

# The Role of 4% Tax Credits and Private Activity Bonds in Financing Affordable Housing

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# Bond Basics

- Issued for the limited purposes specified in Internal Revenue Code §§ 141 through 150
- Issued only by State or Locally authorized entities (i.e. TDHCA, TSAHC or local HFC, PFC or PHA)
- Texas issuers are generally Conduit Issuers
- Primary benefit is to access 4% Housing Tax Credits

# What Rules Apply?

- Internal Revenue Code §§ 141 through 150
- State Statute (§1372 Texas Government Code)
- Texas Bond Review Board Rules (34 TAC §181)
- Qualified Allocation Plan for PAB with tax credits (10 TAC §49 or 50)

# What Rules Apply?

- Every issuer has their own rules or process based on statute and TBRB rules
- TDHCA Bond Rule is 10 TAC §33 or 35 and annually updated with guidelines
- TSAHC utilizes annual RFP process per statutory requirements
- Local issuers create own rules on periodic basis

# Affordability

- Minimum affordability requirements:
  - Bond proceeds may only be used for units reserved for households at 80% or less of the Area Median Income (“AMI”); and
  - 20% of bond units reserved for households at 50% AMI; or
  - 40% of bond units reserved for households at 60% AMI.
- Issuers may have other requirements for affordability
- The minimum affordability term, or Qualified Project Period, is the longer of 15-years or the life of the bonds.

# Bond Structures

- **Private Placements:** a direct sale of the bond to a purchasing entity.
- **Public Offering:** sale of rated bonds through financial markets by an underwriter.
- **Negotiated Sales:** sale of rated bonds to a purchasing entity, usually involving Fannie Mae or Freddie Mac
- **Short-Term Cash Collateralized:** bonds are issued to fund acquisition and construction activities, then repaid using perm mortgage closed at same time.
- **Long-term Agency Purchase:** Various programs involving Fannie Mae or Freddie Mac. Can include public offering or private placement agreements.
- **Taxable Tails:** Additional bonds issued for costs that are not eligible for reimbursement using tax exempt financing.

# Who's involved in a bond issue?

Issuer

Developer/Borrower

Bond Underwriter

Bond Purchaser

Credit Enhancer

Tax Credit Syndicator

Bond Counsel

Residents/Tenants

Trustee  
Trustee Counsel  
Bond Purchaser's  
Counsel

Underwriter counsel  
Developer/Borrower's  
Counsel  
Local Community  
Tax Credit Counsel  
Escrow Agent

Issuer's Counsel  
Financial Advisor  
Local Government  
Title Company

# Who's involved in a bond issue?

- **Issuer's Counsel:** Issuer's can have internal counsel, but often hire outside counsel to work on documents related to the transaction that are not typically the responsibility of Bond Counsel, including compliance agreements, loan documents or other agreements related to the Issuer.
- **Bond Counsel:** Bond counsel is the primary representative for the Issuer and drafts all of the legal documents to be filed for the bond issuance. Bond counsel provides opinions necessary for IRS compliance, state regulations and certification of the tax exempt bond eligibility.
- **Financial Advisor:** Financial Advisors generally work on behalf of the issuer and review the structure of the bonds, analyze cash flows and repayment schedules, and might be involved in pricing the GIC or other investment instruments.
- **Trustee:** Trustees are generally financial institutions that are responsible for collecting and managing bond repayments and payments to the issuer, compliance agencies, insurers, lien holders and other invested parties.



# Who's involved in a bond issue?

- **Developer/Borrower:** The entity responsible for overseeing the construction of the development, its operations and repayment of the bonds. Generally the entity that initiates the development process and selects all of the other parties involved.
- **Developer/Borrower's Counsel**
- **Bond Purchaser:** The entity who lends the bond proceeds to the Developer. The purchaser can be a single entity in the case of a private or negotiated transaction, or can be many individual investors in the case of a public offering for the bonds.
- **Bond Purchaser's Counsel**

# Who's involved in a bond issue?

- **Bond Underwriter:** The entity who conducts the financial analysis for investors. In private or negotiated transactions the underwriting is often completed by the Bond Purchaser. For public transactions the underwriting is contracted by the credit enhancer or developer.
- **Credit Enhancer:** The entity that provides guarantees (letters of credit, direct guarantees, or insurance). Credit enhancers are generally only involved in public transactions.
- **Tax Credit Syndicator:** The entity who joins the developers as a limited partner and purchases any tax credits awarded to the development. The syndicator provides cash equity in exchange for the tax credits.

# How do Issuer's Select Projects?

- Each issuer has different standards
  - Some issuers go through lottery process at TBRB
  - Lottery process includes priority ranking system
  - Some issuers use scoring system to determine selection
  - Some Issuers base pipeline on date of application
  - Some only do one deal a year

# Timeline (the benchmarks)

- Application Review (30 to 60 days)
- Inducement by Issuer
- Reservation Period (180 days)
- TEFRA Hearings (30 days)
- Tax Credit Application (60 to 90 days)
- Bond Document Preparation (30 days)
- Final Approval of Bonds by Issuer
- Approval of Bonds by TBRB
- Approval of Bond Docs by AG (30 days)
- Closing

# Timeline (The Flow Chart)

