

Completing the Financing Puzzle Leveraging Public Housing Funds in New Markets Tax Credit Transactions

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Public housing authorities have actively participated in the New Markets Tax Credit Program in a variety of capacities since the inception of the program. In the early years of the program, public housing authorities acted as lenders and developers, but those early transactions did not typically involve the use of funds from the U.S. Department of Housing and Urban Development (HUD).

Generally, if a public housing authority acted as the lender in a New Markets Tax Credit leveraged financing, the ultimate source of the funding for the leveraged loan proceeds was more likely to be state or local grant or loans funds. More importantly, the project was not an affordable housing project.

For example, in one of our early public housing authority representations in a New Markets Tax Credit leveraged financing, a public housing authority in Oregon was both the lender and the

developer. The public housing authority was a subordinate leveraged lender and formed a 501(c)(3) tax exempt affiliate to act as the qualified active low-income community business. The tax credit investor was a conventional bank and also provided the senior leveraged loan. However, the source of the subordinate leveraged loan proceeds was a grant from the city and the project involved the construction of a new public elementary school to be leased to a school district. No HUD funds were used in the New Markets Tax Credit transaction structure and the project was not an affordable housing project.

In recent transactions, HUD funds have been used in the New Markets Tax Credit transaction leveraged structure. Public housing authorities or redevelopment authorities often act as leveraged lenders and the source of the leveraged loan proceeds have

varied. Those sources have included HUD Community Development Block Grant funds, HUD HOPE VI funds, HUD 108 guaranteed loans for brownfields redevelopment, and HUD Brownfields Economic Development Initiative (BEDI) grants to enhance security of HUD 108 loans. For instance, in a transaction that closed in 2010, a redevelopment authority in Pennsylvania was the subordinate leveraged lender and used HUD 108 loan funds and BEDI grant funds as the source of the leveraged loan proceeds. The senior lender and the investor were conventional lenders. But, the project involved the construction of a multi-story, mixed-use facility with retail space leased to a large, big box retailer.

Until recently, in most instances, affordable housing projects financed with New Markets Tax Credits have been developed by nonprofit corpora-



tions unrelated to any public housing authority. One example involves the use of New Markets Tax Credits to provide working capital financing for a Kentucky nonprofit corporation that provides affordable housing and other housing services in low-income communities. In this situation, a conventional lender acted as investor and leveraged lender and no governmental funds were used. In another example, New Markets Tax Credits were used to finance the renovation of a building in Washington, D.C., owned by a nonprofit corporation for a mixed use facility with low-moderate income rental housing and commercial space leased to an early childhood development center.

However, this challenging economic climate has offered new opportunities for public housing authorities to expand their participation in the New Markets Tax Credit program. Public housing authorities are not only lenders or developers but also are forming affiliates to act as community development entities. By forming affiliated community development entities, the public housing authority is able to launch its own New Markets Tax Credit programs as a way of expanding its arsenal of financing tools available to combat the lack of affordable housing in low-income communities.

In one of the most exciting developments in 2010, a public housing authority in Illinois obtained formal HUD approval to act as lender and developer in a New Markets Tax Credit leveraged financing of an affordable housing project that involves the use of HUD public housing funds. Typically, mixed-finance development of affordable housing is financed with Low-Income Housing Tax Credits and HUD Hope VI capital and operating funds, tax exempt bond proceeds, Community Development Block Grant funds, and other types of federal, state, and local governmental funding. Although not intended as an affordable

housing development tool, this formal HUD approval has cleared the way for creative New Markets Tax Credit models to finance affordable housing projects.

In this precedent-setting transaction, HUD has formally approved the use of public housing funds as the source of leveraged loan financing in a project involving the construction of a new senior citizen affordable housing facility with both public housing units and housing choice voucher units. The mixed-use facility will include a community center, office space for affiliates of the housing authority, a community health center, and retail. In addition, the facility will be LEED-certified with a rooftop garden.

We represent the public housing authority and, as currently structured, the transaction integrates the HUD mixed finance development regulatory requirements into the New Markets Tax Credit "80/20 rule" mixed-use leveraged financing structure. The type of governmental funding used in a leveraged New Markets Tax Credit transaction can present myriad legal issues depending on the program-specific requirements of the applicable government grant or loan program. In this case, we have embarked on a new adventure!

Initially, we had to determine whether the public housing authority could act as the leveraged lender under its state authorizing legislation. This particular housing authority does not have the legal authority to make loans to for-profit entities. As a result, the financing model contemplates that the public housing authority will form a new 501(c)(3) tax-exempt affiliate to act as leveraged lender and a new 501(c)(3) tax-exempt affiliate to act as the qualified active low-income community business. Based on HUD mixed finance regulatory guidance, a public housing authority "affiliate" is considered a third party contractor rather than an "instrumen-

tality" controlled by the public housing authority.

To date, we have successfully obtained HUD approval of the public housing authority's use of public housing funds as the source of leveraged loan proceeds as well as HUD approval of the public housing authority's sole source procurement of the leveraged lender affiliate and the developer affiliate under HUD's mixed finance development regulations. In order to fund the leveraged loan, the public housing authority will make a loan to the leveraged lender affiliate. In addition, the public housing authority will use the HUD funds in conjunction with Illinois Tax Increment Financing dollars from the city. An intergovernmental agreement between the city and the public housing authority was recently approved by city council. Also, the public housing authority is seeking, among other sources of funds, Federal Home Loan Bank funds, Illinois Housing Development Authority Trust Funds, Illinois Energy Commission grant funds, and renewable energy tax credits.

This transaction is scheduled to close in October 2010, and HUD approval of the transaction will be required prior to closing.

Stay tuned! ■

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