MEET THE MONEY:

THE ROADMAP TO FINANCIAL RESOURCES FOR HEALTHY HOUSING and COMMUNITY DEVELOPMENT IN THE COACHELLA VALLEY

TAX-EXEMPT BOND FINANCING

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CALIFORNIA DEBT LIMIT ALLOCATION COMMITTEE
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Agenda

- Overview of Bonds
- CDLAC Structure
- Rural Project Examples
- Accessing the Capital Markets

BONDS

What Are Tax-Exempt Bonds?

- Bonds are a form of debt.

- When investors purchase bonds, they essentially lend money to the bond seller, or issuer. In this way, a bond is similar to an IOU. In return for the bond proceeds, the issuer promises to pay the investor a specified rate of interest over the life of the bond and to repay the bond when it comes due.

- Government agencies sell bonds to finance a variety of projects and activities. Corporations may also sell bonds to finance projects and/or capital expenditures.

- Governments *typically* issue tax-exempt bonds; Corporations *typically* issue taxable bonds.

Municipal Bonds

- Bonds issued by government agencies are called municipal bonds.

- The funds are used to finance projects that benefit the community such as roads, schools, bridges, sewers, parks, water treatment or low-income housing. Most bonds issued by government agencies are tax-exempt, **as defined under the Internal Revenue Code**. This means bondholders do not have to pay federal income taxes and, in most cases, state income taxes on the interest they earn.

- In addition to the tax-exempt status, investors benefit from the taxing authority of the government agencies. That authority strengthens the security of municipal bonds, giving investors greater assurance they will get paid on time and in full.

- The tax-exempt status and minimal risk of default lead investors to agree to lower interest rates relative to other forms of borrowing. As such, government agencies, and thus the taxpayers, can benefit from lower borrowing costs as compared to standard market loans or even taxable bonds.

Private Activity Bonds

- Government agencies may also, in certain cases, issue tax-exempt bonds on behalf of private businesses.

- These bonds are known as "Qualified Private Activity Bonds" and may be issued for various purposes such as low income multi-family housing, industrial development, redevelopment projects, enterprise zones or facilities that treat water, sewage or hazardous materials. The lower borrowing costs facilitate the development of projects that may not otherwise be feasible if financed at market rates.

- Unlike typical municipal bonds, the payment of principal and interest on private activity bonds is not the responsibility of the issuing government agency. Instead, it is the responsibility of the private business receiving the proceeds. By relieving government agencies of the financial obligations associated with bond debt, private activity bonds are a low-risk alternative for communities to finance projects.

CDLAC

California Debt Limit Allocation Committee (CDLAC)

The California Debt Limit Allocation Committee (CDLAC) is a three member Committee comprised of the State Treasurer as Chair, the Governor, and the State Controller.

CDLAC was created in 1986 by Governor Proclamation in response to the 1986 Tax Reform Act, which imposed an annual limit on the dollar amount of tax-exempt private activity bonds that may be issued in a state. Private activity bonds include multifamily and single family housing bonds, student loan, exempt facility bonds and industrial development bonds. The Act also required each state to designate an entity to allocate the state's ceiling among various state and local issuers. In California CDLAC is that entity.

The Committee has three non-voting advisory members, the Director of the Department of Housing & Community Development, the Executive Director of the California Housing Finance Agency, and a local government representative appointed by the Chair of the Committee.

Statutory Responsibilities

State: The California Debt Limit Allocation Committee (Committee) was statutorily created in California by Chapter 943, Statutes of 1987, in response to the 1986 Federal Tax Reform Act. California Government Code Section 8869.80 et seq. defines the Committee's responsibilities as follows:

- Set the Annual State Ceiling: The Committee is required to establish the California allocation limit for private activity bonds (the CAP). The CAP is established as soon as is practicable after the start of each calendar year. Historically, the Committee has set the annual CAP in January, and has used the "per capita" formula as prescribed by the U.S. Treasury. For example, the 2012 cap was set at $3,580,731,640. The 2013 CAP is based on the December 2012 population estimate of 38,041,430 (38,041,430 x $95 = **$3,613,935,850**).

- Allocate the State Ceiling: The California Debt Limit Allocation Committee is granted the sole authority for allocating the annual CAP in California.

- Other Administrative Functions: CDLAC is a fee financed agency which is authorized to prepare forms, establish procedures and regulations, set priorities, require a performance deposit, assess fees, and perform other administrative functions as necessary.

CDLAC Programs

CDLAC is a fee based program and receives no federal or state funding. Agencies and organizations authorized to issue tax-exempt private activity bonds or mortgage credit certificates must receive an allocation from CDLAC. The bonds issued utilizing the private activity bond allocation are purchased by municipal bond investors and the repayment is the obligation of the Borrower not the state.

CDLAC has adopted Regulations for allocating the annual state ceiling. The Regulations give priority to projects or programs that provide the greatest public benefits. Applications for award of allocation are reviewed and recommended through a competitive process.

The Committee has seven (7) program pools for the issuance of tax-exempt private activity bonds:

- Qualified Residential Rental Program (QRRP)
- Single-Family Housing Program
- Teacher Extra-Credit Home Purchase Assistance Program
- Single-Family Home Improvement & Rehabilitation Bond Program
- Student Loan Program
- Small-Issue Industrial Development Bond Program
- Exempt Facilities Program (Water, Solid Waste, Recycling, etc.)

CDLAC Applicants (Issuers)

A CDLAC applicant is any state or local governmental agency, joint powers authority (JPA), special district, non-profit public benefit corporation or any other public agency that is empowered to issue debt. Issuing Authorities include, but are not limited to the following: California Housing Finance Agency (CalHFA), California Statewide Communities Development Authority (CSCDA), and California Municipal Finance Authority (CMFA). In addition, high volume local governmental applicants include City of Los Angeles, Housing Authority of the City of San Diego, Housing Authority of Sacramento, City of San Jose, County of Contra Costa, and City and County of San Francisco.

Qualified Residential Rental Program (Multifamily)

State and local governmental agencies and joint powers authorities can issue tax-exempt housing revenue bonds. These bonds assist developers of multifamily rental housing units to acquire land and construct new units or purchase and rehabilitate existing units. The tax-exempt bonds lower the interest rate paid by the developers. The developers in turn produce market rate, mixed-income, and affordable rental housing for low and very low-income households by reducing rental rates to these individuals and families. Projects that receive an award of bond authority have the right to apply for non-competitive 4% tax credits, administered by the California Tax Credit Allocation Committee (TCAC).

Bond Authority for Rental Projects is awarded to three sub-pools:

- **General Pool** (Projects having more than 50% of total units designated as Restricted Rental Units);
- **Mixed Income Pool** (Projects having 50% or fewer of total units designated as Restricted Rental Units);
- **Rural Project Pool** (Projects located in a rural area as defined by California Health and Safety Code Section 50199.21 but shall not include a Mixed Income Project).

Qualified Residential Rental Program (Multifamily)

- CDLAC attempts to encourage projects that can provide the maximum amount of <u>public benefits</u> to both the residents and the surrounding community. This goal is realized through the minimum application requirements and scoring criteria used to evaluate all projects for potential award. All QRRP Applications are competitively scored (see next slide).

- Each program year, the Committee initially determines whether the allocation process shall be 'Competitive' or 'Open'. If Open, then projects must achieve a minimum score to be eligible for an award of allocation. Since 2008, CDLAC has been under an open allocation process, with General & Rural Pool projects required to score at least <u>60</u> points (out of 130), and at least <u>50</u> points (out of 100) for Mixed Income Pool projects.

Qualified Residential Rental Program (Multifamily)

Point Criteria	Maximum Points Allowed for General & Rural Income Projects	Maximum Points Allowed for Mixed Income Projects
Federally Assisted At-Risk Project or HOPE VI Project	20	20
Exceeding Minimum Income Restrictions:	35	15
Exceeding Minimum Rent Restrictions [Allowed if 10 pts not awarded above in Federally Assisted At-Risk Project or HOPE VI Project]	[10]	[10]
Gross Rents	5	5
Large Family Units	5	5
Leveraging	10	10
Community Revitalization Area	15	15
Site Amenities	10	10
Service Amenities	10	10
New Construction	10	10
Sustainable Building Methods	10	10
Negative Points	-10	-10
Total Points	**130**	**100**

Single-Family Housing Program

State and local governmental agencies and joint powers authorities can issue tax-exempt mortgage revenue bonds (MRBs) or mortgage credit certificates (MCCs) to assist first-time homebuyers to purchase homes. These agencies and authorities may issue MRBs, the proceeds of which back below market interest rate mortgages. As an alternative to issuing MRBs, state and local governmental agencies and joint powers authorities may issue MCCs. Homebuyers use the MCC to reduce their federal tax liability by applying the credit to their net tax due. Homebuyers may purchase single-family homes, either free-standing detached, condominiums or townhouses. Program participants must meet program income limits and must purchase a home that falls within the program's purchase price limitations.

Single-Family Housing Program (Cont.)

Extra Credit Teacher Home Purchase Program

Participants must be employed at a High Priority school and make a commitment to work at a High Priority school for at least three years. In addition, Program participants must meet program income limits and must purchase a home that falls within the program's purchase price limitations.

CalHFA, the state administer, has recently restarted the ECTHP program; offered a combination of a mortgage credit certificate provided using tax exempt bond authority and a subordinate loan funded with Proposition 46 funds.

Single-Family Housing Program (Cont.)

Home Improvement & Rehabilitation Bond Program

Tax-exempt mortgage revenue bonds (MRBs) or mortgage credit certificates (MCCs) can be issued to assist existing or purchasing homeowners to improve or rehabilitate existing homes. Issuing agencies (or underlying program administrators working with the agency) may use the proceeds from an MRB issuance to fund rehab loans, or provide new mortgages to buyers of newly rehabilitated homes. Alternatively, the agency may issue MCCs; used by the homeowner to off-set a portion of the loan interest by using the MCC to reduce their federal tax liability by applying the credit to their net tax due. Single-family homes, either free-standing detached, condominiums or townhouses are all eligible. Program participants must meet program income limits and the loan must be within the program's home value limitations.

Small Issue Industrial Development Bond Program (IDB's)

Small-Issue Industrial Development Bonds (IDBs) are tax-exempt private activity bonds that are issued through state and local governmental agencies to assist manufacturing facilities finance capital expenditures. IDBs support expansions of existing manufacturing companies. IDBs offer interest rate savings to small and midsize manufacturers in contrast to conventional loans. When used by manufacturers, IDBs serve to create new jobs and retain existing jobs within their communities.

Exempt Facility Program

Exempt Facility Bonds are tax-exempt private activity bonds that are issued by state and local governmental agencies to finance a variety of community serving facilities; water, solid waste disposal and waste recycling facilities among them. The tax-exempt bonds provide facility owners with low cost financing in the form of below market interest rate loans. The interest rate savings enable the project owners to maintain lower customer rates or minimize customer rate increases, while at the same time assisting the communities they serve to meet their mandated requirements to protect and enhance the environment. Exempt facility projects also benefit the communities by creating new jobs.

Student Loan Program

Student Loan Bonds are tax-exempt private activity bonds issued by authorized agencies for the purpose of either financing direct loans to college students and their parents or purchasing bundles of already-originated loans on the secondary market. When used for direct lending programs, tax-exempt bond allocation allows lenders to pass on interest rate savings to “needy” students through below market interest rate loans. Needy students are borrowers for whom the cost to attend college exceeds their ability to pay, as determined by their school's financial aid office. Currently, three agencies are authorized to issue tax-exempt bonds for student loan programs in California: ALL Student Loan Corporation, Educational Funding Services, Inc. (EFSI) and the California Educational Facilities Authority.

The HIRE Act of 2010 de-authorized the federal government’s student loan insurance program; a key credit enhancement source for the sale of these bonds. Though it is still possible, the likelihood of any further student loan-backed private activity bond issuance is extremely remote.

2012 Recap

Recent Annual Activity

Annual PAB Volume Cap Award Activity - 2007-2012						
Reflects Number of Projects Awarded Per Year						
Program Pool	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Qualified Residential Rental Program	123	156	84	67	145	103
Single Family Housing Program	27	27	38	19	14	19
Extra Credit Teacher Home Purchase Program	0	0	0	0	0	0
Industrial Development Bond Program	2	7	0	10	2	2
Exempt Facility Program	18	13	1	11	4	10
Student Loan Program	2	1	0	0	0	0
GRAND TOTALS	***172***	***204***	***123***	***107***	***165***	***134***

RURAL PROJECT EXAMPLES

CDLAC and Rural Development

- Awarded allocation to **9** housing projects in the Coachella Valley in the last eight years, and **17** in rural areas of the state so far this year (out of 64).
- Total of **$89 Million** in Bond Authority; creating or preserving **692 Affordable Units** in the Valley.
- Serving Seniors, Families, and Special Needs (Mentally and/or Physically Challenged)
- Rural Projects are typically 1/3rd of the affordable housing developments assisted by CDLAC each year.
- Usually 1-2 community infrastructure projects per year serving the Inland Empire as well.

Project Example

Coachella Valley Housing Coalition
BUILDING COMMUNITIES SINCE 1982

Fred Young Farmworker Apartments

- Housing Description: New Construction of 85 (1, 2, 3 & 4 BRs) Family Units.
- Project Location: City of Indio, Riverside County
- Issuer: California Municipal Finance Authority
- Amount Awarded: $14,000,000
- Transaction specifics: Private Placement with US Bank (construction and permanent Lender), with HOME, FHLB-AHP, MHP, Joe Serna, Jr., and RHS-514.
- Public Benefits: Provide 85 new affordable units (100% of units restricted to ≤60% of AMI, with many ≤25% of AMI), replacing seriously substandard temporary housing.
- Other Information: Project is the first phase of a 950 unit rental and homeownership master planned community; including retail, commercial and public spaces. The Project Sponsor has committed to providing resident services (training, classes, etc.) on-site, with existing residents given priority to return. First phase to be completed in early 2014.

Project Example

<u>The Thunderbird Apartments</u>

- <u>Housing Description:</u> Preservation & Rehabilitation of 54 (2, 3, & 4BR) Units for very-low and low-income families
- <u>Project Location:</u> City of Mecca, Riverside County
- <u>Issuer:</u> California Statewide Communities Development Authority
- <u>Amount Requested:</u> $2,650,000
- <u>Transaction specifics:</u> Private Placement with US Bank
- <u>Public Benefits:</u> HUD-assisted development at-risk of conversion to market rent levels; now renovated and affordable for an additional 55 years.
- <u>Other Information:</u> Also used a USDA Rural Development Loan. Renovation was completed in 2008.

Project Example

Best Way Disposal Co., Inc. dba Advance Disposal Co., Inc.

- Exempt Project Description: Expansion and New Equipment Purchase for a waste disposal and recycling facility.
- Project Location: City of Hesperia, San Bernardino County
- Issuer: California Pollution Control Financing Authority
- Amount Requested: $15,600,000
- Transaction specifics: Variable Rate Demand Obligation (VRDO) Public Bond Sale, credit enhanced by an irrevocable, direct pay Letter of Credit from Bank of the West.
- Public Benefits: Providing water quality, recycling, tax revenues and jobs benefits.
- Other Information: Financing support for a Woman-Owned Small Business (WBE) that had needs greater than the SBA could finance. Completing in March 2014.

ACCESSING THE MARKETS

Where to Begin

- Selecting Your Issuer
  - Location (Eligibility)
  - Familiarity with your Project Type
  - Fees
  - Prevailing Wage

- Building Your Financing Team
  - Bond Counsel
  - Financial Advisor
  - Placement Agent / Underwriter
  - Lender
  - ***Build your team based upon the best bond structure for your project!***

- Follow a Realistic Timeline
  - Readiness = Dollar Savings!

Observations on Accessing Capital

- Private Placements and Invitation-Only QIB Sales have proven to be the best bond sale structures since the downturn. Commercial Banks (particularly those with CRA Requirements) have been especially active here.
- Credit Enhancement, particularly for private activity bonds, will remain scarce for the foreseeable future.
- Further, traditional HUD subsidies like Section 811, HOME and CDBG have taken big budget hits in the last couple years;
- However, new and improved HUD FHA products have been helping more projects.

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