Microsoft Partnership: Stretching Our Resources

Washington State Housing Finance Commission

Management Innovation: Financial

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In recent years, Washington state has seen increased demand for affordable housing bonds in our 4% Low Income Housing Tax Credit program – demand that far exceeds the annual bond cap available. This has left critically needed housing units unbuilt. While exploring bond recycling, we forged a productive collaboration with Washington's own Microsoft Corporation that both filled a critical need for bridge financing and helped the company deploy its capital for affordable workforce housing. Microsoft is also joining the Housing Finance Commission and other corporate partners in innovative financing efforts to build still more housing in our state's highest-cost, tightest housing markets.

Bond Demand Outstrips Supply

Unlike many states, Washington uses every cent of our available bond cap that is tagged for housing, automatically triggering lower-subsidy (4%) housing credits. While the 9% LIHTC program has long been extremely competitive, with the criteria increasingly focused on permanent supportive housing, until recently, the 4% program had been continually available and used heavily by for-profit developers to build "workforce housing," serving families earning up to 60% of area median income.

But starting in 2016, demand for the 4% LIHTC program began to increase dramatically in Washington state. State and local funding started to flow toward meeting the state's worsening rental-housing crisis, releasing dollars that made the 4% program more feasible for nonprofit developers whose projects couldn't compete for the 9% program. This led to bond applications that far exceeded our volume cap. Developers now have so many shovel-ready housing projects that our state could use four times as much bond cap (roughly a billion dollars for local communities) as is currently available.

Bond Recycling: Opportunity and Challenge

Through bond recycling, as short-term affordable housing bonds are paid off, a certain amount of the repaid principle can be redeployed into new affordable housing projects. While recycled bonds are not eligible for the 4% housing credit as they were the first time around, they do increase the overall supply of tax-exempt financing available to developers and free up bond cap that does trigger the credit. Recycled and new bond cap can be blended to make the whole resource go further.

Unfortunately, bond recycling is a very complex financing tool that only a few other states are using, due to tax-code requirements. One of these requires an advancement of funds during the interim period (up to six months) between the time a bond is paid off and when it can be issued again.

For a bond-recycling program to be viable in the long term, the interest paid on the borrowed funds during the interim period cannot exceed the amount of interest earned on the short-term investment. This is impossible to achieve with a conventional lender because of policy and regulatory requirements. As a result, recycling was costly to the borrower and to us, hindering our ability to use it effectively.

A New Partner

Meanwhile, in January 2019, Seattle-area corporation Microsoft announced its commitment of $500 million to advance affordable housing solutions in the Puget Sound region. Unlike many charitable efforts, a relatively small amount was contributed to housing organizations as grants. Instead, Microsoft wanted to create a sustained investment through below-market loans and other partnerships. Their focus, naturally, was on workforce housing that might alleviate housing needs for its thousands of employees. As the company met with local philanthropic leaders, banks, and housing developers, they learned about the Housing Finance Commission.

One of Microsoft's early steps in deploying their capital was to buy the bonds issued by the Commission for a 4% LIHTC project near its campus in East King County—the first time a corporation had supported a project in this way in Washington state. Thanks to a timely introduction, Microsoft's team began directly talking with the Commission about how we could partner.

Line of Credit

Microsoft's Treasury Director and other staff showed a remarkable commitment to learning about the unique and complex transactions of bond financing, spending many hours with the Commission's multifamily housing director and senior finance director. Of the options for partnership, Microsoft and the Commission soon focused in on the need for a solution to the problem of holding advanced funds during the interim period when recycling bonds.

To this challenge, Microsoft offered a generous, no-cost line of credit. The company wanted to earn a return on investment, but it was willing to accept non-traditional terms not available through a conventional lender—namely, a floating, short-term interest rate equal to that earned on the investment of the capital. Thus, its only return would be the interest on the amount the Commission borrows during the short interim period. This ensures there would be no net cost for the use of this capital while bridging the gap.

In October 2019, the Commission and Microsoft negotiated and entered into a Revolving Loan and Security Agreement that allows the Commission to draw down up to $250 million a year from our Microsoft line of credit, meaning we can issue up to $250 million of recycled bonds each year. In return, the Commission will pay to Microsoft the interest earned on the short-term investment as full and complete payment of interest on the borrowed funds.

In January 2020, one year after its original $500 million commitment to affordable housing, Microsoft announced its additional investment of $250 million through the line of credit.

Results

Microsoft's line of credit makes recycling a cost-effective way to stretch our state's housing dollars in the long term. It not only lowers the cost of each transaction, making individual projects pencil for developers, it also gives the Commission a structure and mechanism that allows us to recycle bonds on a much larger scale than we were able to do before.

Halfway through 2020, thanks to the line of credit, the Commission has already recaptured $86 million in recycled bonds and deployed $31 million of it into three new projects creating more than 600 affordable apartments. We expect the total recaptured this year to be between $100 million and $150 million in bond volume cap, an amount that will increase in following years.

Thanks to the flexibility provided by this tool, we are also closing our first-ever project in which our only investment is recycled bonds. The project will build 153 new units at a mix of 50%, 60% and 70% AMI, with roughly a third of the financing coming from the City of Seattle and two-thirds from recycled bonds.

Further Corporate Investments in Housing

Microsoft will also contribute $50 million to another unique financial partnership involving the Commission: the Evergreen Impact Housing Fund. A collaboration between the nonprofit Seattle Foundation and the Commission, the Evergreen Fund will bring in private capital from socially motivated investors – including other large corporate donors – to supplement and extend the LIHTC bond program.

The fund will help fill the gaps currently unfilled by bonds and housing credits to make 4% LIHTC projects feasible again in high-growth urban areas of King County where land and building costs have skyrocketed (but where workforce housing is desperately needed). After implementation in 2020, each year the fund is expected to invest $25-30 million into roughly three LIHTC projects with a total of approximately 650 units. Meanwhile, equity investors and philanthropists can contribute to the fund and earn a return. The program is currently set to run for five years.

Continuing our one-on-one collaboration with Microsoft, we have also begun discussions about extending the Commission's popular Land Acquisition Program. This revolving loan fund allows nonprofits, housing authorities, and some other entities to purchase land for the future development of housing. With Microsoft investment, we could extend the reach of the program and allow land banking for housing that serves up to 120% of area median income.

Finally, we have had preliminary talks with Microsoft about opportunities to support our single-family program by providing additional capacity to warehouse more single-family loans between purchase by our master servicer and the loan's securitization into mortgage-backed securities.

Into the Future

Microsoft's commitment, cooperation and energy, as well as the willingness of other companies to participate in affordable housing as investors instead of merely as donors, has opened a door to new ways of stretching our housing resources. By making use of these private investments for higher-income housing, we can preserve more public funding, bond cap, and housing credits for people with lower incomes and higher needs.

Meanwhile, Microsoft and other corporate investors have sometimes been daunted by the difficulty of producing affordable housing as they try to implement their own initiatives. They have found us a willing and creative partner who can put their capital to good use. We hope our success can lead companies in other states to seek similar partnerships with their local housing finance agencies.