MEMORANDUM

To: Professor Yinger

From: Jessica Allen and Eliana Briceno

Date: April 27, 2015

Subject: Financing Low Income Housing with Multifamily Revenue Bonds

Introduction:

This memo defines the characteristics of Multifamily Revenue Bonds and why they are necessary. We will also evaluate how changes in the tax-exempt status of these bonds may affect municipalities' ability to meet their affordable housing needs, especially for high needs populations. We recommend that policymakers preserve the tax-exempt status of MFR bonds because of their importance as a tool for creating affordable housing units. In addition, we recommend that state Housing Finance Agencies and Housing Authorities prioritize MFR bond issues for agencies like non-profits who seek to serve those with the lowest incomes and highest needs.

Multifamily Revenue Bond Purpose and Characteristics:

The multifamily revenue (MFR) bond is a private activity bond that can be issued by state and local governments or public authorities on behalf of private and non-profit developers for a public purpose, namely to construct or renovate low-income rental units. The Department of Housing and Urban Development (HUD) defines low-income housing facilities by the proportion of low-cost units they have. In order to be considered low-income housing, the developer must build a facility that has "a minimum of 20% of the units designated to individuals earning no more than 50% of the area median income or 40% of their units reserved for individuals at or below 60% of the area median income."[1] These ratios are enforces at the state and local levels, where MFR bonds are usually issued by Housing Finance Agencies and Housing Authorities. MFR bonds have helped produce almost 1 million affordable rental units for low income families.[2]

The need for this kind of low income rental housing has increased with the decline of the housing market in recent years. In the United States, the population of low-income renters has increased over the past few decades due to the growth of the national

[1] http://www.pfauthority.org/private-activity-programs/affordable-multifamily-housing-bonds/

[2] https://www.ncsha.org/advocacy-issues/housing-bonds

population combined with stagnant wages.[3] Currently, there are over 11.5 million families with extremely low income (ELI) in the nation (meaning that the household income is below 30% of the area's median income) and many more disadvantaged families who fall above this designation. However, there are only about 3.3 million homes that would be affordable enough for these families to rent, in which the rent would not cause an excessive burden on the family by requiring more than 30% of the household income.[4]

The state of New York has a particular need for housing that serves ELI families, individuals with HIV/AIDS, alcohol and substance abusers, the mentally ill, the homeless, those with physical disability, victims of domestic violence, individuals with disabilities, the elderly and frail elderly.[5] In Onondaga County, a household of four making less than $20,000 a year is classified as ELI. Onondaga County has a total of 19,503 ELI families who require low-income housing, but there are only 5,155 affordable rental units available. This means that 14,347 ELI families are left without access to affordable housing.[6] While competition for affordable housing has increased, the role of the federal government in stimulating the growth of low-income housing options has been reduced significantly. The Federal housing assistance budget authority had fallen almost 50% since its peak in the late 1970s and public housing or project-based rental assistance programs for low income households have all seen declining funding in the face of federal budget cuts.[7]

In addition to these budget cuts, the federal government has shifted resources to encourage developers to build affordable housing units using the Low Income Housing Tax Credit (LIHTC), or "Section 42" credit. This dollar-for-dollar tax credit is given directly to developers from state housing agencies to incentivize private investment in low-income housing units.[8] Because LIHTC produced units' rents are based on area median income, it tends to help households that have slightly higher incomes. According to a 2008 National Low Income Housing Coalition report, "the Low Income Housing Tax Credit (LIHTC) has emerged as the most significant federal program producing affordable housing for low

[3] http://www.shimberg.ufl.edu/publications/UScompare.pdf
[4] http://urban.prod.acquia-sites.com/mapping-americas-rental-housing-crisis
[5] http://www.shimberg.ufl.edu/publications/UScompare.pdf
[6] http://urban.prod.acquia-sites.com/mapping-americas-rental-housing-crisis
[7] http://nlihc.org/sites/default/files/Housing-Assistance-2008.pdf
[8] http://www.nmhc.org/Content.aspx?id=7325

income Americans. Yet more than 60% of the units funded in 2005 were targeted at households with 50% AMI or above. By contrast, only 7% of LIHTC units targeted households in the 30% AMI or less category."[9] As such, LIHTC cannot address the demand for affordable housing for ELI families on its own.

The Section 8 housing vouchers program is a crucial, rent-based assistance program. In Syracuse, the Syracuse Housing Authority (SHA) receives federal funds for about 3,500 vouchers due to budget cuts at the federal level and competition with other housing authorities for funds. However, the waiting list for these vouchers has been closed due to a backlog of over 10,000 applications.[10] Along with the barrier created by the scarcity of these vouchers, Section 8 requires that recipients pay 30% of their household income in rent. There are also rules to apply for vouchers that require that no convicted felons live in the unit, and that families who have previous evictions report them- these factors may disqualify them from the program. Additionally, private landlords are not required to accept these vouchers and may choose not to rent units to those using Section 8. These aspects of the program may make them prohibitive for ELI families or those with special needs.

The use of MFR bonds is one way that government agencies can encourage private and non-profit firms to address the public problems that occur when those with low socio-economic status are underserved in the private housing market. In communities with a high demand for affordable housing and low reserves to pay for such capital projects, MFR bonds are especially important. These bonds give private and non-profit developers access to tax-free borrowing, which lowers the costs associated with building low-income rental units, and makes the project overall more affordable.

States' annual issuance for MFR bonds in 2014 was capped at $100 per capita, with a state minimum cap of $296.830 million (this ensures that bond issuance in states with smaller populations is not prohibitively low).[11] Within this cap, the bonds are backed by the federal government. However, debt issued by non-traditional issuers, like public

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[9] http://nlihc.org/sites/default/files/Housing-Assistance-2008.pdf
[10] http://www.syracuse.com/news/index.ssf/2012/04/a_backlog_for_low-income_house_assistance_leaves_more_than_10000_households_struggling.html
[11] http://nlihc.org/sites/default/files/2014AG-245.pdf

housing authorities, is often outside the scope of the state cap.[12] These bonds are different from other municipal bonds because although they are issued in the name of local agencies, they are not obligations of those local agencies and are not backed by their taxing power or public revenue sources. The developer who receives the bond issue is solely responsible for payment.[13] As *State Fiscal Institutions: An Evolution* states, the primary source of debt service for these bonds is the rent payments from the produced rental units.[14]

MFR bonds are tax-exempt bonds like other municipal bonds, which means that the interest paid to investors on those bonds is exempt from federal (and often state income) taxes. Investors, especially those with high federal marginal income taxes, find these tax-exempt bonds more desirable than those whose interest is taxed, and because the bonds "require less interest than they would from taxable debt to produce the same after tax return."[15] The Housing and Economic Recovery Act from 2008 and the American Recovery and Reinvestment Act from 2009 made most of the MFR bonds tax exempt from federal and individual alternative minimum taxes (ATM), which has led to a lower financial cost for investors resulting in more interest saving for developers, which is passed on to renters.[16]

The MFR Bonding Process:

Several factors influence how the bond will be issued such as "transaction type (conduit or pooled), choice of Issuer, the policies and procedures of the Issuer, the type of project, the type of Borrower (for-profit or not for-profit), the financing structure, applicable state law and other factors."[17] However, most of the MFR bonds followed the steps described in Appendix 1.[18] For developers who are looking to obtain a MFR bond funded loan but do not want to take the lead in executing a bond financing, it would be best for them to go through a state housing finance agency.[19] Due to the fact that both traditional and non-traditional debt issuers can use MFR bonds, it is difficult to find useful

[12] Rodriguez Tejedo, Maria Isabel. *State Fiscal Institutions: An Evolution."* ProQuest Information and Learning Company, 2007. Page 59.

[13] Rodriguez Tejedo. Page 44, footnote 47.

[14] Rodriguez Tejedo. Page 44, footnote 47.

[15] https://www.orrick.com/Events-and-Publications/Documents/2709.pdf, page 3

[16] https://www.orrick.com/Events-and-Publications/Documents/2709.pdf, page 3

[17] https://www.orrick.com/Events-and-Publications/Documents/2709.pdf, page 39

[18] https://www.orrick.com/Events-and-Publications/Documents/2709.pdf, page 39-43

[19] https://www.orrick.com/Events-and-Publications/Documents/2709.pdf, page 34

data for New York State regarding who the bonds are issued to and the demographic information of renters. The NYS Housing Finance Agency is one of the most "prolific" issuers of MFR bonds, with issuances totaling more than $1 billion in 2009.[20] The Syracuse Housing Authority issues MFR bonds on behalf of organizations that fulfill their mission to "provide quality, safe and affordable housing."[21]*

Threats to MFR Bonds:

Recently, policy makers have proposed changing the structure of the tax exemption for municipal bond interest, including the MFR bond. In 2010, President Obama proposed eliminating private purpose bonds altogether through his National Commission on Fiscal Responsibility. Although this did not progress, he supported capping tax-exempt municipal bond revenue or eliminating the municipal bond tax exemption completely several times throughout his tenure. Similar bipartisan reform proposals have been the result of Congressional hearings led by Senator Max Baucus (D) during his time as the Chair of the Senate Finance Committee, and Representative Dave Camp (R) during his time as Chair of the Ways and Means Committee.

According to Mindy La Branche, a Legislative and Policy Associate for the National Council of State Housing Agencies, "the tax exemption for housing bonds, and all municipal bonds, may face its biggest threat since Congress last considered tax reform in 1986," due to bipartisan proposals to cap tax-exempt interest revenue in Congress, as well as from the President. President Obama has proposed a cap on the value of deductible interest on municipal bonds for high income investors or eliminating private activity bonds altogether over his tenure. La Branche also projects that "Eliminating or capping the tax exemption for municipal bonds would have a significant negative impact on municipal bond investment, directly increasing borrowing costs for HFAs and detracting from their ability to provide affordable housing opportunities… The ultimate impact, however, would likely fall not on bond issuers and investors but on the bond programs' ultimate beneficiaries, including

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[20] http://www.nyshcr.org/AboutUs/BondSales/HFA.htm

[21] Mission taken from the SHA website.

*In an informal interview, David Paccone, the Assistant Executive Director and Director of Development for the SHA stated that organizations such as the Rescue Mission and Loretto, an organization that focuses on elder care, are examples of the types of organizations for whom they normally issue MFR bonds.

homebuyers and renters, who would bear the cost of higher interest rates demanded by investors."[22]

Policy Recommendation:

Some argue that restricting or eliminating bonds like the MFR bond altogether would not hurt communities' ability to provide affordable housing because of the presence of other programs like federal Section 8 housing vouchers, public housing, and LIHTC. These types of programs allow government to alleviate some of the difficulties families face when searching for affordable housing. However, a closer examination of who actually benefits from LIHTC and an evaluation of the local issues with relying on federal housing assistance programs like Section 8 in Onondaga County and Syracuse, NY reveals that providing low-income housing, especially units that fit the needs of families with ELI and or special needs requires a variety of strategies. These programs require much more government spending to maintain, making them susceptible to budget cuts, while using MFR bonds requires only administrative spending and can be managed at the state and local levels.

Because MFR bonds provide a way for private and non-profit developers to borrow the necessary funds for these types of capital projects tax-free, they can be used to further decrease the costs associated with building low-income housing and thus incentivize firms to provide affordable units. The financing of low-income housing by private and non-profit firms, and even among diverse non-profits, may be approached in very different ways. Each project has the goal of providing affordable housing units; however, profit margins and target demographics may determine which avenue makes the most sense for different developers. In the case of non-profits that assist underserved families with ELI and special needs, a range of financing tools is especially crucial because their building and maintenance costs may be significantly higher while their return-on-investment may be significantly lower. As such, preserving supply-side programs that help lower the cost of *producing* low-income housing, like the MFR bond, is imperative.

In addition, to ensure that the housing needs of those with the greatest needs in the community are being met, it would be in the interest of the State of New York and other

[22] http://nlihc.org/sites/default/files/2014AG-245.pdf

states to implement a preference system when determining which developers get MFR bond issues. Currently in New York, the NYS Housing Finance Agency issues MFR bonds on a first-come, first-served basis. Alternatively, states like California have structured their preference system to reflect the state's priority of incentivizing the production of affordable housing for those with the previously mentioned special needs.[23] This means that MFR bond issuers like housing authorities give preference to projects that specifically target underrepresented populations. If this model were to be implemented in the state of New York, housing projects that aim to help ELI families and individuals like those with HIV/AIDS, alcohol and substance abuse, mental illness, homelessness, physical disability, domestic violence, developmental disabilities, and the elderly and frail elderly, will be higher priority to receive MRF bond issues. This will increase efficacy of how the MFR bond is granted to developers.

Conclusion:

Because of its characteristics and a lack of practical alternatives, we believe that the Multifamily Revenue Bond is a valuable tool for increasing the number of affordable rental units in the market, especially for those with extremely low income and special needs. In order to maintain these bonds as an accessible tool that lowers developer's costs, we recommend that their tax-exempt status be maintained. Additionally, the benefits of these bonds for high-needs populations may be maximized by instating prioritization standards in issuing agencies, like housing authorities and housing finance agencies, which prioritize the construction of housing that meets the needs of these populations.

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[23] http://www.shimberg.ufl.edu/publications/UScompare.pdf

Appendix 1: MFR Bonding Process Steps[24]

1. *Consult Bond Counsel* – bond counsel will help with the validity and tax exemption of the bond and the drafting of the legal documents.
2. *Find a Lender (Public Sale or Private Placement)* – most multifamily housing projects are financed on a project-by project bases, which means that the developers need to find a Lender to extend credit to in exchange for real estate security interested in the project. The Lender plays a major role in the financing of the project and is the driving force in the transaction. Finding a Lender early is important to make sure the transaction is feasible and get a idea when the project will be completed.
3. *Choose the Issuer* – in the case that the Lender is not the issuer, the developer can consult with the Bond Counsel on what public entity will serve as the Issuer of the bond.
4. *Engage the Underwriter (Public Sale)* – publicly sold bonds, such as the MFR bond, require an Underwriter. An underwriter is the investment banking firm responsible for marketing the bonds, helping to structure the financing, presenting the transaction to rating agencies to obtain ratings on the bonds and/or to bond insurers or credit providers, and purchasing *(i.e.*, underwriting) the Bonds for resale to investors.
5. *Consider a Financial Advisor* – in some cases, financial consultants are brought into the process because of their expertise with many financing structures and often help with the tax credit side of the transactions.
6. *Adopt a Reimbursement Resolution* – if the developer intends to use bond proceeds to reimburse itself for project expenditures incurred prior to the issuance of the bonds, the Borrower will want the issuer to pass a "reimbursement resolution" establishing a date after which (and up to 60 days before which) costs incurred can be reimbursed with bond proceeds.
7. *Apply for (and Receive) Volume Cap/Tax Credits* – unless the Borrower is a 501(c)(3) corporation, the project will need to receive an allocation of volume cap

[24] https://www.orrick.com/Events-and-Publications/Documents/2709.pdf, page 39-43

authority (see "Federal Tax Law") to have tax-exempt private activity bonds issued on its behalf.

8. *Conduct TEFRA Hearing and Approval* – Bond counsel is usually responsible for completing the TEFRA process. TEFRA approval does not need to be received until just before the transaction closes, but Issuers and other entities having control over the transaction often require TEFRA approval early on.

9. *Drafts of Documents* – Bond Counsel, Underwriter's Counsel and Lender's Counsel prepare and circulate to the working group drafts of the bond documents, the underwriting documents and the loan documents. These typically include some combination of an Indenture, a Loan Agreement, a Regulatory Agreement, a Bond Purchase Agreement, an Official Statement, a Letter of Credit or Credit Enhancement Agreement, a Reimbursement Agreement, a Promissory Note, a Mortgage or Deed of Trust, subordination and intercreditor agreements, and ancillary loan security documents. Alternative documentation may be used in the case of a private placement.

10. *Conference Calls* – the finance teams hold conference calls to discuss the process and the drafts of the legal documents.

11. *Issuer Approval* – once the documents by all the parties have been finalize, the bond issuer adopts a bond resolution (drafted by bond counsel) authorizing the sale and issuance of the bonds, execution and delivery of the legal documents, and distribution of the Official Statement, if any.

12. *Preliminary Official Statement* – For a public sale, a preliminary Official Statement containing information about the bonds, the Issuer, the project and any credit enhancement, but excluding certain final pricing information, is mailed to potential purchasers of the Bonds. In the case of variable rate demand bonds that can be put (i.e., sold back to the Issuer) on seven days' (or other short) notice, the delivery of a Preliminary Official Statement is optional.

13. *Credit Approval* – after revision of all the documents, the Lender commits to extend credit to the project.

14. *Bond Sale* – for a public sale, the underwriter completes marketing of the bonds to the public and enters into the Bond Purchase Contract with the Issuer,

which is usually accepted and approved by the Borrower in the case of a conduit transaction. For variable rate bonds, this step may take place the day before closing; for fixed rate bonds, the bond sale occurs a week or more before closing.

15. *Final Official Statement* – for a public sale, a final Official Statement containing the final sale information is prepared for delivery to purchasers of the Bonds at or before receipt of their purchase confirmations.

16. Closing – the Bonds are delivered to the Underwriter or directly to the bondholder in exchange for payment of the purchase price of the Bonds simultaneously with delivery of final executed copies of the legal documents, and various certificates, receipts and opinions. In the case of a conduit financing, the loan is typically funded concurrently, and real estate documents securing the loan of the bond proceeds to the Borrower, as well as the Regulatory Agreement, are recorded in the county recorder's office of the county in which the project is located.