Multifamily Rental Housing

Financing with Tax-Exempt Bonds
ABOUT THE AUTHOR

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DISCLAIMER: Nothing contained in this pamphlet should be construed or relied upon as legal advice. Instead, this pamphlet is intended to serve as an introduction to the general subject of the use of tax-exempt bonds to finance multifamily rental housing projects, from which better informed requests for advice, legal and financial, can be formulated.

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Multifamily rental housing projects provide affordable housing for low-income families throughout the country; many of these projects are financed in whole or in part with tax-exempt bonds.

Governments of all levels (federal, state and local) are involved in providing housing for those who cannot otherwise afford it at market rates. In the past, subsidized housing was often built directly by the public sector. Now, governments prefer to accomplish their housing policy goals by providing tax credits and other assistance (such as eligibility to use tax-exempt bonds) to private Borrower/Developers of housing projects that are consistent with those goals. Borrower/Developers have become sophisticated in using these government incentive programs to generate the equity and/or debt they need to finance their projects.

This pamphlet is designed to introduce Borrower/Developers, municipalities and others to the role of tax-exempt bonds in the financing of multifamily rental housing projects.

Orrick is the nation's premier tax-exempt bond counsel firm, ranking number one (in terms of dollar volume of bonds issued) for over the past decade, with extensive experience in all types of housing financings. Orrick has been bond counsel, underwriter’s counsel or other counsel on more than 600 financings and refinancings of multifamily housing projects aggregating nearly $9.7 billion in the past decade.
CHAPTER TWO

Advantages of Tax-Exempt Bonds

Few Borrower/Developers finance multifamily housing projects out of their own equity. Most use some combination of four sources of funds:

(1) Conventional bank loan, often from the Borrower/Developer’s regular lender

(2) Tax-exempt bonds, privately placed or sold in a public offering

(3) Equity from
   • personal or company funds or
   • tax-credit investors (see Chapter 5F )

(4) Local government funds, in the form of equity (grants) or debt (subordinate loans) from or administered by a city, housing authority or redevelopment agency

For the most part, these options are not mutually exclusive.¹ Most projects are financed with some combination of debt and equity, and some make use of all four of the sources listed above. Tax-exempt bonds are a valuable part of many financing structures both because they offer better rates of interest than other forms of debt and because the use of tax-exempt bonds for a project can make it easier for a Borrower/Developer to receive other tax credits for the project (see “Tax Credits” below).

¹ Certain tax credits (so-called 9% credits) are not available for projects financed with tax-exempt bonds. However, other tax credits (so-called 4% credits) may be used in connection with tax-exempt bonds. (See Chapter 6F).
A. Better Rates

The public capital markets typically offer lower interest rates than private placements or bank financing. However, tax-exempt financing generally offers lower interest rates than taxable debt no matter how either type is sold. Because interest paid on tax-exempt debt is exempt from federal income tax (and usually income tax of the state in which issued as well), the investor requires less interest to produce the same after-tax return as taxable debt would produce. The difference varies from time to time based on market factors, but tax-exempt rates are usually 30% to 35% lower than rates for comparable taxable debt. For example, spreads between tax-exempt and taxable interest rates on 30 year bonds over the past five years were roughly as follows:

<table>
<thead>
<tr>
<th>Ratings²</th>
<th>Tax-Exempt Bonds (5 yr. avg.)</th>
<th>Taxable Bonds (5 yr. avg.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA</td>
<td>5.11%</td>
<td>6.64%</td>
</tr>
<tr>
<td>AA</td>
<td>5.23%</td>
<td>6.88%</td>
</tr>
<tr>
<td>A</td>
<td>5.39%</td>
<td>6.99%</td>
</tr>
<tr>
<td>BBB</td>
<td>5.53%</td>
<td>7.19%</td>
</tr>
</tbody>
</table>

B. Better Terms

Conventional taxable debt, whether in the form of a bank loan or negotiable securities, generally has less flexible terms than tax-exempt debt. Tax-exempt debt generally may be issued on a long-term, fully amortizing (e.g., 20–30 year), fixed interest rate basis, compared to most taxable debt which is usually issued with a shorter term at a variable interest rate indexed to prime, U.S. Treasuries or LIBOR. If preferred, tax-exempt debt also may be issued on a variable rate basis; in fact, most publicly-offered multifamily housing revenue bonds issued in recent years have been variable rate bonds.

² Ratings refer to independent appraisals of the credit quality of the bonds and the likelihood of their repayment performed by one or more of the credit rating agencies: Standard & Poor’s Corporation, Moody’s Investors Service or Fitch Ratings. The ratings are expressed as letter grades AAA, AA, A, BBB (expressed as Aaa, Aa, A and Baa by Moody’s) from highest to lowest investment grade ratings, with +/- or numerical subcategories. Ratings are considered very important by the underwriters in marketing the bonds and by investors in determining what interest rates will induce them to purchase the bonds. Bonds also may be sold without a rating, although usually at materially higher interest rates.
CHAPTER THREE

Types of Projects and Developers

A. Types of Housing Projects

Tax-exempt bonds are used to finance a variety of multifamily housing projects.

Low-Income Rental Projects – an apartment complex may be made up entirely of rental units offered to low-income tenants, often at restricted rents.

Rental Units in a Mixed-Income Project – certain units within an apartment complex or other development may be set aside for low-income tenants, while other units are available at market rates. The whole development may be bond-financed. Mixed-income projects are often favored in downtown urban areas.

Mobile Homes – mobile home parks may be financed with tax-exempt bonds, provided certain affordability requirements are met.

Senior/Assisted Living – some bond-financed housing projects are built specifically for senior citizens; they may include on-site medical staff and facilities.

B. Types of Borrower/Developers

The term “Borrower/Developer” is used here to describe generally the party in a tax-exempt bond financing that receives the bond proceeds and uses them to construct or acquire or refinance a multifamily housing project. This is typically a single-purpose entity created to act as Borrower/Developer for one transaction only; the single-purpose entity may itself be made up of several subsidiaries.
Borrower/Developers may be:

**For-Profit Corporations**

**Limited Partnerships** – this is *by far the most common form*, almost always a single-purpose, single-asset entity. (See below);

**501(c)(3) Corporations** – See Chapter 9;

**Governmental Entities** – State housing agencies, cities, counties, redevelopment agencies, local housing authorities and other public entities may act as Borrower/Developers or as partners in a Borrower/Developer partnership (see below).

Single-purpose limited partnerships consist of one or more General Partners and one or more Limited Partners. The chart below shows the organizational structure of a typical single-purpose Borrower/Developer limited partnership.

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3 The discussion in this pamphlet is generally limited to non-governmental Borrower/Developers.
The General Partner is what we usually think of as the “developer,” the party responsible for constructing, acquiring or refinancing the housing project and managing it so that it generates revenues.

**General Partners** may be

- individuals
- for-profit corporations (from the smallest to the largest)
- trusts
- governmental entities
- 501(c)(3) Corporations

or almost anything else.

Limited Partners are shielded somewhat from the risk of poor project performance. They may join the partnership to receive tax credits (See Chapter 5F) or for other reasons, often related to the General Partner’s larger corporate structure.

**Limited Partners** may be, among other things,

- for-profit corporations
- limited liability companies (LLCs)
- limited partnerships
- trusts or individuals (this is uncommon).

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4 501(c)(3) Corporations may serve as General Partners as true “Developers,” or they may be included as General Partners for tax reasons. In some states (including California, for example) limited partnerships with not-for-profit General Partners are exempt from local property taxes.
CHAPTER FOUR

Uses of Proceeds

A. New Construction or Acquisition/Rehabilitation

Proceeds of tax-exempt multifamily housing bonds are primarily used for the purposes below:

- New construction
- Acquisition with rehabilitation
- Acquisition\(^5\)

New Construction. New construction projects are self-explanatory: a Borrower/Developer uses the proceeds of tax-exempt bonds to construct a new multifamily rental housing facility that qualifies as a “qualified residential rental project” under the Internal Revenue Code (see Chapter 6C).

Construction of a new project involves certain risks that are absent where an existing project is being financed: costs may exceed projections, units may not be rented when expected, etc. Long-term financing for new construction projects is therefore often divided into a “construction phase,” beginning when bonds are issued, and a “permanent phase,” which begins if and when the project has been constructed and occupied. Because construction is inherently risky, Borrower/Developers can expect to pay higher interest rates during the construction phase than during the permanent phase, and they may also need to obtain special guarantees or lines of credit during construction (see Chapter 5).

\(^5\) Pure acquisitions are mostly done by 501(c)(3) Borrower/Developers (see Chapter 9).
**Acquisition/Rehabilitation.** “Acquisition/rehab” describes a transaction in which the Borrower/Developer uses the bond proceeds to acquire an existing facility, which may or may not already contain rental units set aside for low-income families, and makes substantial changes and improvements to it such that it constitutes a qualified residential rental project (see Chapter 6D). An acquisition/rehab deal may also involve using bond proceeds to pay off current loans or other financing for the project being acquired.

Because there is less construction risk in an acquisition/rehab deal than in a new construction deal, the Borrower/Developer should expect the interest rate(s) established at bond issuance to be typical of a permanent phase financing.

**B. Other Uses of Bond Proceeds**

In addition to paying the costs of a project (whether new construction or acquisition/rehab) after issuance, tax-exempt bonds may be used to reimburse a Borrower/Developer for costs incurred before bonds are issued, as well as to finance certain costs associated with the bond issuance itself.

**Reimbursing Prior Capital Expenditures.** Under certain circumstances, capital expenditures that could qualify for financing with tax-exempt bonds, but which are made prior to issuance of the bonds, can be reimbursed with proceeds of the bonds when issued.

1. Certain preliminary “soft costs” such as architectural, engineering, surveying, soil testing and similar costs paid prior to commencement of acquisition, construction or rehabilitation of a project may be reimbursed up to 20% of the aggregate issue price of the bonds issued to finance the project. Land acquisition, site preparation and similar costs are not included in such “soft costs.”
2. Any other capital expenditures (including costs of issuance) paid before the bonds are issued may be reimbursed if they are paid after, or not more than 60 days before, the Issuer of the bonds expresses “official intent” to reimburse such expenditures by resolution, declaration or other action that meets the requirements of applicable tax regulations; provided that the reimbursement is made no later than 18 months after the later of the date the cost is paid or the date the project is placed in service (but in no event more than 3 years after the cost is paid).

One of the first steps in any serious consideration of a tax-exempt financing for a multifamily housing project should be the adoption by the Issuer of an official intent reimbursement resolution (See Chapter 8 regarding choosing an Issuer). Properly drafted, it can be fairly general, simple and nonbinding. There is no cost or liability to not issuing the bonds or not using the proceeds for reimbursement. (See Chapter 10 regarding steps to issuing bonds.)

**Costs of Issuance.** Costs incurred in connection with issuing the bonds, such as the underwriter’s discount or fees, fees of bond counsel and other lawyers and consultants, rating agency fees, trustee’s fees and the like, may be included in the bond issue. Under federal tax law, no more than 2% of the bond issue may be used on costs of issuance (which do not include the cost of any bond insurance or credit enhancement); as a result, the Borrower/Developer may pay some costs of issuance from its own funds, particularly for smaller bond issues, or may finance costs of issuance with taxable bonds or a second loan.

**Capitalized Interest.** Interest payable on the bonds for a period not to exceed the longer of (i) three years, or (ii) the period in which the project is to be constructed plus one year, may be included (i.e., capitalized) in the bond issue. The capitalized interest is generally held by the bond trustee and used to pay interest on the bonds, with the result that the Borrower/Developer does not have to pay any debt service on the bonds during such period.

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6 Public entities and non-profit 501(c)(3) corporations may adopt their own reimbursement resolutions, but for-profit Borrower/Developers need to have the Issuer adopt a reimbursement resolution for their projects.
Reserves. In some cases, a debt service reserve fund may be established and held by the bond trustee. This reserve fund may be funded with bond proceeds and generally may be equal to the lesser of 10% of the bond issue, 125% of average annual debt service on the bonds or maximum annual debt service on the bonds. The debt service reserve fund is used to pay debt service on the bonds if for any reason the Borrower/Developer fails to pay.
FINANCING WITH TAX-EXEMPT BONDS

CHAPTER FIVE

Financing Structures

A. Financing Structures

There are two basic structures for multifamily housing revenue bonds:

- Publicly-offered
- Privately-placed

Publicly-offered bonds are purchased by investors who, as a general rule, have no first-hand information about the project or the Borrower/Developer. These investors are interested in investing in tax-exempt securities; they are not investing in a real-estate venture and they do not want to take “real-estate risk”. As a result, almost all publicly offered multifamily rental housing revenue bonds are directly or indirectly insured or guaranteed by a “credit enhancer” (see Section B, below).

Privately-placed bonds, by comparison, are held by banks or other lenders that have conducted their own investigation into the creditworthiness of the project and understand that they are taking real-estate risk. The economic substance of these transactions is a straightforward loan from the lender (the bond purchaser) to the Borrower/Developer.

B. Public Sale

Structure and Documentation. In a public offering transaction, the Bonds are issued by a state or local governmental entity (the “Issuer”) which, under applicable state law, has the power to issue bonds to finance multifamily housing projects. The
Bonds are issued pursuant to an indenture or trust agreement (the “Indenture”) between the Issuer and a bank trustee (the “Trustee”) who, for the benefit of the bondholders and (to a limited extent) the Issuer, holds the funds and any other collateral pledged under the Indenture to secure payment of the Bonds and, if necessary, enforces certain rights of the bondholders and the Issuer.

The Issuer loans the proceeds of the Bonds to the Borrower/Developer pursuant to a Loan Agreement or Financing Agreement (the “Loan Agreement”). The Issuer assigns all of its rights (except limited rights to receive fees and indemnification), including the right to receive repayments of the loan from the Borrower/Developer, to the Trustee as security for the Bonds pursuant to the Indenture. Under the Loan Agreement, the Issuer loans the bond proceeds to pay the costs of constructing, acquiring or refinancing the project, as applicable. The Loan Agreement sets out the terms of repayment of and security for the loan. A deed of trust is typically recorded as an encumbrance upon the project to further secure the loan; it is also assigned to the Trustee.7

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7 This describes a transaction in which the issuer acts as a “conduit,” but does not underwrite the project or extend any of its own credit to the project. In this case, the bonds are limited obligations of the issuer, payable only from revenues generated by the project and other funds received from guarantors or credit enhancers. Tax-exempt bonds are also used in “issuer-driven” programs in which an issuer, such as a state or local housing agency with its own substantial balance sheet, actually underwrites individual projects.
In addition to the Indenture and the Loan Agreement, there is generally a “Regulatory Agreement” (sometimes called a Land Use Agreement) between the Borrower/Developer, the Issuer and (sometimes) the Trustee. The Regulatory Agreement is recorded against the project and restricts the use of the project so as to ensure compliance with applicable tax laws (See Chapter 6).

*Ratings; Credit Enhancement.* Most tax-exempt multifamily housing revenue bonds sold to the public are supported by some kind of credit enhancement. As a result, these bonds receive a credit rating based on the credit enhancer’s credit, not the creditworthiness of the project. For example, bonds backed by Fannie Mae (the largest multifamily housing revenue bond guarantor) typically carry a “AAA” rating.

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*Note that the creditworthiness of the Borrower/Developer, which is typically a single-purpose entity created solely to own and/or manage the Project, is rarely at issue, even where no credit enhancement is in place.*
Credit enhancement may take any of the following forms, among others:

- Direct-pay letter of credit\(^9\)
- Standby letter of credit\(^10\)
- Bond Insurance
- Fannie Mae/Freddie Mac credit agreement
- Mortgage-backed security\(^11\)
- Guaranty from third-party (sometimes related to Borrower/Developer)

Credit enhancement allows bondholders to disregard the risk that Borrower/Developer will be unable, as a result of an under-performing project or for any other reason, to make payments of principal and interest on the bonds.\(^12\) Purchasers of these bonds, such as money-market funds and, indirectly, the individual investors in such funds, are not in a position to evaluate and absorb the credit risks inherent in real-estate ventures. Credit enhancers, however, are equipped to perform this kind of underwriting; they evaluate a project and, if it meets their requirements, provide insurance, a letter of credit or some other kind of guaranty for the benefit of the

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\(^9\) A direct-pay letter of credit allows the trustee to draw on the letter of credit to pay scheduled payments of principal and interest. The letter of credit provider then looks to the Borrower/Developer for reimbursement, usually on the same day on which the Trustee draws on the letter of credit. Bondholders receive payment directly from the provider of the letter of credit.

\(^10\) A standby letter of credit may be drawn upon only if there is a failure by some other party to make a payment. For example, a bank with a particularly strong credit rating (such as the Federal Home Loan Bank) might issue a standby letter of credit to back up a direct-pay letter of credit issued by a bank with a lower credit rating. If the first bank fails to make a payment requested by the Trustee, the Trustee can draw on the standby letter of credit. Standby letters of credit can also be issued to support payments directly from the Borrower/Developer to the Trustee (so that if the Borrower/Developer fails to make a payment, the Trustee draws on the standby letter of credit), but this is no longer common.

\(^11\) Some credit enhancers (such as Ginnie Mae) provide the Trustee with a "mortgage-backed security" that pays principal and interest matching payments owed on the bonds. In substance, this is equivalent to a direct-pay letter of credit.

\(^12\) In most cases, the Issuer of the bonds is technically the party obligated to make debt service payments, but only to the extent it receives funds from the Borrower/Developer under a loan agreement. If the Borrower/Developer defaults under the loan agreement, the Issuer has no money with which to pay bondholders and no obligation to use any of its own funds to that end.
bondholders. The credit enhancers essentially fill the role of real estate lender, and the bond buyers then look only to the creditworthiness of the credit enhancer.

Well established credit enhancers include the following, each of which has its own requirements and procedures for Borrower/Developers:

- Letter of Credit Banks
- Bond Insurers
- Fannie Mae
- Freddie Mac
- The Department of Housing and Urban Development (HUD)
- Federal Housing Administration (FHA – part of HUD)
- Ginnie Mae (part of HUD, usually “wraps” FHA-insured mortgages)

**Government-Sponsored Enterprises.** Fannie Mae and Freddie Mac are so-called “government sponsored enterprises.” They are shareholder-owned corporations, originally created by the federal government to provide capital and liquidity to the home mortgage market; they now operate largely independently of the federal government.

Fannie Mae and Freddie Mac provide credit enhancement for housing revenue bonds in the form of credit enhancement agreements that function like direct-pay letters of credit. They also make billions of dollars in conventional loans to Borrower/Developers (often for the same projects for which they credit-enhance bonds), as well as purchasing and holding tax-exempt and taxable multifamily housing revenue bonds.

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13 Because they are not banks, Fannie Mae and Freddie Mac do not issue “letters of credit.” Fannie Mae typically calls its credit instrument a “Credit Enhancement Instrument,” while Freddie Mac calls its version a “Credit Enhancement Agreement.” Both function like letters of credit.
To understand the roles Fannie Mae and Freddie Mac play as credit enhancers, it is important to know what they do not do. They do not underwrite, originate or service their own loans (for these purposes, providing credit enhancement on bonds may be considered equivalent to making a loan). Rather, in a Fannie/Freddie deal, an approved lender/servicer\(^{14}\) does the underwriting for the project and provides Fannie/Freddie with a completed application package for approval. If the application is approved, the bonds will be credit-enhanced by Fannie/Freddie, but the lender/servicer is the party that actually demands and collects payments from the Borrower/Developer (to reimburse payments made under the Fannie/Freddie credit facility).

Borrower/Developers interested in working with Fannie Mae or Freddie Mac should consult with an approved lender/servicer. Current lists of approved lender/servicers are available at

\[
\text{www.fanniemae.com, and} \quad \text{www.freddiemac.com.}
\]

Fannie Mae and Freddie Mac also do not take construction risk. As a result, a Borrower/Developer of a new construction project to be credit-enhanced by Fannie/Freddie must find another source of credit enhancement during construction. A common structure, shown in the chart below, features a construction-phase letter of credit issued from a commercial bank to Fannie/Freddie.

\(^{14}\) Fannie Mae calls its lender/servicers “Delegated Underwriting and Servicing (DUS) Lenders.” Freddie Mac calls them “Seller/Servicers.” These are often regional banks in the business of making home mortgage loans.
During the construction phase, the Trustee draws on the Fannie/Freddie credit facility to make interest payments, and Fannie/Freddie is reimbursed from a capitalized interest fund held under the Indenture. If construction is substantially delayed — two to three years is a typical construction period — Fannie/Freddie has the option of calling the bonds and drawing immediately on the bank’s letter of credit to pay off the Bonds. Fannie/Freddie is then out of the transaction and the

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15 Because projects do not begin generating revenue until construction is largely complete, Borrower/Developers typically borrow enough money at closing to cover interest payments expected to be made during the construction period (in addition to the costs of construction); this additional borrowed money is called “capitalized interest.”

16 In this situation, the bank may have the option of purchasing the bonds in lieu of redemption. Keeping the bonds outstanding preserves their volume cap allocation (See Chapter 6A), which would be lost upon redemption; if construction is completed successfully and the project produces the required cash flows, the bonds may be remarketed to the public at a later date.
bank has to look to the Borrower/Developer for repayment. On conversion to the permanent phase, the bank letter of credit is cancelled and only Fannie/Freddie (and the approved lender/servicer) is left. This is only one of many possible Fannie/Freddie structures. Fannie Mae’s and Freddie Mac’s bond programs change all the time, so Borrower/Developers should consult with bond counsel about how best to structure a transaction with Fannie/Freddie credit enhancement.

**Underwriting.** Publicly sold bonds are sold by the Issuer to the Underwriter pursuant to a bond purchase contract containing certain representations of the Issuer and the Borrower/Developer. The underwriter sells the bonds to its customers. In a fixed rate transaction, the bond purchase contract also sets out the interest rate to be borne by the bonds and specifies any premium or discount at which the bonds are to be sold. Variable rate bonds are sold at par and bear a different interest rate from time to time according to the market.

**Disclosure.** The federal securities laws require that all information that an investor would reasonably find to be material in deciding whether or not to buy the bonds be disclosed to the investor in connection with the offering and sale of the bonds. The instrument for such disclosure in a public offering is the Official Statement. The official statement typically describes the bonds, the indenture, the loan agreement, the regulatory agreement, the project, the Borrower/Developer, any construction contract or arrangements, operating projections, and any credit enhancement. In the case of variable rate demand bonds that can be put (i.e. sold back to the Issuer) on seven days’ (or other short) notice and backed by a letter of credit, it may be enough for the Official Statement to include only minimal information about the project and the Borrower/Developer while providing more information about the bonds and the credit enhancer. Although the Official Statement is the Issuer’s document (which is why it is called an “Official” Statement), the Borrower/Developer is often responsible for much of the information in it and may be expected to indemnify the Issuer for any suits arising out of misstatements or omissions in the Official Statement. The Official Statement is typically prepared by the underwriter and its counsel. The underwriter’s responsibility is to have a reasonable belief (based on “due diligence”) that the information in the Official Statement is true and complete so that it can have a reasonable basis to recommend the bonds to its customers.
C. Private Placement

Publicly sold bonds are not right for every project. Because the costs of offering bonds to the public are largely fixed, but project sizes and costs vary widely, some transactions are too small to justify the cost of a public offering. Certain transactions may also be too risky for the public capital markets. Furthermore, private placement transactions often can be put together and closed more quickly than public sales. In such cases, bonds are sold directly to, and held by, a bank or other lender (see chart, below).

THE MONEY FLOW

In substance, a private placement is a real-estate loan by the bondholder. The Borrower/Developer essentially borrows money from a bank or other lender, just as it would if no bonds were issued, but the debt takes the form of a bond transaction in which the lender holds the bonds. These transactions are generally simpler and, as a result, cheaper to execute than public sales, because there are fewer parties and fewer documents.
Well-established private-placement lenders include:

- Commercial Banks
- Non-Bank Financial Institutions with special programs, including
  - Newman & Associates
  - Merrill Lynch
  - SunAmerica
- Specialty buyers, including
  - Charter Mac
  - Muni Mae

**Structure and Documentation.** In form, though not always in substance, private placements are similar to public sales in many respects. The Bonds are issued by a governmental Issuer, and the proceeds are loaned to the Borrower. Loan proceeds are disbursed to pay the costs of constructing, acquiring or refinancing the project. There is always a loan document – it can be a multiparty agreement or merely a note endorsed by the Borrower/Developer – setting out the terms of repayment of and security for the loan, including various financial and operating covenants of the Borrower/Developer. A Deed of Trust and a Regulatory Agreement are typically recorded against the Project. The same tax rules that apply to publicly-sold bonds, such as low-income set-asides, limits on costs of issuance, and so forth, apply to a private placement.

Unlike in a public sale, however, the lender is the only bondholder in a private placement and is usually involved, with its own counsel to represent it, throughout the transaction. As a result, the parties have more latitude in documenting the transaction than they would if bonds had to be sold to investors with no seat at the negotiating table. For example, there may be no need to create a trust estate or employ a trustee to protect the rights of bondholders, so that the familiar Indenture/Loan Agreement combination may not be used. In some cases, the Issuer does not even formally make the loan to the Borrower/Developer; rather, the Bondholder
(i.e. the Lender) makes the loan itself and assigns it absolutely to the Issuer, who concurrently assigns it back to the Lender to secure payment on the Bonds.

Different lenders and finance teams have developed different instruments to accomplish the task of documenting the issuance of the bonds and the making of a loan to the Borrower/Developer. Borrower/Developers should consult with bond counsel about the documents to be used in a specific private placement.

**Disclosure Requirements.** Because the lender is the only bondholder in a private placement, there is often no need for an underwriter or for a disclosure document.

### D. Real Estate Security

Credit enhancers in public sales and lender/bondholders in private placements (both “lenders” for these purposes) demand that the Borrower/Developer mortgage the multifamily housing project to be acquired or constructed, to secure repayment of the financing. In the case of a credit enhancer, such as Fannie Mae, Freddie Mac, or a letter of credit bank, the actual source of funds for the financing is the bondholders, but the lender is the party taking the risk that the Borrower/Developer will fail to pay, so the lender is the party that demands a security interest in the project.¹⁷

Lenders engage their own counsel to protect their interests. Lender’s counsel prepares a set of security documents, such as one or more deeds of trust, subordination agreement(s), intercreditor agreement(s) and promissory note(s), to evidence the Borrower/Developer’s obligation to repay the loan and the lender’s enforcement rights and remedies, including foreclosure. Many of these documents are recorded in the county recorder’s office of the county in which the project is located, along with the Regulatory Agreement.

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¹⁷ Some state housing finance agencies operate multifamily housing programs in which the agency is not only the issuer of the bonds, but also takes the real-estate credit risk, acting, in effect, as credit enhancer by adding the issuer’s own general obligation as additional security for the repayment of the bonds.
E. Refinancings/Restructurings

Bond counsel who specialize in multifamily housing quickly become familiar with all kinds of refinancing and restructuring transactions. Below is a list of some especially common transaction types:

**Refunding** – bonds are issued to refund other bonds

**Refinancing** – bonds are issued to refund a conventional loan or other financing\(^{18}\)

**Credit substitution** – a new credit enhancer replaces the old one

**Interest mode change** – bonds convert from variable rate to fixed rate, or vice versa

**Loan conversion** – bond terms change upon completion of construction

It seems that few multifamily housing revenue bonds make it to maturity without being refunded or restructured in some way. Early on, deals are often restructured or refinanced because interest rates change or credit structures change, or because the underlying project performs differently than originally expected. Later, tax credit investors typically transfer their interest in the project to the developer, at which point bringing in new financing becomes particularly attractive to the developer. Some of the popular credit enhancement programs, such as those offered by Fannie Mae and Freddie Mac, seem to contemplate by their terms refinancing after 15–20 years.

Borrower/Developers may want to consult with bond counsel about the possibility of refinancing or restructuring their existing debt for a project, particularly when interest rates are low.

F. Tax Credits

Section 42 of the Internal Revenue Code provides for credits to support housing projects containing units set aside for low-income tenants who pay restricted rents. These Section 42 tax credits offer Borrowers/Developers the opportunity to raise

\(^{18}\) For tax-exempt bonds, this is only possible where the Borrower/Developer is a 501(c)(3) corporation.
equity for such projects by creating a partnership in which the investors, as passive limited partners, are considered for tax purposes to own nearly all of the project and therefore receive the tax credits as they accrue over time (tax credits are typically received over a period of 10 years). In return, the limited partners make capital contributions to the partnership, either through cash up front (or, more typically, installments during construction) in an amount related to the present value of the tax credits to be received over time.

Section 42 tax credits fall into two categories: “4% Credits” and “9% Credits.” 9% Credits are generally more difficult to obtain than 4% Credits and are available only for new construction projects. They are valuable enough, however, to pay much of the cost of a project. Tax-exempt bonds may not be used to finance a project that receives 9% Credits.

Each state receives an annual dollar amount of Section 42 tax credits to allocate to projects. The total amount of all Section 42 tax credits allocated within the state for that year may not exceed the annual allocation. An exception is made, however, where a portion of the cost of a multifamily rental housing project is financed with tax-exempt bonds for which the issuer already received private activity bond volume cap (“Volume Cap”). (See Chapter 6A). In that case, 4% Credits allocated to the project are exempted from the state’s annual tax credit allocation in proportion to the amount of the tax-exempt bonds used in relation to other funding sources. The “50% Rule,” shown below, adds to the effect of this exception by exempting all 4% credits allocated to a project from the state limit if the project is financed primarily with tax-exempt bonds.

50% Rule: If 50% or more of the cost of the land and the building constituting the project is financed with tax-exempt bonds, no portion of any 4% Credits allocated to the project counts against the state’s annual allocation.

In practice, states generally award 4% credits to projects for which they have also awarded private-activity bond volume cap only to the extent that the 4% credits are exempted from the state limit. Borrower/Developers should assume that a failure to meet the requirements of the 50% Rule will result in a substantial loss of tax credit allocation.
CHAPTER SIX

Federal Tax Law

A. Volume Cap

The housing Borrower/Developers described in this book are generally private entities, whether for-profit or not-for-profit (see Chapter 3). As a result, bonds issued on their behalf are “private activity bonds.”

In most cases, an issuer must be specifically authorized by a state to issue private activity bonds. Just as states receive an annual allocation of Section 42 tax credits, each state also receives an annual allocation, called “volume cap,” to be allocated to issuers of private activity bonds. With notable exceptions (see Chapter 9), private activity bonds may only be issued pursuant to an allocation of volume cap by the state.

States are largely free to set up their own processes for allocating volume cap. As a result, practices vary widely from state to state. In general, however, states allocate volume cap to meet their public policy objectives, so they favor the use of private activity bonds to finance projects they feel are worthwhile. Multifamily housing enjoys a high priority or preference for volume allocation in most states. Nevertheless, Borrower/Developers should recognize that they will likely need to compete for volume cap wherever their projects are located and become familiar with the allocation processes in those states.

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19 The amount of Section 42 tax credits and volume cap awarded to each state is based on the state’s population. Every state receives a certain minimum amount, however, so the least populous states actually receive proportionally more Section 42 tax credits and volume cap per capita for allocation than do other states.
B. TEFRA

In addition to receiving an allocation of volume cap, private activity bonds used to finance a particular project must be approved by both (i) the issuer of the bonds or the governmental entity on whose behalf the bonds are issued and (ii) an “applicable elected representative” of the jurisdiction in which the project will be located. This requirement is set forth in the Tax Equity and Fiscal Responsibility Act of 1982 (“TEFRA”). The governmental body or bodies giving such approval – they could be a cities, counties, a state or some other entity – must publish a TEFRA notice in an appropriate journal (at least 14 days before a hearing), conduct a TEFRA hearing and give TEFRA approval prior to issuance of the bonds.

For multifamily rental housing projects, the governmental body is generally the city or county in which the project will be built or acquired. Often, this city or county is also issuer of the bonds, in which case the TEFRA hearing and approval can be conducted by the Issuer when the bonds are approved (the TEFRA notice must still be published two weeks ahead of time).

C. Income Set-Asides and Other Restrictions

For private activity bonds to be used to finance a “qualified residential rental project” (as defined in Section 142(d) of the Internal Revenue Code), the project must meet certain affordability requirements under that section of the Code. The Borrower/Developer may choose between the “20% at 50%” standard or the “40% at 60%” standard:

20% @ 50%. At least 20% of the residential units in the project are rented to individuals whose income is 50% or less of area median income.

40% @ 60%. At least 40% of the residential units in the project are rented to individuals whose income is 60% or less of area median income.

Although the governmental body must give the public a chance to speak at the TEFRA hearing, approval is not put to a public vote and the governmental body may give approval in spite of public opposition to a project.
Area median incomes are determined for each “Metropolitan Statistical Area” by the U.S. Department of Housing and Urban Development (HUD). Adjustments are made for household size.

Section 142(d) does not limit the rent that may be charged to tenants; it only requires that the tenants themselves meet the income requirements. In theory, a Borrower/Developer could charge market-rate rents to individuals whose incomes put them in a low-income category but who can afford, for whatever reason, to spend a lot on rent. Many projects are nonetheless subject to rent limits because of state law limitations on issuers or state procedures regarding volume cap allocation, or because they receive Section 42 tax credits.

These income set-asides apply to the project throughout the “qualified project period” which begins when 10% of the units have been rented and generally lasts at least 15 years\textsuperscript{21}. State or local laws or regulations may extend the qualified project period considerably. Issuers ensure compliance with the affordability rules by requiring that a Regulatory Agreement (also known as a Land Use Agreement) be recorded to encumber the project and provide remedies if the affordability requirements are not met.

Section 142(d) does not offer the Borrower/Developer any incentive to go beyond 20% at 50% or 40% at 60%. As long as the project passes one of those tests, tax-exemption is possible. Tax credits, however, are granted in proportion to the number of units set aside for tenants whose incomes are at or below 60% of the area median. As a result, projects designed to receive tax credits often have substantially more than 40% of their units set aside for these tenants; in fact, many contain no units rented at market rates. Cities and counties in which projects are located also tend to prefer projects with as many affordable units as possible, meaning that many multifamily rental housing projects financed with tax-exempt bonds end up with most or all of their residential units set aside for low-income tenants.

\textsuperscript{21} Under Section 142(d), the qualified project period ends on the later of (1) the date 15 years after the first date on which 50% of the units are rented (2) the date on which no tax-exempt private activity bonds are outstanding with respect to the project or (3) the date on which any HUD assistance under Section 8 is terminated with respect to the project.
D. Special Rules for Acquisition/Rehabilitation Projects

Tax-exempt bonds are often used to finance the acquisition and rehabilitation of an existing multifamily rental housing project, rather than the construction of a new project. In addition to complying with the affordability rules, the Borrower/Developer of an acquisition/rehabilitation project must also spend an amount equal to at least 15% of the total amount of bond proceeds used to acquire the buildings and other improvements (but not the land) that make up the project. In other words, tax-exempt bonds cannot be used merely to acquire an existing project if no improvements are made (see Chapter 9 regarding not-for-profit Borrower/Developers for an important exception to this rule).
Laws regarding the issuance of multifamily housing revenue bonds by state and local governments vary from state to state. As a general matter, however, any issuer of housing revenue bonds needs to have statutory and/or constitutional authority to issue bonds and make loans to Borrower/Developers. Typical types of issuers include (also see Chapter 8, below):

- State and local housing finance agencies and housing authorities
- Cities and Counties
- Redevelopment Agencies
- Joint powers authorities

States have typically passed laws over time granting these entities the authority to issue bonds. As a result, the state laws applying to a particular bond-financed project may depend in large part on whether the Issuer is a city, a county, a housing agency, etc.

State laws may affect almost any aspect of a transaction, including:

- affordability restrictions
- rent restrictions
- prevailing wage requirements
- security requirements (especially regarding security interests in land)
- financial structuring\textsuperscript{22}
- documentation
- taxes, including property taxes
- rating requirements

Borrower/Developers should expect bond counsel to be familiar with state law and should work with bond counsel to ensure compliance with applicable state laws.

\textsuperscript{22} For example, some state authorizing statutes may not allow an issuer to issue variable rate debt, or may not permit the issuer to enter into agreements relating to derivative financial products.
CHAPTER EIGHT

Choosing an Issuer

Borrower/Developers interested in financing multifamily housing projects with tax-exempt bonds must find a governmental entity to issue bonds on their behalf.23

A. What Issuers are Eligible?

Borrower/Developers need to begin by finding an issuer that can legally issue bonds to finance their project in its planned location. Cities and counties, and their issuing authorities, can typically only issue bonds for projects located within their territorial limits. State housing agencies by comparison, may be able to issue bonds for projects located anywhere in the state.

In addition to legal limits, practical and political considerations may prevent certain issuers from issuing bonds for projects in certain areas. For example, a city or county may insist on serving as the issuer of bonds for a project located within its borders, even if a statewide issuer, joint powers authority or some other entity could legally issue bonds for the project. This is particularly common where the city or county itself contributes to the financing of the project, whether through grants, subordinate loans, fee waivers or otherwise.

23 In some states or jurisdictions, Borrower/Developers have little or no choice in this matter. A state may have a statewide housing authority, for example, that serves as the issuer for all housing revenue bonds issued in the state.
B. Factors to Consider in Choosing an Issuer

*Structuring Flexibility.* State law requirements, credit considerations and policy considerations vary from issuer to issuer and may limit the financing structures available to a project (See Chapter 7). Within the limits of state law, true conduit issuers are typically more flexible in this regard than state housing agencies and other sponsors of “issuer-driven” multifamily housing bond programs. A large state housing agency, for example, is likely to have a well-established financing structure in place, usually involving some amount of asset pooling and cross-collateralization of projects. In this case, the Borrower/Developer can either participate in the program or not, but should not expect to bring its own financing structure or team to the table.

Issuers are often further limited by their own policies prohibiting financing structures that they consider risky or experimental. To this end, they may impose minimum rating requirements or minimum bond denominations or they may restrict ownership of the bonds rated below a certain level to sophisticated investors. Borrower/Developers should confirm that their preferred issuer is authorized and willing to issue bonds that work with their preferred financing structure.

*Issuer Cooperation.* Borrower/Developers may also want to consider how easy or difficult an issuer will be to work with. The governing bodies of some cities and towns may meet infrequently and they may require documents to be submitted to them weeks in advance. These scheduling constraints can make it difficult to put a deal together in a timely fashion. On the other hand, some issuers may be willing to meet almost on demand. Borrower/Developers should consider both an issuer’s stated scheduling policies and its apparent willingness to be flexible in considering whether the issuer is likely to delay or, worse yet, kill a deal because of its scheduling constraints.

*Additional Requirements.* As a matter of law or policy, some issuers may insist that a multifamily housing project for which they issue bonds go beyond the “20% at 50%” or “40% at 60%” income requirements of Section 142(d), or that affordability be maintained for longer than the minimum project period required by the tax law. In particular, issuers may require that additional units be set aside for tenants of certain income levels, or they may impose monthly or annual rent limits on already-restricted units.
**Fees.** One factor to consider about a potential issuer is its fees. Most issuers charge an initial issuance fee, followed by an annual fee based on the size of the bond issue. In evaluating an issuer’s fee requirements, Borrower/Developers may want to ask some of the following questions:

- Is the annual fee fixed at issuance or does it reduce as the bonds amortize?
- Does the issuer charge a fee for refundings, credit substitutions or other post-closing restructurings?
- Are the issuer’s fees in any way linked to the credit rating on the bonds?
- How much work will the issuer do in the way of compliance monitoring, administration, or otherwise, for which the Borrower/Developer would otherwise have to hire a third party?

**Professional Team.** Some issuers retain their own legal counsel or financial advisors whose fees the Borrower/Developer must pay. These arrangements are often so firmly established that, from the Borrower/Developer’s point of view, compensation of these parties essentially constitutes a part of the issuer’s fee. In addition, particularly demanding lawyers or financial advisors for the issuer may add hours of time and expense to a deal by demanding revisions to documents, holding up the schedule, requiring additional calls to negotiate terms or even by requesting that other counsel deliver non-standard opinions.
Tax-exempt financing is available to both for profit and not-for-profit Borrower/Developers of multifamily rental housing. Some special rules apply to nonprofits that qualify as 501(c)(3) organizations (as defined in Section 501(c)(3) of the tax code). State and tax laws applicable to not-for-profit Borrower/Developers differ in many respects from the rules laid out in the preceding chapters. Note that simply having a 501(c)(3) organization as a general partner in a limited partnership does not qualify a project for tax-exempt financing under these special 501(c)(3) rules.

**Types of 501(c)(3) Borrower/Developers.** The tax treatment of a not-for-profit Borrower/Developer depends in part on the charitable purpose underlying the Borrower/Developer’s 501(c)(3) status. Entities obtain 501(c)(3) status by applying to the Internal Revenue Service and setting forth in detail their proposed “charitable” activities. The most common charitable purposes encountered in the multifamily rental housing area are:

1. providing low-income housing for “relief of the poor and distressed”
2. “lessening the burdens of government”

As a general rule, not-for-profit Borrower/Developers do not have to comply with the income restrictions of Section 142(d) (see below for an important exception to this rule). Rather, they have to meet affordable housing requirements related to their own charitable status.

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24 In the nonprofit context, the tax law draws a fine line between "housing" and "health care." Housing developers should be aware that for a project to constitute multifamily housing for tax purposes, each rental unit must have its own cooking facilities. An assisted living facility with communal cooking and dining areas, for example, would be considered a health care project, not a housing project.
**Safe Harbor for “relief of the poor and distressed”**. The most common charitable purpose for housing nonprofit is what the tax law refers to as relief of the poor and distressed. Unlike the bright-line affordability rules for tax-exempt bonds and tax credits, the affordability guidelines applied to these 501(c)(3) corporations are “safe harbors.” In other words, a not-for-profit Borrower/Developer can be assured of being considered charitable within the meaning of Section 501(c)(3) so long as it complies with the applicable affordability guidelines (set forth below). Failure to comply would not, however, guarantee a loss of 501(c)(3) status, given the right specific facts and circumstances, but the Borrower/Developer would not be able to avail itself of the safe harbor.

501(c)(3) organizations whose charitable purpose is the provision of affordable housing to relieve the poor and distressed are required to set aside 75% of their units for tenants whose income does not exceed 80% of area media income. 20% or 40% of the units (which may be part of the 75%), must also be set aside for tenants with incomes at or below 50% or 60% of the area median, respectively.²⁵

**Lessening the Burdens of Government Organizations**. Borrower/Developers charged with lessening the burdens of government are subject to income and affordability limits that are individually set depending on the specific motivations of and government involvement in the organization. Organizations in which there is minimal government involvement should expect to set aside 100% of the units in any multifamily rental housing project for tenants whose median income does not exceed 120% of area median income and to satisfy something like the 20% at 50% or the 40% at 60% tests.

**Special Rules for Acquisitions**. In addition to complying with income restrictions related to their 501(c)(3) status, not-for-profit developers may, under certain circumstances, have to meet the income requirements of Section 142(d) (20% of units set aside for tenants at or below 50% of area median income, or 40% at 60%). Specifically, where a Borrower/Developer wants to acquire an existing multifamily rental housing project, rather than construct the project from the ground up, the

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²⁵ See IRS Revenue Procedure 96-32 for more details on these safe harbors.
tax code requires either “substantial rehabilitation” or compliance with the income restrictions of Section 142(d). Unlike the 15% rehabilitation requirement for for-profit Borrower/Developers, substantial rehabilitation in this context means that not-for-profit must spend on rehabilitation at least an amount equal to the total amount of bond proceeds used to acquire the buildings and other improvements (but not the land) that make up the project. This is often prohibitively expensive, leading Borrower/Developers to opt for compliance with Section 142(d) instead.

**No Volume Cap/Non-AMT.** Perhaps the most significant difference between tax-exempt bonds for which the Borrower/Developer is a 501(c)(3) organization (often called “501(c)(3) bonds”) and other tax-exempt multifamily rental housing bonds is that **501(c)(3) bonds do not need to receive an allocation of volume cap.** In other words, there is no limit to the principal amount of 501(c)(3) bonds that can be issued in a state in any one year. This makes a big difference to Borrower/Developers who do not have to go through the process of competing for volume cap allocation, especially in states and/or development environments in which volume cap is scarce.

Unlike most housing revenue bonds, 501(c)(3) Bonds are not subject to the alternative minimum tax, meaning that interest on the Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes.

**State Law Differences.** Many states have housing revenue bond statutes that track the requirements of the tax code. For example, a typical state statute would require the issuer of multifamily housing revenue bonds to ensure compliance with the Section 142(d) income restrictions, as well as possibly adding annual rent restrictions or extending the minimum project period. Because the tax code imposes different, and often more lenient, rules on not-for-profit Borrower/Developers than their for-profit counterparts, some states have enacted alternative housing revenue bond statutes designed specifically to enable the issuance of 501(c)(3) bonds for multifamily rental housing projects. These statutes also often impose fewer burdens and restrictions on the Borrower/Developer than standard housing revenue bond statutes. Not-for-profit Borrower/Developers should consult with bond counsel about the state law requirements that apply to their projects.
**For-Profit Managers.** Private developers, operators and managers may play a role in tax-exempt financings by not-for-profit Borrower/Developers. For example, a not-for-profit Borrower/Developer may choose not to operate all or part of a project and instead contract with a private operator or manager to do so.

The tax rules governing private operators or managers (hereafter, for convenience, referred to as “managers”) are set out in Revenue Procedure 97-13 and restrict the term of the management contract, the compensation of the manager and the corporate relationship between the manager and the nonprofit corporation, generally as follows:

1. The term of the manager’s contract (including any renewal options exercisable unilaterally by the manager) may not exceed 15 years or such shorter term as may be required on account of the type of compensation provided.

2. Compensation must not be based on net profits, and must meet one of several tests which restrict the way the manager’s fee is determined. Depending on how the manager’s fee is determined, the maximum term of the contract may be substantially less than 15 years.

In addition to the requirements above, to prevent the manager from having a relationship with the nonprofit Borrower/Developer that could substantially limit the nonprofit’s ability to exercise its rights under the management contract, the tax law does not allow the manager to control (for example, appoint) more than 20% of the members of the board of the nonprofit and no board member of the nonprofit corporation may be the chief executive officer of the manager or its governing board (or vice versa).
CHAPTER TEN

Steps to Issuing Bonds

The scheduling and steps to completion of a multifamily housing revenue bond transaction depend on the choice of Issuer, the policies and procedures of the Issuer, the type of project, the type of Borrower/Developer (for-profit or not-for-profit), the financing structure, applicable state law, and other factors. In general, however, the following is illustrative of the basic steps in a typical tax-exempt bond issue for a Borrower/Developer of a multifamily rental housing project:

*Consult bond counsel.* Bond Counsel is the law firm primarily responsible for rendering an opinion on the validity and tax exemption of the Bonds and for drafting the legal documents to be executed by the Borrower/Developer and the Issuer in connection with the bond issue (and in some cases for creating a not-for-profit corporation to act as Borrower/Developer and obtaining a 501(c)(3) determination). While Bond Counsel typically represents the Issuer, and the Borrower/Developer is represented by its own counsel, Bond Counsel’s fees (like all other expenses of the transaction) are often paid by the Borrower/Developer and many Issuers permit the Borrower/Developer to choose or at least request Bond Counsel. It is important to have a Bond Counsel experienced in multifamily housing revenue bond financings and, given the tax driven nature of most such financings, particularly experienced in the complex tax laws that govern the tax-exemption of interest on the Bonds.

Orrick is the nation’s premier tax-exempt bond counsel firm, ranking number one for over the past decade, with extensive experience in all types of housing financings. It has been bond counsel, underwriter’s counsel or other counsel on more than 600 financings and refinancings of multifamily housing projects aggregating nearly $9.7 billion in the past decade.
It is important to involve Bond Counsel early to determine whether the Borrower/Developer and the project it wishes to finance are eligible for tax-exempt financing and to help design the basic legal and structural conditions for such a financing. Most bond counsel will provide preliminary advice on these matters without charge in case the transaction proceeds no further.

**Choose the Issuer.** Determine with Bond Counsel what public entity will serve as the Issuer of the Bonds. In some states or in some situations, there may be several possible issuers with different policies, procedures, politics, governing laws and fees.

**Find a Lender (public sale or private placement).** Because multifamily housing projects are generally financed on a project-by-project basis, rather than on the Borrower/Developer’s overall credit, the Borrower/Developer has to find a party to extend credit to its project in exchange for a real estate security interest in the project. This party, the Lender, could be a credit enhancer, (such as a letter of credit bank, Fannie Mae or Freddie Mac) a state housing agency or other governmental entity that underwrites multifamily housing projects (in which case the Lender may also be the Issuer) or a bond purchaser in a private placement. The lender plays a major role in structuring the financing and is a driving force in the transaction. Lender’s counsel typically prepares most or all of the real estate documents evidencing the lender’s security interest in the project. Consulting a lender early is crucial to determining whether a transaction is feasible, what it will look like and when it can be completed.

**Engage the Underwriter (public sale only).** For publicly sold bonds, the Underwriter is the investment banking firm responsible for marketing the bonds, helping to structure the financing, presenting the transaction to rating agencies to obtain ratings on the bonds and/or to bond insurers or credit providers, and purchasing (i.e., underwriting) the Bonds for resale to investors. The Underwriter’s counsel is primarily responsible for preparing the Bond Purchase Contract and the Official Statement. If a Lender has not yet been brought into the transaction (see above) consulting the Underwriter early on may help determine what sort of lenders would be willing to extend credit to the project, what rates of interest the Borrower/Developer can expect to pay, and to work out the basic structure of the financing with Bond Counsel.
**Financial Advisor.** Because there are pros and cons to different financing structures and because there are many underwriters and private placement buyers to choose from, some Borrower/Developers engage a financial consultant or advisor to explore the options and recommend the best approach for their project. These consultants are familiar with the variety of financing structures and can often help with the tax credit side of transactions as well.

**Adopt a reimbursement resolution.** If the Borrower/Developer intends to use bond proceeds to reimburse itself for expenditures incurred prior to the issuance of the bonds, the Borrower/Developer will want the issuer to pass a “reimbursement resolution” establishing a date after which (and up to 60 days before which) costs incurred can be reimbursed with bond proceeds. Bond counsel can describe the specific tax rules regarding reimbursements and will normally provide this fairly simple resolution on request.

**Apply for (and receive) volume cap/tax credits.** Unless the Borrower/Developer is a 501(c)(3) corporation, the project will need to receive an allocation of volume cap authority (see Chapter 6A) to have tax-exempt private activity bonds issued on its behalf. The Borrower/Developer should become familiar with the application procedures for volume cap (and tax credits, if the project will be financed in part with 4% tax credits) in the state(s) where its project(s) will be located.

**Drafts of Bond Documents.** Bond Counsel prepares and circulates to the working group initial drafts of the bond documents. These are, typically, an Indenture, a Loan Agreement and a Regulatory Agreement. In a private placement, however, alternative documentation may be used.

**Drafts of Underwriting Documents.** If applicable (see Chapter 5), the Borrower/Developer works with the Underwriter and its counsel to prepare a draft of the portion of the Official Statement that sets forth the relevant financial and operating information about the Borrower/Developer and/or the Project. Underwriter’s counsel prepares and circulates to the working group initial drafts of Bond Purchase Contract and Official Statement.
Drafts of Credit Documents. Counsel to the credit enhancer (public sale) or lender/bondholder (private placement) prepares and circulates to the working group drafts of documents evidencing the credit provider’s security interest in the project. These typically include one or more deeds of trust to be recorded against the project, as well as subordination agreements, promissory notes, reimbursement agreements, intercreditor agreements, environmental indemnities and a variety of other documents, depending on the structure of the transaction.

Conference Calls. The finance team holds one or two conference calls to discuss the foregoing documents followed each time by circulation of revised drafts.

Conduct TEFRA hearing and approval. (See Chapter 6B). Bond counsel is normally responsible for making sure the TEFRA process is completed. From a pure tax law standpoint, TEFRA approval does not need to be received until just before the transaction closes, but issuers or other entities having control over the transaction (such as the state board charged with allocating volume cap) may require TEFRA approval early on.

Issuer Approval. After receiving substantially final drafts of any major document to which it is a party, the bond issuer adopts a bond resolution (drafted by bond counsel) authorizing the sale and issuance of the bonds and execution and delivery of the legal documents and distribution of the Official Statement, if any.

Credit Approval. After reviewing the bond documents and other documents, as well as projected cash flow numbers, the credit enhancer (in the case of a public sale) or the lender/bondholder (in the case of a private sale) issues a formal commitment to extend credit to the project.

Preliminary Official Statement. For a public sale, a preliminary Official Statement containing information about the bonds, the issuer, the project and any credit enhancement, but excluding certain final pricing information, is mailed to potential purchasers of the Bonds. In the case of variable rate demand bonds that can be put (i.e. sold back to the Issuer) on seven days’ (or other short) notice, the delivery of a Preliminary Official Statement is optional.
**Bond Sale.** For a public sale, the underwriter completes marketing of the bonds to the public and enters into the Bond Purchase Contract with the Issuer which is usually accepted and approved by the Borrower/Developer. For variable rate bonds, this step may take place the day before closing; for fixed rate bonds, the bond sale occurs a week or more before closing.

**Final Official Statement.** For a public sale, a final Official Statement containing the final sale information is prepared for delivery to purchasers of the Bonds at or before receipt of their purchase confirmations.

**Closing.** The Bonds are delivered to the Underwriter or the lender/bondholder, as the case may be, in exchange for the purchase price, simultaneously with delivery of final executed copies of the legal documents, and various certificates, receipts and opinions. At the same time, real estate documents securing the loan of the bond proceeds to the Borrower/Developer, as well as the Regulatory Agreement, are recorded in the county recorder’s office of the county in which the project is located.
Contact Information
Members of Orrick’s Multifamily Housing Group

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Multifamily Rental Housing

Financing with Tax-Exempt Bonds