

# HOUSING BOND REPORT

A MONTHLY PUBLICATION ON THE LOW-INCOME HOUSING TAX-EXEMPT BOND INDUSTRY

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## Promoting Innovative Solutions to New York's Short Supply of TEBs

By Anne Townsend, Staff Writer, Novogradac & Company LLP

Public officials, affordable housing developers and advocacy groups may have a solution to the high demand for, and low supply of tax-exempt housing bonds (TEBs) in New York State — a situation frustrating many of the region's affordable housing professionals.

In 2006, the New York City Housing Development Corporation (HDC) issued \$1.66 billion of TEBs to finance the construction and preservation of 8,473 apartments across multiple income levels in New York City, the largest bond volume in its history and more than any other housing finance agency in the nation, according to data from Thompson Financial. However, the New York State Housing Finance Agency (NYHFA) announced in February that it had been asked to finance approximately \$4.8 billion worth of TEBs, but expected to have only \$590 million available to developers in 2007. Following the announcement, the shortage began to receive wide-spread media coverage and is believed to have been influenced by many variables, including a surge in interest for 80/20 projects and a surplus of TEBs from special funds.

As a result of the significant gap between supply and demand, NYHFA revised its criteria for awarding the bonds. The revised criteria left many developers without TEBs, which play an important role in the financing of affordable rental housing in many areas where such housing is in high demand. (More information on the shortage is available in the April 2007 issue of *Housing Bond Report*.)

In response to the shortage, and based on the assumption that other states have and could experience similar situations, HDC officials drafted and submitted an innovative legislative proposal to Congress. If passed,

the proposal would allow for the "recycling" of multifamily housing bonds, the same way single-family housing bonds can be used.

The Internal Revenue Service (IRS) requirements for getting the as-of-right tax credits available to developers who use TEB financing state that at least 51 percent of the total development cost must be financed using TEBs, and this financing has to be in place through construction. "Generally, a 100 percent affordable project doesn't have enough cash flow to underwrite the payments on 51 percent TEB financing, so at the time the property is converted to permanent, some portion of the TEBs are redeemed; they are repaid," said Eric Bluestone, a member of the National Association of Home Builders (NAHB) and a partner at The Bluestone Organization, a New York-based developer, builder and property manager of residential housing.

Bluestone said that the bond shortage in New York is due in part to the bonds being repaid early. When this happens, the bonds are not available for re-use, as are other public activity bonds. "You've only gotten the benefit of [the tax-exempt housing bond] for a short period of time," he said.

HDC's proposal would amend current Treasury Regulation 1.150-1(d)2(ii)(B) to provide that the obligor of an issue used to finance qualified residential rental projects would not include the recipient of the loan. Rental projects would then be treated like obligors of issuers financing qualified mortgage loans, qualified student loans and similar program investments. The proposal also solicits a regulation or other IRS pronouncement under

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Section 42 of the Internal Revenue Code (IRC), providing for the recycling of prepayments into other projects, either directly or through a refunding issue, to satisfy the requirement of Section 42(h)(4)(A)(ii).

The mechanism would allow for the prepaid increments to be re-used within 10 years, rather than lost as it is now. In turn, the supply of TEBs would not be depleted as quickly as it is currently, allowing for the financing and ultimate construction of more affordable housing. HDC estimates that this would generate as much as \$500 million in new bonding capacity in New York during the first year that it is allowed.

Carolyn Brus, spokesperson for the HDC, explained the urgency behind the proposal. "Demand for affordable housing in New York is outstripping supply, even as the national housing market seems to be undergoing a slowdown," she said. "The inability to issue more TEBs limits the development of affordable housing in New York."

Brus also described three other initiatives aimed at increasing the availability of TEBs. The first is the provision of an additional allocation of volume cap to each state based on the per capita population living in difficult development areas (DDAs). According to HDC, the additional allocation to New York based on volume cap would result in an additional \$1 billion for the state, including \$680 million for New York City; it would also increase volume cap for 37 states.

The second initiative is already under way and involves the use of taxable bonds in New York City's 80/20 program, in which 80 percent of a project's units are available to residents at market rates and 20 percent of the units are available at affordable rates. New York City recently reintroduced its Taxable 80/20 Program, which like all taxable debt is not subject to the private activity bond volume cap. HDC is currently working to make the taxable bond program more attractive to developers by reducing the spread between TEBs and taxable bonds.

Finally, HDC recently began using bonds structured with a "make whole" provision, which can save a developer some of the cost associated with borrowing. Under the provision, the developer agrees to pay a premium if paying the loan ahead of schedule. This premium allows the bond investors to earn their expected return no matter what, even if the bonds are called prior to their maturity. HDC noted that investors are willing to pay a premium for the extra security.

Interested parties can help support the proposal by contacting members of Congress and urging them to support this legislation. "Acting as advocates, housing industry professionals can write or call state and federal officials on our behalf," Brus said.

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Additionally, Brus said that as of June 2007, despite a pipeline of \$500 million in proposed affordable housing developments, HDC is currently unable to finance any further low-income, mixed-income or 80/20 housing until January unless state or federal officials replenish the corporation's supply of private activity bond volume cap. ❖

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