

# Don't Let This Happen to You: Avoiding Title & Survey-Related Delays

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# Introduction & Overview

1. Not a Subdivided Lot
2. Appurtenant Easements
3. Reciprocal Easements
4. Zoning & Utilities
5. Additional Threshold Items
6. Standard v. Special Exceptions
7. Use Agreements or Restrictive Covenants
8. Subordinate Debt
9. What's New?

# 1. Not a Subdivided Lot (cont'd)

- Impediment to foreclosure
- Affects legal conveyance of land
- May impact availability of building permit
- Might be taxed with neighbor's land
- Rollback Taxes
- Zoning Issues

## 2. Not a Subdivided Lot (cont'd)

### Legal Subdivision



Sample State Statutory Language:

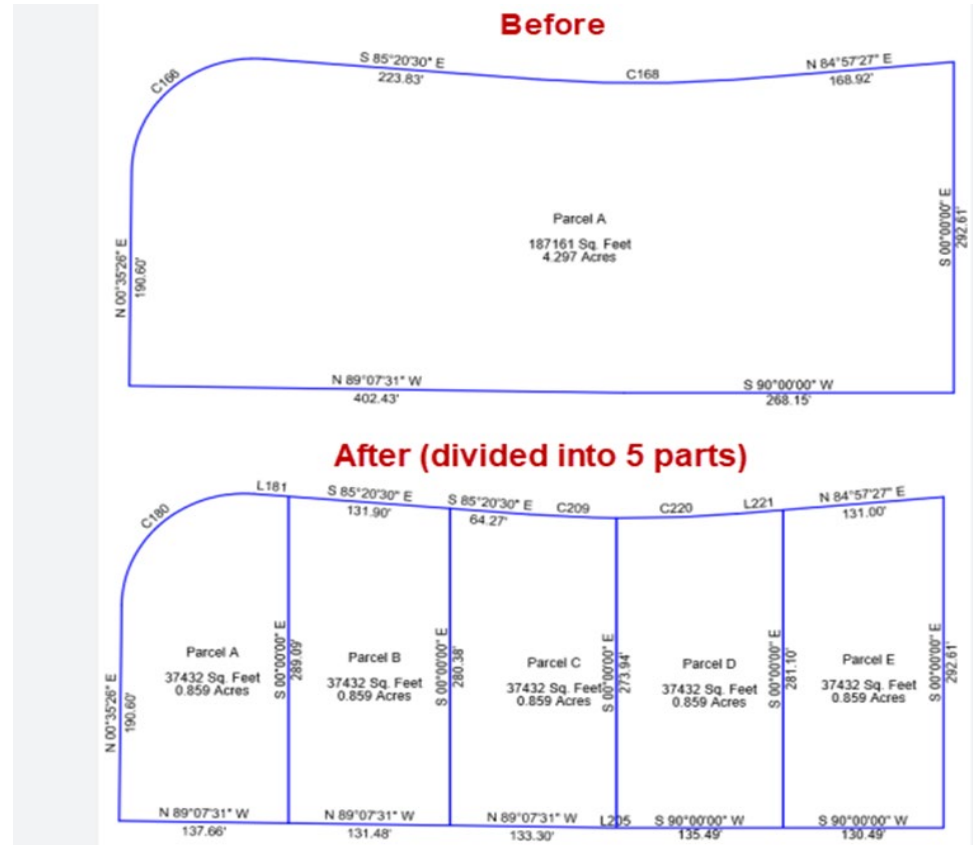
*No person may subdivide land without the approval of the subdivision plat by the local government.*



# 3. Not a Subdivided Lot (cont'd)

## Why Not?

- Affects legal conveyance of land
- Zoning Laws
- Utilities
- Local rules matter



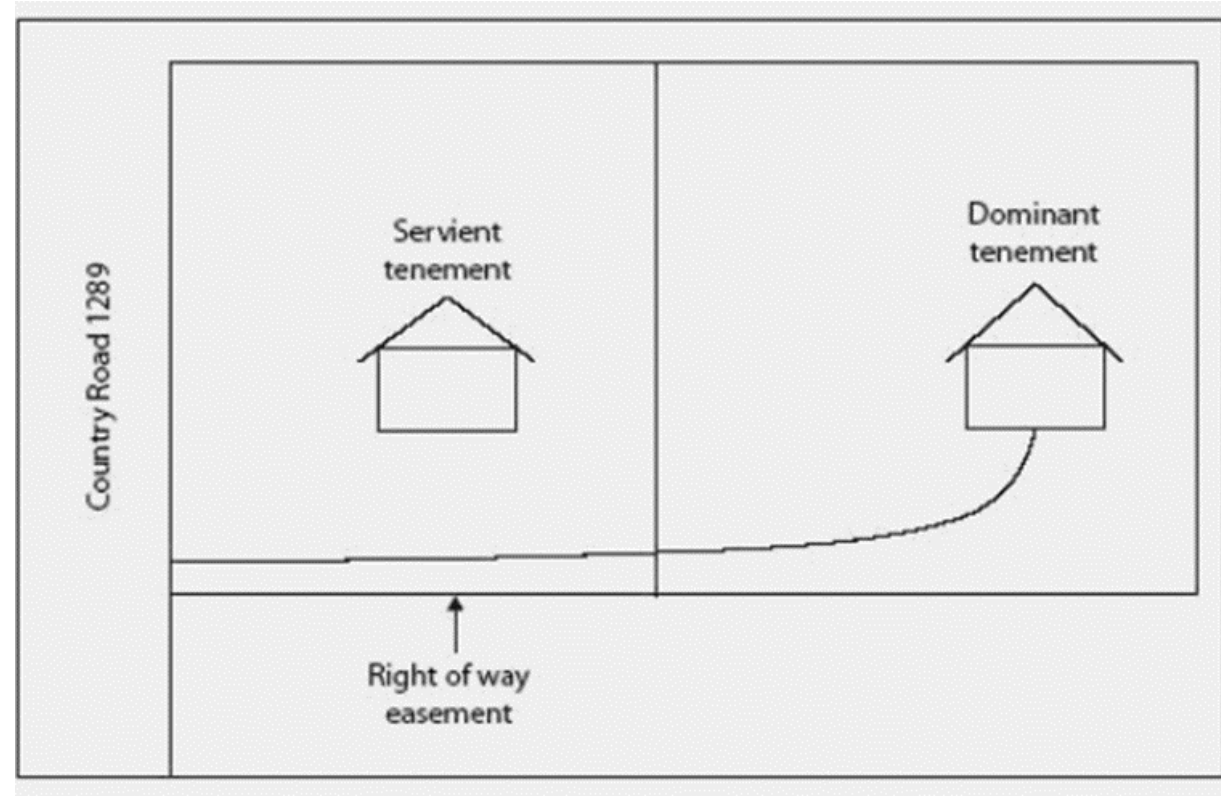
## 4. Not a Subdivided Lot (cont'd)

### **Additional Lender & Closing Issues**

- Impediment to foreclosure
- May impact availability of building permit or C of Os
- Timing & Closing on FHA Loans (legal descriptions)
  - Call out to HUD Counsel
  - Ask for pre-review, clearance and green-light to record ASAP
  - Record while HUD still reviewing the rest of the package
  - Survey should contemplate the plat will be recorded at the time we submit, even if not recorded yet (if at Initial, Final is different)
- Taxed as one lot & Rollback Taxes

# 5. Appurtenant Easements

- Beneficial Easements
- Appurtenant and should be insured in Title Policy as part of the Mortgaged Property
- Easements needed from adjacent landowners
- May be necessary to obtain building permits and other development approvals





# 6. Reciprocal Easements

- Facilitate common utility facilities, access and/or sharing of amenities
  - Common Driveway & Access (pedestrian and vehicular)
  - Shared Parking
  - Utilities
  - Pools, Gyms, Community Rooms, Playgrounds & Sports Facilities
- Requires special attention in underwriting
- Impact on marketability
- Additional Expenses (shared costs of use, maintenance – how are these split between parties?)
- Some are Appurtenant (insure on Schedule A)

# 7. Zoning & Utilities

## Zoning

- Use
- Parking
- Setbacks



## Utilities

- Appurtenant easements
- Capacity
- Connections



# 8. Additional Threshold Items

- Commercial Leases, HUD Commercial Lease Rider & SNDAs (includes cell tower leases)
- Oil/Gas Leases
  - Waiver of surface rights & exploration
  - City Ordinance prohibiting drilling within X feet of a building
  - Watch for high pressure pipeline easements
- Ground Lease
  - HUD Ground Lease Addendum
  - Fee Joinder
    - Very specific rules on how to modify addendum
    - Not a Leasehold Mortgage
    - Not a Leasehold Title Policy

## 9. Additional Threshold Items (cont'd)

- Table A items on survey, especially setting of monuments (Item 1)
- “Sneaky” easements – e.g., flowage easement

# 10. Standard v. Special Exceptions

- What is an exception? See Schedule B, Part II (exclusions from coverage)
- Standard Exception Examples:
  - Taxes or special assessments which are not shown as existing liens by the Public Records.
  - Any lien, or right to a lien, for services, labor or material not recorded in the Public Records.
  - Encroachments, overlaps, boundary line disputes, or other matters which would be disclosed by an accurate survey and inspection of the premises.
- Special Exception Examples (public-record documents usually found at the County Recorder's Office pertaining to the parcel):
  - Plats
  - Easements
  - CC&R's
- Contact counsel early if any exception seems out of the ordinary!

# 11. Use Agreements or Restrictive Covenants

- HUD Rider 19.15 required for any and all Restrictive Covenants with affordability restrictions on rents and occupancy based on tenant incomes (Bonds, LIHTCs, and subordinate debt)
- Different agencies and different forms
- LIHPRHA Use Agreements or Section 8 Use Agreements
- Age Restrictions or Density Bonuses
- HOME Loans, “HOME-like,” National Housing Trust Fund
- Surviving foreclosure (Ted Toon Memo)

# 12. Subordinate Debt

- Secured
  - Subordination Agreement (Private & Public)
  - Re-subordination for new FHA-insured loan
- Unsecured
  - Surplus Cash Note or Residual Receipts Note
- Equity Bridge Loan for Tax Credit Projects
  - 19.16 Equity Bridge Loan Rider – LIHTC Projects
- Problematic States or Agencies – MN, PA

# 13. What's New?

- NEW TITLE 2021 ALTA Policy & Forms
- HUD OGC is still only accepting the 2006 ALTA Policy.
- Lender counsel's reviewing and summarizing changes
- New title instructions and required endorsements are forthcoming.



# Questions? Guidance? Advice?

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# 2023 ANNUAL WESTERN MORTGAGEE ADVISORY COUNCIL (WMAC)

## HUD CONFERENCE

September 18-20, 2023  
The Intercontinental Hotel  
San Francisco, California

### Combining Tax-Exempt Short-Term Bonds with Taxable GNMA Sale for Affordable Apartment Financings\*

Presented by:

**Norris George & Ostrow PLLC**

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San Francisco Skyline

# Short-Term Cash Backed Bond and Private Activity Bond Volume Update

September 18-20, 2023

Presented by:



**NORRIS GEORGE & OSTROW PLLC**

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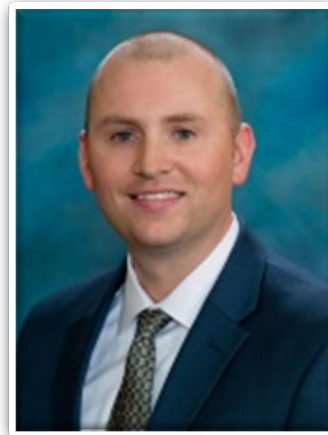


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- I. TAX EXEMPT SHORT-TERM CASH-BACKED BONDS – WHY WE USE THEM AND HOW THEY WORK – A QUICK OVERVIEW**
- II. MAKING FHA FINANCINGS COMPETITIVE IN TODAY’S HIGH INTEREST RATE WORLD**
- III. ADDING OTHER DEBT LAYERS TO PROVIDE BRIDGE FINANCING, CLOSE FUNDING GAPS AND MEET THE 50% TEST**
- IV. QUICK U.S. AND WESTERN REGION PRIVATE ACTIVITY BOND VOLUME UPDATE**

# I. TAX EXEMPT SHORT-TERM CASH-BACKED BONDS – WHY WE USE THEM AND HOW THEY WORK – A QUICK OVERVIEW

- Affordable multifamily rental apartment financings generally don't work without 4% Low Income Housing Tax Credits ("4% LIHTC"), which generally funds about 40% of total development costs.\*
- **The 50% Test: To be eligible for 4% LIHTC, the Borrower must finance at least 50% of eligible basis in the building and land\*\* with volume limited tax-exempt private activity bonds under Section 142(d) and keep these bonds outstanding until the project's placed-in-service date.**
- To satisfy the 50% Test in today's interest rate environment, **we issue tax-exempt short-term cash backed bonds to "magically convert" FHA Lender Advances into "tax-exempt bond proceeds"** when these funds are advanced to the Borrower to pay project costs.

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\* Usually 100% of units are rented to families at 60% of AMI or less, adjusted for family size.

\*\* Basically, for a 100% affordable project, total development cost less cost of any commercial components.

- **Typical terms today for 221(d)(4) new construction project:**
  - **Bonds have 4-year maturity sold to 3-year “Mandatory Tender” at a yield today of about 4.00%.**
  - **Bonds backed by verified escrow of cash and 3-year U.S. Treasury Bonds.**
  - **Rated Aaa by Moody’s or AA+ by S&P.**

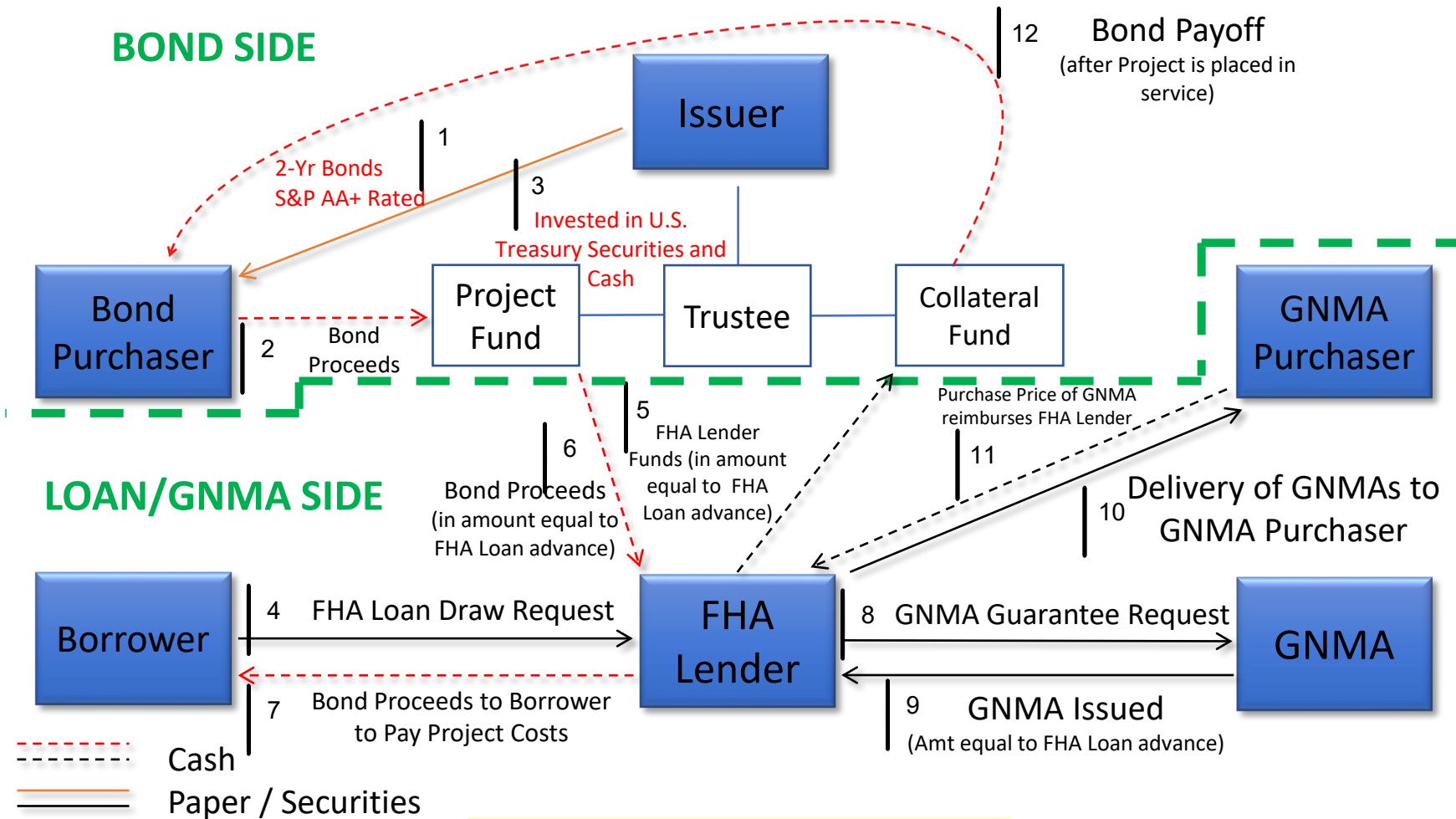
- **Two funds** established under Bond Trust Indenture:
  - a **“Project Fund”** in which all the **tax-exempt bond proceeds** are deposited, and
  - a **“Collateral Fund”** in which **FHA Lender advances** are deposited.
- **As each dollar of tax-exempt bond proceeds is disbursed from the Project Fund to pay project costs, an equal amount FHA Lender advances are simultaneously deposited into the Collateral Fund.**
- This occurs through an **accounting entry. Ownership of the fixed escrow of 3-year U.S. Treasury Bonds is transferred step-by-step** in these amounts to the Collateral Fund from the Project Fund, **without liquidation.**
- The **principal of the Bond issue thus remains 100% cash collateralized.**
- **All Bond interest is payable from the yield on the 3-year U.S. Treasury Bonds, which is locked in at closing.**

- **When** the project loan has been fully funded, rehabilitation or construction has been completed and the **project has been placed in service** the **tax-exempt bonds are redeemed**.
- The **only remaining debt is the FHA insured loan**.
- We have a simple funds flow diagram that explains this on the following slide.



# Taxable GNMA Sale with Tax Exempt Short-Term Cash Backed Bonds

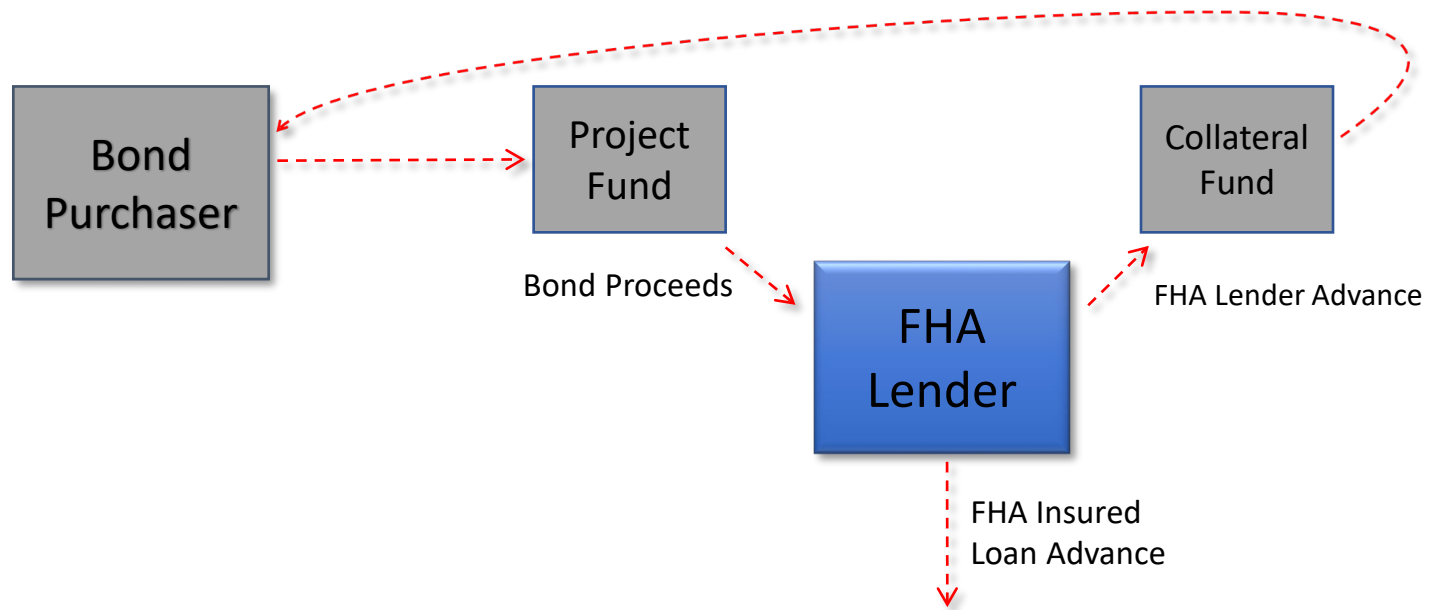
## Interactive Flow Chart



**Just Kidding!!!\***

\* For those who really want to do a deep dive, we can provide you with an interactive version of this detailed diagram!

# Simplified Funds Flow Chart

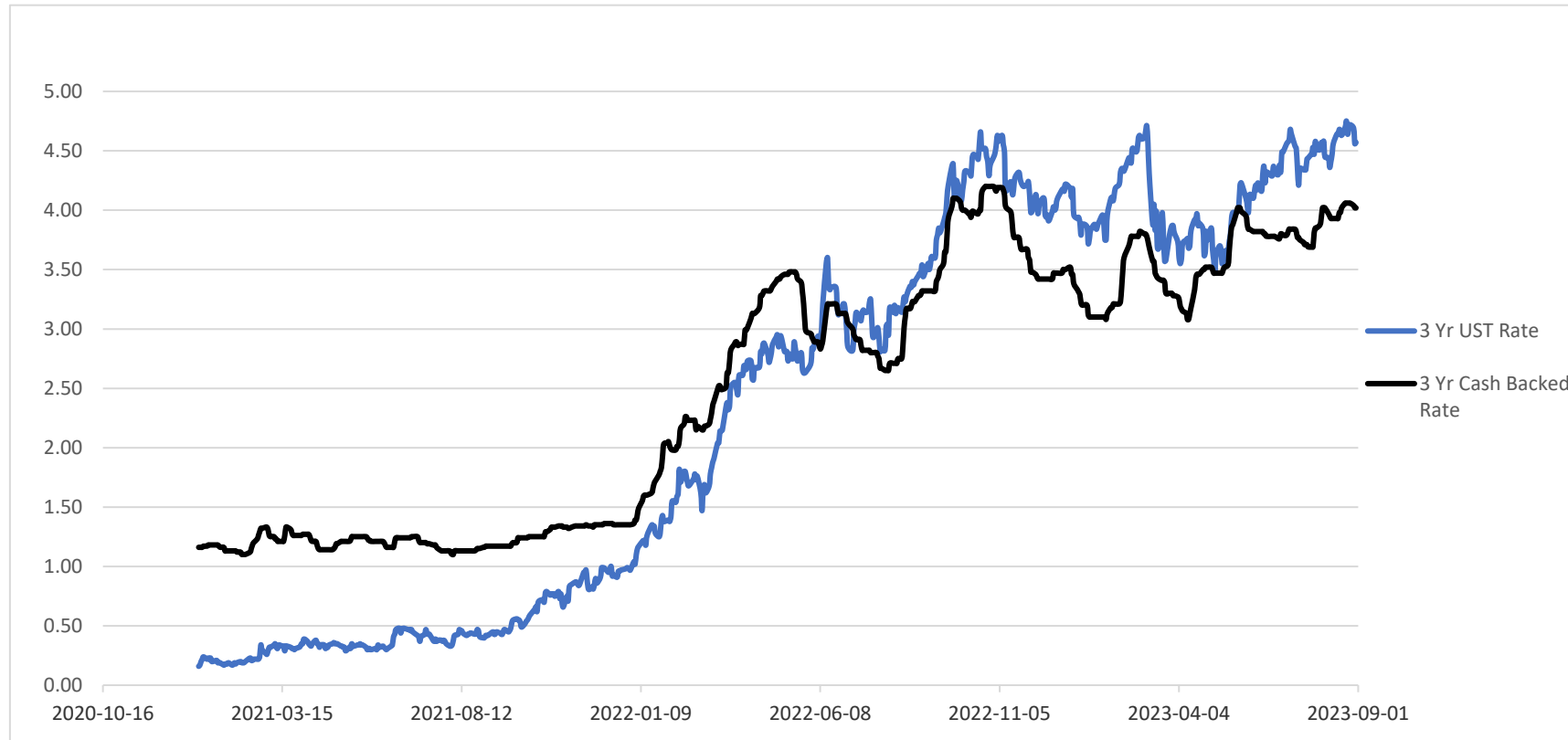


Project Placed  
in Service

\* Credit to Kenji Tamaoki at PGIM who created the first simplified funds flow chart 6 or 7 years ago.

- Today, the yield on 3-year **U.S. Treasury securities** is about **4.50%** – about **50 basis points higher than a current bond yield of about 4.0%**.
- **This results in no negative arbitrage**, which otherwise would be required to be funded upfront.

3-YEAR TAX-EXEMPT SHORT-TERM CASH BACKED BOND RATES  
VS.  
3-YEAR U.S. TREASURY RATES (2021-TODAY)



- **If FHA loan is less than 50% of Eligible Basis, we can close this “collateral gap” by converting some equity installments into bankruptcy remote “subordinate loan” proceeds if proper steps are taken.**

# Sample Short-Term Cash-Backed Tax-Exempt Transaction

## New Construction/Sub Rehab – 4-Year Bonds, with 3-Year Mandatory Tender

Expected Placed-In Service Date	30 Months
Initial Mandatory Tender Date	36 Months*
Stated Bond Maturity	48 Months
Bond Sale	Public offering of Moody's Aaa or S&P AA+ rated Bonds
Interest Earnings from Eligible Investments	4.50%
Initial Bond Coupon Rate	4.00%
Net Negative Arbitrage	\$0

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\* Bonds are sold to the 36-month mandatory tender date. If delays are encountered on placing project in service then bonds can be remarketed to new buyers providing up to 12 additional months before tax-exempt debt goes away.

# APPROXIMATE ALL-IN BORROWING RATES ON THE FHA INSURED LOAN (The “Real” Construction/Permanent Loan)

	<u>Moderate Rehab</u>	<u>Sub Rehab-Acq. Large 1<sup>st</sup> Draw</u>	<u>Sub Rehab-New Cons</u>
Mortgage Loan Interest Rate			
GNMA Pass Through Rate	<b>5.65%</b>	<b>5.80%</b>	<b>6.05%</b>
3 <sup>rd</sup> Party Fees	N/A	N/A	N/A
Servicing + GNMA Fee	0.25%	0.25%	0.25%
<b>Total ML Rate</b>	<b>5.90%</b>	<b>6.05%</b>	<b>6.35%</b>
Add: MIP	0.25%	0.25%	0.25%
<b>Total All-in Borrowing Cost</b>	<b>6.15%*</b>	<b>6.30%</b>	<b>6.60%*</b>

- Spreads on taxable multifamily GNMA sales to 60-year US Treasury have been significantly higher since rates began to rise in early 2021 and thus do not enjoy the same advantage over other affordable multifamily lending rates as is the case in a normal interest rate environment where they can have a 50-100 basis point or greater advantage.
- However, there is **no re-underwriting of the loan at the permanent loan stage** and **no balloon on a 35 or 40-year loan amortization**. FHA loans do require greater processing times, and Davis Bacon wage rates apply on new construction and substantial rehabilitation loans.

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\* Note: bonds are sized to 52 – 54% of Tax Credit basis; under long-term muni bond structures used before 2009, bond issue would be larger (equal to taxable loan amount) with higher costs.

# SUMMARY OF BORROWING/ UNDERWRITING RATES PRINCIPAL TAX EXEMPT DEBT PRODUCTS FOR 100% AFFORDABLE PROJECTS

	Estd. Actual All-In Borrowing and Perm Period Underwriting Rate
<b>1. Bank Private Placement</b> -Mod Rehab -Sub Rehab/New Cons Cons Period Perm Period	 <b>5.75% to 6.25%</b>  <b>6.50% to 7.50% Floating*</b> <b>5.75% to 6.25%*</b>
<b>2. Freddie Mac “TEL” Program</b> (Mod Rehab, Sub Rehab, New Cons)	 <b>Similar to Bank Private Placements above</b>
<b>3. Fannie Mae “M.TEBS” Structure</b>	 <b>6.15% to 6.55%</b>
<b>4. Short-Term Cash Backed Tax Exempt Bonds with Taxable Loan Sale</b> FHA §223f or RD Mod Rehab FHA §221(d)(4) or RD Sub Rehab / New Cons	 <b>6.15%</b> <b>6.60%</b>
<ul style="list-style-type: none"> <li>• It’s no secret that with spread expansion which has occurred on taxable GNMA security sales over the last 18 months, <b>FHA executions do not presently enjoy the 50-100 basis points yield advantage we have seen in many past markets since the 2008 financial crisis.</b></li> <li>• <b>One of the most difficult tax-exempt debt markets we have seen in many years, but it has been supported by additional federal, state and local subordinate loan funding which has resulted in volume being lower but greater volume of financings than the increase in rates would otherwise suggest.</b></li> <li>• <b>All of these long-term all-in borrowing rates are about 200 basis points or more higher than 2 years ago.</b></li> </ul>	

\* These rates may now be lowered on some financings through the use of caps and/or swaps by 50 to 100 basis points or more. This involves complexities and some “black swan” risks but has helped some private placements lower rates and close funding gaps.

## II. MAKING FHA FINANCINGS COMPETITIVE IN TODAY'S HIGH INTEREST RATE WORLD

### MAJOR BENEFIT OF SHORT-TERM CASH BACKED BONDS IN AN INVERTED YIELD CURVE WORLD

- Short-term cash backed **bond yields are now MUCH HIGHER: very generally 4.0% or a bit higher in recent months, versus 1% or lower as recently as late 2021.**
- This has created a **unique, substantial opportunity.**
- **Adding Tax-Exempt Short-Term Cash Backed Bonds (“Cash Backed Bonds”) to any debt structure can produce quite substantial extra financing proceeds.**

### HOW DOES THIS WORK?

- Versus many other structures, FHA Loans with short-term cash backed bonds involve **two sets of construction period interest** – interest on the FHA insured loan **plus** interest on the cash backed bonds – **which go into tax credit basis.**
- At a 4% coupon over a 2.5-year construction period, this **additional tax credit basis equals 10% of the Bond amount.**
- In a difficult to develop area (“DDA”) or qualified census track multiply by 1.3 = **13% of the Bond amount.**



- If state tax credits are involved, this may rise to say 15%-18% of the Bond amount – say **16% of the Bond amount.**
- If tax credits sell for 45¢/\$1.00, this implies **additional tax credit proceeds = 7.2% of the Bond amount.**
- The structure may involve additional costs equal to 2.0% of Bond amount, but even after deducting this, **the structure can produce additional financing proceeds equal to 5.0% of the Bond amount** – in today's inverted yield curve environment!!!
- Since the Bond amount is often equal to or just under the FHA Loan amount, **this is like getting 5% or more in FHA loan proceeds!!!**
- **FHA lenders should point this out!** It makes that **6.60% all-in Borrower's cost** on a Section 221(d)(4) new construction loan **look more like a 6.20%** against many other executions.

## **ANOTHER CREATIVE IDEA: LOWERING THE PERM RATE WITH A HIGH CONSTRUCTION PERIOD RATE**

- In July, we closed a Section 221(d)(4) Acquisition/Rehab Loan where all proceeds were disbursed at Closing. Thus, the loan would have priced like a 223(f).
- At the time the 10-year Treasury was about 30 basis points lower than today – so let's say the 223(f) rate would have been a 5.90%.
- **The lender lowered the perm rate by another 30-35 basis points – say 5.50% at today's rates by setting a construction period rate 120 basis points above the permanent rate.**
- Since almost all of this additional interest goes into tax credit basis, **roughly 40% or more of that comes back to the Borrower as additional tax credit proceeds.**

## POSSIBILITY OF RETAINING POSITIVE ARBITRAGE ON SOME FINANCINGS

- We've noted above, in today's market the rate on 3-year Treasuries (about 4.50%) is about 50 basis points higher than the tax-exempt bond coupon (about 4.0%).
- Over a 3-year period to mandatory tender, **this is about 1.5% of the FHA loan amount.**
- The following section describes 3 other types of tax-exempt debt we can add to our structure to close funding gaps, help meet the 50% test and make the FHA structure more competitive.
- These structures generally **bear tax-exempt interest rates** far below equity returns but **in the 6-10% range.**
- **Some but not all bond counsel firms will allow us to blend that yield** with our 4.0% cash backed bond yield which may pull it up toward or above our 4.50% Treasury earnings rate, **allowing the Borrower to keep some or all of the positive arbitrage.**
- If 10% of the tax-exempt debt consists of these tax-exempt issues at an 8.0% yield and Bond Counsel allows us to blend the yields, **this would allow the Borrower to keep 80% or more of this positive arbitrage to offset Project Costs!!!** If available, **this is like another 1.0% bump in loan proceeds, bringing our comparable yield in slide 16 to around a 6.10%.**

### III. ADDING OTHER DEBT LAYERS TO PROVIDE BRIDGE FINANCING, CLOSE FUNDING GAPS AND MEET THE 50% TEST

1. Taxable and Tax-Exempt **Tax Credit Equity Backed Bridge Loans**
2. Taxable and Tax-Exempt **Seller Take Back Debt**
3. Tax Exempt **Cash Surplus Backed Bonds**

# 1. TAXABLE AND TAX-EXEMPT **TAX CREDIT EQUITY BACKED BRIDGE LOANS AND BONDS**

- On financings involving an **FHA loan**, any **bridge loan** must be **secured by a pledge of tax credit equity installments, deep pocket general partner guarantees of completion and payment and/or possibly a pledge of general and/or limited partnership interests**. Such debt can have no claim on the Project and is subordinate to the FHA Loan and payable only from the sources described above.
- Such tax credit equity bridge loans may take one of **two forms**:

## **A. Taxable Bridge Loan**

- A taxable bridge loan is sometimes provided by the **tax credit syndicator**, backed by the collateral described above.

# 1. TAXABLE AND TAX-EXEMPT **TAX CREDIT EQUITY BACKED BRIDGE LOANS AND BONDS**

## **B. Tax-Exempt Tax Credit Equity Backed Subordinate Bonds**

- **A Tax-Exempt** Tax Credit Equity Backed Subordinate Bond issue, secured by the collateral described above can also be used.
  - If meeting the 50% test is a challenge, Tax-Exempt Tax Credit Equity Backed Subordinate Bonds can sometimes be **delivered to the syndicator** to help meet that test\*.
  - A number of our underwriter clients can also structure a **Publically Offered** Tax Exempt Tax Credit Equity Backed Subordinate Bond issue to provide this type of bridge financing on relatively attractive terms – *e.g.*, **tax-exempt interest rates of 6.0% or so.**
  - Such a separate series of tax-exempt bonds can involve **additional documentation costs** and, if publically offered, will not reduce selling costs, but can improve tax credit pricing and help meet the 50% test.

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\*These bonds may be taxable to the syndicator, but they will nonetheless count for purposes of meeting meet the 50% test.

## 2. TAXABLE AND TAX-EXEMPT **SELLER TAKE BACK DEBT**

Funding gaps can also sometimes be closed through the use of **“Seller Take Back Debt.”**

### **A. Taxable Seller Take Back Note**

- Under this approach, a simple **“Taxable Seller Take Back Note”** is executed by the Borrower and **delivered to the Seller** in lieu of cash, in payment of a portion of the project purchase price.
- A **simple Taxable Seller Take Back Note** can **dramatically reduce the need for cash at closing.**
- This is also often used to **maximize the purchase price on RAD transactions and other preservation deals**, where the **new borrower** has been set up by or **has a close relationship with the housing authority or profit-motivated project seller.** A **robust purchase price increases the federal and state tax credits** available to the purchaser.

## 2. TAXABLE AND TAX-EXEMPT **SELLER TAKE BACK DEBT**

### **B. Tax Exempt Subordinate Seller Take-Back Bonds**

- As an **alternative**, the seller take-back note or a portion thereof can also be effectively **converted to tax-exempt debt by having** the issuer of the cash backed tax-exempt bonds issued to meet the 50% test also **issue Tax Exempt Subordinate Seller Take Back Bonds**. These bonds are backed by a surplus cash note from the Borrower. **Advantages: Lowers cash required to close and no underwriting or origination fee on these tax-exempt bonds** since they are acquired by the seller. **Disadvantage: 2 sets of tax-exempt bond documents.** Interest Rate: ~8.0% tax-exempt.
- Especially **if the Seller is a for-profit entity**, this also **makes the seller take-back terms more attractive** to the Seller (interest is tax-exempt).
- These Bonds count as tax-exempt debt for **satisfying the 50% Test**, if needed.
- These subordinate tax-exempt bonds can be **delivered to the Seller** as partial consideration of the transfer of the project **without cash changing hands**.

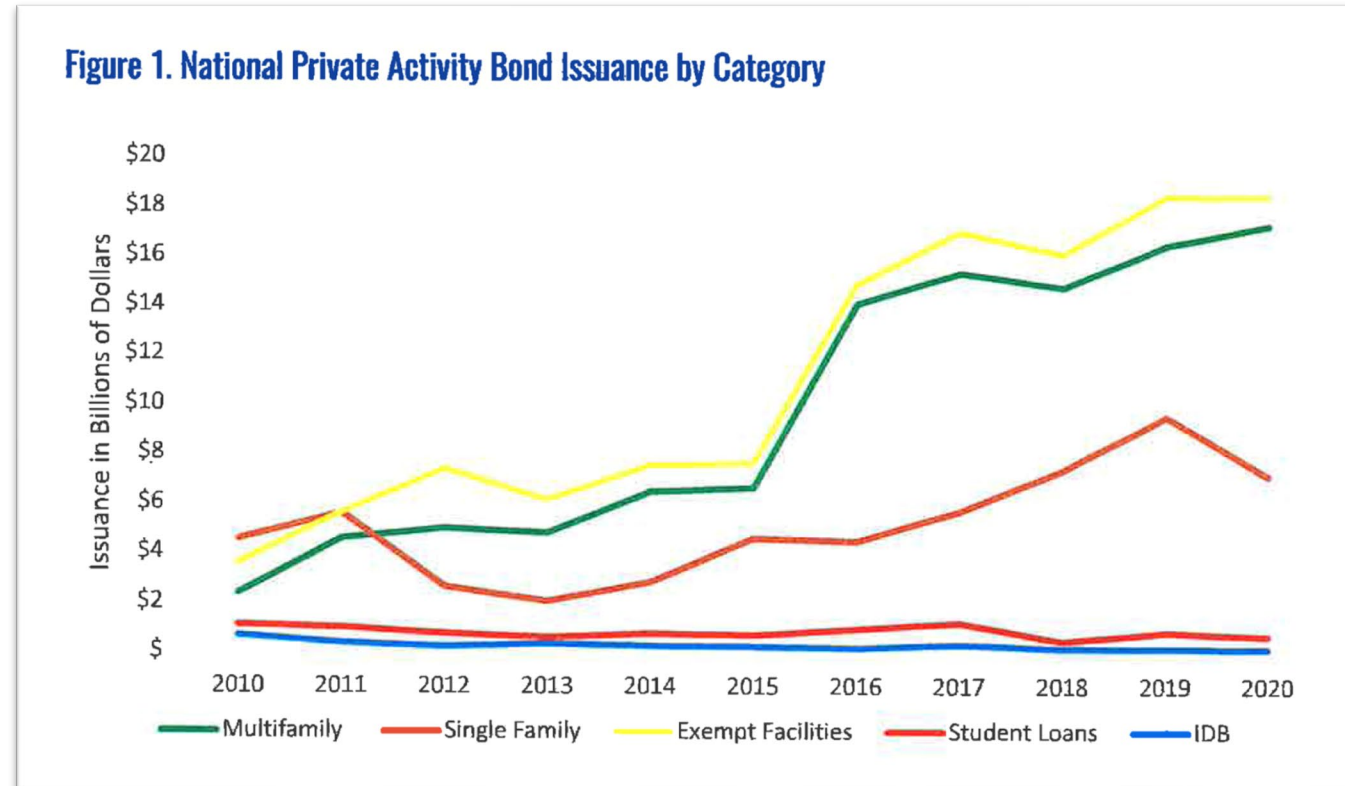


### 3. TAX-EXEMPT CASH SURPLUS BACKED BONDS

- To address funding gaps, it is possible to structure and sell **tax-exempt subordinate bonds secured by a pledge of surplus cash from the Project** as defined in the FHA Regulatory Agreement. Such bonds typically also entail a debt service reserve fund typically sized to cover the maximum annual debt service on the bonds and/or a guaranty of the bonds by a deep pocket general partner of the Borrower.
- **Such bonds are generally structured as term bonds** set to mature, depending on the availability of moneys available from surplus cash term bonds, after the FHA insured loan has been fully amortized. In today's market, they might be expected to **bear interest at tax-exempt rates of 6.0 to 10.0%**. While these rates are higher than most tax-exempt bond rates, they are much lower than the yields which would be required to fill these gaps from equity funding sources.

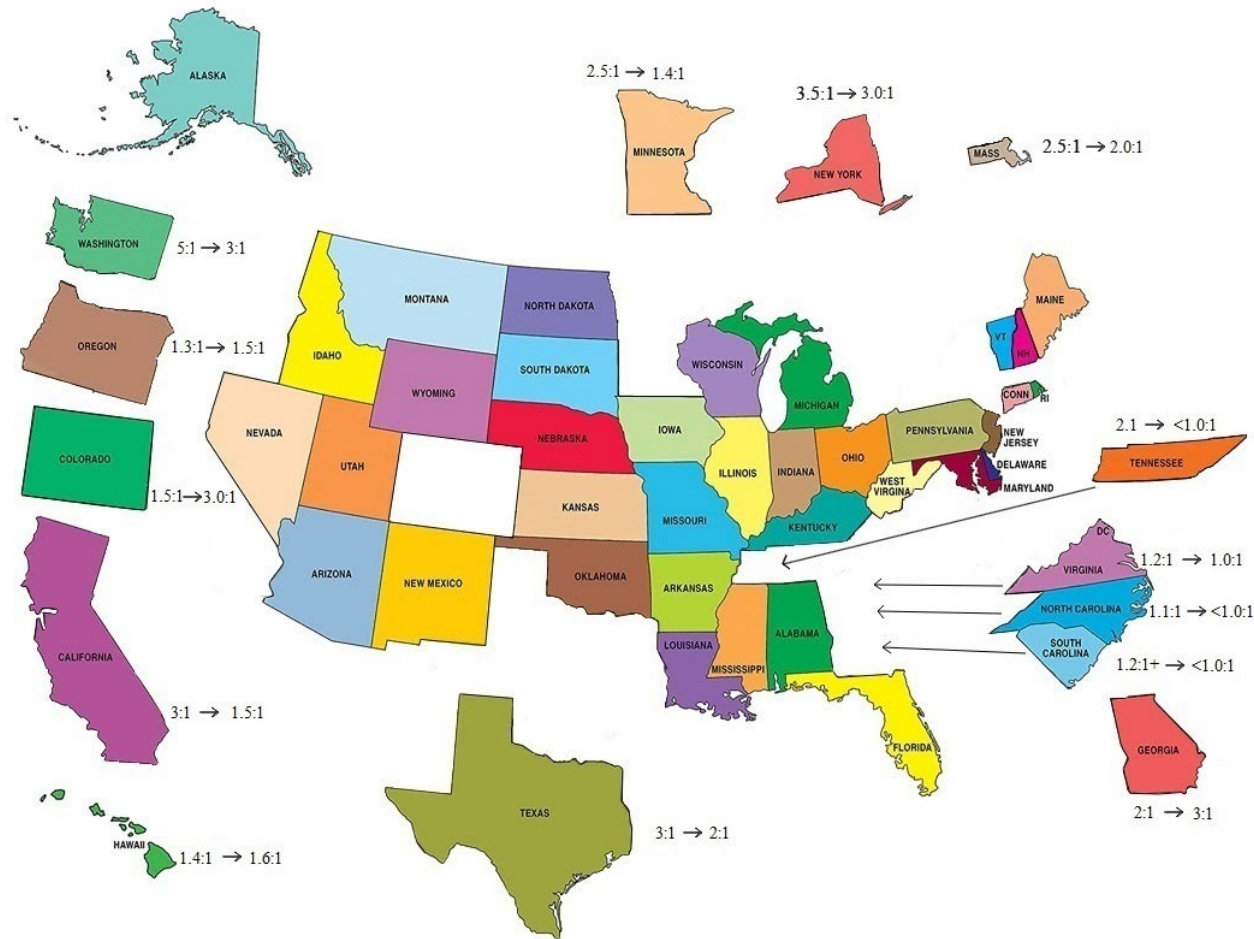
## IV. QUICK U.S. AND WESTERN REGION PRIVATE ACTIVITY BOND VOLUME UPDATE

- According to the Council of Development Finance Agencies (“CDFA”), tax-exempt multifamily bond volume rose from just over \$6 billion in 2015 to about \$17 billion in 2020, as shown in the chart below.
- This was an annual **increase in the use of PAB volume for multifamily of over 25% per year** over this **five-year period**.



- As a result, in 2021 and early 2022, **in about 18 states**, before the recent upward surge in interest rates, **the demand for multifamily volume exceeded the state's annual PAB allocation and any carryforward PAB volume**, as shown in the following slide. Following the lower bond volume in a number of states triggered by the recent dramatic rise in interest rates, **that oversubscription has eased in some states**, though it has actually grown larger in a few others, as shown in our maps.

# Volume Limited States and “Guestimated” Oversubscription Ratios\*



\* Our NGO estimates are based on published data, supplemented by conversations with industry colleagues active in tax-exempt multifamily bond and loan financings in our nationwide practice. We believe the true level of oversubscription cannot be assessed by simply comparing multifamily PAB volume applications filed to multifamily PAB allocations, since this does not reflect developers who would have filed in severely oversubscribed states, but did not make the effort to do so due to the perceived low likelihood of obtaining an award. For example, in 2021 California had about \$7.0 billion of multifamily PAB applications and allocated about \$3.5 billion to multifamily, suggesting a 2:1 oversubscription ratio. But it was common knowledge that the State’s top priority was new construction. Knowledgeable California industry colleagues told us they were confident there would have been another \$1.0 billion applied for on acquisition-rehab/preservation financings, but developers simply did not apply due to the very low likelihood of receiving an award. This was our 2021 estimate of oversubscription in California, close to 3:1 rather than 2:1 in that robust year. The more recent estimates reflect our estimates for 2023.

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- Proposal to reduce the 50% Test to a 25% Test.
  - Anyone's guess.
  - The Senate Finance Committee head is a Democrat! The new Chairman of the House Ways and Means Committee is a Republican. But, he is a friend of Low Income Housing Tax Credits. 😊 Unfortunately, he is from a rural state (Missouri) and probably favors 9% credits. 😞 So let's not bet the ranch (so to speak) on this making it in this year.
  - In addition, budget scoring will likely make any reduction in the percentage temporary or to a level higher than 25%. 😞
- But the general reduction in oversubscription ratios in a number of high growth states like California and Texas shown in slide 27 suggests more volume is now available relative to demand than in the last few years.