

IHDA Direct Purchase Bond Program

Illinois Housing Development Authority

Management Innovation: Financial

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Overview and Management Challenge

State Housing Finance Agencies (“HFA”) strive to create and preserve affordable multifamily rental housing by leveraging their balance sheets and bond indentures. To do this effectively, HFAs must manage their financial exposure, particularly with acquisition and construction lending. Limited construction exposure is critical to preserving or improving the bond rating for the HFA as determined by the bond rating agencies. Putting capital to work building and rehabilitating affordable housing and judicious financial management is a delicate balancing act. To address this challenge, the Illinois Housing Development Authority (“IHDA” or “Authority”) and its banking partners created an innovate product to better manage construction lending exposure—the IHDA Direct Purchase Bond Program.

Innovation

The IHDA Direct Purchase Bond Program is structured as either a taxable 9% LIHTC deal or a 4% tax-exempt bond deal. During construction, a bank provides financing and underwrites all risks. IHDA will issue bonds or tax-exempt notes on a conduit basis at the initial construction loan closing. At conversion, or final closing, IHDA will rely on the forward Bond Purchase Agreement (“BPA”) executed at initial closing for a refunding with an agreement from IHDA to deliver a marketable bond with a CUSIP and a bond rating (assumed to be Aaa). Under the forward BPA, the construction lender is then obligated to purchase the bonds at conversion at the pass-through rate agreed upon at the initial construction loan closing.

IHDA originates and services the long-term bond/loan so all payments flow through the Authority. This generates long-term revenue to the Authority through interest spread and servicing fees, and helps build equity in its bond indenture. Credit risk during the permanent period for the underlying loan that collateralizes the bond is shared between IHDA and HUD (generally 50% IHDA / 50% HUD), which effectively eliminates all credit risk to the bank purchasing the permanent bond. 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 development being financed.

Benefits

The IHDA Direct Purchase Bond Program provides several financial benefits for the Authority, its 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 bond rating agencies monitor the level of construction exposure an HFA carries, this can affect an Authority’s bond rating. By using the IHDA Direct Purchase Bond Program, the Authority has eliminated the need to provide its guaranty during construction. The construction loan is normally structured as a draw-down facility, which eliminates interest costs on fully-funded bond structures.

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 Direct Purchase Bond Program provides long-term, fully-amortizing financing with a 10- to 15-year lockout and a small pre-payment fee of \$5,000 after lockout.

Most importantly, this structure can lower 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 3.40% as of April 20, 2021 for long-term, fully-amortizing financing. Current taxable pricing using the IHDA pass-through structure is 4.25% as of April 20, 2021 for long-term, fully-amortizing financing, whereas typical taxable bank loans are currently trading at approximately 5.0%. While bank financing typically includes a balloon structure at the 5% rate, IHDA estimates that a fully-amortizing rate offered by a bank would be as much as 0.3% higher than the balloon rate.

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. Final Closing / Refunding Bonds: 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 forward BPA for the permanent financing. Similar structures have been utilized for 9% taxable deals using taxable bonds/notes.

Conclusion

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 without jeopardizing HFA’s bond ratings. It provides favorable terms for both lenders and borrows and achieves considerably reduced interest rates for the creation and preservation of 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 while efficiently managing its balance sheet and financial exposure.

DIRECT PURCHASE BOND PROGRAM

SECTION 542(C) RISK-SHARING CREDIT ENHANCED BOND STRUCTURE

Description	<p>For either a taxable 9% deal or a 4% tax-exempt bond deal, IHDA will enter into a Bond Purchase Agreement (BPA) to issue bonds at closing or to issue refunding bonds at project stabilization with an institution selected by the borrower. This institution will normally be the same firm providing the construction financing.</p> <ul style="list-style-type: none"> • Borrower or sponsor selects financial institution that will enter into the forward BPA. <ul style="list-style-type: none"> ◦ Institution must be acceptable to IHDA in all respects. • Fees payable to the financial institution, if any, must be fully disclosed to IHDA at initial application. • IHDA will facilitate all aspects of the closing process related to the permanent financing, the BPA, and the issuance of the bonds. • All costs related to the permanent financing and bond refunding (if applicable) will be paid by the borrower. • The interest rate under the BPA for the permanent period will be set at the initial closing of the construction loan. • IHDA will issue and service the long-term bond(s) with payments flowing through IHDA. • At stabilization, IHDA will deliver either a tax-exempt or taxable bond. • Pricing and pricing methodology must be acceptable to IHDA.
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For more information, please visit IHDA's website: www.ihda.org/developers

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Products & Services	<ul style="list-style-type: none"> • IHDA structures a short-term and/or long-term conduit bond or loan (for tax-exempt transactions). Long-term bonds are issued at closing or at stabilization as part of a refunding. • IHDA allocates 4% or 9% Low Income Housing Tax Credits (LIHTC), subject to the IHDA's Qualified Allocation Plan (QAP) and underwriting requirements. • IHDA provides a permanent, taxable or tax-exempt mortgage.
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For more details	See IHDA Bond Programs information
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Benefits	<ul style="list-style-type: none"> • Long-term, fully-amortizing financing provided by IHDA (up to 40-years). • 100% of the credit risk during the permanent period shared between IHDA and HUD (generally 50% IHDA / 50% HUD). • Strong investor interest for Aaa/AAA-rated, Risk-Sharing credit enhanced securities allows IHDA to provide competitive, long-term mortgage rates. • IHDA will deliver a long-term bond with a rating and a CUSIP to the investor. The HUD Risk-Sharing credit enhancement should equate to a Aaa/AAA rating on the bond. A final rating will be obtained for each deal and is subject to rating agency review.
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Financing the creation and preservation of affordable housing

Effective Date: July 2019

Section 542(c) Risk-Sharing Program Information	<p>IHDA has originated and expects to originate loans under the Section 542(c) Risk-Sharing Program. Section 542(c) of the Housing and Community Development Act of 1992, as amended (the "Risk-Sharing Act") authorized the Secretary of HUD to enter into risk-sharing agreements with qualified state or local housing finance agencies ("HFAs") to underwrite and process loans for which HUD, acting through the Federal Housing Administration ("FHA"), will provide full mortgage insurance for eligible developments. HUD has promulgated regulations at 24 C.F.R. Part 266 (the "Regulations") pursuant to the Risk-Sharing Act. The HUD Risk-Sharing Program allows IHDA to carry out certain HUD functions, including the assumption of underwriting, loan management, and property disposition functions and responsibility for defaulted loans, and provide for reimbursement of HUD for a portion of the loss from any defaults that occur while the HUD contract of mortgage insurance is in effect.</p>
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Participating qualified state and local HFAs, including IHDA, may originate and underwrite affordable housing loans including new construction, substantial rehabilitation, refinancing, and housing for the elderly. The program provides full FHA mortgage insurance to enhance HFA bonds to investment grade. IHDA may elect to share from 10 to 90 percent of the loss on a loan with HUD. IHDA reimburses HUD in the event of a claim pursuant to terms of a Risk-Sharing agreement.



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SECTION 542(C) RISK-SHARING CREDIT ENHANCED BOND STRUCTURE

Bond Loan Amount	\$3,000,000 to \$75,000,000
Bond Loan Term & Amortization	15-40 years <i>Loan terms with a balloon structure will be considered on a case-by-case basis. Maximum loan term cannot exceed 75% of building's remaining economic life.</i>
Bond Loan-to-Value (LTV) & Debt Service Coverage Ratio (DCSR)	<u>New Construction/Substantial Rehab (up to 40-year term)</u> 1.11 or 90% (greater than 90% of units with long-term rental assistance) 1.15 or 87% (affordable housing transactions) <u>Refinance/Acquisition/Mod Rehab (up to 35-year term)</u> 1.15 or 87% (greater than 90% of units with long-term rental assistance) 1.176 or 85% (affordable housing transactions)
Affordability Requirements	As limited by LIHTC and bond regulatory and extended use agreements
Recourse	<u>Construction:</u> full recourse with full repayment & completion guaranties and environmental indemnity <u>Permanent:</u> non-recourse with standard industry carve outs and environmental indemnity <i>Mortgage Credit Review (MCR) and HUD 2530 clearance required for the sponsor(s), borrower(s), guarantor(s), property manager, general contractor, and any other entity(ies)/owner(s) as required by IHDA and/or HUD.</i>
3rd Party Studies	Sponsors are required to provide studies, reliance letters, and insurance certificates (when required) from vendors that follow IHDA's published standards. Studies include, but are not limited to: market study, environmental, appraisal, insurance, and Property Needs Assessment (PNA).
Bond Loan Lockout	<u>Construction:</u> Pre-payable <u>Permanent:</u> Minimum of 10-years from commencement of amortization
Mortgage Insurance Premium (MIP) & Loan Servicing	0.25% for each (included in bond loan interest rate)
Wage Requirements	Davis Bacon labor standards or Illinois prevailing wage requirements apply.
Subsidy Layering Review	Required on bond loans with LIHTC, HUD/government assistance, and/or Section 542(c) Risk-Sharing
Limited Distributions	Limited distributions, including both the equity base and annual distribution percentage, may be required in accordance with IHDA's limited distribution policy and, if applicable, HUD guidelines.
Fees & Costs	Borrower will pay for or reimburse IHDA for all reasonable and customary costs related to issuing the bonds, closing the bond loan, and award LIHTC and/or other resources required.



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Estimated Fees

Preliminary Project Assessment (PPA) Fee: \$750 (non-profit); \$1,500 (for profit)

Application Fee: \$1,500 (non-profit); \$2,500 (for profit)

Bond Origination Fee: 1.75% (short-term <10 years); 1.00% (>10 years)

Loan Origination Fee: 0.75% (when IHDA finances underlying bond loans)

Bond Inducement (if applicable): \$10,000

4% LIHTC Fee: 1.00% of the 10-year credit amount

Bond Counsel Fee: \$50,000 (for deals with a refunding, use \$100,000 total)

Issuer's Counsel Fee: \$17,500 (for deals with a refunding, use \$35,000 total)

Issuer Financial Advisor Fee: \$10,000

Miscellaneous Fees: \$5,000

Rating Agency Fee (if applicable): \$40,000 (estimated)

IHDA Legal Fee: \$35,000 (estimated; varies depending funding sources)

IHDA Cost & Plan Review / Draw Inspection Fee: \$5,000 - \$15,000

Trustee: \$6,000 set-up fee at closing; \$3,000 annually

Mortgage Insurance Premium (MIP) for HUD Risk-Sharing deals: fourteen (14) months of a MIP reserve in the amount of 0.25% of the Permanent Loan Amount must be capitalized and funded by the Borrower prior to closing as follows:

- The borrower shall pay HUD six (6) months of MIP and the IHDA eight (8) months of MIP.
- 0.25% MIP included in rate for ongoing premiums.

Project Reserves: Six months of debt service and operating expenses

Bond Reserves - Maximum Annual Debt Service Reserve (MADS): Estimated at six-months of debt service reserves at to the bond rate for non-conduit deals. Final reserve determined once permanent bond rate is set.

Ongoing Bond Servicing/Administration Fee: 0.25% (0.20% with bond issuance size >\$100 million)
(included in interest rate if using IHDA debt financing)

IHDA Compliance Fee: \$25/unit/year (applies to LIHTC deals and HUD Risk-Sharing deals)

Third-Party Reports: Engaged/paid by construction lender or Borrower (adhering to IHDA standards as posted on the IHDA's website)

Make-Whole Provision: If bonds are repaid prior to year 10, IHDA will charge a fee equal to the amount of the unearned Ongoing Bond Servicing/Admin Fee and the additional bond issuance fee that would have been applicable at closing for short-term bonds < 10-years.

Good Faith Deposit: \$50,000 (credited at closing, payable prior to loan committee and required to engage bond counsel)

The above fees are typical for most bond deals. Actual fees are subject to change and will be determined after a full application is received.