

Category: Special Achievement**INTRODUCTION**

Recent market turmoil has taken its toll on the housing sector. Foreclosures are at all-time highs and continue to grow monthly nationwide. While many programs have focused on stabilizing the single-family housing market to preserve residential neighborhoods, the multifamily residential market has also been hard hit by the declining economy. Record job losses have challenged project owners to maintain adequate occupancy rates and attain projected income levels. This is the case in New York City, where new multifamily rental projects have seen increasing balance sheet stress. These projects were underwritten at rent levels that were attainable at the peak of the housing market but are no longer feasible in the current environment.

To help stabilize the finances of these properties, the New York State Housing Finance Agency (HFA) used the provisions of the Housing and Economic Recovery Act of 2008 ("HERA") and American Recovery and Reinvestment Act ("ARRA") to create an innovative recycling bond program. The program's goal is to replace taxable bonds with tax-exempt bonds and thereby provide debt service savings that can improve projects' financial strength and stability.

DEVELOPMENT

Under our 80/20 program, multifamily developers must lease 20% of their rental project units to low-income New Yorkers. The program, which has been in existence for many years, experienced high demand during the real estate boom of 2006, 2007 and 2008. During this period, several 80/20s were financed using a combination of limited tax-exempt bonds and taxable bonds. Due to the downturn in the economy and resultant job losses, demand for rental units has decreased and developments that had been underwritten at peak rent levels were put at financial risk. Therefore, when we looked to take advantage of the recycling provisions of HERA, we identified this problem as the highest and best use of this new resource.

DESCRIPTION

HERA, adopted in July, 2008, allows for the replacement refunding of multifamily prepayments from transactions issued in the prior four years. These refunding bonds (hereafter referred to as recycling bonds) must be issued before the redemption of the existing project bonds and must be used for other qualifying multifamily projects, though without the attendant benefit of tax credits. Although HERA eliminated the alternative minimum tax ("AMT") penalty on all housing bonds issued after its enactment, it complicated the ability to combine recycled bonds with a new series of bonds because the recycled bonds retained their initial AMT status. That is, bonds subject to the AMT were still subject to the AMT when recycled for a new project. ARRA, which was adopted in January 2009, provided that

bonds issued after January 1, 2004, could be refunded on a non-AMT basis. This provision, coupled with the new replacement refunding ability under HERA, allowed us to combine recycled bonds and new bond proceeds into one non-AMT series of bonds.

We decided the recycling bond resource is best used for recently financed 80/20 projects for three reasons: 1) these projects, as part of their capital structure, do not rely on tax credits, which are not available with recycled bond allotments; 2) these projects are typically financed with variable rate demand bonds, which makes it easier for us to accommodate the recycling of prepayments over time; and 3) these projects were identified as a policy priority because their viability helps stabilize neighborhoods.

To coordinate the issuance of recycled bonds for 80/20 projects prior to the retirement of the bonds that are being prepaid, we instituted limits on projects' prepayment schedules. Typically, prepaying projects are 100% affordable, where all the units are set aside for low-income tenants. These projects are usually financed with fixed-rate bonds and are structured to prepay a portion of their bonds after construction using tax credit equity. Also, these projects generally cannot afford to carry the debt service costs on their construction bonds indefinitely. Scheduling the prepayments and retirement of the bonds in such a way that the prepayments can be captured for recycling purposes presents major challenges. Our goal was to avoid causing financial burden to the prepaying project, while at the same time balancing the project's flexibility to prepay with our need to efficiently collect the prepayments. To that end, we designed a twice-a-month fixed schedule for prepayments.

We took several steps to minimize the costs of these transactions. First, we received permission from the State's Division of the Budget to waive the bond issuance charge usually assessed for all refunding and new money bond issues. Also, we did not charge a fee for issuing the additional tax-exempt bonds. Second, we scheduled the issuance and closing of the recycled bonds to coincide with the 2009 issuances for the 80/20 projects (most of our 80/20 deals are financed over a three-year period). Third, although we expected to receive the prepayments to be recycled over several months, we drafted the Official Statement to include the full amount of the bonds (akin to a "shelf registration"). Subsequent recycling bond issuances will utilize the same Official Statement (with bring down opinions), have the same CUSIP, and will be priced at the same time and at the same weekly rate as the outstanding bonds. Structuring the bond issue in this way allows for greater interest rate savings because larger bond issues achieve the best pricing due to the liquidity that size provides.

THE PROGRAM AT WORK

HFA has already issued \$18 million of the expected \$120 million of prepayments to be recycled for transactions in calendar year 2009. The remaining prepayments are expected to be recycled into three other financings.

320 West 38th Street

On April 30, 2009, HFA issued \$111,680,000 320 West 38th Street Housing Revenue Bonds, 2009 Series A, which included the Agency's first use of mortgage prepayments to recycle volume cap. The variable rate bond issue (rated Aa2 by Moody's), consisted of \$102 million of new issue bonds and \$9.68 million of recycled bonds and was sold at a yield of 0.32%. Comparable taxable bonds reset at 0.93% the same week. The final portion of the project's \$17.5 million recycling bond allocation was issued in May of 2009. Assuming an average spread of 75 basis points between non-AMT and taxable bonds, the project will ultimately receive debt service savings of approximately \$1.3 million over a 15 year period.

600 West 42nd Street

On July 29, 2009, HFA issued \$100,500,000 600 West 42nd Street Housing Revenue Bonds, 2009 Series A, which included \$100 million of new issue bonds and \$500,000 of recycled bonds. The variable rate bond issue, rated Aaa by Moody's, was sold with a yield of 0.25%. Comparable taxable bonds reset at a rate of 0.95% the same week. The final portion of the project's \$34.1 million recycling bond allocation will be issued over the course of the next few months. Assuming the same 75 basis point spread, the project is expected to achieve debt service savings of \$2.5 million.

CONCLUSION

In a year of limited resources and credit constraints, our innovative recycling program enabled us to be proactive in supporting the multifamily housing sector. That has protected both multifamily projects that are potentially at risk as well as the surrounding neighborhoods during this time of economic uncertainty.