PROGRAM: MFA 501(c)3 Bond Financing for Affordable Rental Housing

AGENCY: The Mortgage Finance Authority

DESCRIPTION: 501(c) (3) bonds are a desirable source of financing for multifamily housing, because the bonds themselves require no allocation of private activity bond volume cap or other scarce resources. The projects benefit from bond interest rates equal to or better than other tax exempt bond rates, but in lower-rent markets additional subsidies or gap financing may be needed to achieve economic viability. The interest income is tax exempt to the bond owner, and is "non-AMT" income. The lower return on the bond investment benefits the project through a lower loan rate. Other advantages of 501(c)(3) financing, compared with private activity bonds, include avoidance of the continuous rental requirements, the land and existing property limitations, and the prohibition on advance refunding. Because by definition, the owner must be a nonprofit or government entity, this financing is not compatible with Tax Credits.

ELIGIBILITY: By MFA statute, ratings of A or better are required for publicly sold bond issues. Private placements must be A-rated and credit enhanced.

STRUCTURE:

- This financing may be done in one of two ways:

    - As a "conduit" issuer, MFA issues the bonds used to fund the mortgage, but the credit enhancement for the bonds must be provided through other sources available to the developer of the project. Bond proceeds may be used for both construction and permanent financing, or permanent financing alone.
    - Alternatively, MFA may provide construction and permanent financing through its 542(c) loan program in conjunction with the bonds. In this case, MFA originates the permanent mortgage and obtains the permanent credit enhancement for the bonds (in the form of FHA mortgage insurance).

- Following the submission of a complete application by the developer, MFA will begin processing the request. Forms are available, and requests may be submitted at any time of year. MFA will adopt an inducement resolution, if needed, at the first or second board meeting following the submission. If all requirements are met promptly by the developer, the bond closing can occur within 60 days of the delivery of firm financing and credit enhancement commitments. The second resolution required by MFA – the bond resolution itself – cannot be passed until all credit enhancement and financing commitments are in place. The process would proceed as follows:

    - Application Submission and Application Fee Payment(s) (Bond Request and 542(c) Developer Kit Application Materials if a 542(c) loan is requested)
    - Developer/MFA Staff Meeting
    - Commitment Fee Payment, Direct Cost Deposit Payment and Inducement Resolution
    - Scoping Meeting with All Financial Interests and Counsel Represented
    - Financing and Credit Enhancement Commitments (or, for 542(c) loans, Board Approval and Loan Commitment)
    - Document Drafting
    - TEFRA Hearing

- Bond Resolution
- Closing

- MFA selects the trustee, bond counsel, and financial advisor through its own independent procedures. An investment bank may be proposed by the developer. The developer's banker may select one of MFA's banking team members, and shares and other issues are to be worked out between the two.
- The developer will be responsible for all costs of issuance. Other direct costs of MFA, and fees will be paid as follows:

  - **Application Fee** due at submission of application. Ten dollars per unit, and nonrefundable.
  - **Commitment Fee** due prior to preparation of bond documents, in the amount of 50 basis points (0.5%) of the bond issue amount, and nonrefundable.
  - **Direct Cost Deposit** due prior to scoping meeting, in the amount of 50% of MFA's Cost of Issuance. Credited against MFA's COI and excess, if any, returned at closing. (Additional COI due to other third parties will also be the obligation of the developer.)
  - **Annual Administration Fee** paid with debt service, in the amount of 30 basis points per annum, in the rate.
  - **Trustee Fee** paid with debt service, in the amount of 3.5 basis points per annum, in the rate.
  - **Transfer Fee** of $5,000, plus direct cost reimbursement, due at submission of request for transfer of ownership or substitution of credit enhancement.

- Additional fees must be paid for 542(c) loans, and the schedule is published separately.

QUALIFICATIONS/CRITERIA:

- 501(c)(3) bonds may be used to fund acquisition, new construction, rehabilitation, or refinancing of a residential rental project, as well as related costs. No minimum rehabilitation limits are imposed. Typically, projects involving fewer than 20 units are not good candidates for bond transactions because the transaction costs may be too high.
- The ownership of the project must reside in a government entity or a nonprofit corporation which has obtained a 501(c)(3) determination letter from the IRS. This entity will be carefully scrutinized by MFA's bond counsel to ensure that its organizational documents, purposes, structure, and prior activities are all consistent with IRS requirements. Legal opinions from the nonprofit's counsel will be required. If an MFA loan is provided, the entity will have to be a newly formed, single asset entity, and obtaining tax exempt status for a new nonprofit can take a long period of time.
- 501(c)(3) bond projects are given a "reasonable transition period" to meet set aside requirements in the case of acquisition of tenanted projects. Typically, 12 months is allowable.
- Management contracts must comply with applicable management contract rules relating to tax exempt government bonds.

Use restrictions for 501(c)(3) bond issues are derived from the IRS's nonprofit activity rules rather than from the bond rules per se. To verify the nonprofit's eligibility for a 501(c)(3) bond issue, the housing must be used for charitable purposes, which are best demonstrated through set-asides. The IRS's "safe harbor rule" for this determination is as follows:

  - 75% of the units must be occupied by households earning no more than 80% of median income; and

    - Either 20% of the units must be occupied by households earning no more than 50% of median income; or 40% of the units must be occupied by households earning no more than 60% of median income.

- Up to 25% of the units may be offered at market rates, for tenants earning more than 80% of median income. All set-aside unit rents must be "affordable to the charitable beneficiaries". This can usually be satisfied with "a rental policy that complies with government-imposed rental restrictions…" commonly set at 30% of the applicable income limit and adjusted for family size.
- Projects which meet the criteria of other MFA multifamily programs may be eligible for additional subsidies.
- For more information, contact Linda Bridge Director of Housing Development Phone (505) 767-2262 or, in New Mexico, 1 (800) 444-6880
- Visit the MFA's homepage at http://www.housingnm.org/ or call (505) 843-6880
  (800) 444-6880 (Toll free in New Mexico)