

## **NATIONAL COMMUNITY DEVELOPMENT LENDING SCHOOL**

### **FINANCING AFFORDABLE MULTI-FAMILY HOUSING AGENDA**

- I. Personal Introduction
- II. Goals for the class
- III. Student introduction and one question you want answered
- IV. Project budget & Operating budget – Knowing the Difference Between the Two
- V. Loan Sizing based on NOI
- VI. Low Income Housing Tax Credits – A Brief Overview of How Tax Credits Work
- VII. HAP Contracts –Project-Based Rental Subsidies and How They Impact Underwriting
- IX. Break
- VIII. Case Study: Edgewater Village as a 9% tax credit deal – Putting the Pieces Together
- IX. Livingston Manor – A Quick Look at a Complicated Deal
- X. Tax Exempt Bonds 101 – How Bond Deals Vary From 9% LIHCT Transactions
- XI. Break
- XII. Case Study: Edgewater Village as TE bond/4% tax credit deal
- XIII. Break
- XIV. Guarantor/Sponsor analysis
- XV. Summary
- XVI. Question
- XVII. Adjourn

## SAMPLE DETAILED OPERATING BUDGET

Nmbr	Type	Size	Mo. Rent	Stabilized
60	2-BR/2BA	921	\$ 800	\$ 576,000
60	2-BR/2BA	995	\$ 830	\$ 597,600
56	3-BR/2-BA	1175	\$ 895	\$ 601,440
<b>Gross Rents</b>				<b>\$ 1,775,040</b>
Premiums/Other				\$ 26,400
Effective Gross Income				<b>\$ 1,801,440</b>
Vacancy 5.5%				(99,079)

**Net Rental Income** **\$ 1,702,361**

### PER UNIT

Legal/Accounting	\$ 17,000	\$ 97
Insurance	\$ 18,000	\$ 102
Real Estate Taxes	\$ 141,500	\$ 804
Repairs & Maintenance	\$ 35,200	\$ 200
Decorating/Turnover	\$ 23,500	\$ 134
Pool Maintenance	\$ 14,100	\$ 80
Advertising	\$ 18,000	\$ 102
Trash Removal	\$ 16,000	\$ 91
Payroll	\$ 175,500	\$ 997
Electric	\$ 24,000	\$ 136
Water	\$ 62,000	\$ 352
Gas	\$ 5,000	\$ 28
Admin	\$ 24,000	\$ 136
Grounds	\$ 26,900	\$ 153
Other Taxes/Fees	\$ 7,900	\$ 45
Management Fee	68,094	\$ 387

**TOTAL OPERATING EXPENSES** **\$ 676,694** **\$ 3,845**

Reserves (\$240/unit) \$ 42,240 \$ 240

**TOTAL EXPENSES** **\$ 718,934** **\$ 4,085**

NOI **\$ 983,426**

Debt Service (7%, 30 yrs)

DCR - Bank of America **1.20**

Net Cash Flow

**SAMPLE DETAILED DEVELOPMENT BUDGET**

<b>SOURCES OF FUNDS</b>		<b>USES OF FUNDS</b>	
Bank Debt	\$ 10,490,000	Acquisition	\$ 801,600
Tax Credit Equity	\$ 5,962,083	Site Improvements	\$ 2,689,800
DC DHCD	\$ 730,000	Construction	\$ 8,855,000
Interim Income	\$ 940,460	Contingency (5%)	\$ 577,240
Deferred Developers Fee	\$ 2,199,167	Site Development Bonds	\$ 45,000
GIC Income	\$ 343,209	Payment/Performance Bond	\$ 112,860
		Permits/Fees	\$ 171,900
		Tap Fees	\$ 34,700
		Proffers	\$ 90,200
		Construction Interest	\$ 1,626,009
		Insurance	\$ 63,862
		Borrower Engineer	\$ 369,550
		Borrower Architect	\$ 233,500
		Bank/Borrower Architect	\$ 18,000
		RE Taxes	\$ 50,000
		Construction Consultant	\$ 16,500
		Appraisals/Mkt Study	\$ 40,000
		Title/Recording	\$ 46,000
		Legal	
		- Bank	\$ 25,000
		- Borrower	\$ 222,500
		- Underwriter	\$ 20,000
		- Reilly/FNMA	\$ 65,000
		Bank Underwriting Fee	\$ 104,900
		Bank L/C Fee (30 mos)	\$ 262,250
		45 Days Interest	\$ 90,000
		30-Day Lag	\$ 56,389
		DCHFA Fees	\$ 326,200
		Underwriter Fees	\$ 64,600
		COI Fees	\$ 97,000
		Perm Loan Fees	\$ 168,700
		Bridge Loan Interest/Synd Fee	\$ 260,000
		Acq. Loan Fee/Interest	\$ 39,166
		Marketing/Leasing	\$ 185,000
		Misc.	\$ 25,000
		DCHA Construction Inspection	\$ 50,000
		Tax Credit Fees	\$ 20,000
		Soft Conting	\$ 115,000
		Developer Fee	\$ 2,501,493
		Community Outreach Coord.	\$ 125,000
<b>TOTAL</b>	<b>\$ 20,664,919</b>	<b>TOTAL</b>	<b>\$ 20,664,919</b>

## Tax Credit Tutorial

1. What are they:
  - a. The Federal Low Income Housing Tax Credit program was established to provide economic incentives for the private sector, primarily Corporate America, to invest in affordable housing projects.
  - b. The LIHTC allows the holder -- be it an individual but more likely a corporation -- to reduce their federal tax bill dollar-for-dollar by the amount of the credit for 10 years. If I have \$20M in annual tax credits, and owe the IRS \$50M, I can pay just \$30M and send the IRS verification of my tax credits and be done with my tax obligation for the year.
  - c. Since Corporate America pays slightly less than \$1 for each dollar worth of tax credit, there is an economic incentive to participate in the program -- which drives cash into affordable housing development.
  
2. How They Work -- Big Picture
  - a. Affordable housing developers compete for and are awarded tax credits on a competitive basis. States award tax credits to affordable housing projects based on a scoring system that tends to favor deeper affordability restrictions, projects with non-profit developers and projects with a social service component.
  - b. In return for receiving this federal tax benefit, developers commit to create and maintain their apartment properties as affordable housing. Minimum affordability restrictions are 20%/50% or 40%/60%.
  - c. However, while developers could certainly use the tax break, their more immediate need is cash today to build their project. So they sell these credits to Corporate America and use the cash to build their affordable housing project.
  - d. Tax Credits => Cash => Affordable Housing
  
3. Availability of Tax Credits
  - a. Each state has a fixed allocation of 9% tax credits based on population size. Currently, the allocation calculation is about \$1.50/resident. NYC, Chicago and LA are exceptions -- they get their own allocations separate from the state.
  - b. In addition, each state and/or jurisdiction has a set amount of tax-exempt Private Activity bonds it can issue, also calculated at approximately \$1.50/resident. To the extent states use their Private Activity bonds to finance affordable housing, these projects receive an automatic allocation of 4% tax credits.
  - c. 9% credits and 4% credits both work in a similar fashion and provide equity to affordable housing projects. But as described below, 4% credits generate less equity than 9% credits.
  - d. Since 9% credits are more attractive to developers, and their supply is limited, there is typically fierce competition to win these credits from the state allocating agencies. This poses some substantial challenges to the developer -- they need to have done significant due diligence to submit a competitive tax credit application, but there is no guarantee of success. Significant time and money -- key developer resources -- are at risk before learning if a tax credit application is successful.
  - e. Competition for tax-exempt bonds and in turn the 4% credits is generally less competitive. Most states have more bond capacity than is allocated during a given year. And certain projects won't work with just 4% credits because they don't generate enough equity. However, since the credits are as-of right, many developers only pursue projects that can work with bonds and credits.

#### 4. Who's Who

- a. As noted above, in return for the credits, developers promise to maintain their properties as affordable housing. This is tested annually through a formal audit, where tenant files are reviewed to verify that residents are not earning more than was noted in the original tax credit application or is allowed by the IRS.
- b. The tax credits flow to the investor – Corporate America – by virtue of the project maintaining its affordability. If the developer fails to meet this test – even inadvertently – the IRS can cancel the tax benefits to the investor.
- c. Because of this ‘recapture’ risk, corporate America tends to invest in LIHTC projects not directly but through syndicators – companies established to serve as the intermediary between the developer and the investor. The syndicator manages the reporting and oversight requirements of the tax credit project and generally makes sure the project is operated in compliance with tax credit laws.
- d. With a syndicator in the deal, the investor is more confident that the project will run per plan and that the IRS won't come along and take back the tax credits. For this service, the syndicator is paid a fee.

#### 5. Calculating the Tax Credits

- a. The maximum tax credit award is a function of eligible project costs. Eligible costs are loosely defined as the costs necessary to acquire and build an affordable housing property: site acquisition, hard construction costs, construction period interest, some portion of developer fee and some financing costs. Speak to an accountant for more detail.
- b. Depending on whether the developer is applying for 4% or 9% credits, that percentage is then multiplied by the total eligible basis. The result is the annual tax credit.
- c. Since the low income housing tax credit is a 10-year benefit, the annual tax credit is then multiplied by 10 for the gross tax credit amount.
- d. Gross Tax Credit Calculation Exhibit.

#### 6. Calculating Net Equity

- a. As noted above, the syndicator takes a fee for providing a host of oversight and back-office services. This fee is paid out of the gross equity amount.
- b. In addition, these tax benefits are taken over the course of 10 years, so a dollar in benefits received in 2013 is worth less than a dollar in benefits received today. As a result, the credits have a declining value over the 10-year award period, which is reflected in the investor's acquisition price for the credits.
- c. In addition, the ultimate investor typically wants to pay less than \$1 in cash for the \$1 in tax benefits since most other investments that company would consider offer some sort of return. To incent the investor to purchase LIHTCs, there needs to be a return on this investment. They want to purchase the credits for below par.
- d. For these reasons, most developers who sell their credits through syndicators receive about \$0.80/\$1.00 in today's market.

**Calculating Tax Credit Basis and Gross Credit Amount - 4%**

<b>USES OF FUNDS</b>		Eligible	Amount	4% Credits	10 Years
Acquisition	\$ 4,750,000	Yes	\$ 4,750,000	\$ 180,500	\$ 1,805,000
Rehab	\$ 6,000,000	Yes	\$ 6,000,000	\$ 228,000	\$ 2,280,000
Contingency	\$ 600,000	Yes	\$ 600,000	\$ 22,800	\$ 228,000
Architect and Engineer	\$ 330,000	Yes	\$ 330,000	\$ 12,540	\$ 125,400
Legal and Accounting	\$ 60,000	Yes	\$ 60,000	\$ 2,280	\$ 22,800
Bank Financing Fee (1%)	\$ 100,000	Yes	\$ 100,000	\$ 3,800	\$ 38,000
Construction Pd. Interest	\$ 500,000	75%	\$ 375,000	\$ 14,250	\$ 142,500
Insurance	\$ 50,000	No	\$ -	\$ -	\$ -
RE Taxes	\$ 75,300	No	\$ -	\$ -	\$ -
Developer Fee	\$ 1,000,000	45%	\$ 450,000	\$ 17,100	\$ 171,000
Title/Recording	\$ 50,000	Yes	\$ 50,000	\$ 1,900	\$ 19,000
Partnership Fees	\$ 7,500	No	\$ -	\$ -	\$ -
Marketing	\$ 10,000	No	\$ -	\$ -	\$ -
Transition Reserve	\$ 430,000	No	\$ -	\$ -	\$ -
Operating Reserve	\$ 300,000	No	\$ -	\$ -	\$ -
<b>TOTALS</b>	<b>\$ 14,262,800</b>		<b>\$ 12,715,000</b>	<b>\$ 483,170</b>	<b>\$ 4,831,700</b>

**Calculating Net Tax Credits - 4%**

<b>USES OF FUNDS</b>		Eligible	Amount	4% Credits	10 Years
Acquisition	\$ 4,750,000	Yes	\$ 4,750,000	\$ 180,500	\$ 1,805,000
Rehab	\$ 6,000,000	Yes	\$ 6,000,000	\$ 228,000	\$ 2,280,000
Contingency	\$ 600,000	Yes	\$ 600,000	\$ 22,800	\$ 228,000
Architect and Engineer	\$ 330,000	Yes	\$ 330,000	\$ 12,540	\$ 125,400
Legal and Accounting	\$ 60,000	Yes	\$ 60,000	\$ 2,280	\$ 22,800
Bank Financing Fee (1%)	\$ 100,000	Yes	\$ 100,000	\$ 3,800	\$ 38,000
Construction Pd. Interest	\$ 500,000	75%	\$ 375,000	\$ 14,250	\$ 142,500
Insurance	\$ 50,000	No	\$ -	\$ -	\$ -
RE Taxes	\$ 75,300	No	\$ -	\$ -	\$ -
Developer Fee	\$ 1,000,000	45%	\$ 450,000	\$ 17,100	\$ 171,000
Title/Recording	\$ 50,000	Yes	\$ 50,000	\$ 1,900	\$ 19,000
Partnership Fees	\$ 7,500	No	\$ -	\$ -	\$ -
Marketing	\$ 10,000	No	\$ -	\$ -	\$ -
Transition Reserve	\$ 430,000	No	\$ -	\$ -	\$ -
Operating Reserve	\$ 300,000	No	\$ -	\$ -	\$ -
<b>TOTALS</b>	<b>\$ 14,262,800</b>		<b>\$ 12,715,000</b>	<b>\$ 483,170</b>	<b>\$ 4,831,700</b>
					<b>\$0.80/\$1.00</b> Credit Rate
					<b>\$ 3,850,044</b>

**Calculating Net Tax Credits - 9%**

<b>USES OF FUNDS</b>		Eligible	Amount	9% Credits	10 Years	
Acquisition	\$	4,750,000	Yes	\$ 4,750,000	\$ 427,500	\$ 4,275,000
Rehab	\$	6,000,000	Yes	\$ 6,000,000	\$ 540,000	\$ 5,400,000
Contingency	\$	600,000	Yes	\$ 600,000	\$ 54,000	\$ 540,000
Architect and Engineer	\$	330,000	Yes	\$ 330,000	\$ 29,700	\$ 297,000
Legal and Accounting	\$	60,000	Yes	\$ 60,000	\$ 5,400	\$ 54,000
Bank Financing Fee (1%)	\$	100,000	Yes	\$ 100,000	\$ 9,000	\$ 90,000
Construction Pd. Interest	\$	500,000	75%	\$ 375,000	\$ 33,750	\$ 337,500
Insurance	\$	50,000	No	\$ -	\$ -	\$ -
RE Taxes	\$	75,300	No	\$ -	\$ -	\$ -
Developer Fee	\$	1,000,000	45%	\$ 450,000	\$ 40,500	\$ 405,000
Title/Recording	\$	50,000	Yes	\$ 50,000	\$ 4,500	\$ 45,000
Partnership Fees	\$	7,500	No	\$ -	\$ -	\$ -
Marketing	\$	10,000	No	\$ -	\$ -	\$ -
Transition Reserve	\$	430,000	No	\$ -	\$ -	\$ -
Operating Reserve	\$	300,000	No	\$ -	\$ -	\$ -
<b>TOTALS</b>	<b>\$</b>	<b>14,262,800</b>		<b>\$ 12,715,000</b>	<b>\$ 1,144,350</b>	<b>\$ 11,443,500</b>
						<b>\$0.80/\$1.00</b> Credit Rate
						<b>\$ 9,118,524</b>

## HAP Contract Tutorial

1. What they are
  - a. A contract between owner and HUD whereby owner agrees to keep project affordable at some percentage of AMI (typically 60%) and HUD will pay a portion of the tenant's rent
  - b. HAP contracts were very popular in the 1960s and 1970s as a means of creating affordable units that were privately owned. They guaranteed rental payments to owners, so landlords were willing to participate.
  - c. Most contracts were for 20 years, and got 10-year extensions upon expiration. Now they are typically on an annual renewal basis, though none has been cancelled.
2. How rent payments are split between tenant and HUD
  - a. Under a HAP, tenants pay 30% of their income in rent, and HUD pays the balance. If a tenant earns less than a certain amount (varies by region), they pay nothing and HUD pays 100% of the rent.
3. Mark up/down to market
  - a. When a HAP expires, owners can go in for a one-time mark up to market so as to adjust the rent to market levels. HUD sets the rent based on a market study, and then gives annual increases based on the increase in operating expenses.
  - b. It is not uncommon for HUD to be aggressive in determining new market rents. You need to underwrite according to what you/appraiser believe to be true market rents.
  - c. When HAP rents are increased, this helps the developer but has no impact on the tenant – they continue to pay 30% of their income and HUD pays the balance. That's why mark-up-to-market projects don't lead to significant displacement.
  - d. It's possible that HAP rents are above market and in some situations you'll have mark down to market. In these instances, HUD sometimes needs to forgive some portion of the debt they have on the property.
4. How lender's underwrite these contracts and why
  - a. Although no HAP has yet to be cancelled in the US, it will happen. And lenders need to underwrite accordingly.
  - b. Lender's typically underwrite to the lesser of HAP rent or the appraiser's rent. If HAP rent is less than the appraiser, then that is exactly what HUD will pay you so you need to use that figure in your pro-forma. If it's the other way around, you need to know that should the HAP be cancelled, you could end up at that lesser rent amount. It's conservative, but over a 30-year loan term, plenty of HAPs will be cancelled and projects will end up as market units.
  - c. If you think your project will likely remain a Section 8 property if the HAP went away – in other words, if the only people who would move in there would be people with their own Section 8 vouchers, you should consider FMR for the area. FMR is the max HUD will pay under a Section 8 voucher, and if it's less than the HAP contract or market, you should consider that in your underwriting. Infrequent, but not impossible.

Type	HAP	Appraisal	Section 8	Bank
2-BR/1-BA	640	\$ 625	648	\$625
3-BR/1.5BA	860	\$ 875	875	\$860
4-BR/2-BA	955	\$ 950	930	\$930

5. Transition reserve and why
  - a. Most deals that have a HAP contract are required (by Fannie and Freddie) to have a transition reserve, typically sized at 6 months of debt service. The reason for the reserve is that should the HAP get cancelled, and tenants move out en masse, the funds will be used to prepare the units for re-leasing and cover any shortfalls in operations. Don't forget to include it.

### The Set-Up

Rick Gendron, President of South Side Development Corporation (“SSDC”), was recently contacted by a broker, Drew Fitch, who offered Mr. Gendron the option to purchase a 223-unit apartment property in Edgewood, Maryland called Edgewater Village. Mr. Fitch said the sales price was \$4.75 million (\$21,300/unit) and that he would agree to hold the property off the market for six weeks while Mr. Gendron considered the acquisition and spoke with several sources of financing about putting a deal together.

SSDC, a for-profit developer, was founded in 1995 to acquire and preserve affordable housing in select markets along the East Coast. To date, the firm has acquired over 2,000 units and has approximately 450 more in various stages of development. Even though SSDC had not previously worked in Maryland, Mr. Gendron knew this market well since he grew up nearby. Edgewood is a stable and growing suburban community located between Washington, DC and Philadelphia, with great access to both employment markets. Several large national retailers have central warehouses in this area from which they supply their stores from Boston to the Carolinas. In addition, several high-tech employers, including Broadcom and Microsoft, have large office campuses in the nearby town of Rising Sun.

For the past several years, the main focus of housing development in Edgewood has been single-family homes. Over this period, there has been virtually no new construction of rental units even though occupancy rates have remained above ninety five percent. The primary reason for this has been the lack of vacant land on which developers can build new housing. Multi-family development has consisted primarily of rehabbing existing properties and taking them up market. By the time Mr. Gendron got the call from Mr. Fitch, over 80% of the large apartment properties in Edgewood were characterized as market rate or upscale housing. This was forcing many of the area residents, employed in the nearby warehouses or other moderate wage occupations, to move out of Edgewood in search of cheaper rent.

Edgewater Village was an anomaly for the Edgewood community. The property was constructed to serve low and moderate income residents. The original developer secured HUD financing for the project in return for committing to target families earning no more than 60% of AMI. Further, Mr. Gendron knew that if his firm didn’t buy the property, it would probably be sold to Mr. Richard Rich, who would pay off the HUD mortgage, kick out the tenants and convert the property to market rents.

### The Real Estate

Edgewater Village consists of 43 1-BR/1-BA units, 156 2-BR/1BA units and 24 3-BR/2-BA units located in 18 buildings and surrounded by 250 parking spaces. Within walking distance of Edgewater Village there are three shopping complexes providing a variety of goods and services. Less than a half mile from the site is an elementary school and a commuter train station. Mr. Gendron found the site especially attractive because public schools, hospitals, shopping and major sources of employment were located within a relatively short distance from the site and were accessible by both car and public transportation.

The property was built in 1975 and had not experienced any significant renovation since construction. There was extensive deferred maintenance on site, and all of the units needed updating. The apartments had original kitchens and baths, dangerously outdated electrical service, single-pane windows and leaky roofs, among other issues.

Another defining feature of Edgewater Village Apartments was that 100% of the units were covered by a HAP contract (a HUD project-based Section 8 contract). Under a HAP contract, tenants pay 30% of their income in rent and the balance is paid by HUD. The current owner had been diligent about submitting his annual requests for rent increases based on rising expenses, but this hadn’t really enabled him to keep pace with the market rents given the strong demand for housing in the area. Actual rents at the property were \$600, \$650 and \$700 per month for 1BR, 2BR and 3BR unit types, but this was substantially below what other landlords were getting in the market. Mr. Gendron had seen a market study from the year before showing market rents at \$700, \$780 and \$867 for these unit types.

Since the HAP contract was about to expire, Mr. Gendron knew he could go back to HUD for a mark-up-to-market in the HAP and get HUD to pay these higher market rents. Best of all, the increase would have

## CASE STUDY – 9% TAX CREDITS

- 2 -

no impact on the tenants – they would continue to pay 30% of their income in rent, and the balance would be paid by HUD. Further, these 'market' rents fell below the maximum tax credit rents in Edgewood because the AMI was \$70,000 for a family of four. This was important because Mr. Gendron was aware he would need an allocation of Low Income Housing Tax Credits to make the deal work, and therefore would be capped at the maximum LIHTC rents.

Mr. Gendron spent the next few days walking the site and completing a detailed unit-by-unit analysis of the deferred maintenance and rehab needs on site. He met with the Tenants Association to get their opinion of the property condition, and ultimately developed the following scope of work for the project.

- New kitchens and baths in all units, including fixtures and appliances
- New site lighting
- New low flow toilets, sinks and faucets
- New hot water heaters and HVAC units
- New roofs and windows throughout
- Tuckpointing and sidewalk repairs
- New common doors in all buildings
- Extensive landscaping, including general upgrades to site and playground
- A new community building

Based on the scope of work, Mr. Gendron estimated that rehab/property stabilization would take 18 months

### The Financing

The next step was for Mr. Gendron to meet with his architect to put together a rehab budget based on the scope of work. Mr. Gendron met with three general contractors with whom he had worked in the past, in order to estimate construction costs. Mr. Gendron concluded, after meeting separately with the three contractors, that rehab costs would be \$6,000,000 including contractor overhead and profit. Soft costs would be as follows:

Architectural & Engineering Fees	5.5% of Construction
Financing Fees	1% of loan amount
Title Insurance and Recording Fees	\$ 50,000
Construction Loan Interest	\$500,000
Insurance during Construction	\$ 50,000
Real Estate Taxes during Construction	\$ 75,300
Legal and Accounting Fees	\$ 60,000
Marketing	\$ 10,000
Partnership Management Fee	\$ 5,000
Partnership Publication	\$ 2,500
Transition Reserve (6 mos)	\$ 430,000
Operating Reserve	\$300,000
Developer Fee	10% of development costs, not to exceed \$1MM
Contingency	10% of Construction

With this information in hand, Mr. Gendron scheduled a meeting with the Maryland Community Development Administration (CDA), to find out about the availability of 9% tax credits. At the meeting, Mr. Gendron learned that a project that was supposed to be financed by CDA had recently fallen out. As a result, the agency had \$550,000 in available tax credits, or \$5.5 million in gross tax credits over 10 years, for his project. Encouraged, Mr. Gendron immediately set up a meeting with two syndicators to find out the sales price for credits. Both groups indicated they would be willing to buy the credits at \$0.70 per credit dollar with all equity paid in at closing.

Next, he met with his friendly banker at Bank of America to find out the loan terms they would provide to him on this deal. His lender told him the Bank would require a debt coverage ratio of 1.20 and a maximum LTV of 80%. The lender also thought he could lock in Mr. Gendron's interest rate at 7.75% and

## CASE STUDY – 9% TAX CREDITS

- 3 -

provide a 20-year loan amortized over 30 years. The lender had recently done a multi-family deal in this market and felt comfortable that Mr. Gendron's pro-forma rents would be borne out in the HUD market study, which is required in order to mark the HAP rents up to market, as well as in the Bank-ordered appraisal.

Next, they talked about operating expenses. Current operating expenses at the property were over \$4,500 per unit, but Mr. Gendron was confident that when the rehab was complete, and his management team in place, he could operate the property at \$4,000/unit in expenses before \$200/unit in reserves. The lender thought that figure was reasonable. His other project in that market was operating at \$3,800/unit but he was aware that tax credit projects typically have slightly higher operating costs. He also noted that he thought an 8.5% cap rate was appropriate for the project.

Finally, Mr. Gendron was fairly confident that if he could raise the required equity and find a lender for the construction and perm debt, he could convince the Maryland Housing Authority ("MHA") to provide the gap financing for the project. MHA provides its monies as a "soft" second mortgage so that interest and principal are due and payable only if available from project cash flow. They agreed to lend him the lesser of 1) the amount of any permanent financing gap or 2) \$500,000 – their single project limit.

Mr. Gendron left MHA's office, took a cab to the airport and boarded his private jet back home. As he sat back in his big leather chair, he penciled out the numbers for the deal and concluded that he could make the acquisition and rehab of Edgewater Village work given the financing pieces and requirements, as long as he was able to secure an increase in project rents. Do you agree with him?

### The Assignment

- Develop Project Budget
- Develop an operating Budget
- Describe the strengths and weaknesses of the deal?
- What questions do you have for Mr. Gendron
- Based on what you know now, would you do the deal?

EDGEWATER VILLAGE APARTMENTS				
9% Tax Credit Deal				
Nmbr	Type	Size	Bank Rents	BANK PRO-FORMA
	1-BR/1-BA			\$ -
	2-BR/1BA			\$ -
	3-BR/1-BA			\$ -
				-
Preliminary Proforma Analysis				
Edwater Apartments Edgewood, Maryland				
OPERATING			Stabilized	
Total Gross Potential Rent			\$	-
Vacancy/collection Loss			\$	-
<b>EFFECTIVE GROSS INCOME</b>			\$	-
<b>TOTAL OPERATING EXPENSE</b>				
	<i>Per Unit</i>		\$	-
Replacement Reserves				
<b>TOTAL EXPENSES</b>			\$	-
	<i>Per Unit</i>		\$	-
<b>NET OPERATING INCOME</b>			\$	-
<b>Term Bank Loan</b>				
<b>DSC</b>				
<b>Cash Flow/Loss</b>			\$	-

**EDGEWATER VILLAGE APARTMENTS  
9% Tax Credit Deal -- All Equity At Closing**

<b>PROJECT BUDGET</b>			
<b>SOURCES OF FUNDS</b>		<b>USES OF FUNDS</b>	
Bank Loan		Acquisition	
Tax Credit Equity		Rehab	
MHA		Contingency	
		Architect and Engineer	
		Legal and Accounting	
		Bank Underwriting Fee (1%)	
		Construction Pd. Interest	
		Insurance	
		RE Taxes	
		Developer Fee	
		Title/Recording	
		Partnership Fees	
		Marketing	
		Transition Reserve	
		Operating Reserve	
<b>TOTALS</b>	<b>\$ -</b>	<b>TOTALS</b>	<b>\$ -</b>

Deferred Equity

**EDGEWATER VILLAGE APARTMENTS**

<b>CONSTRUCTION PROJECT BUDGET</b>		
<b>SOURCES OF FUNDS</b>		<b>USES OF FUNDS</b>
Bank Loan		Acquisition
Tax Credit Equity		Rehab
MHA	\$ -	Contingency
Deferred Developer Fee	\$ -	Architect and Engineer
		Legal and Accounting
		Bank Underwriting Fee (1%)
		Construction Pd. Interest
		Insurance
		RE Taxes
		Developer Fee
		Title/Recording
		Partnership Fees
		Marketing
		Transition Reserve
		Operating Reserve
<b>TOTALS</b>	<b>\$ -</b>	<b>TOTALS</b>

<b>TERM PROJECT BUDGET</b>		
<b>SOURCES OF FUNDS</b>		<b>USES OF FUNDS</b>
Bank Loan		Acquisition
Tax Credit Equity		Rehab
MHA		Contingency
Deferred Fee		Architect and Engineer
		Legal and Accounting
		Bank Underwriting Fee (1%)
		Construction Pd. Interest
		Insurance
		RE Taxes
		Developer Fee
		Title/Recording
		Partnership Fees
		Marketing
		Transition Reserve
		Operating Reserve
<b>TOTALS</b>	<b>\$ -</b>	<b>\$ -</b>

## Tax Exempt Bonds 101

### 1. How does the structure work

- Jurisdictions receive a fixed annual allocation of tax-exempt bonds they can use for a variety of economic development projects. They often use them as a means of raising low-cost capital for affordable housing deals.
- Investors buy TE bonds because they pay a decent rate of interest, and they don't pay taxes on the interest earned. But these investors generally won't buy bonds if payment of principal and interest is contingent on RE performance.
- Borrowers approach Fannie Mae/Freddie Mac/Insurance companies to step in and provide a guarantee of payment to the bondholders, for a fee.
- With this guarantee – called credit enhancement -- from a highly rated public company (typically AAA), investors will buy the bonds – and at a fairly low interest rate because there is little risk that they won't get repaid. Note rates are currently in the 5.5% range.
- In terms of the deal mechanics, the jurisdiction issues/sells bonds to raise money to make the loan to an affordable housing project, and they then assign this loan to Fannie/Freddie. They take an up-front fee and typically an annual fee for allocating this limited resource of TE bonds to the project.
- The resulting loan has all the characteristics of a regular taxable loan you would get from a Bank – a certain interest rate, a fixed amortization and debt service payments.
- The borrower signs typical loan docs with Fannie who is effectively their lender or credit enhancer in the deal since they are on the hook to the bondholders.
- However, Fannie Mae does not take construction and lease-up risk.
- So, commercial banks run letters of credit to Fannie Mae during construction/lease-up period. This means that if something goes wrong with the deal, and Fannie Mae has to repay some or all of the bondholders, they will then draw on the Bank's L/C and get reimbursed.
- Provided all goes right, Fannie Mae returns the Bank's L/C at stabilization and conversion to permanent loan, and Fannie is the Permanent Lender for 30 years.
- **For affordable housing deals, the TE bonds automatically come with 4% tax credits. In general, 4% tax credits generate a little less than half the equity raised by 9% credits. Coupled with the low interest rate, this deal structure is a very powerful tool for financing affordable housing.**

### 2. Key parties to a bond deal not found in conventional deals:

- Issuer: The governmental body that is committing a share of its annual bond allocation to the transaction. EG – DCHF, Maryland CDA. No risk.
- Underwriter: Prepares all documentation for, and carries out, the public bond sale to the public market. They set up the amortizations schedules and cash flows. EG – Red Capital,
- Trustee: The trustee manages all of the funds after closing. After approval by the Bank and issuer, they pay out all construction draws. They also make all P&I payments based on the underwriter's schedule.
- Too many attorneys.

### 3. Outside of the significant costs and line items that are included in a bond deal and not in a conventional one, lenders need to take a serious look at how the construction period interest is calculated. The net amount of construction period interest is based on the negative arbitrage calculation

- The way funds flow in bond deals is as follows: 100% of the bonds are sold on day one (this is the only way to fix the interest rate), and the unused portion is funded into a Guaranteed Investment Contract – a fixed interest account – or GIC.
- Borrower is paying interest on the full amount of the bonds from day one, even though they may be using only a portion of the proceeds. It's important to note the borrower has a constant payment obligation to the bondholders throughout the deal. They are not paying interest only on the portion of used bond proceeds, but 100%.

- However, the borrower earns interest on the unused portion of the bond proceeds that are sitting in the GIC to offset the payments owed to the bondholders. Keep in mind that the GIC balance will decline over the term of the deal as funds are pulled out to pay project development costs.
  - **The net of these two – what you pay and what you earn – is your construction period interest that flows through to the sources and uses.**
4. As noted above, there are three moving parts to the Negative Arbitrage calculation:
- Interest rate on bonds: What the borrower owes the bondholders
  - Interest rate on GIC: What the borrower earns on the unused bond proceeds. Subject to recent fluctuation. It can change between underwriting and closing.
  - Draw schedule: How fast the bond proceeds get withdrawn to pay project costs. This is truly subjective and requires considering:
    - What gets paid at closing, what are the sources to pay those costs and what's left over as your initial deposit in the GIC
    - How realistic is the borrower's draw projections. Will draws be even throughout or will the project start slow and then ramp up (typical). Be conservative.
    - Are there any equity payments due mid construction that may pay some project costs. If so, proceeds linger in the account longer and borrowers earn more interest.

### Negative Arbitrage Tutorial

5. How do you determine the borrower's interest rates for a bond deal?
- The rate is a build-up of various pieces. It starts with the rate on the tax exempt bonds and includes the fees that all of the involved parties need to get paid. The rate stack is as follows:
    - Bond rate: 30 year fixed or 18-year remarket will effect the note rate. Today rate for a 30-year bond is about 5.65%
    - Add issuer fee – range widely, from 12.5 bps to 40 bps
    - Add trustee fee – 5 bps
    - Fannie Mae guarantee and servicing fees – 90 – 105 bps depending on LTV/DCR/strength of deal
  - But there is a different rate during construction and perm because Fannie is not really in the deal during construction – all their risk is borne by construction lender. However, since most banks are only AA rated, they will charge something for the risk associated with having their AAA credit backstopped by only AA credit – typically 20 - 30 bps.
    - Bond rate
    - Add issuer fee bps
    - Add trustee fee
    - Add Fannie Mae 'credit risk'

### Rate Stack Exhibit

6. What is an L/C Fee?
- All bond deal budgets will have a line item for L/C fees. Remember that the Bank is providing an L/C to Fannie Mae during construction in case something goes wrong, and they need to be paid for this risk.
  - In a bond deal, all of the interest calculated above is being paid to the bondholders, not to the Bank since they don't technically have a loan out. The Bank is paid in L/C fees, typically 100 bps/year paid quarterly and in advance. This is built into a project budget in addition to an interest reserve.
  - The L/C Fee is in addition to the underwriting fee the Bank gets paid for underwriting the deal, getting it approved and providing a commitment to the borrower.
7. Appraisal Issues
- Fannie allows for **up to** a 100 bps reduction in the cap rate to account for the favorable financing because the tax exempt interest rate is below the market rate. Because the tax exempt financing

- goes with the real estate in foreclosure (assuming compliance with affordability requirements), this is considered to add value to the real estate.
- Fannie is recognizing the net present value of differential between the amount an owner would pay in debt service at a market rate of interest, and what they'll pay at the lower, favorable rate. As a short cut, the appraiser makes this adjustment to the cap rate but it cannot vary more than 100 bps from the market rate.
  - In addition, Fannie will typically allow a loan of up to 90% LTV against TE bond-financed projects. As a result of these two factors, developers can borrow more money against the property and complete a more substantial rehab

### **Favorable Financing Exhibit**

Negative Arbitrage Tutorial - Base Case

INTEREST CALCULATION - GIC @ 6.36%, Bond @ 6.5%

Month	Begin CF Balance	Assumed Draw	Ending CF Balance	Interest Earned	Interest Paid	Net Interest Due
1	\$ 9,500,000	\$ 2,584,781	\$ 6,915,219	\$ 36,651	\$ 51,458	\$ (14,808)
2	\$ 6,915,219	\$ 176,831	\$ 6,738,388	\$ 35,713	\$ 51,458	\$ (15,745)
3	\$ 6,738,388	\$ 311,007	\$ 6,427,381	\$ 34,065	\$ 51,458	\$ (17,393)
4	\$ 6,427,381	\$ 345,340	\$ 6,082,041	\$ 32,235	\$ 51,458	\$ (19,224)
5	\$ 6,082,041	\$ 533,522	\$ 5,548,519	\$ 29,407	\$ 51,458	\$ (22,051)
6	\$ 5,548,519	\$ 814,374	\$ 4,734,145	\$ 25,091	\$ 51,458	\$ (26,367)
7	\$ 4,734,145	\$ 813,374	\$ 3,920,771	\$ 20,780	\$ 51,458	\$ (30,678)
8	\$ 3,920,771	\$ 867,212	\$ 3,053,559	\$ 16,184	\$ 51,458	\$ (35,274)
9	\$ 3,053,559	\$ 383,212	\$ 2,670,347	\$ 14,153	\$ 51,458	\$ (37,305)
10	\$ 2,670,347	\$ 898,045	\$ 1,772,302	\$ 9,393	\$ 51,458	\$ (42,065)
11	\$ 1,772,302	\$ 683,617	\$ 1,088,685	\$ 5,770	\$ 51,458	\$ (45,688)
12	\$ 1,088,685	\$ 457,183	\$ 631,502	\$ 3,347	\$ 51,458	\$ (48,111)
13	\$ 631,502	\$ 178,992	\$ 452,510	\$ 2,398	\$ 51,458	\$ (49,060)
14	\$ 452,510	\$ 214,568	\$ 237,942	\$ 1,261	\$ 51,458	\$ (50,197)
15	\$ 237,942	\$ 229,205	\$ 8,737	\$ 46	\$ 51,458	\$ (51,412)
16	\$ 8,737	\$ 8,737	\$ -	\$ -	\$ 51,458	\$ (51,458)
17	\$ -	\$ -	\$ -	\$ -	\$ 51,458	\$ (51,458)
18	\$ -	\$ -	\$ -	\$ -	\$ 51,458	\$ (51,458)
19	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
<b>TOTALS</b>		<b>\$ 9,500,000</b>		<b>\$ 266,495</b>	<b>\$ 926,250</b>	<b>\$ (659,755)</b>

<b>Net Interest to Project</b>	<b>\$ 659,755</b>
--------------------------------	-------------------

Negative Arbitrage Tutorial - Scenario 2

INTEREST CALCULATION - Same draw schedule and bond rate, different GIC rate (2.5%)

Month	Begin CF Balance	Assumed Draw	Ending CF Balance	Interest Earned	Interest Paid	Net Interest Due
1	\$ 9,500,000	\$ 2,584,781	\$ 6,915,219	\$ 14,407	\$ 51,458	\$ (37,052)
2	\$ 6,915,219	\$ 176,831	\$ 6,738,388	\$ 14,038	\$ 51,458	\$ (37,420)
3	\$ 6,738,388	\$ 311,007	\$ 6,427,381	\$ 13,390	\$ 51,458	\$ (38,068)
4	\$ 6,427,381	\$ 345,340	\$ 6,082,041	\$ 12,671	\$ 51,458	\$ (38,787)
5	\$ 6,082,041	\$ 533,522	\$ 5,548,519	\$ 11,559	\$ 51,458	\$ (39,899)
6	\$ 5,548,519	\$ 814,374	\$ 4,734,145	\$ 9,863	\$ 51,458	\$ (41,596)
7	\$ 4,734,145	\$ 813,374	\$ 3,920,771	\$ 8,168	\$ 51,458	\$ (43,290)
8	\$ 3,920,771	\$ 867,212	\$ 3,053,559	\$ 6,362	\$ 51,458	\$ (45,097)
9	\$ 3,053,559	\$ 383,212	\$ 2,670,347	\$ 5,563	\$ 51,458	\$ (45,895)
10	\$ 2,670,347	\$ 898,045	\$ 1,772,302	\$ 3,692	\$ 51,458	\$ (47,766)
11	\$ 1,772,302	\$ 683,617	\$ 1,088,685	\$ 2,268	\$ 51,458	\$ (49,190)
12	\$ 1,088,685	\$ 457,183	\$ 631,502	\$ 1,316	\$ 51,458	\$ (50,143)
13	\$ 631,502	\$ 178,992	\$ 452,510	\$ 943	\$ 51,458	\$ (50,516)
14	\$ 452,510	\$ 214,568	\$ 237,942	\$ 496	\$ 51,458	\$ (50,963)
15	\$ 237,942	\$ 229,205	\$ 8,737	\$ 18	\$ 51,458	\$ (51,440)
16	\$ 8,737	\$ 8,737	\$ -	\$ -	\$ 51,458	\$ (51,458)
17	\$ -	\$ -	\$ -	\$ -	\$ 51,458	\$ (51,458)
18	\$ -	\$ -	\$ -	\$ -	\$ 51,458	\$ (51,458)
19	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
<b>TOTALS</b>		<b>\$ 9,500,000</b>		<b>\$ 104,754</b>	<b>\$ 926,250</b>	<b>\$ (821,496)</b>

<b>Net Interest to Project</b>	<b>\$ 821,496</b>
--------------------------------	-------------------

Negative Arbitrage Tutorial - Scenario 3

INTEREST CALCULATION - Same GIC and bond rate as base case, different draw schedule

Month	Begin CF Balance	Assumed Draw	Ending CF Balance	Interest Earned	Interest Paid	Net Interest Due
1	\$ 9,500,000	\$ 3,000,000	\$ 6,500,000	\$ 34,450	\$ 51,458	\$ (17,008)
2	\$ 6,500,000	\$ 350,000	\$ 6,150,000	\$ 32,595	\$ 51,458	\$ (18,863)
3	\$ 6,150,000	\$ 500,000	\$ 5,650,000	\$ 29,945	\$ 51,458	\$ (21,513)
4	\$ 5,650,000	\$ 600,000	\$ 5,050,000	\$ 26,765	\$ 51,458	\$ (24,693)
5	\$ 5,050,000	\$ 800,000	\$ 4,250,000	\$ 22,525	\$ 51,458	\$ (28,933)
6	\$ 4,250,000	\$ 900,000	\$ 3,350,000	\$ 17,755	\$ 51,458	\$ (33,703)
7	\$ 3,350,000	\$ 800,000	\$ 2,550,000	\$ 13,515	\$ 51,458	\$ (37,943)
8	\$ 2,550,000	\$ 700,000	\$ 1,850,000	\$ 9,805	\$ 51,458	\$ (41,653)
9	\$ 1,850,000	\$ 600,000	\$ 1,250,000	\$ 6,625	\$ 51,458	\$ (44,833)
10	\$ 1,250,000	\$ 500,000	\$ 750,000	\$ 3,975	\$ 51,458	\$ (47,483)
11	\$ 750,000	\$ 400,000	\$ 350,000	\$ 1,855	\$ 51,458	\$ (49,603)
12	\$ 350,000	\$ 300,000	\$ 50,000	\$ 265	\$ 51,458	\$ (51,193)
13	\$ 50,000	\$ 50,000	\$ -	\$ -	\$ 51,458	\$ (51,458)
14	\$ -	\$ -	\$ -	\$ -	\$ 51,458	\$ (51,458)
15	\$ -	\$ -	\$ -	\$ -	\$ 51,458	\$ (51,458)
16	\$ -	\$ -	\$ -	\$ -	\$ 51,458	\$ (51,458)
17	\$ -	\$ -	\$ -	\$ -	\$ 51,458	\$ (51,458)
18	\$ -	\$ -	\$ -	\$ -	\$ 51,458	\$ (51,458)
19	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
<b>TOTALS</b>		<b>\$ 9,500,000</b>		<b>\$ 200,075</b>	<b>\$ 926,250</b>	<b>\$ (726,175)</b>

<b>Net Interest to Project</b>	<b>\$ 726,175</b>
--------------------------------	-------------------

Negative Arbitrage Tutorial - Scenario 4

**INTEREST CALCULATION** - Same draw schedule and GIC rate as base case, different Bond rate @ 7%

Month	Begin CF Balance	Assumed Draw	Ending CF Balance	Interest Earned	Interest Paid	Net Interest Due
1	\$ 9,500,000	\$ 2,584,781	\$ 6,915,219	\$ 36,651	\$ 55,417	\$ (18,766)
2	\$ 6,915,219	\$ 176,831	\$ 6,738,388	\$ 35,713	\$ 55,417	\$ (19,703)
3	\$ 6,738,388	\$ 311,007	\$ 6,427,381	\$ 34,065	\$ 55,417	\$ (21,352)
4	\$ 6,427,381	\$ 345,340	\$ 6,082,041	\$ 32,235	\$ 55,417	\$ (23,182)
5	\$ 6,082,041	\$ 533,522	\$ 5,548,519	\$ 29,407	\$ 55,417	\$ (26,010)
6	\$ 5,548,519	\$ 814,374	\$ 4,734,145	\$ 25,091	\$ 55,417	\$ (30,326)
7	\$ 4,734,145	\$ 813,374	\$ 3,920,771	\$ 20,780	\$ 55,417	\$ (34,637)
8	\$ 3,920,771	\$ 867,212	\$ 3,053,559	\$ 16,184	\$ 55,417	\$ (39,233)
9	\$ 3,053,559	\$ 383,212	\$ 2,670,347	\$ 14,153	\$ 55,417	\$ (41,264)
10	\$ 2,670,347	\$ 898,045	\$ 1,772,302	\$ 9,393	\$ 55,417	\$ (46,023)
11	\$ 1,772,302	\$ 683,617	\$ 1,088,685	\$ 5,770	\$ 55,417	\$ (49,647)
12	\$ 1,088,685	\$ 457,183	\$ 631,502	\$ 3,347	\$ 55,417	\$ (52,070)
13	\$ 631,502	\$ 178,992	\$ 452,510	\$ 2,398	\$ 55,417	\$ (53,018)
14	\$ 452,510	\$ 214,568	\$ 237,942	\$ 1,261	\$ 55,417	\$ (54,156)
15	\$ 237,942	\$ 229,205	\$ 8,737	\$ 46	\$ 55,417	\$ (55,370)
16	\$ 8,737	\$ 8,737	\$ -	\$ -	\$ 55,417	\$ (55,417)
17	\$ -	\$ -	\$ -	\$ -	\$ 55,417	\$ (55,417)
18	\$ -	\$ -	\$ -	\$ -	\$ 55,417	\$ (55,417)
19	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
<b>TOTALS</b>		<b>\$ 9,500,000</b>		<b>\$ 266,495</b>	<b>\$ 997,500</b>	<b>\$ (731,005)</b>

**Net Interest to Project** \$ **731,005**

## **Interest Rate Build Fixed Rate Transactions**

### **Permanent Rate**

TE Bond Rate	5.65%
Fannie Mae Guarantee	0.50% (depends on deal)
Fannie Mae Servicing	0.45%
Issuer Fee	0.25%
Trustee	<u>0.05%</u>
<b>All-In Rate</b>	<b>6.90%</b>

### **Construction Rate**

TE Bond Rate	5.65%
Fannie Mae Guarantee	0.00%
Fannie Mae Servicing	0.00%
Fannie Mae Rating Risk	0.20% (assumes AA rate L/C provider)
Issuer Fee	0.25%
Trustee	<u>0.05%</u>
<b>All-In Rate</b>	<b>6.15%</b>

Favorable Financing Tutorial

From Appraisal

Specific Market Value Estimates Requested	With Market Rate Financing	Below Market Bond Financing
1. As Is Market Value of the subject's vacant land	\$528,000	N/A
The Following Value Estimate Assume Completion of Construction		
2. With restricted rents (before stabilization)	\$9,660,000	\$10,880,000
3. With market rents (before stabilization)	\$9,660,000	\$10,880,000
4. Upon reaching stabilized occupancy at restricted rents	\$10,400,000	\$11,620,000
5. Upon reaching stabilized occupancy at market rents	\$10,400,000	\$11,620,000

Appraiser's NOI: \$987,788  
 Cap Rate 9.5%  
 Value \$10.4MM

**Debt Capacity \$9,360,000 (LTV constrained)**

Cap Rate 8.5%  
 Value \$11.6MM

**Debt Capacity \$10,450,000 (LTV constrained)**

## CASE STUDY – TAX EXEMPT BONDS AND 4% CREDITS

- 1 -

A week later, Mr. Gendron met with the folks at Maryland CDA and found out some bad news. The deal that had fallen through -- which in turn had made the 9% tax credits available for the redevelopment of Edgewater Village – had been resuscitated. It seems some very clever Bank of America lender had figured out a way to make the deal work after all. As a result, there were no 9% credits for Mr. Gendron's deal.

But before he could get too dispirited, CDA proposed an alternative. They were willing to allocate to him up to \$13MM in tax-exempt bond cap to make his deal work. In addition, since the project would now be financed with tax-exempt bonds, it would also be entitled to receive 4% tax credits. Based on the project's eligible basis, the annual credit amount would be \$220,000, or \$2.2 million in gross tax credit equity. Before leaving, the director of CDA handed Mr. Gendron a schedule of fees associated with tax-exempt bond/4% tax credit deals that he would have to pay in addition to the costs associated with a 9% LIHTC transaction. These included the issuer's upfront fee of 75 bps and the underwriter's fee of 50 bps, as well as \$50M in attorneys fees. CDA also noted that they would add 25 bps to the all-in permanent rate as their on-going fee, and the trustee would add 10 bps.

Mr. Gendron knew that the reduction in tax credits was significant enough to seriously jeopardize the feasibility of this project. After all, he just lost \$3.3 million in gross financing sources. Before going any further, he decided it was time to engage a HUD-approved market study analyst to complete a rental survey. This would tell him the HUD approved current market rents for Edgewater Village Apartments, and if they were higher than he originally thought, perhaps he would be able to borrow some additional funds and help close this financing gap.

A week later, Roger received a copy of both the HUD rent survey and the property appraisal that had been ordered by his lender at Bank of America. While the HUD market study analyst and the bank's appraiser did not conclude exactly the same rent structure, they were quite close. Further, their figures were better than Mr. Gendron had initially hoped.

Nmbr Units	Unit Type	Current Rents	Appraisers Mkt Rent	HUD Rents	Max. LIHTC Rents
43	1-BR/1-BA	\$ 600	\$ 750	\$ 770	\$ 930
156	2-BR/1BA	\$ 650	\$ 845	\$ 840	\$ 1,050
24	3-BR/1-BA	\$ 700	\$ 920	\$ 915	\$ 1,210

Armed with this information, Mr. Gendron met with a Fannie Mae DUS lender to see if Fannie Mae would provide the necessary credit enhancement to publicly sell the bonds. Mr. Gendron sat down with the DUS lender for a few hours and talked through his pro-forma rents and expenses. He also stressed the importance of securing Fannie Mae's involvement in order to preserve this project as affordable housing. By the end of the meeting, Mr. Gendron had a preliminary indication that Fannie would provide the permanent credit enhancement on the deal. The DUS lender would charge a 1% up-front fee to secure Fannie's commitment, and the borrower would be responsible for paying both Fannie Mae's and the DUS lender's legal fees, which added up to \$50,000. When Mr. Gendron asked about interest rates, he was told that current Fannie-Mae enhanced tax exempt bonds were pricing at 5.5%, and that Fannie's guarantee and servicing fee for this deal would be 0.95%.

Mr. Gendron then circled back with his friendly lender at Bank of America to confirm that they would provide a construction period letter of credit in lieu of a conventional construction loan. The lender told Mr. Gendron he would do the deal for a 1% up-front fee and 100 bps per year in L/C fees. Mr. Gendron and his friendly banker then put together a pro-forma draw schedule and interest reserve calculation as noted below, which assumes that GIC earnings at 3%.

## CASE STUDY – TAX EXEMPT BONDS AND 4% CREDITS

- 2 -

Month	Begin CF Balance	Assumed Draw	Ending CF Balance	Interest Accrued	Interest Paid
1	\$ XXXXXXXX	\$ 3,976,750	\$ 8,523,250	\$ 21,308	\$ 47,896
2	\$ 8,523,250	\$ 450,000	\$ 8,073,250	\$ 16,819	\$ 47,896
3	\$ 8,073,250	\$ 500,000	\$ 7,573,250	\$ 15,778	\$ 47,896
4	\$ 7,573,250	\$ 550,000	\$ 7,023,250	\$ 14,632	\$ 47,896
5	\$ 7,023,250	\$ 600,000	\$ 6,423,250	\$ 13,382	\$ 47,896
6	\$ 6,423,250	\$ 650,000	\$ 5,773,250	\$ 12,028	\$ 47,896
7	\$ 5,773,250	\$ 700,000	\$ 5,073,250	\$ 10,569	\$ 47,896
8	\$ 5,073,250	\$ 700,000	\$ 4,373,250	\$ 9,111	\$ 47,896
9	\$ 4,373,250	\$ 700,000	\$ 3,673,250	\$ 7,653	\$ 47,896
10	\$ 3,673,250	\$ 700,000	\$ 2,973,250	\$ 6,194	\$ 47,896
11	\$ 2,973,250	\$ 600,000	\$ 2,373,250	\$ 4,944	\$ 47,896
12	\$ 2,373,250	\$ 600,000	\$ 1,773,250	\$ 3,694	\$ 47,896
13	\$ 1,773,250	\$ 500,000	\$ 1,273,250	\$ 2,653	\$ 47,896
14	\$ 1,273,250	\$ 450,000	\$ 823,250	\$ 1,715	\$ 47,896
15	\$ 823,250	\$ 450,000	\$ 373,250	\$ 778	\$ 47,896
16	\$ 373,250	\$ 373,250	\$ -	\$ -	\$ 47,896
17	\$ -	\$ -	\$ -	\$ -	\$ 47,896
18	\$ -	\$ -	\$ -	\$ -	\$ 47,896
<b>TOTALS</b>		<b>\$ 12,500,000</b>		<b>\$ 141,257</b>	<b>\$ 862,125</b>

### Assignment

- Develop an operating budget based on the rental information noted above. Assume expenses are the same as noted in the earlier case.
- Show the 'rate build' for both the construction and perm rate
- How much debt can Mr. Gendron borrower given the new NOI and interest rate (assume a 30-year amortization)
- Assume Mr. Gendron negotiates a deal with his syndicator for \$0.75/credit dollar with 80% paid in at closing and the balance at conversion, prepare a construction period and permanent period development budget.
- How would you value this property?
- What is the final LTV?

			Bank	<b>BANK</b>
Nmbr	Type	Size	Rents	<b>PRO-FORMA</b>
43	1-BR/1-BA	706		\$ -
156	2-BR/1BA	860		\$ -
24	3-BR/1-BA	1032		\$ -
				-
<b>Preliminary Proforma Analysis</b>				
<b>Edgewater Apartments</b>				
<b>Edgewood, Maryland</b>				
<b>OPERATING</b>			<b>Stabilized</b>	
<b>Total Gross Potential Rent</b>			\$	-
Vacancy/collection Loss	5%		\$	-
<b>EFFECTIVE GROSS INCOME</b>			\$	-
<b>TOTAL OPERATING EXPENSE</b>				-
	<i>Per Unit</i>		\$	-
Replacement Reserves			\$	-
<b>TOTAL EXPENSES</b>			\$	-
	<i>Per Unit</i>		\$	-
<b>NET OPERATING INCOME</b>			\$	-
<b>Term Loan</b>			\$	-
<b>DSC</b>				-
<b>Cash Flow/Loss</b>			\$	-

**EDGEWATER VILLAGE APARTMENTS**

<b>PROJECT BUDGET</b>			
<u>SOURCES OF FUNDS</u>		<u>USES OF FUNDS</u>	
Bank L/C	\$ -	Acquisition	\$ -
Tax Credit Equity	\$ -	Rehab	\$ -
MHA	\$ -	Contingency	\$ -
Deferred Fee	\$ -	Architect and Engineer	\$ -
		Legal and Accounting	\$ -
		Bank Underwriting Fee (1%)	\$ -
		Bank L/C Fee	\$ -
		Net Interest to Project	\$ -
		Insurance	\$ -
		RE Taxes	\$ -
		Developer Fee	\$ -
		Title/Recording	\$ -
		Partnership Fees	\$ -
		Marketing	\$ -
		Issuer Fee	\$ -
		Underwriter Fee	\$ -
		Issuer/Underwriter Legal	\$ -
		Fannie Mae Loan Fee	\$ -
		Fannie Mae/DUS Legal	\$ -
		Transition Reserve	\$ -
		Operating Reserve	\$ -
<b>TOTALS</b>	<b>\$ -</b>	<b>TOTALS</b>	<b>\$ -</b>

<b>PROJECT BUDGET</b>			
<u>SOURCES OF FUNDS</u>		<u>USES OF FUNDS</u>	
Bank L/C	\$ -	Acquisition	\$ -
Tax Credit Equity	\$ -	Rehab	\$ -
MHA	\$ -	Contingency	\$ -
Deferred Fee	\$ -	Architect and Engineer	\$ -
		Legal and Accounting	\$ -
		Bank Underwriting Fee (1%)	\$ -
		Bank L/C Fee	\$ -
		Net Interest to Project	\$ -
		Insurance	\$ -
		RE Taxes	\$ -
		Developer Fee	\$ -
		Title/Recording	\$ -
		Partnership Fees	\$ -
		Marketing	\$ -
		Issuer Fee	\$ -
		Underwriter Fee	\$ -
		Issuer/Underwriter Legal	\$ -
		Fannie Mae Loan Fee	\$ -
		Fannie Mae/DUS Legal	\$ -
		Transition Reserve	\$ -
		Operating Reserve	\$ -
<b>TOTALS</b>	<b>\$ -</b>	<b>TOTALS</b>	<b>\$ -</b>

## Sponsor Analysis – Tricks of the Trade

If you don't have a liquid borrower that can cover unexpected problems in a deal, then you need to structure the deal around the sponsors weakness. **What would you suggest?**