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Factors to Consider When Choosing an Issuer of Multi-Family Housing Revenue Bonds

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Housing developers interested in financing multifamily housing projects with tax-exempt bonds must find a governmental entity to issue bonds on their behalf. In some states or jurisdictions, such as Nevada, where the Nevada Housing Division issues all multifamily housing revenue bonds, developers have little or no choice. In jurisdictions where a choice is offered, the selection of the best conduit issuer for the job may affect the costs of financing the project, both at closing and thereafter. It may also increase or reduce significantly the amount of work involved. This article describes some of the factors that developers and other parties should consider in selecting an issuer of multifamily housing revenue bonds.

Territorial Jurisdiction and Powers

Few issuers have the legal right to issue bonds to finance projects in every jurisdiction within their state. Typically, cities and counties, and their issuing authorities, can issue bonds only for projects located within their territorial limits. Likewise, joint powers authorities, such as the California Statewide Communities Development Authority, generally are confined to the territorial limits of their constituent members. Developers must determine which issuers have the legal right to issue bonds to finance their project in its planned location.

In addition to legal limits, practical and political considerations may prevent certain entities from issuing bonds for projects in certain areas. For example, a city or county may insist on serving as the issuer of bonds for projects located within its borders. This is particularly common in situations where the city or county contributes to the financing of the project, whether through grants, subordinate loans, fee waivers or otherwise. A developer who prefers to use a particular joint powers authority or statewide issuing entity as its issuer may, therefore, be forced to use another issuer for projects in certain areas. Cities and counties typically exercise this power by refusing to give TEFRA approval or other required local consent to projects unless their conditions are met. It is worth noting that state housing finance agencies often are exempt from the local restrictions faced by other would-be issuers.

Fees

It goes without saying that developers will consider fees in choosing an issuer. 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, developers may want to find out, among other things:

- if the annual fee is fixed at issuance or if it reduces as the bonds amortize,
- if the issuer charges a new issuance fee for refundings, credit substitutions or other post-closing restructurings,
- if the fee is in any way linked to the credit rating on the bonds, and
- how much work the issuer does in the way of compliance monitoring, administration, or other activities, for which the developer would otherwise have to hire another party.

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Approval of Project and Documents

Meeting schedules and agenda requirements vary widely from issuer to issuer. The governing bodies of smaller cities and towns may meet once a month or less, with summer recesses and holidays further reducing the number of meetings. Other issuers, by comparison, meet more or less on request on relatively short notice. Some issuers require documents be submitted for approval three weeks or more in advance of the meeting at which they are to be approved, while other issuers will accept documents up to the day of the meeting. In many states, volume cap allocations must be used quickly or they will be lost. Without some scheduling flexibility on the part of the issuer it can be difficult to put together a working group, settle on a financing structure, and draft and submit documents for approval, all in time to get the deal done. In considering whether the issuer is likely to delay or, worse yet, kill a deal because of its scheduling constraints, developers should consider both an issuer's stated scheduling policies and its apparent willingness to be flexible.

Scheduling requirements are only part of the approval picture. Each issuer and its counsel have their own understanding of how near to final form the documents need to be to gain approval. Developers may wish to steer clear of issuers that are particularly strict on this point. Not only does it cause delay if documents need to be near-perfect before the issuer will approve them, but an issuer can bring a deal to a halt by refusing to allow relatively routine structuring changes - a change in the initial interest payment date, for example - to be made after approval.

Choosing Professionals

Some issuers retain their own legal counsel or financial advisors whose fees must be paid by the developer. Often these arrangements are so firmly established that, from the developer's point of view, compensation for these parties is an essential part of the issuer's fee. In addition to the direct cost of paying an issuer's lawyer or financial advisor, developers should consider how much added work these parties may require of the other professionals involved in the transaction, additional work that likely will be paid by the developer. An importunate lawyer for the issuer may add hours of time and expense to a deal by demanding revisions to documents, requiring additional calls to negotiate terms or even by requesting that other counsel deliver non-standard opinions.

Issuers may also require that a working group include certain bond counsel or co-bond counsel, particular underwriters or underwriters' counsel, or a specific trustee. Developers should take into account the costs, direct and hidden, of working with the issuer's preferred professionals.

Structuring Flexibility

State law may impose certain limits on the terms of an issuer's bonds. For example, some issuers may not be authorized to issue variable

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rate bonds, or to issue any bonds in connection with swaps, interest rate caps or other derivative products. Many issuers are subject to usury laws that limit the maximum interest rate payable on their bonds. Developers should confirm that their preferred issuer is authorized to issue bonds that work with the expected financing structure.

Although conduit issuers have no payment obligation with respect to the bonds they issue, they recognize that if the bonds go into default, they may well be included as defendants in resulting bondholder suits. Issuers therefore often try to avoid financing structures that they consider too risky or experimental. Some common issuer-imposed restrictions designed to limit the risk of litigation are minimum rating requirements, minimum bond denominations and restriction of bond ownership to qualified institutional buyers and/or accredited investors who deliver a "big boy letter." Developers, underwriters and other working group members are often (though by no means always) ahead of issuers in terms of their understanding and comfort with cutting edge financing structures. To the extent possible, developers should try to find an issuer that will allow both their preferred deal structure and be comfortable enough with the structure to permit reasonable changes and modifications along the way to closing.

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 percent at 50 percent" or "40 percent at 60 percent" income requirements of Section 142(d) of the tax code. 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. In recent years, however, as the use of tax credits has become more common, multifamily housing projects often exceed both the Section 142(d) requirements and any local requirements in terms of income restrictions and affordability.

Following Through to Closing

Some issuers have developed a reputation for killing deals at, or near, closing. Quite simply, developers should beware of these issuers. Not only is it expensive to carry a deal through all the required stages of negotiation, drafting, approval and even pricing, only to have it collapse at the finish line, but the collapse itself may burden the developer for months or years to come. The California Debt Limit Allocation Committee, which allocates volume cap to multifamily housing projects within California, deducts 10 points (for reference, successful applications in the most recent allocation round scored 70 points or more) from each application submitted by a developer within two years after any failure by the developer to close a bond deal after receiving allocation. Exceptions are made if the developer can show that the failure was entirely beyond its control, but it is always best to avoid being put in this position.

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Assuming all goes well and that bonds are issued to finance a project, the conduit issuer's participation in the transaction often continues after closing; we will discuss questions of ongoing issuer involvement in an upcoming article.

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