Entry Form
2018 Annual Awards for Program Excellence
Entry Deadline: Friday, June 15, 2018, Midnight ET

Each entry must include a completed entry form. Please complete a form for each entry your HFA is submitting. The completed entry form will become the first page of your entry.

This form is a fillable PDF. Type your information into the entry form and save it as a PDF. Please do not write on or scan the entry form. **Questions: Call 202-624-7710 or email awards@ncsha.org.**

Entry Title: Enter your entry's title exactly as you wish it to be published on the NCSHA website and in the awards program.

IHDA/FHA Risk-Sharing Pass-Through Structure

Category: Rental Housing

Subcategory: Encouraging New Production

Entry Summary: A 15-word (max) summary of the program, project, or practice you are entering.

Innovative risk-sharing structure creates financial benefits for HFAs, private lenders, and borrowers.

HFA: Illinois Housing Development Authority

HFA Staff Contact: Andrew Field

Phone: 312-836-5335

Email: afield@ihda.org

Visual Aids:
Are you mailing to NCSHA 10 copies of any visual aids that cannot be included in your entry PDF? ☐ Yes ☑ No

Payment:
☑ My HFA is mailing a check to NCSHA.
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Leveraging FHA Risk-Sharing Credit Enhancement

As rental demand surges to record levels across the nation, the creation of new affordable rental housing is critical. The number of households in the rental market increased by 9 million across the U.S. between 2005 and 2015, the largest gain in any 10 year period on record, and the number of Illinois households in the rental market today is 18 percent higher than a decade ago. But even as HFAs find themselves working in an era of reduced resources and rising construction costs, the U.S. Department of Housing and Urban Development's ("HUD") Housing Finance Agency ("HFA") Risk-Sharing Program for Insured Affordable Multifamily Loans ("FHA Risk-Sharing Program") provides a unique opportunity for credit enhancements for multifamily loans. The Illinois Housing Development Authority ("IHDA" or "Authority") feels it is important to provide long-term, fully-amortizing financing products to support the creation and preservation of affordable housing, as most bank permanent financing structures utilize a balloon loan and can result in refinancing risk at maturity. To support this effort, IHDA leverages the Risk-Sharing credit enhancement through FHA's Risk-Sharing program to provide competitive rates and terms while reducing overall project risks – effectively bringing more financing options to an increasingly underserved market.

The FHA Risk-Sharing Program provides credit enhancement for multifamily mortgages underwritten by HFAs by allowing them underwrite FHA loans in returning for sharing the risk of losses on those loans. By leveraging the Risk-Sharing credit enhancement, IHDA can achieve a reduction in permanent pricing, which in turn allows for increased loan proceeds. The extremely competitive rates and terms further reduces or eliminates financing gaps in deals. Given the limited resources available to fill financing gaps, this financing structure allows IHDA to produce more affordable housing units.

This structure also allows IHDA to "play nice in the sandbox" with banks and other financing partners. While banks are traditionally motivated to provide construction financing to meet their Community Reinvestment Act ("CRA") goals, they are less interested in providing long-term project financing, and the Authority has historically competed with them to provide both construction and permanent financing facilities. However, since construction financing is typically greater than permanent financing, the IHDA pass-through structure allows banks to continue meeting their CRA needs through higher construction financing facilities, while also reducing the costs and risks of providing permanent financing. Depending on the structure, the bank may be able to obtain CRA lending test credit for the construction financing and CRA investment test credit for the bond purchase related to the long-term loan within the same transaction.

Innovation

The IHDA pass-through structure contemplates either a taxable 9% deal or a 4% tax-exempt bond deal. A bank provides financing and underwrites all risks during construction. For the permanent period, IHDA utilizes a forward Bond Purchase Agreement ("BPA") in which the Authority has an agreement with a bank to deliver either a tax-exempt or taxable security (depending on deal type) at stabilization.

The pass-through rate under the BPA for the permanent period is set at the initial closing of the construction loan. The term and amortization for the permanent period can be as long as 40-years.

Assuming a bond is issued, IHDA will provide a rating as well as a CUSIP so the bond is a public, marketable security that can be sold by the bank at any time. The FHA Risk Sharing credit enhancement currently results in a Aaa rating on the bond.

IHDA originates and services the long-term bond/loan so all payments flow through the Authority. This generates long-term revenue opportunities to the Authority through interest spread and servicing fees. 100% of the credit risk during the permanent period is shared between IHDA and the Federal Housing Agency (FHA) (generally 50% IHDA / 50% FHA), which effectively eliminates all credit risk to the bank. This elimination of risk results in a reduction in the bank's cost of funds and reserve requirements, which lowers the pass-through rate to IHDA and ultimately to the borrower.

Benefits

This Pass-Through provides a number of direct financial benefits for HFAs, their lending partners and their borrowers. To start, this structure eliminates construction risk to the Authority by partnering with a bank to provide financing. Using IHDA's balance sheet to provide construction financing typically requires the use of either the Authority's GO or some other form of collateral as a guaranty for a construction loan. As rating agencies monitor the level of construction exposure an HFA carries, this can affect an Authority's bond rating. By using the IHDA pass-through structure, we have eliminated the need to provide a guaranty during construction.

This structure also provides fully-amortizing facilities that eliminate refinancing risks. While traditional bank loans utilize a balloon structure, which is the typical funding approach the Authority sees on taxable loans and many agency executions, the IHDA pass-through structure provides long-term, fully-amortizing financing with a 10-year lockout and a small pre-payment fee of $5,000 after lockout.

Most importantly, this strategy lowers borrowing costs for HFA partners, increasing their capacity to create much-needed affordable housing. Current tax-exempt pricing utilizing the IHDA pass-through structure is 5.05% as of May 25, 2018 for long-term, fully-amortizing financing, compared to rates of 5.25% or higher in similar structures using a public bond issuance. Current taxable pricing using the IHDA pass-through structure is 5.65% as of May 25, 2018 for long-term, fully-amortizing financing, whereas typical bank loans are currently trading at 6.0% to 6.50%. While bank financing typically includes a balloon structure, IHDA estimates that a fully-amortizing rate offered by a bank would be as much as 0.3% higher than the balloon rate, resulting in rates as high as 6.80%. This means that the IHDA pass-through structure reduces long-term taxable borrowing costs anywhere from 0.65% to 1.15%, a considerable savings for the borrower.

4% Bond Deal Example

1. Initial Closing: IHDA to issue three tranches of conduit loans (tax-exempt) with construction risk underwritten by note/bond purchaser
    a. Tranche A: $2,935,000 (fully funded)
        i. Term: 43 years (2-year construction + two 6 month extensions + 40 year perm)
        ii. Interest rate: TBD

      iii. Amortization: I/O for two (2) years, fully amortizing thereafter
      iv. Prepayment: allowed without penalty after 12-18 month lockout
      v. Investor: TBD
   b. Tranche B: $3,070,000 (draw down)
      i. Term: 2-years (two 6-month extensions available)
      ii. Interest rate: TBD
      iii. Amortization: I/O
      iv. Prepayment: allowed without penalty after 12-18 month lockout
      v. Investor: TBD
   c. Tranche C: $3,860,000 (draw down)
      i. Term: 2-years (two 6-month extensions available)
      ii. Interest rate: TBD
      iii. Amortization: I/O
      iv. Prepayment: allowed without penalty after 12-18 month lockout
      v. Investor: TBD

2. <u>Final Closing / Refunding Bonds</u>: IHDA to issue long-term 4% tax-exempt bonds backed by a risk-sharing loan.
   a. Refund Tranche A construction loan
      i. $2,935,000
      ii. Term: 40-years
      iii. Interest rate: TBD (to be locked at initial closing pursuant to a forward bond purchase agreement "Forward BPA")
      iv. Rating: Moody's
      v. Credit Enhancement: FHA Risk-Sharing Program
      vi. Prepayment: 10-year lock-out
      vii. Investor: TBD (purchase commitment pursuant to Forward BPA)

The above 4% deal summary is an example of one utilized by IHDA with a large national bank as the construction lender and a BPA for the permanent financing. Similar structures have been utilized for 9% taxable deals, and the construction lender, who sets the interest rate(s) for construction facilities and faces the borrower, underwrites all construction list. All credit risk during the permanent period is assumed by the Authority under the FHA Risk-Sharing Program. IHDA originates a permanent loan/bond with a pass-through rate set by the bond purchaser or funding lender (depending on whether a bond or a loan is issued) plus a spread (including servicing and Mortgage Insurance Premium (MIP)).

<u>Conclusion:</u>

Given the considerable savings generated by this structure and the need to stretch every available resource, this is an effective strategy to help HFAs keep pace with the growing demand for affordable housing. It provides favorable terms for both lenders and borrows, and achieves considerably reduced interest rates for affordable housing. This structure is a strategy that helps IHDA increase the stock of affordable housing, and ensures the Authority will be able to offer competitive financing in an underserved segment of the market.