NH&RA Annual Meeting 2011

New Bond Financing Structures Panel

Hyatt Regency Coconut Point,
Bonita Springs, Florida
February 24, 2011

New Bond Financing Structures Panel

Contact Information

John Peck **Peck, Shaffer & Williams LLP** *201 East Fifth Street, Suite 900* *Cincinnati, OH 45202* *513-639-9212* *jpeck@peckshaffer.com*	**John Rucker** **Merchant Capital L.L.C.** Lakeview Center, Suite 400 2660 EastChase Lane Montgomery, Alabama 36124 334-234-5100 *johnr@merchantcapital.com*
Mikiyon Alexander **Standard & Poor's** 55 Water Street, 38th Floor New York, NY 10041 212-438-2083 *mikiyon_alexander@sandp.com*	**Alysse Hollis** **Peck, Shaffer & Williams LLP** *201 East Fifth Street, Suite 900* *Cincinnati, OH 45202* *513-639-9213* *ahollis@peckshaffer.com*

New Bond Financing Structures

- John Peck – Introduction
- John Rucker – Market Overview
- Mikiyon Alexander – S&P Ratings for Affordable Housing
- Alysse Hollis – Legal/Structural Issues

S&P Affordable Housing (Stand-alone) Ratings

- Transactions structured to achieve investment-grade (for senior debt) ratings based on the perceived strength of the subject property as well as the project participants, chiefly, the project owner, the manager and the asset manager.
- Recent transactions have received ratings in the A (+/-) for senior debt with subordinate debt in the BBB (+/-) range and junior subordinate debt in the BB(+/-) range. NO GUARANTEE THAT SIMILAR TRANSACTIONS WILL ACHIEVE SIMILAR RATINGS.
- Interest rates are driven by market but no fee stack so rate on bonds equals rate on mortgage loan; third-party fees (Issuer, Trustee, rebate) can be negotiated and paid outside stack (taken into account as expenses).

Process and Timing

- Allow at least 90 days from submittal of application to closing.
- Can take more or less time depending on factors including:
  - Time of year (harder to get transactions done quickly during "busy season" (i.e. end of year));
  - Deal volume experienced by S&P (staff can only process so many transactions at one time – S&P makes every attempt to address all transactions in timely manner but as with any organization they have limited resources);
  - Complexity of transaction (i.e. pooled transactions; issuer requirements; anything that requires a deviation from the norm can take more time).

STEP 1:
Submittal of Rating Application Package

- Application consists of four "Profiles" (Project Profile, Owner Profile, Manager Profile, Asset Manager Profile);
- Applicants are required to provide detailed information about the physical facilities to be financed as well as project participants;
- Requires that third-party reports, including appraisal, property condition reports, environmental reports, be submitted
- Requires that financial projections/pro forma be submitted.

Step 1 Cont.

- Importance of having financing team involved from the beginning;
- Sometimes all third parties aren't available/current – may be some flexibility in this area;
- Historical financials may be difficult to obtain;
- Experienced financing team can help work with S&P to gather and present data in a meaningful way.

STEP 2:
Site Visit; Determination of NOI

- Once engagement letter with S&P is signed, a site visit is scheduled;
- S&P will review application and conduct preliminary analysis to determine whether additional information is needed and/or whether pro forma assumptions are supported by data;
- Once site visit and preliminary review are complete and NOI is established, S&P will go to committee and give verbal rating.
- Meanwhile, parties are working to produce required bond and offering documents, real estate documents, HUD-required documents, etc.

STEP 3:
Legal Review and Documentation

- S&P will review all legal documentation to determine whether there are any structural issues that would affect the rating as preliminarily determined in Step 2.
- Parties are preparing to market bonds as soon as final written rating report is received

STEP 4:
Receipt of Rating; Sale of Bonds; Closing

- S&P will issue final rating letter;
- Bonds are marketed, sold and closing scheduled;
- Closings can seem very simple since there are typically fewer parties than on credit-enhanced transactions (Fewer parties also means lower costs of issuance! However, rating fees are higher than on credit-enhanced transactions.).

Legal Structure

- “Lockbox” structure whereby all “Project Revenues” are deposited with trustee and used to:
  - Pay debt service;
  - Fund Debt Service Reserve Fund (MADS);
  - Fund tax and insurance escrows;
  - Pay project operating expenses and administrative fees;
  - Fund replacement and operating reserves.

Legal Structure Cont.

- The order of the “waterfall” can vary slightly from transaction to transaction, however S&P has typically required that debt service be funded first (including funding any deficiency in DSRF).
- Additional considerations in flow of funds where subordinate debt is included – priority of payment depends on structure of subordinate debt.

Legal Structure Cont.

- After funds are to used to fund the various buckets in the waterfall, any excess flows through to the Surplus Fund where can it be used for various purposes until released to project owner annually after audited financials show coverage test is met for the most recent annual period.
- Failure to meet coverage test can result in requirement to hire consultant to improve project performance.
- Continued failure to meet coverage test can result in rating downgrade.
- S&P will conduct annual surveillance which may include site visit and meetings with owner/manager.

Coverage Levels

- Ratings are coverage driven:
  - On senior (A-rated) debt, coverage levels have been 1.50x or more for non-Section 8 projects, as low as 1.20x for Section 8 projects;
  - Subordinate tranches will have lower coverage requirements and lower ratings;
  - Allowed to go to 1.0 coverage during construction;
  - No set LTV requirements; LTV constraints are assumed to be consistent with DSC constraints.

Reserve Requirements

- Typical Reserves (held by Trustee):
  - Debt Service Reserve Fund equal to maximum annual debt service (MADS);
  - Operating Reserves – range from one month's operating expenses to six months' operating expenses
  - Replacement Reserve – can be determined based on PNA/REAC reports.

Structuring

- Typical Bond Structure:
  - 30/35-year maturities;
  - 10-year lockout.
  - Senior/subordinate debt structured to achieve appropriate debt service coverage while maximizing revenue.

Discussion