

Recent Developments on Short-Term Cash-Backed Tax-Exempt Bonds and Fannie Mae Tax-Exempt Monthly MBS Pass-Through Bonds



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RECENT DEVELOPMENTS ON
SHORT-TERM CASH-BACKED TAX-EXEMPT BONDS
AND
FANNIE MAE TAX-EXEMPT MONTHLY MBS PASS-THROUGH BONDS

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- **We still live in an upside down interest rate world.**
- U.S. Treasury Bonds and GNMA securities (and Freddie Mac and Fannie Mae backed loans and securities) trade at yields substantially below all other long-term credits, including long-term municipal bonds backed by those same credits.

Long-Term Rate Comparison: 30-Year MMD (Tax-Exempt) Versus 10-Year Constant Maturity Treasury (Taxable) January 1, 2008 - Present



SHORT-TERM CASH-BACKED BONDS STILL WORK

Assume Project with \$21,000,000 Total Development Costs

FHA Loan = \$15,000,000

Traditional Long-Term Tax Exempt GNMA Backed Bonds

Short-Term Cash Back Bonds with Taxable GNMA Sale

Tax-Exempt Bond Size

\$15,000,000

\$11,000,000¹

Note \$4.0 Mil Lower Bond Size

Tax Exempt Bond Term

223(f)

221(d)(4)

223(f)

221(d)(4)

35 Years

42 Years

2 Years

2 Years

Mortgage Loan Interest Rate

Bonds

3.85%

3.85%

GNMA

3.00%

3.50%

3rd Party Fees

0.15%

0.15%

3rd Party Fees

N/A

N/A

Servicing +
GNMA Fee

0.25%

0.25%

Servicing +
GNMA Fee

0.25%

0.25%

Total **ML Rate**

4.25%

4.25%

Total **ML Rate**

3.25%

3.75%

Add: MIP

0.25%

0.25%

Add: MIP

0.25%

0.25%

Total **All-in
Borrowing
Cost**

4.50%

4.50%

Total **All-in
Borrowing
Cost**

3.50%

4.00%

Interest Rate Savings: 223f: 100 Basis Points; 221(d)(4) 50 Basis Points!!

PLUS

Much Lower Negative Arbitrage





with Short-Term Cash-Backed Bonds

	Traditional Long-Term Bonds	Short-Term Cash-Backed Bonds
Negative Arbitrage (Deposit):	$4.0\% \times \$15,000,000 \times 2 \text{ years}$ = \$1,200,000 (8.0% of ML)	$0.5\% \times \$11,000,000 \times 2 \text{ years}^*$ = \$110,000 (1.0% of ML)
Negative Arbitrage (Actual):	\$600,000 (4.0% of ML)	\$55,000 (0.50% of ML)

*If Project placed in service in month 12; assumes 1.0% Bond coupon partially offset by 0.5% reinvestment rate.

Results of Structure - Borrower

Major Advantages:

1. **Qualifies for 4% LIHTC.** 
2. **Lowers Mortgage Rate 50 to 100 basis points.** 
3. **Avoids huge (4-8%) negative arbitrage deposit** on new construction/sub rehab (§221(d)(4)) deals. 
4. **Eliminates on-going issuer/administrative fees after 1-3 years; huge benefit** where issuers charge major (25-50 basis points) ongoing fees as long as bonds are outstanding. 

Major Disadvantages:

0. **None (ok, a small cap i deposit).** 

Increased Volume of Section 221(d)(4) New Construction/Sub Rehab Loans

- Section **221(d)(4)** loans now make up a much larger percentage of FHA loans we see.
- Have longer **expected placed-in-service dates, e.g., 1.5 – 2 years.**
- Thus **longer, e.g., 2-3 year bond maturities.**
- Thus **higher bond coupons, e.g., 1.00 – 1.30%** (v. 0.50 – 0.80% for §223(f)).
- Thus **much greater negative arbitrage – potentially 3-4% of Bonds** (v. 0.5 – 1.0% for §223(f)).

Increased Volume of Section 221(d)(4) New Construction/Sub Rehab Loans

- **Managing reinvestment becomes critically important.**
- With properly structured investments, may be able to **reduce negative arbitrage by half or two-thirds or more.**

BUT

- **Bond counsel firms may vary on what type of investment vehicles they will permit** and on whether they will permit long-term investments with this structure.
- If the **Borrower** has a choice of Issuers and Bond Counsel, it **should discuss alternatives carefully with the bank or investment bank** and/or the registered municipal financial advisor structuring the tax-exempt debt and with the bond purchaser's counsel **at the outset of the financing.** In these cases differences in Bond Counsel firm positions on reinvestment may critically impact the results which can be achieved.

Use of Cash-Backed Tax-Exempt Short-Term Bonds with Broader Range of Taxable Loans

- Short-term cash-backed tax-exempt bonds are now being **used in any scenario where Borrower can achieve lower borrowing rates and/or lower negative arbitrage than through a taxable loan** as compared to a long-term tax-exempt municipal debt structure.
 - **Also** now used with:
 - **Fannie Mae and Freddie Mac Mod Rehab Loans**
 - **Rural Development Loans** (financed with taxable GNMA sales);
 - **Seller “Take-Back” Loans;**
 - **Other Subordinate Loans (e.g. HOME, CBDG);**
 - **50/50 Risk Share Mod Rehab Loans** under **new Federal Financing Bank loan purchase program;** and
 - **Other Taxable Loans.**

Comparison of Short-Term Cash-Backed Bonds + FHA to Private Placements and Other Executions

- **FHA** insured loan is the **only available credit enhancement which is non-recourse during pre-Conversion phase** – all others (Private Placement, Fannie Mae, Freddie Mac) require deep pocket General Partner guarantees during this phase.*
- On an **FHA 221(d)(4)** sub rehab/new construction loan, there is a cost certification at final endorsement, but **no new loan underwriting**; differs from sub rehab/new construction private placement deals and sub rehab/new construction Fannie/Freddie deals where there is a **new loan underwriting and possible loan downsizing** based on DSC or LTV at **“Conversion.”**
- **FHA loans offer a 35 year (§223(f) or a 40 year (§221(d)(4) level payment loan amortization with no balloon; versus a 16 to 18 year balloon** on a private placement, Fannie or Freddie deal.
- **FHA offers greater prepayment flexibility** – closed for 2 years to 108% decreasing 1% per year thereafter to par v. yield maintenance of 12% or higher declining over a longer period (e.g., 15 years) for all others (Private Placements, Fannie Mae, Freddie Mac).

*Note: Some guaranties will be required in connection with the 4% LIHTC on these financings.

Comparison of Short-Term Cash-Backed Bonds + FHA to Private Placements and Other Executions

- **On the other hand**, especially in high cost markets, **many projects require a construction loan** that is **much larger than** the supportable **permanent debt**. A portion of the larger **construction loan often provides critical “bridge” financing** to later tax credit equity installments and subordinate loan pay-ins.
- **Private placement sponsors and bank construction lenders on Fannie/Freddie sub rehab or new construction financings will readily provide such a larger construction loan** since the entire construction loan is secured by a first deed of trust; **with FHA**, on the other hand, **no lien on real estate is permitted to secure a tax credit or other bridge loan**.
- Instead, **on FHA loans the bridge loan** (either taxable or in the form of subordinate tax exempt bonds if needed to satisfy the 50% rule) must be **secured by a pledge of tax credit equity installments, deep pocket general partner guarantees of completion and payment and/or possibly a pledge of general and/or limited partnership interests**. Such debt may be more difficult to place.

Comparison of Short-Term Cash-Backed Bonds + FHA to Private Placements and Other Executions

- While private placement perm rates are often 25-75 basis points higher than FHA, **private placements do offer very low perm rates that are locked at closing (e.g., 4.15% to 4.35% including third party fees on fully funded mod rehab loans or 4.40% to 4.55% for a draw down construction/perm loan)**; and the structure readily accommodates a loan pay-down at Conversion from other funding sources.
- **Private placements and Fannie and Freddie deals avoid Davis Bacon wages** required for sub rehab (very generally > \$40,000 per unit)/new construction FHA Section 221(d)(4) loans, and may offer more flexible/quicker loan underwriting.
- Private placements **may also be available from non-bank financial institution sponsors** and may be especially attractive in non-CRA driven markets.

Conclusion

- **Hundreds of financings combining short term cash backed tax exempt bonds with taxable loan sales have closed in the eight years since 2008.**
- **Almost all of the country's major bond counsel firms have now issued unqualified approving opinions. Documents and rating agency criteria also now very well developed.**
- **In today's "upside down" interest rate world this is now THE WAY (and THE ONLY sensible WAY) to finance affordable housing projects backed by FHA insured or other GNMA eligible mortgage loans, including certain Section 538 Rural development loans. For these AFFORDABLE FHA AND RD loans, YOU WILL USE SHORT-TERM BONDS – CALL US AT THE OUTSET!!!**
- **The structure can also now be used to substantially lower the all-in interest rate for Fannie Mae and Freddie Mac enhanced "moderate rehabilitation" and certain other taxable loans.**
- **We believe it is unlikely market conditions will change in next 3-5 years to favor traditional long-term tax exempt bond structure; we think the "upside down" interest rate world, at least with respect to these types of credits, is here for a full generation following 2008.**

NEW FANNIE MAE TAX-EXEMPT MONTHLY MBS PASS-THROUGH

- Over the past few years, **over \$3.0 billion** of agency backed (Ginnie Mae, Freddie Mac, Fannie Mae) **tax exempt single family mortgage revenue monthly pass-through bonds** have been sold, **lowering coupons by 25-35 basis points** versus traditional semi-annual pay long-term tax exempt bonds. Buyers want the security of an immediate, monthly agency pass-through.
- Now two Fannie Mae tax exempt **multifamily** monthly MBS pass-through bond issues have closed.
 - In January, Fannie Mae closed a **\$21.75 million, 16-year fixed rate tax exempt multifamily** Fannie Mae MBS pass-through **issue** of the **Illinois Housing Development Authority** for Fullerton Apartments, a **mod rehab** project.
 - A **second \$23,150,000** issue by the **Texas Department of Housing and Community Affairs for the Williamsburg Apartments** closed in December of 2015.
- These Bonds were **“Aaa” rated by Moody’s** and were **publicly offered** by **RBC Capital Markets**, as the underwriter.
- Under this structure, the Trustee on these monthly-pay fixed-rate bonds simply passes through the monthly Fannie Mae MBS payment to the Bondholder on next business day on a tax exempt basis.

COMPARISON OF FANNIE MAE TAX-EXEMPT MONTHLY MBS PASS-THROUGH STRUCTURE TO OTHER FANNIE MAE ENHANCED EXECUTIONS

Date of Official Statement	\$ Amount of Bonds/Loan	10-Yr U.S. Treasury	Taxable Fannie Mae MBS	Estd. Semi-Annual 16-yr TE Fannie Mae Enhanced Bonds	TE Bond Yield 16-yr Fannie Mae Monthly MBS Pass-Through	Servicing and Guarantee Fee	ML Rate
IHDA – Fullerton Ct. 01/21/15	\$21,750,000	1.87%	3.05%	3.25%	3.00% Savings v. Taxable MBS – 5 basis points Savings v. TE Semi- Annual Bond – 25 basis points	0.97%	3.97%
TDHCA – Williamsburg 12/02/15	\$23,150,000	2.18%	3.45%	3.50%	3.34%* Savings v. Taxable MBS – 11 basis points Savings v. TE Semi- Annual Bond – 16 basis points	1.01%	4.46%

*Bonds had a bond coupon equal to the MBS Pass-Through rate of 3.45% and were sold at a price of 101%.

NEW FANNIE MAE TAX-EXEMPT MONTHLY MBS PASS-THROUGH

- **Coupon is expected to decline even further as more “cross over” MBS buyers come in on future deals** and if **tax exempt rates continue to slowly recover** versus taxable rates as the distrust of municipal bonds and other non-U.S. government debt securities created by the 2008 financial crisis continues to subside. One would **expect** this execution to become more and **more competitive**. Most likely to be used in **markets where tax exempt bond volume is available through issuers who charge very low (e.g., 5-10 basis points per year) or no ongoing fees**.
- In such markets, the monthly MBS pass-through structure almost eliminated (reduces to about 45 days) the net negative arbitrage associated with **the Borrowers, paying two sets of interest under the short-term cash-backed bonds plus taxable Fannie Mae MBS sale structure**.
- For sophisticated developers, this **structure allows potentially more flexible prepayment options; yield maintenance** through 10 years to par call **versus** absolute **10-year lock-out** associated with traditional municipal bonds.
- On the other hand, **short-term cash backed bonds plus taxable Fannie Mae MBS sale** may be continue to be a **better option** where **ongoing Issuer fees are very high (eg., 25 – 50 basis points)**.

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SUMMARY OF MAJOR TAX EXEMPT DEBT EXECUTIONS

	Estd. Actual All-In Borrowing and Underwriting Rate
1. Short-Term Cash Backed Tax Exempt Bonds with Taxable Loan Sale	
FHA/ GNMA §223f (Mod Rehab)	3.50%
FHA/ GNMA §221(d)(4) (Sub Rehab / New Cons)	4.00%
Fannie Mae or Freddie Mac Mod Rehab (Freddie deemphasizing – see “TEL” Structure Below)	4.50%
2. Private Placement	
-Mod Rehab	3.80% to 4.25%
-Sub Rehab/New Cons	2.30% to 2.55%
Cons Period	(Cons Period; SIFMA or LIBOR +220-250)
Perm Period	3.90 % to 4.35%
3. New Freddie Mac “TEL” Program (Mod Rehab, Sub Rehab, New Cons)	(Cons Period; SIFMA or LIBOR +220-250)
	Perm 3.80% to 4.35%
	(lower end for mod rehab)
4. 18-Year Maturity FR Freddie/Fannie Publicly Offered Bonds	
(Sub Rehab/New Cons or “Forward” Loan)	5.00% to 5.20%
5. New 16-Year FR Fannie Mae Tax Exempt Monthly	
Pass-Through Publicly Offered Bond Structure (Mod Rehab)	4.00% to 4.50%