Minnesota Housing
Finance Agency

Tax-Exempt Bonds Informational Guide

May 16, 2016

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Introduction [1]

Statutory Requirements

Tax-exempt bonds are regulated by Internal Revenue Code Section 142 and Minnesota Tax-Exempt Bond Statute: 474A.047.

What are tax-exempt bonds?

Tax-exempt bonds are municipal bonds and are different from most other securities because of the federal tax exemption on interest earned. Interest income is not included in gross income for purposes of federal income taxation. Municipal bonds are often referred to as tax-exempt bonds. If, as in Minnesota, municipal bonds are exempt from state income tax, they are known as double exempt. Minnesota Housing obligations are tax exempt from federal and Minnesota personal income tax to residents of Minnesota.

What types of tax-exempt bonds are used to finance multifamily construction?

Minnesota has several types of housing bonds, including:

- **General Obligation (GO) Bonds**: GO bonds are payable from any of the issuer's funds and are secured by a pledge of full faith and credit of the issuer for timely payment of principal and interest to the bondholder.
    - **Rental Housing Bonds** fall under this category, even though it is expected that they will be repaid from revenues of the loans. Typically Minnesota Housing issues Rental Housing Bonds for multifamily projects.
- **Revenue Bonds**: Revenue bonds are payable from, and secured only by, the earnings of a revenue-producing enterprise, a mortgage loan or a portfolio of loans.
    - **Conduit Bonds** fall under this category. Minnesota Housing issues conduit revenue bonds when the project does not have a first mortgage loan from Minnesota Housing. Short-term conduit bonds may also be cash collateralized; the repayment of the loan to the borrower is secured solely by cash advanced from other permanent funding sources as the borrower incurs project costs.
- **State Appropriation Bonds**
    - **Housing Infrastructure Bonds (HIB)** are neither revenue nor General Obligation bonds. They are payable from the amount the state has promised to appropriate each year for debt service.

[1] This manual is provided solely for general informational purposes. It is not providing legal or financial advice. Minnesota Housing is not responsible for any decision making based on the information set forth in this guide. Interested parties wishing to utilize tax exempt bonds should obtain advice from independent sources, including consultation with knowledgeable legal counsel and bond professionals.

What is Minnesota Housing's annual bonding authority, and how is it determined?

Federal tax law governs how much the state as a whole is allocated each year in bonding authority (volume cap) and by when any allocated authority must be used. It is determined by population. For example, in 2016 it will be $100 times the state population. State law determines how the state allotment is allocated between different state issuers of private activity bonds. Minnesota Statute 474A describes the allotment process.

Minnesota Housing is an entitlement issuer and has other special status, which means all unused bonding authority at the end of each year is transferred to Minnesota Housing.

Minnesota Housing's bonding authority varies from year to year. In 2015, Minnesota Housing was allocated $125 million through its entitlement portion, which increases slightly each year. The additional amount, which automatically transfers to Minnesota Housing at the beginning of December of each year, if no other issuer has requested it, has varied greatly. Over the past five years it has been as low as $145 million and as high as $300 million. The amount depends on how active other issuers in the state are. Minnesota Management and Budget monitors bonding allocation for state agencies, including Minnesota Housing.

How do bonds interact with other Minnesota Housing funding sources?

Low and Moderate Income Rental (LMIR) First Mortgage. In a tax-exempt bond transaction with Minnesota Housing, either one or two series of bonds are issued. Long-term bonds fund the permanent LMIR end loan. Short-term bonds, when issued simultaneously with long-term bonds, fund the LMIR Bridge Loan. The bridge loan typically bridges a portion of the tax credit equity. Together, both bond series should be in an amount sufficient to meet the 50% test. When this occurs, the development is eligible to receive 4% tax credits. (For additional information on how to qualify for tax credits refer to Article 8 of the Qualified Allocation Plan (QAP) and Chapter 7 of the Housing Tax Credit (HTC) Manual).

Since 2014, the bond market has not offered competitive interest rates for long-term bonds. As a result, Minnesota Housing is currently issuing only short-term bonds to fund LMIR Bridge Loans. LMIR end loans are funded with other Minnesota Housing sources. In addition to a LMIR loan, Minnesota Housing may also make a deferred loan with this structure.

NOTE: LMIR Bridge Loans are not HUD-insured, and permanent LMIR loans are not typically HUD-insured until the end loan closing occurs, after construction completion.

Non-HIB Deferred Loan Only. Conduit bond transactions occur when Minnesota Housing does not have a first mortgage on the project. The project is financed with Minnesota Housing conduit bonds and deferred funding from Minnesota Housing, but the first mortgage is with an outside lender. Minnesota Housing does not provide conduit bond financing currently for projects that do not have Minnesota Housing deferred funding.

HIB. An award of HIB private-activity bonds may be used in place of, or in addition to, traditional tax-exempt bonds, qualifying a development for 4% housing tax credits. Some projects may require additional tax-exempt bonds to meet the 50% test. Housing infrastructure bonds are issued for multiple projects at a time. Then, HIB becomes a deferred loan and source of permanent financing for each individual development.

What is the process for securing non-competitive 4% tax credits?

In addition to competitive 9% housing tax credits, Minnesota Housing allocates non-competitive 4% housing tax credits through the issuance of tax exempt bonds (aka rental housing bonds). Initial eligibility is based upon the structuring of the bonds; however, Section 42 and the allocating agency establish a separate set of procedures to qualify for the tax credits. See the QAP and HTC manual for additional details. The project must comply with the QAP that is in effect for the calendar year in which the tax-exempt bonds were first issued.

Minneapolis, Saint Paul, Washington County and Dakota County are sub-allocators that have the authority to allocate tax credits in their jurisdiction. This includes 4% tax credits via tax-exempt bond financing. Please refer to the sub-allocators QAP for additional details.

Other Minnesota cities and counties may have bonding authority and can issue tax-exempt bonds, but Minnesota Housing allocates 4% housing tax credits via a 42(m) letter. In order to receive the letter, the developer must submit all the documents required for an application for tax credits as established by the Minnesota Housing in the QAP and Procedural Manual and any additional information requested by the Allocating Agency. The 42(m)(2)(D) letter is a requirement in the application. If the bond issuer is Minnesota Housing, the Agency will issue the 42(m)(1)(D) and 42(m)(2)(D) letters following board commitment. If the bond issuer is a city or county and is not one of the sub-allocators listed above, that entity must perform the 42(m)(2)(D) review and provide the 42(m)(2)(D) letter. Minnesota Housing then provides the 42(m)(1)(D) letter. See QAP and HTC manual for additional details.

Applicants seeking Minnesota Housing tax-exempt bonds can apply via the annual Request for Proposals (RFP) or on a pipeline basis with a LMIR or MAP loan application. Minnesota Housing's policy is to issue conduit bonds only when the borrower is also receiving a deferred loan from Minnesota Housing.

Chapter 1 – Selection Underwriting

1.01 Deal Structure

Loan Amount. The bridge loan should be sized to cover both the LMIR permanent mortgage and the portion of tax credit equity that requires bridging. Bonds are issued in $5,000 increments; round up to the nearest $5,000. The borrower should determine the appropriate bridge loan sizing so that the project will meet the 50% test for 4% tax credits and meet Minnesota Housing's Closing in Balance underwriting standard.

Ultimately the borrower's counsel and the tax credit syndicator's counsel will make the final determination of the amount of bonds needed, but the borrower should estimate and size the bonds using a buffer of 53 percent (rather than 50 percent) so that the project satisfies the 50% test.

Bridge Loan Term. The bridge loan will have a minimum loan term of approximately 18 months and will mature one month prior to maturity of the bonds. The bonds may be optionally redeemed after 12 months; this should be discussed with Minnesota Housing if this option is desired. The loan term is based on the construction schedule, which means if the construction schedule is longer, the loan can have a longer term. If the construction schedule is shorter, due to yield limitations, the term will not be reduced.

NOTE: This rule may not apply when long term bonds are also issued for the same project.

Interest Rate. The interest rate will be set by the market at the time of the bond sale. Minnesota Housing requires the bridge loan to bear interest at an annual rate equal to the interest rate on the bonds, plus 1.0 percent. For example, if the interest rate on the bonds is 1.50 percent, the borrower will be charged 2.50 percent. Once the project is selected and is near closing, Minnesota Housing's bond underwriter will provide an estimated interest rate to use until the bonds are priced.

NOTE: The borrower must pay interest on the total amount of the loan from the time the bonds are issued, not on the principal amount of the loan that has been drawn down.

1.02 Analysis and Bond Tests

Beginning with the 2015 RFP, developers submitting dual applications have been required to complete the Bond Tests Analysis spreadsheet. Minnesota Housing's underwriters use this as a starting point to determine eligibility for bond financing. For technical assistance, contact Minnesota Housing.

Scattered Site Projects. For a scattered site development, each separate site must meet the income set-aside, 50% test, rehab test and Minnesota's Fair Market Rent (FMR) test.

Ownership Assessment. Organizational charts for the current and future ownership entities showing the ownership percentage, cash flow, and residuals must be sent to Minnesota Housing post-selection. Minnesota Housing's Finance counsel will determine what, if any, additional bad costs there are and if there are sufficient good costs to support the loan amount. Refer to Appendix B for sample organizational charts pre- and post-sale.

50% Test. One of the major requirements for a development to qualify for 4% housing tax credits is the use of tax-exempt private activity bonds to pay for at least 50% of total basis costs plus land through the construction period. To initially estimate the bond amount required, use this equation:

Bonds required for 50% test = 0.53 * (total basis + land)

This is a rough estimate that may be used during initial selection. The developer should consult with their tax attorney to ensure that the project meets the 50% test as require by Section 42. The actual amount of bonds issued may be higher if Minnesota Housing is bridging tax credit equity.

Good Costs/Bad Costs. Certain development costs, also known as good costs, may be paid with tax-exempt bonds, while other bad costs may not. There must be enough good costs to support the final loan amount.

Good costs and bad costs are listed on the Bond Tests Analysis spreadsheet under the Bond Costs from Workbook tab. Some bad costs will not automatically categorize and will need to be adjusted manually. For example, development fees, general contractor fees and overhead, or architect's fees are considered bad costs when there is an identity of interest between the borrower and these parties, since payments to related parties (as defined by federal tax law) may not be bond financed. Complete the Ownership Assessment mentioned above to help determine good/bad costs.

The Bond Tests Analysis, Bond Costs from Workbook tab calculates the anticipated amount of bonds required based on 50 percent of good costs plus a 3 percent buffer. The amount of good costs shown plus the buffer should be compared to the amount of bonds needed to meet the 50% test (the total basis + land amount). If the former is not at least equal to the latter, there are not enough good costs to support the amount of bonds needed to meet the 50% test.

If a project contains commercial or non-residential space, costs related to those portions of the development are considered bad costs.

If at any time during post-selection there are updates to good/bad costs, please send that information to the Minnesota Housing underwriter. Minnesota Housing's finance and bond counsel make the final determination of good costs. Minnesota Housing's counsel must determine there are adequate good costs to support the amount of bonds; however, Agency finance and bond counsel make no determination about the 50% test. The borrower's and syndicator's counsel determine this.

Rehab/Acquisition Ratio. Rehab must be greater than or equal to 15 percent of the acquisition amount financed by bonds.

$$\frac{\text{Rehab costs}}{\text{(Building acquisition – land cost) financed by bonds}}$$

This calculation is included in the Bond Tests Analysis, Bond Costs from Workbook tab.

Income Restrictions. Units must be restricted to Section 42 and Section 142(d) income requirements, with a minimum set-aside of either 40 percent of units at 60 percent AMI or 20 percent of units at 50 percent AMI.

State Requirements.

- FMR Rents – 20 Percent of Units: At least 20 percent of units must have rents at or below Fair Market Rent (FMR) or Exception FMR for existing housing. Units that have project-based federal rental assistance (e.g., Section 8) are deemed to meet this condition.
- Extend Affordability/Rental Assistance: The owner is obligated to extend any existing affordability restrictions and any rental assistance agreements for the maximum term permitted.

Chapter 2 – Post-Selection Process

2.01 Reimbursement Declaration

Minnesota Housing will execute the reimbursement declaration soon after selection. It allows eligible expenses incurred up to 60 days prior to execution of the reimbursement declaration to be paid with the bond proceeds. There are some costs that may be covered prior to the 60 day period (architect, engineering, soil testing, etc.), but not land acquisition or site prep. The reimbursement declaration does not expire.

2.02 TEFRA Hearing

A Tax Equity and Fiscal Responsibility Act (TEFRA) hearing is required for all projects using private activity bonds. The bonds must be issued within one year of the TEFRA hearing or another TEFRA hearing must be held. Notice must be published at least two weeks prior to the hearing.

The hearing gives the public the opportunity to comment. If there are attendees, Minnesota Housing's underwriter records all comments made by the public about the proposed project.

The bond amount stated in the TEFRA hearing will include a 20 percent buffer to the anticipated amount of the bonds. If the final bond amount increases more than 10 percent above the amount stated in the TEFRA notice, the TEFRA hearing must be held again.

2.03 Bond Fees

The borrower and the Minnesota Housing underwriter must ensure that appropriate bond fees are included in the Workbook. The fees are preliminary estimates and are subject to change once the bond underwriter completes her or his analysis.

Bond fees in conjunction with a Minnesota Housing first mortgage:

- Issuance Fee:
  - $100,000 plus
  - 0.75 percent of short-term bond amount
  - This fee includes bond counsel, bond underwriter, etc.
- LMIR Bridge/Construction Loan Origination Fee:
  - 0.50 percent of bond amount/bridge loan amount

A first mortgage origination fee for the LMIR end loan and a Minnesota Housing Inspection Fee should also be included in the Workbook.

Conduit Bond Fees (bonds with deferred loan only or no Minnesota Housing first mortgage):

Fees may vary depending on the structure of the bonds being issued, but may include:

- Issuance Fee
- Financial Advisor:
- Bond Counsel:
- Semiannual fee during term of bonds

HIB:

- There are no fees associated with HIB.

2.04 Underwriting

From selection to closing, the borrower must submit an updated Workbook to the Minnesota Housing underwriter whenever there are changes. **The borrower and Minnesota Housing underwriter must monitor changes to ensure they do not affect the Bond Tests/Analysis completed previously, especially good costs.** Additionally as the amount of bonds changes, fees must be adjusted accordingly.

Prior to Mortgage Credit Committee approval, the borrower must provide a letter from her or his counsel verifying that the project is anticipated to meet the 50% test. Refer to Appendix B for a sample letter.

The timing of bond issuance affects the following:

- **Applicable Percentage**: The tax credit applicable percentage is based on the month in which the bonds are issued.
- **QAP Scoring**: The project must meet the minimum score for the QAP in the year in which the bonds are issued.
- **Tax Credit Land Use Restrictive Agreement (LURA)**: The project must adhere to the tax credit LURA for the year in which the bonds are issued.

2.05 Bond Team Communications and Process

Individual project bond issue with a Minnesota Housing first mortgage. Beginning after selection, Minnesota Housing's underwriter works with the Agency's in-house finance counsel on a number of tasks. At least eight weeks prior to closing, the Minnesota Housing underwriter will send the current Workbook and proposed timeline for closing to the Agency's outside bond underwriter.

The outside bond underwriter will coordinate regular conference calls with the Agency's bond team, beginning at least one month prior to mailing of the Preliminary Official Statement (POS). The outside bond underwriter will submit cash flows to credit rating agencies three to four weeks prior to mailing the POS.

Minnesota Housing's underwriter must communicate to the bond team any changes made to the project timeline, including changes to the amount of bonds. The borrower must keep Minnesota Housing's underwriter informed of any changes, as changes may cause a delay in project closing.

Conduit bond issue with a Minnesota Housing deferred loan. The conduit bond structure is driven by the borrower's bond underwriter instead of Minnesota Housing's bond underwriter. The borrower's bond underwriter leads the bond calls, manages the distribution list, and sends out the closing timeline. Minnesota Housing's bond counsel and financial advisor participate with the borrower's bond underwriter on the bond calls.

Prior to adding the project to Minnesota Housing's board meeting agenda, the following must be completed:

- Deposit to be applied to Minnesota Housing's costs (contact Minnesota Housing's underwriter for amount and where to submit)
- Signed Agreement and Indemnification from sponsor (not the single asset entity that will own the project)
- Review of 50% test
- Review good costs/bad costs
- Review buyer and seller ownership structures
- Mortgage Credit Committee approval of the project

Prior to the board meeting, the following must be completed:

- TEFRA hearing scheduled, notice published, and hearing held
- Drafts of all documents to be referenced in the authorizing resolution:
  - Indenture
  - Loan Agreement
  - Bond Purchase Agreement
  - Bond Compliance Agreement
  - Preliminary Official Statement (POS)
- Both the board resolution (prepared by Minnesota Housing's bond counsel) and the Preliminary Official Statement (prepared by the bond underwriter's counsel) need to be sent to the board secretary, in accordance with the Agency schedule. The resolution must be in final form; the POS should be close to a final draft.

HIB issue (multiple projects issued together). For projects with HIB and no additional tax-exempt bonds, Minnesota Housing's HIB program manager coordinates issues for multiple projects together, one or more times during each year funds are available. The borrower must keep Minnesota Housing's underwriter updated on the project's timeline.

Bond Team for Each Type of Transaction

	LMIR Bridge Loan	**Conduit Bonds**	**HIB only**
Borrower's Primary Point of Contact	Minnesota Housing Underwriter	Minnesota Housing Underwriter	Minnesota Housing Underwriter
Markets and Sells Bonds	Minnesota Housing's outside bond underwriter	Borrower's / first mortgage lender's bond underwriter	N/A – larger bond issue for multiple projects
Reviews Good/Bad Costs	Minnesota Housing's in-house finance counsel and outside bond counsel	Minnesota Housing's in-house finance counsel and outside bond counsel	Minnesota Housing's in-house finance counsel and outside bond counsel
Determines Final Amount of Bonds for 50% Test	Borrower's and syndicator's counsel	Borrower's and syndicator's counsel	Borrower's and syndicator's counsel
Drafts Preliminary Official Statement	Minnesota Housing's in-house finance counsel	Borrower's / first mortgage lender's bond underwriter's counsel	N/A – larger bond issue for multiple projects
Drafts Series Resolution for Board Meeting	Minnesota Housing's outside bond counsel	Minnesota Housing's outside bond counsel	N/A – larger bond issue for multiple projects
Presents Board Report for Bridge Loan	Minnesota Housing Underwriter	N/A	N/A

Chapter 3 – Approvals

3.01 Mortgage Credit Committee

Once Minnesota Housing receives applicable due diligence items from the borrower and final construction bids are in, Minnesota Housing's underwriter will complete a mortgage credit report and present it to the Mortgage Credit Committee for approval. The interest rate for the bridge loan will be determined closer to closing.

NOTE: Minnesota Housing's Mortgage Credit Committee is an internal, decision-making committee.

3.02 Board

Board approval is required for the LMIR loan as well as the bridge loan. The language the Minnesota Housing underwriter uses in the board report includes "not to exceed". The underwriter also includes the amount of the bonds indicated in the TEFRA notice (along with the buffer amount). The board report does not include the exact amount of bonds the underwriter anticipates issuing. The amount of bonds listed in the board report should match the amount of bonds in the Series Resolution that the CFO presents at this same board meeting.

The POS must list the actual anticipated loan amount, whereas the Series Resolution should include a buffer over the anticipated loan amount that matches the bridge loan "not to exceed" amount in the Minnesota Housing underwriter's board report.

3.03 42m Letter

The Minnesota Housing loan processor reviews the due diligence for the 42m letter after Mortgage Credit Committee approval. Once the project has been approved by the board, the Minnesota Housing tax credit technician prepares the draft 42m letter. As soon as payment for the reservation fee has been received, the technician sends the draft letter to the borrower for review.

Chapter 4 – Closing of Minnesota Housing Bridge Loans

Important: Confidentiality and Requests for Information

Minnesota Housing does not include the borrower in the bond documentation process except in the case of conduit bond transactions. If the borrower or her or his counsel requests information, Minnesota Housing's underwriter refers the borrower to the Agency's finance counsel. Minnesota Housing's finance counsel is the only party that can release information to the borrower, outside investors or other parties.

4.01 Loan Commitment

Minnesota Housing's underwriter transfers the file to closing as soon as possible after Mortgage Credit Committee approval. Loan documents can be emailed to the borrower after Mortgage Credit Committee approval. All due diligence items (including the first draw) must be approved, and all loan document comments must be final, prior to executing the loan commitment. The POS for the bonds will not be mailed, and the bonds cannot be priced, until the loan commitment has been executed. At the time of signing the loan commitment, the borrower must also pay, by check, the bridge loan origination fee.

Additionally, the following must occur prior to executing the loan commitment:

- HUD firm approval received
- Section 8 or rental assistance contract executed, if applicable
- Minnesota Housing board approval for the LMIR loan, bridge loan, bond resolution and POS
- All funding committed
- No other outstanding items

The Minnesota Housing underwriter will notify the bond team once the commitment has been executed.

4.02 Preliminary Official Statement (POS)

Within a few days of executing the loan commitment, the POS describing the bonds being offered for sale by Minnesota Housing, will be posted.

4.03 Pricing and Closing on the Bonds

Approximately one week after the POS is posted, the bonds will be priced and the outside bond underwriter will execute a contract of purchase with Minnesota Housing. The outside bond underwriter schedules the bond pricing and closing. Bonds are not typically priced on a Monday, Friday, or a day before or after a holiday.

Once the bonds have been priced and sold, Minnesota Housing's bond counsel is required to obtain written approval from the Governor's office in order to render its opinion that interest on private activity bonds is tax exempt. The Governor's office receives a copy of the TEFRA hearing minutes, notices of publication, minutes reflecting board approval and a copy of the final Official Statement. The Governor's office typically takes between a few days and a week to deliver the Governor's approval of the issuance of the bonds.

Approximately one week after the bonds are priced, the closing occurs. Closings do not typically occur on a Monday, Friday, or a day before or after a holiday.

Minnesota Housing's closer schedules a pre-closing meeting with the borrower on the business day immediately prior to the bond closing. All remaining documents are executed during or prior to the pre-closing. Syndication proceeds must be received by the title company prior to the pre-closing.

4.04 Post-Closing

Bond Compliance Agreement. The bond compliance agreement runs from the date 10 percent of units are first occupied through the later of:

- Maturity of the bonds, or
- 15 years from date 50 percent of units are first occupied, or
- Termination of the Section 8 contract.

Minnesota Housing's Housing Management Officer (HMO) monitors the property for compliance under the Bond Compliance Agreement. The Bond Compliance Agreement is an attachment to the Management Agreement, and the Management Agreement must contain a provision referencing the Bond Compliance Agreement. Additional monitoring requirements include:

- Exhibit B of the Bond Compliance Agreement

  Exhibit B is an attachment to the Bond Compliance Agreement. The document is required to be filled out when the property is 50% occupied. Exhibit B is used to document the bond compliance agreement's:
  - Commencement date
  - End dates of occupancy restriction and rental restrictions

- Annual Certifications

  During the compliance period, the following forms may need to be submitted annually to Minnesota Housing (see Bond Compliance Agreement)
  - IRS Form 8703
  - Certification of Compliance form 474A.047

- Financial Reporting and Annual Inspections

  In addition to the annual certification, the following financial reporting and oversight may be required by Minnesota Housing:
  - Submit monthly operating reports
  - Annual budget approvals
  - HMO Annual inspections

Chapter 5 – Housing Infrastructure Bonds (HIB)

5.01 Types of HIB

HIB are awarded in the annual RFP and are structured as either a repayable or forgivable deferred loan. There are two program types for HIB. Economic Development and Housing Challenge (EDHC) HIB is used for preservation of federally assisted housing. Housing Trust Fund (HTF) HIB is used for permanent supportive housing projects. The types of bonds issued are listed below:

Private Activity. This is the most commonly issued type of HIB through the annual RFP. Loans are structured as deferred, repayable loans, with a 30 year term. HIB proceeds count towards the 50% test for 4% tax credits. The project must satisfy all of the bond tests discussed in *1.02 Analysis and Bond Tests.* The borrower can be any type of entity except for a governmental entity. These bonds count against Minnesota Housing's volume cap.

Governmental. Governmental HIB loans are structured as deferred, forgivable loans with a 30 year term. The borrower can be any type of entity. Proceeds do **not** count towards the 50% test for tax credits. Bonds issued do not count against Minnesota Housing's volume cap. A TEFRA hearing is not necessary for governmental HIB loans financed by a separate series of HIBs; however, to allow Minnesota Housing maximum flexibility in structuring HIBs, the TEFRA hearing requirements must be met.

501(c)3. To use 501(c)3 HIB, the borrower must be a non-profit organization. Loans may be repayable or forgivable. Proceeds do **not** count towards the 50% test for tax credits. Bonds issued do not count against Minnesota Housing's volume cap. A TEFRA hearing is not necessary for 501(c)(3) HIB loans financed by a separate series of HIBs; however, to allow Minnesota Housing maximum flexibility in structuring HIBs, the TEFRA hearing requirements must be met.

More information about HIB is available in the EDHC and HTF program guides.

5.02 Underwriting and Process

Fees. There are no bond fees or additional costs for HIB loans. Some projects may be financed with both a HIB loan and a LMIR bridge loan funded by the proceeds of other tax-exempt bonds of Minnesota Housing. In such cases, fees will be charged on the LMIR bridge loan but not on the HIB loan.

Reimbursement Declaration and TEFRA Hearing. For all HIB projects, the process is the same as discussed in 2.01 and 2.02. If the project is financed by another type of tax-exempt bonds and HIB, the reimbursement declaration and TEFRA amounts should cover the total amount of both bond types.

Bond Issuance. For HIB, bond issues will finance loans for multiple projects. Bonds are not issued for each project separately, and properties are not collateral for the bonds. For approval purposes, a HIB loan is treated in the same manner as a deferred loan. Mortgage Credit Committee approval is required for the HIB loan but, after the initial selection, additional Minnesota Housing board approval is not necessary.

Minnesota Housing's board approval of the issuance of bonds lists each HIB loan that may be financed with the proceeds of those bonds. Because bonds are not issued individually for each project, the Minnesota Housing underwriter will not be working with the outside bond underwriter on these projects unless another type of tax exempt bonds is also a source.

The timing of bond issuance affects the following:

- **Applicable Percentage**: The tax credit applicable percentage is based on the month the bonds are issued. In the case of projects funded with multiple HIB issues in different years, the borrower's counsel elects which applicable percentage to use.
- **QAP Scoring**: The project must meet the minimum score for the QAP in the year in which the bonds are issued. In the case of projects funded with multiple HIB issues in different years, use the QAP in the year the first bonds were issued.
- **Tax Credit Land Use Restriction Agreement (LURA)**: The project must adhere to the tax credit LURA for the year in which the bonds are issued. In the case of projects funded with multiple HIB issues in different years, use the LURA in the year the first bonds were issued.

5.03 Post-Closing

Bond Compliance Agreement or Tax Exemption Agreement. The bond compliance agreement runs from date 10 percent of units are first occupied through the later of:

- Maturity of the bonds, or
- 15 years from date 50 percent of units are first occupied, or
- Termination of the Section 8 contract

The Bond Compliance Agreement is used with private activity and certain 501(c)3 bonds. The Tax Exemption Agreement is used with governmental and some 501(c)3 bonds and terminates when the bonds have been paid in full.

Minnesota Housing's Housing Management Officer (HMO) monitors the property for compliance under the Bond Compliance Agreement. The Bond Compliance Agreement is an attachment to the Management Agreement, and the Management Agreement must contain a provision referencing the Bond Compliance Agreement. Additional monitoring requirements include:

- Exhibit B of the Bond Compliance Agreement

  Exhibit B is an attachment to the Bond Compliance Agreement. The document is required to be filled out when the property is 50% occupied. Exhibit B is used to document the bond compliance agreement's:
  - Commencement date
  - End dates of occupancy restriction and rental restrictions

- Annual Certifications

  During the compliance period, the following forms may need to be submitted annually to Minnesota Housing (see Bond Compliance Agreement)
  - IRS Form 8703
  - Certification of Compliance form 474A.047

- Financial Reporting and Annual Inspections

  In addition to the annual certification, the following financial reporting and oversight may be required by Minnesota Housing:
  - Submit monthly operating reports
  - Annual budget approvals
  - HMO Annual inspections

Appendix A: Definitions

4% housing tax credits	Non-competitive low-income housing tax credits (LIHTC) that projects qualify for by using tax-exempt bonds that are private activity bonds and are outstanding at least until the project's placed in service date to finance at least 50 percent of project costs. Projects must meet the minimum point threshold in the state Qualified Allocation Plan (QAP) and use tax-exempt bonds for at least 50 percent of basis plus land.
42(m)(1)(D)	Section 42(m)(1)(D) requires the tax credit allocator to produce a letter verifying the development complies with the applicable QAP. The applicable QAP is that of the allocating agency responsible for the 42(m)(1)(D) tax credit review. In most jurisdictions, the QAP refers to the HTC Manual, which in most cases requires the development comply with underwriting benchmarks contained in the manuals.
42(m)(2)(D)	Section 42(m)(2)(D) requires that the tax-exempt bond issuer produce a letter determining that the development is financially feasible and that no excess credits are awarded. The applicable underwriting criteria and benchmarks are those of the tax credit allocating agency responsible for the 42(m)(1)(D) determination.
501c(3)	To be tax-exempt under section 501(c)(3) of the Internal Revenue Code, an organization must be organized and operated exclusively for exempt purposes set forth in section 501(c)(3), and none of its earnings may inure to any private shareholder or individual.
Bond	A bond is a debt investment in which an investor loans money to an entity (typically corporate or governmental) that borrows the funds for a defined period of time at a variable or fixed interest rate. Bonds are used by companies, municipalities, states and sovereign governments to raise money and finance a variety of projects and activities. Owners of bonds are debtholders, or creditors, of the issuer.
Cash collateralized	Conduit bond transactions in which the bonds are cash-collateralized by funds from other lenders, including from an outside MAP first mortgage.
Conduit bonds	A bond issued by a governmental entity but repaid by another entity benefiting from the financing generated by the issuance of the bond. For example, a business might be the borrower using the proceeds of the bonds issued by the governmental entity to raise capital for a real estate development project. The governmental entity would have no obligation to

	pay the bondholders except from loan repayments made by the borrower and would bear no responsibility for repayment if the borrower defaulted.
EDHC	Economic Development and Housing Challenge deferred loan program.
FMR	Fair Market Rent.
Governmental bonds	Governmental HIB loans are forgivable and are structured as deferred, forgivable loans with a 30 year term. The borrower can be any type of entity. Proceeds do **not** count towards the 50% test for tax credits. Bonds issued do not count against Minnesota Housing's volume cap.
HIB	Housing Infrastructure Bonds are a funding source awarded through Minnesota Housing's annual consolidated RFP. Typically new HIB is available for legislative appropriation in state bonding years that are even numbered years. HIB includes several program types, some of which are private activity bonds that qualify a project for 4% tax credits, while others are governmental bonds that are issued to fund forgivable loans and do not qualify a project for tax credits. Typically HIB is structured as a deferred, 30 year loan.
HTF	Housing Trust Fund. HTF Housing Infrastructure Bond proceeds can be used for the cost of construction, acquisition, preservation and rehabilitation of supportive housing. Among comparable proposals for permanent supportive housing, preference will be given to supportive housing for individuals and families who either: 1) have been without a permanent residence for at least 12 months or at least four times in the last three years, or 2) are at significant risk of lacking a permanent residence for 12 months or at least four times in the last three years.
LMIR	Low and Moderate Income Rental first mortgage program. LMIR loans are typically insured by HUD through its risk-sharing program.
MAP	FHA insured first mortgages through HUD's Multifamily Accelerated Processing program, which includes 221(d)(4), 223(f), etc. Minnesota Housing is a MAP approved first mortgage lender. MAP term sheets are available at mnhousing.gov
negative arbitrage	The result of paying a higher interest rate on bonds than is achieved from the investment of bond proceeds.
POS	Preliminary Official Statement. The official statement will provide investors with all of the details regarding the bonds being issued. Issuers who prepare an official statement must make it available to all purchasers, as well as to

	any investor or broker dealer who requests one. An official statement includes: • The Terms of the Offering • Purpose of the Issue • Summary • Description of Bonds • Description of The Issuer • Financial Data for The Issuer or the Conduit Borrower • Regulatory Matters • Feasibility Statement • Legal Proceedings • Type of Indenture (Open/Closed) • Authorization of Bonds • Security Pledged, if any • Construction Plans • Tax Status
Private activity bonds	A municipal debt obligation that is issued by a governmental entity to fund projects in which used by a non-governmental entity in its trade or business or security by property used in a trade or business. Since the interest on certain types of these obligations may be exempt from gross income and therefore beneficial in terms of tax liability, private activity bonds are often used by cities, townships and other governmental entities to attract private funding for projects that may feature some advantage to the general public.
Qualified Allocation Plan (QAP)	Section 42 of the Internal Revenue Code (IRC), requires that state allocating agencies develop a Qualified Allocation Plan (QAP) for the distribution of the tax credits within their jurisdiction. The current and proposed QAPs are available at mnhousing.gov
Residential rental bonds	In Minnesota, governed by § 474A.047, tax-exempt bonds issued to finance residential rental projects that meet the requirements of Section 142(d) of the Internal Revenue Code.
Section 142(d)	Internal Revenue Code § 142 Exempt facility bond. *(excerpt below):* (a) General rule. For purposes of this part, the term "exempt facility bond" means any bond issued as part of an issue, 95 percent or more of the net proceeds of which are to be used to provide…qualified residential rental projects (1) In general. The term "qualified residential rental project" means any project for residential rental property if, at all times during the qualified project period, such project meets the requirements of subparagraph (A) or (B), whichever is elected by the issuer at the time of the issuance of the issue

	with respect to such project: (A) 20-50 test. The project meets the requirements of this subparagraph if 20 percent or more of the residential units in such project are occupied by individuals whose income is 50 percent or less of area median gross income. (B) 40-60 test. The project meets the requirements of this subparagraph if 40 percent or more of the residential units in such project are occupied by individuals whose income is 60 percent or less of area median gross income. For purposes of this paragraph, any property shall not be treated as failing to be residential rental property merely because part of the building in which such property is located is used for purposes other than residential rental purposes.
Section 42	Internal Revenue Code § 42 Low-income housing credit (LIHTC) regulations
Spread	The difference between the bid and the ask price of a security or asset.
Sub-allocator	Eligible cities and counties that have the authority to administer tax credits locally. These include Minneapolis, Saint Paul, Dakota County and Washington County.
Tax-exempt bonds	A bond, issued by a municipal, county or state government, whose interest payments are not subject to federal income tax, and sometimes also state or local income tax.
TEFRA	Acronym for "Tax Equity and Fiscal Responsibility Act" of 1982. As a pre-condition for the exclusion from gross income for federal income tax purposes of interest on all qualified private activity bonds, TEFRA requires, among other things, that the issue be approved (TEFRA approval) either by an elected official or body of elected officials of the applicable governmental entity after a public hearing (TEFRA hearing) following reasonable public notice (TEFRA notice) or by voter referendum of such governmental entity.
Workbook	The Microsoft Excel spreadsheet used to apply for Minnesota Housing multifamily funding.
Yield	The income return on an investment. This refers to the interest or dividends received from a security.

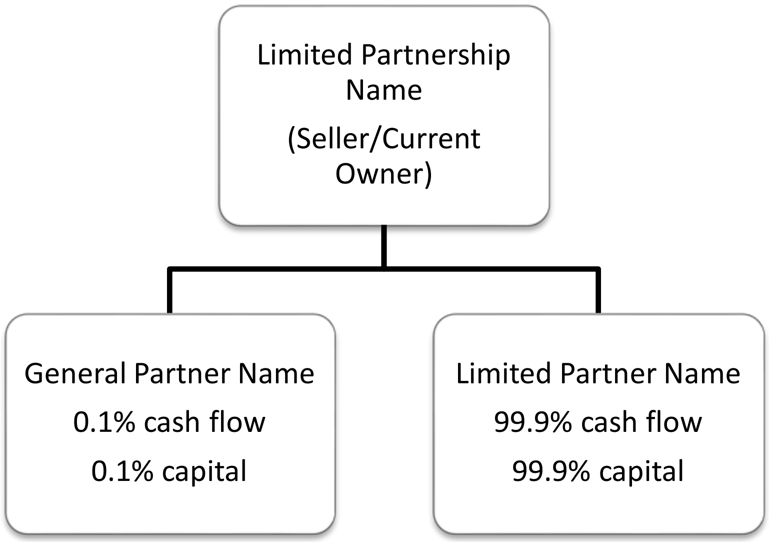
Definitions courtesy of Investopedia, Municipal Securities Rulemaking Board, and Investorwords.

Appendix B: Sample Documents

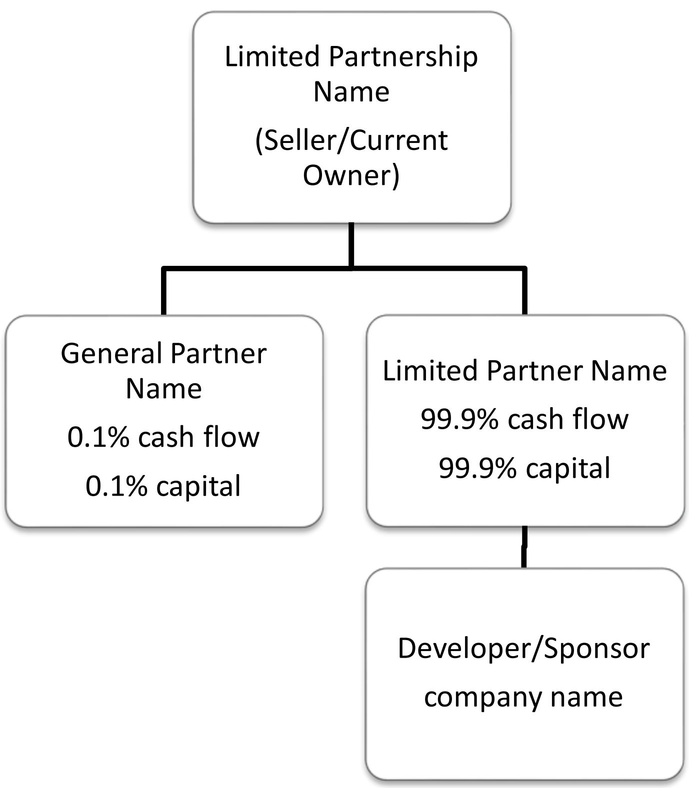
1. Organizational charts
2. Letter from attorney re: 50% test

1. Sample Organizational Charts

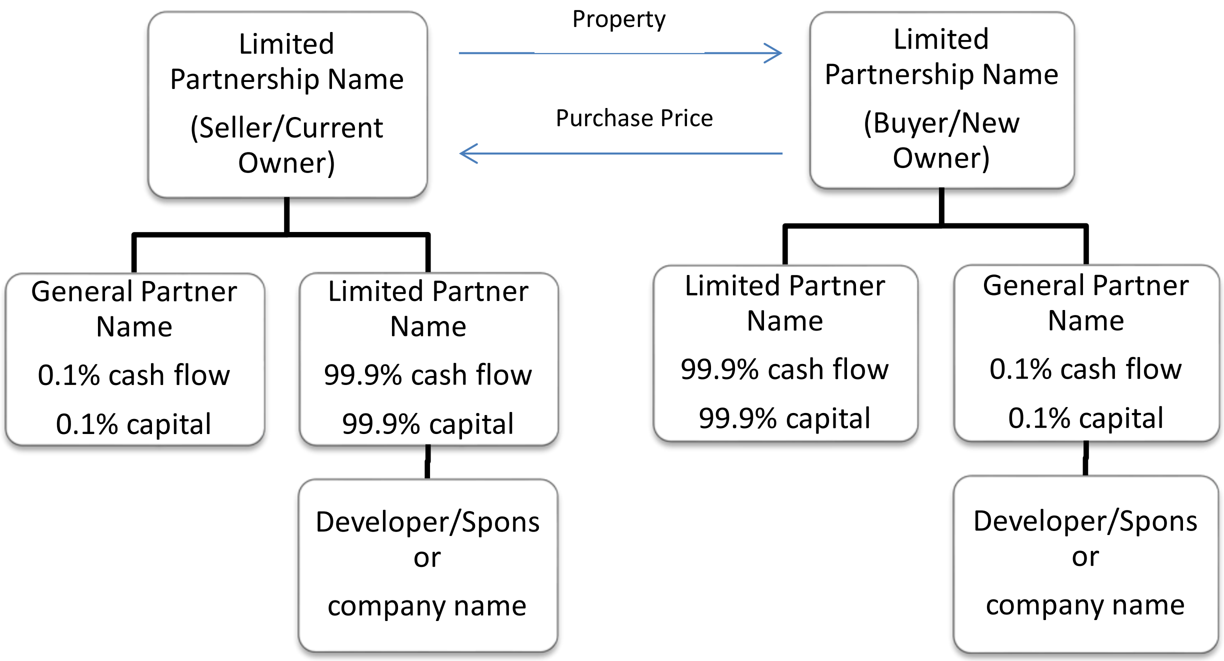
Original Structure of Seller (From Initial Closing – Date)



Structure of Seller following exit of Limited Partner (as of Date)



Structures as of Closing Date for Sale of Project



2. Sample Letter from Attorney Re: 50% Test

Today's Date

Syndicator Contact
Syndicator Name
Address
Address

Entity Name Limited Partnership (the Partnership) has applied to Minnesota Housing Finance Agency for approximately $____ of Rental Housing Bonds (Project Name), Series Year (the Bonds) and $_______ Housing Infrastructure Bonds (if applicable). Internal Revenue Code Section 42(h)(4)(B) provides that no housing credit allocation is required with respect to the entire qualified basis of a qualified low-income housing project if 50% or more of the aggregate basis in building, and the land on which the building is located, is financed with the proceeds of tax exempt bonds that are taken into account for purposes of the volume cap under Section 146 (50% Test).

The following preliminary information has been provided by Developer Name.

Amounts are prior to closing and actual construction.

Tax Exempt Bonds	$_______
Tax Exempt - HIB	$_______
Total Tax Exempt Bonds	$_______
Less cost of issuance	(______)
Numerator	$_______
Land	$_______
Buildings	_______
Land Improvements	_______
Personal Property	________
Denominator	$________

Preliminary percentage of aggregate basis financed by tax exempt bonds equals ______%.

Based on the information provided above, the Partnership meets the 50% test. The percentage of aggregate basis financed by tax exempt bonds will change if there is a change in the amount of bonds issued, the costs paid from bond proceeds, or the basis in land, building, land improvements or personal property.

This advice reflects our professional judgment based on the facts as stated and authorities existing as of the date of this letter. In the event of subsequent developments, including statutory, legislative or any other changes, our advice may change.

Sincerely,
Name
Firm