HOT TOPICS AND BEST PRACTICES

FOR TAX-EXEMPT BONDS FINANCING AFFORDABLE AND WORKFORCE RENTAL HOUSING IN OREGON

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WELCOME AND INTRODUCTIONS

The Work We're Doing

- Fast approaching 100 Private Activity Bond Financed Projects in just over 3 Years
- More than $1 Billion in PAB Issuance over this period, fully utilizing Private Activity Bond Volume Cap
- With projects across Oregon and almost all projects leveraging both State or local gap-funding sources.

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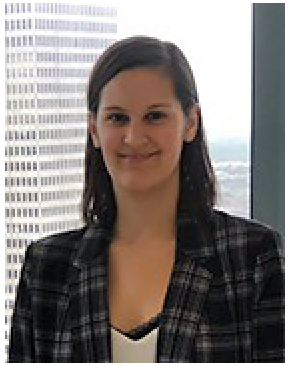

Lyndsey Hill

Overview

- Intake and Kick-Off
- Tax-Exempt Debt Structuring for Tax Purposes
- Department/Issuer Approval Process
- Other Resources and Priority Requirements
- Closing Process and Logistics
- Post-Issuance: Tax Compliance Basics & Reissuance
- Post-Issuance: Extensions, Modifications & Amendments
- Private Activity Bond Volume Cap Shortfall: Headwinds and Tailwinds

INTAKE AND KICK-OFF

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Housing Project Financing Life-cycle

- Intake
- Kick-Off
- Check-In Calls – Funder & Public Approvals
- Check-In Calls – Final Documents and Closing Conditions
- Pre-Closing
- Closing

Loi/Kick-off Intake Questionnaire

- Intake Questionnaire responses are used in a number of ways:
  - Letter of Intent
  - Engagement Letter
  - Interested Parties List
  - Identifying matters that may result in delays or require additional analysis

Communications Prior To Kick-off

- Open communication is essential to identifying timing constraints and legal issues as early as possible in the transaction
- Examples of deal points for early discussion:
  - HUD SLR review
  - Timing for project-based vouchers
  - Related-party financing structures (i.e., affiliated Bond Purchaser and LIHTC Investor)
  - Short-term, construction period-only Bonds
  - HUD RAD Conversion projects
  - Timing and conditions of land acquisition

Kick-off Call Process

- Interested Parties List
  - Orrick prepares master IP List draft in coordination with Sponsor/Developer
  - Complete and accurate IP List is critical to scheduling a productive kick-off call
    - All parties
    - All counsel
- Doodle Poll often used to schedule initial call
- Prior to kick-off call, we will reach out to the assigned Production Analyst
  - OHCS approval schedule and other key dates
  - Identify any areas of concern

TAX-EXEMPT DEBT STRUCTURING FOR TAX PURPOSES

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What Are Eligible Uses of Tax-exempt Bonds?

- "Qualified residential rental facilities" consist solely of apartment units, various lobby and hallway areas, common kitchens, tenant recreation facilities, and necessary maintenance, electrical, heating, plumbing and sanitation space common to the project that are made available for rental to the general public, consistent with age or disability preferences applicable to the project.
- Each residential unit must contain separate and complete facilities for living, sleeping, eating, cooking and sanitation.
- Good costs of the project include normal landscaping around the exterior of the structures and within a project.
- Good costs of the project do <u>not</u> include any commercial space financed with the Bonds, including space leased to governmental or non-profit agencies.

What Are Eligible Uses of Tax-exempt Bonds? (Cont.)

- Capital expenditures
  - 95% of proceeds must be used for “qualified residential rental facilities”
  - Land, new buildings or equipment, building renovation
- Refinancing prior bond issues
- Reimbursing prior capital expenditures
  - Only after a reimbursement resolution
- No working capital
- Financing costs
  - Costs of issuance (limited to 2%)
  - Capitalized interest (generally until placed-in-service date)
  - Reserves (limited generally to lesser of 10%, 125% of average annual debt service or max annual debt service)

Scenarios That Could Raise Federal Tax Issues

(Related Party Considerations)

- Borrower Issues a Seller Take-Back Note as part of the Purchase Price for the Project
- Bondholder is a Substantial User of the Bond-Financed Project
- Bond Purchaser and the LIHTC Investor are on the Same Organizational Chart

Strategies to Avoid Related Party Issues
(Buyer And Seller)

- Can avoid related party issues by allocating all bond proceeds to the rehab and not the acquisition
  - This allows all payments to be made to the contractor who is not a related party
  - However, there likely will still be an issue on the tax credit side, so tax credit counsel still needs to determine that the parties are not related
- Bond documents help by requiring the buyer and seller to covenant that the seller will never acquire enough of an equity interest in the buyer to be treated as a related party
  - But if the acquisition is structured with a seller take-back note, then these covenants are not enough

Strategies to Avoid Related Party Issues
(Seller Take-back Notes)

- If there is a seller take-back note at closing
  - The buyer’s counsel must render a 707(b) opinion, or
    - Note that this must be an unqualified opinion, which borrower’s counsel may resist providing
  - The sale must be restructured to eliminate the seller take-back note
    - Avoids potential for the note to be reclassified as equity in the borrower that is owned by the seller

Strategies to Avoid Related Party Issues
(Bondholder And LIHTC Investor)

- When the bond purchaser and the LIHTC investor are related parties
  - Requires yield calculations to be completed by Caine Mitter early in financing process
- If there is excess yield, potential options include:
  - Switch to a cash collateralized bond structure
    - This allows the bonds to be sold publicly so that the bondholders will no longer be related to the obligor
  - Senior/Subordinate bond or note structure

TEFRA Process

- Tax Equity and Fiscal Responsibility Act of 1982 a.k.a. “TEFRA”
- Public notice, hearing and approval requirement
- Required for all 4% transactions
- Requires public notice to be published at least seven days prior to hearing
  - Department posts notice electronically on website
- Hearing providing opportunity for public comment to be provided on the proposed project and bond issuance
- Department practice for issuance is Governor approval
- Treasurer approval is permitted for certain matters (re-issuance)

DEPARTMENT/ ISSUER APPROVAL PROCESS

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Analyst Report

Internal staff report prepared by OHCS production analyst

Pro Forma

- Includes summary, bond structure, sources and uses, substantially final project budget and schedule of values (SOV), etc.
- Ensures sufficiency of funding sources

Appraisal

- Must be prepared by an Approved Appraiser
- Includes market study to estimate value of subject property

Completed report advances to Finance Committee or HSC for project approval

Subsequent Approvals

Finance Committee

Meets every Tuesday

Internal Department review committee

Approves LIHTC allocation and other funding resources

Housing Stability Council

Meets first Friday of every month

Governed by ORS Chapter 456

Governor-appointed body

Approves range of state funding resources

Governor Approval

The final approval to occur

Required under TEFRA rules (notice, hearing, approval by highest elected official or body in jurisdiction)

Approvals Generally

Bonds are issued by a Bond Declaration, as set forth in Oregon statutes, not by a Bond Resolution

Department of Justice provides legal sufficiency findings

Bonds are issued by the State Treasurer, not by Oregon Housing & Community Services Department

GAP RESOURCES & PRIORITY REQUIREMENTS

Gap Funding Sources

- LIFT (Local Innovation and Fast Track Program), including from MCOF (Market Cost Offset Fund); PSH (Permanent Supportive Housing Program); GHAP (General Housing Account Program), including from MCOF; HPF (Housing Preservation Fund); MEP (Multifamily Energy Program)
- National Housing Trust Fund
- Agriculture Workforce Housing Tax Credit
- Mental Health Housing Fund
- Metro and PHB (Portland Housing Bureau) Funded Loans and Grants
- Other Local Government resources, such as HOME, Urban Renewal grants, Metro TOD
- Other non-profit group grant funds

Master Priority & Subordination Agreement

- The Priority & Subordination was developed by OHCS, DOJ and Orrick several years ago as part of the recognition of "best practices" for the Pass-Through/Conduit Revenue Bond program
- In addition to identifying required recorded documents, it has operated to standardize priorities and eliminate (for the most-part) debates about recording order
- The document is intentionally heavy on "Priority" and light on "Subordination" – so we don't object to secured parties requiring separate Subordination Agreements to address stand-still and other subordination rights and obligations in greater detail
- Orrick does not typically prepare title/escrow instructions for the Title Company, given the priorities established by the Priority & Subordination

Other Secured Funding Sources And Recorded Encumbrances

- Covenants (Recorded) for PHB and Metro GO Funded Loan or Grants
- Covenants (Recorded) for other OHCS Funding (HPF, GHAP, OMEP, Other)
- Covenants (Recorded) for other Local Govt Funding (URA, Home, Other)
- Sponsor Loan Trust Deed(s) (OHCS grants, MMT, ETO, Metro TOD, Other)
- Seller Note Trust Deed (typically from GP/Sponsor)
- IH Covenant (City of Portland – PHB)
- Legacy Encumbrances (LIHTC Declarations & Regulatory Agreements)

First Lien Requirement

- ORS 456.548(18) “Residential loan” means …a loan that is for the acquisition, construction, improvement or rehabilitation of residential housing and, if the loan is for acquisition or construction of residential housing, that is secured by a first lien on real property located in the state
- OAR 813-035-0033 – "To be eligible for Project financing, a prospective Borrower shall comply with the terms contained in … the Project financing documents, and other Program or Department requirements… Project documents, including all Loan Documents, must be in form and substance as approved or required by the Department at its sole discretion
- LIFT/PSH funding is required to have a shared first lien position
  - Accomplished through an Inter-Creditor Agreement

CLOSING PROCESS AND LOGISTICS

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Execution, Delivery And Recording Of Documents

- Getting signature packets distributed, signed and delivered to required parties
- DocuSign does not work for most documents
- All recordable documents must be original "wet ink" signatures and notarized, and should be delivered to Title Company prior to Closing Date
- FedEx and UPS lose things – plan ahead!
  - Beware of rural locations and schedules
- Delayed authorization to close may result in recording delays
  - May or may not be an issue for funders
  - Bonds are "issued" upon funding and authorization to close regardless of recording status

Flow of Funds at Closing

- "Best Practice" has been to have all funds required for closing go to the Title Company, except in the case of a public offering where the Underwriter is required to wire the bond purchase price to the Trustee
- The Settlement Statement is a critical closing document, particularly for Bank funding. It is critical to get "inputs" to the Settlement Statement well in advance of the closing to confirm funding required to close (and allow time for the requisition of public funds)
- Where there is a public offering of the Bonds, the Underwriter prepares a Flow-of-Funds or Closing Memorandum documenting the payments required under the Bond Purchase Agreement and confirming the payments to and from the Trustee and the Title Company

Closing Documentation

- At pre-closing, Orrick establishes an Electronic Closing Room utilizing Box.com with the Orrick Closing Memo and List of Documents serving as the Transcript Index
  - Some financial institutions aren't able to access Box.com due to firewall and other security measures; Orrick can provide alternative delivery methods
- The Electronic Closing Room remains open to the working group for downloading individual documents or bulk downloading of the entire transcript
- In order to reduce costs and preserve resources, Orrick delivers transcripts only in an electronic format, absent requests for hard copies or other formats

POST-ISSUANCE: EXTENSIONS, MODIFICATIONS & AMENDMENTS

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Amendments and Modifications

- Extensions and modifications are now routine for most Projects, as a result of construction delays, cost escalation and funding shortfalls, with resulting delays in lease-up, stabilization and conversion
- Any amendment or modification of Bond (or Bank) documents impacting the terms and conditions of the Bonds requires review by Bond counsel
- LIBOR Phase-out
  - LIBOR is going away, and many existing instruments are going to have to be modified to replace the LIBOR index as a result
  - LIBOR-based interest rates are most commonly used for construction period interest computations

Condo Formation and Other Legal Description Changes

- Bond documents used in Projects using condominium structure, provide for substitution of "condo" project description on formation of "affordable project" unit
- Legal description changes are commonly being seen as a result of final, as-built surveys, and as part of the replat or partitioning after closing
- This is accomplished by master/form document amendments modifying legal description for all Transcript Documents – requiring signatures from all parties and notary for recorded Amendment/Modification document

Supplemental Bond Issuance

- Project cost increases resulting in need to additional Private Activity Bond issuance to meet LIHTC 50% test – typically also generating additional LIHTC equity
- Requires additional scrutiny of Bond document additional bonds/indebtedness provisions
- Requires new TEFRA, FC and HSC approvals
- Need direction for OHCS on Issuer fees and approach to additional LIHTC

Conversions

- With or without bond or bank document amendments
- Satisfaction of bank document requirements for permanent financing, including stabilization, minimum coverage and other conditions
- Final cost certification confirming permitted use of bond proceeds (95/5 Test)
- Right-sizing of permanent debt per permanent lender requirements and conditions

POST-ISSUANCE: TAX COMPLIANCE BASICS & REISSUANCE

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Reissuance & its Tax Implications

- Generally, a reissuance occurs under federal tax law when there are significant modifications to the terms of a bond so that the bond ceases to be the same bond for tax purposes
- Reissuance rules are technical in nature and while there are general guidelines, it is critical to review all that is occurring with respect to the project and financing
- A reissuance is typically not problematic to address, provided it is addressed on a timely basis.   It is often critical for LIHTC purposes that a reissuance not be triggered prior to the project being placed-in-service
  - Reissuance generally is treated the same as issuing a new bond and doing a refunding for federal income tax purposes

Practical Effects of Reissuance

- A new IRS Form 8038 must be filed
- Tax diligence
- Full tax-exempt opinion or no adverse opinion
- For conduit deals:
  - The actual governmental issuer must be involved
  - Tax diligence can be burdensome
  - Potentially a new opinion from bond counsel

Post-issuance Compliance and Rebate

- Borrowers are reminded that they need to pick a rebate agent at closing
  - Requires affirmative selection by the Borrower
- Rebate computations and payments
- Post-conversion distress scenarios
- Public offering transactions have continuing disclosure obligations of the Borrower (subject to Rule 15c2-12)
- IRS Audit letters would be addressed to the Issuer, with Issuer potentially directing response and resolution pursuant to reserved rights

Rebate Payments

- Arbitrage rebate payments are required to be paid no later than 60 days after each “5th Bond Year” and 60 days after the final redemption date
  - Payments made after 60 days need to include late interest on underpayment. Late interest rates are high, and change quarterly. Making a late payment is better than making no payment at all (willful neglect will cost you a 50% penalty in addition to late interest if it can be proven)
- 90% payment due at each installment computation date
- 100% payment (or remaining 10%) due at final maturity/redemption date

Shameless Pitch #1: BLX Group

About BLX

- The BLX group is a team of experienced professionals who specialize in arbitrage rebate, continuing disclosure, private use monitoring, bond proceeds investment, debt issuance, and interest rate swaps. They provide clients with the certainty they need to properly fulfill their obligations for tax-exempt financings from a compliance and optimization perspective. BLX is registered with the SEC and MSRB as a municipal advisor, and with the State of California as an investment adviser.

Clients

- BLX advises clients in the municipal and non-profit sectors, including state and local governments, as well as a variety of tax-exempt debt issuers and conduit borrowers. Clients range from small townships to large state agencies, and from local non-profits, museums, and charter schools to sophisticated hospital systems, housing issuers, and higher education institutions.

Rebate Compliance – BLX GROUP

- **Call BLX for a free preliminary consultation**
  - Due to the depth of their experience, BLX can answer many of your questions with easily accessible information about your bond issue
- **Engage BLX to perform your calculation**
  - Experience and technical/financial proficiency to consistently identify the lowest legally permissible arbitrage liability
  - BLX's expertise enables them to accommodate even the most complex circumstances and to apply beneficial analytical alternatives when available
  - A professional opinion, by BLX, and a legal opinion, by Orrick, are included in each completed arbitrage report

Call Robin Schlimgen at 480-539-4084 or
Sandee Stallings at 214-989-2701
for more information

PRIVATE ACTIVITY VOLUME CAP ALLOCATION SHORTFALL: HEADWINDS & TAILWINDS

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Headwind: A Wind Blowing Directly in Front, Opposing Forward Motion

- Rising Interest Rates
- Rising Construction Costs
- Lack of Sustainable Gap Funding
- Limited Volume Cap

Tailwind: A Wind Blowing in The Direction Of Travel; a Wind Blowing From Behind

- Oregon's historically under-utilized Private Activity Bond Volume Cap capacity
- State General Obligation Bond funded LIFT Program
- City of Portland – Voter Approved General Obligation Housing Bond Program
- Measure 102 – Voter Approved Constitutional Amendment
- Metro – Voter Approved General Obligation Housing Bond Program
- Historically favorable long-term Interest Rate Environment
- Minimum 4-percent Floor for Low Income Housing Tax Credits (LIHTC)

Without a PAB Award, Can My Project Proceed?

- NON-LIHTC PROJECTS
- 501(C)(3) PROJECTS
- USING RECYCLED VOLUME CAP
- INNOVATING ON GAP FUNDING
- MIXED INCOME PROJECTS
- WORKFORCE OR MIDDLE-HOUSING PROJECTS
- SENIOR/SUBORDINATE DEBT STRUCTURES

2023 Qualified Allocation Plan (Rev. 10/31)

- Establishes Competitive Criteria for Allocation and Award of Volume Cap
- Covers both 9% and Bond/4% projects
- Percent of PAB: Portland Metro 65%; Balance of State 35%
- Award Order – First: Housing Authority Projects; Second: Projects with Significant Local funds; Third: Projects with OHCS or Federal funds; Fourth: Projects without Subsidy
- Resource Prioritization: Culturally Specific; Serving Lowest Incomes; PSH
- Project Readiness – Project Delays

501(c)(3) Bonds

- May be used to provide permanent tax-exempt financing for the following types of projects:
  - Affordable housing projects, subject to IRC income limits, senior living or student housing projects, workforce or other housing in furtherance of a tax-exempt purpose of a 501(c)(3) organization or workforce housing "alleviating the burden of government"
- May also be used as bridge financing until volume cap is available
- May be issued by a 501(c)(3) entity directly into the taxable market
- Debt issued on a tax-exempt basis must be issued by a qualified governmental conduit issuer for the benefit of the 501(c)(3) entity
- Tax-exempt 501(c)(3) Bonds do not generate LIHTC

Volume Cap Recycling

- Converting short-term use of volume cap to long term use by re-allocating pay-down at Conversion to new long-term issuance
- Five Rules:
  - Volume Cap can be recycled only once
  - New loan must be made within six months of repayment of old loan
  - New loan must be made within four years of closing date of original bonds
  - Maturity of new bonds cannot be more than 34 years from closing date of original bonds
  - All other QRRP Private Activity Bond Rules apply
- Bonds issued with recycled Volume Cap do not count toward 50% LIHTC Test
- Tax-exempt PAB Bonds issued using recycled cap do not generate LIHTC

Questions?

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