued for a project – to get the 4% credits – are paid off after the property is placed in service.

Another hot growth area has been direct purchases of tax-exempt multifamily housing bonds, primarily by national financial institutions seeking both yield and credit for this investment under the Community Reinvestment Act (CRA). According to Novogradac, such direct, or private, placements have occurred at a growing pace in California. Meanwhile, New York State enacted legislation in 2011 that permits private placements to banks of bonds issued by state and local housing agencies.

Finally, another new twist, according to Rucker, is structuring multifamily housing bond issues with a larger taxable "tail." Whereas it has been common for multifamily issues to consist primarily of tax-exempt bonds with a very small amount – or tail – of taxable bonds, the favorable current interest rate environment make it advantageous to structure offerings in which short-term taxable bonds may account for as much as 20% of the dollar amount of the entire bond issue, Rucker said. The very low interest rate on the taxable bonds (lower than the rate on the long-term tax-exempt bonds) produces an even lower "blended" borrowing rate than with a small taxable tail or a straight tax-exempt bond issue. Proceeds from taxable bonds can also used to pay for the excess "bad costs" of a tax-exempt multifamily bond issue. No more than 5% of the proceeds of a tax-exempt bond issue may be spent on the ineligible or "bad" costs of the issue. TCA

– Sam Hankin