



USDA'S SECTION 538 GUARANTEED PROGRAM

PART I: UNDERSTANDING PROGRAM IMPACTS ON AFFORDABLE HOUSING

THE WEBINAR WILL BEGIN PROMPTLY AT 2PM (ET)

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USDA'S SECTION 538 GUARANTEED PROGRAM

Part I: Understanding Program Impacts on Affordable Housing Projects

**May 30, 2018
2:00 PM (ET)**



Housing Assistance Council

Building Rural Communities since 1971

LET'S BUILD SOMETHING TOGETHER





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Upcoming Events

**USDA'S SECTION 538 GUARANTEED PROGRAM
PART II: Preservation and Rehabilitation of Section 515 Rental Housing
June 6, 2018**

**SECTION 502 PACKAGING TRAINING FOR NONPROFITS DEVELOPERS
LIVERPOOL, NY
September 24-26, 2018**

**HAC 2018 RURAL HOUSING CONFERENCE (RHC)
Washington, DC
December 4-7, 2018**



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United States
Department of
Agriculture

Rural Development



**JOEL C. BAXLEY, ADMINISTRATOR
RURAL HOUSING SERVICE**

Joel Baxley, Administrator, Rural Housing Service USDA



- USEFUL LINKS

To advance the preservation effort, we've established a web site that lists all of our properties, with their mortgage maturity dates and other details. <https://www.rd.usda.gov/programs-services/multi-family-housing-direct-loans>

- To stay in touch with everything that is happening in the programs, please provide us your email address at <https://public.govdelivery.com/accounts/USDARD/subscriber/new> and we will send you program updates and alerts on all program developments through our GovDelivery portal.

Rural Eligibility Link: <https://eligibility.sc.egov.usda.gov/>



United States
Department of
Agriculture

Rural Development



Presented by Edgar Morales

USDA's Section 538 Guaranteed Program Part I: Understanding Program Impacts on Affordable Housing Projects

USDA Rural Development doing their part in Rural Communities.

The Mission of Housing and feeding everyone

Proving Safe, Decent & Sanitary affordable Housing

Private – Public Partnership

Leveraging Resources

Technical assistance



“ Partnerships “



“Committed to the future of rural communities”

“ Collaborating “

Historical Perspective

The purpose of the **Section 538** Guaranteed Loan Program is to increase the supply of affordable rural rental housing, it differs in some important ways from USDA's Section 515. Section 538 focuses on partnerships between USDA and qualified lenders, whereas Section 515 loans are directly funded from USDA to nonprofit or for-profit rural housing developers.

Section 538 History

Statutory Authority: Title V, Section 538 of the Housing Act of 1949; 42 U.S.C. 1490



July 22, 1998 - Published in the Federal Register as interim final rule.

July 16, 1999 - The final rule was effective 7 CFR Part 3565

2001 -2005 only a hand full of loans annually

2006 – first 3 Bond deals Closed

2009 – first 4 section 515 transfers w/section 538 Close

2009 – Program loses it's Interest Credit

2010 – 2015 Program demand at all-time high

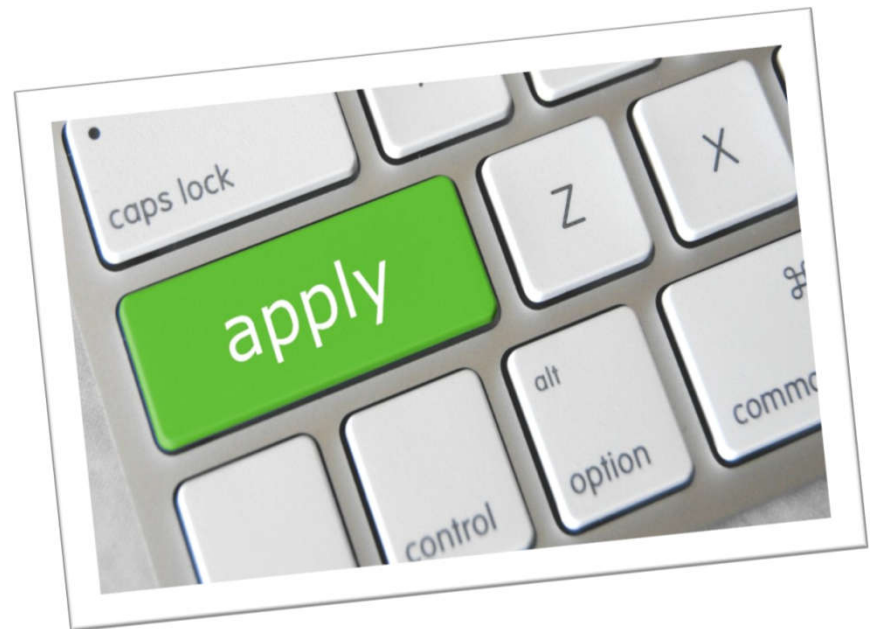
2016 – Program reaches **1 Billion in closed Loans!**

2017- Obligated over \$188 million

Section 538 Guaranteed Program

Availability of Funding

- NOSA/NOFA ??? (published in Federal Registrar)
- Historic annual authority averaged \$150 million
- FY 2016 Obligated \$148 million +
- FY 2017 Obligated \$188 million YTD
- Program is Budget Neutral
- FY 2017 Authority level at \$230+ million
- FY 2018 \$230+ million
- **Program is Lender Driven**



538 Program at a Glance

- USDA guarantees loans made by private, USDA approved lenders
- Eligible rural areas 35k or less not next to an MSA
- No loan size limits
- Program allows for permanent only loans, construction/perm loans and rehab/perm loans (\$6,500/unit minimum rehab)
- 538 Guarantee can be used to enhance tax-exempt bonds (if avail)
- USDA Fees: 1% at closing; 0.50% annually (MIP)
- Lender Origination Fee: varies by lender
- LIHTCs not required
- Finance projects up to 30% of 115% of AMI



Leveraging the Section 538 Guaranty

- Nearly all 538 loans closed have been in conjunction with tax credit either 9% or 4% w/tax exempt bonds (Historical)
- Well over half have included secondary debt financing such as 515, HOME, FHLB, etc.
- Mixed Income “Income Averaging” Projects
- Compatible with “Opportunity Zones”
- Workforce Housing
- Works well with Sec 8 HAP, RD 521 RA



Benefits for Developers to use the 538

- 538 loans can be used for acquisition rehab & New Construction
- Does not have to be an RD asset at origination
- Maximize Loan Dollars
- Maximum 90% LTV (97% for non-profits)
- Minimum 1.15 times DSCR on all serviceable debt
- 25 - 40 year term & amort or any combination thereof (25/40, 30/30, 30/40,40/40, etc.)
- Program allows for conversion to perm at C of O with funding of a reserve (2% of TDC) that is used to cover operating expenses and debt service during lease up
- No Davis-Bacon requirement
- 538 Loans qualify for CRA credit.



538 vs. other Market Rate financing

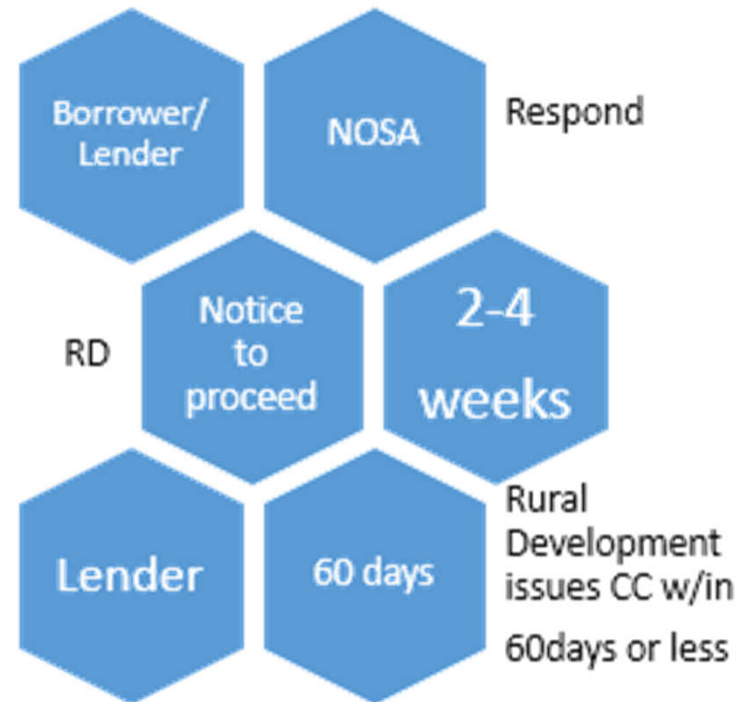
- USDA guarantee allows loans to be sold in the marketplace at attractive rates that benefit the project and the developer.
- Loan options include the ability to lock-in long-term interest rates at the time of closing of construction loan
- LIHTCs not required
- Finance projects up to 30% of 115% of AMI
- Competitive lower rates
- Up to 40 year amortization



New!

Section 538 Rate modification and 538 refinance
now available.

Applying for Section 538



CONCLUSION

SUMMARY OVERVIEW

- Not a Direct loan, USDA Guarantees Lenders Loan
- Program is Lender driven
- No Loan limits
- New Construction & Rehab
- Readily available funding
- No tenant recertification required
- Initial occupancy up to 115% of AMI
- Eligible Rural areas w/populations up to 35k



USDA is an equal opportunity provider, employer, and lender.

Who to Contact:

Rural Development Headquarters Staff

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Low Income Housing Tax Credit Market: The Syndicator Perspective

May 30, 2018



Leading with Ideas
DEMONSTRATING THROUGH ACTION
Transforming with Capital
SUSTAINING THROUGH POLICIES AND PARTNERSHIP

The Tax Credit Program



- Created by the Tax Reform Act of 1986 under Reagan
 - Section 42 of the Internal Revenue Code – IRS program
 - Has built or renovated ~2.8M homes across America
- Capital subsidy funding 25-80% of the cost. Market is mostly banks and insurance companies seeking regulatory credit and/or real return.
- The Presidential election in 2016 brought the real expectation of tax reform – and prices adjusted assuming 20-25% tax rates in 2017 (typically 8-20 cents per credit reduced investment)

The Tax Credit Program



- First devaluation of the investment value occurred with The Tax Cuts and Jobs Act signed 12/22/2017
 - Corporate tax rate decreased from 35% to 21%
 - 40-year depreciation now 30 years
 - 27.5-year depreciation available only with limited interest deductions – so pretty much all deals use 30-year schedules.
 - Bonus depreciation available (immediate for FF&E and Site Improvements) declining percentages through 2022
 - Overall, the reduction in equity raise is thought to reduce the system's capacity by over 235,000 units over the next 10 years (14% reduction in equity market)
 - Could have been worse...private activity bonds were on the chopping block

Challenges in the Market



- Overall pricing is down to the range of \$.83-\$1.02 this year with most 9% deals from \$.86-\$.92
- Base Erosion and Anti-Abuse Tax rules limiting some investment at least short term from banks owned or operating outside of the USA
- Losses less valued - bonus depreciation not always ok
- Alternatives are more valuable with lower tax rates and higher interest rates
- With interest rates rising, the value of bridging equity is reduced so pricing down with earlier funding
- Overall – institutions revising their tax plans

Suggestions for Syndication



- Given the volatility in the market, if you have a preferred partner, engage early. Rural Rehabilitation deals need to be slotted in multi-investor funds if not going into one of the GSE funds
- GSE Duty-to-Serve locations are very specific and depend on the street address
- Investors are taking longer to get to yes. 2-3 week RFP processes are very difficult to respond to in a timely way
- Pushing the envelope on terms is hard right now. Square deals get the best pricing as investors are pulling back on giving away terms

Positives



- Good News for Rural Deals
 - Fannie Mae and Freddie Mac back in the market for \$500M each
 - Multi-investor funds are back in action after being down in 2017
 - Some CRA markets are overbought, pushing demand to secondary and tertiary markets for yield, helping pricing.
- The Omnibus Spending Bill passed in March 2018 helps
 - Increased the 9% LIHTC allocation by 12.5% for 4 years
 - Gets us 28,000 units of production capacity over term
 - Made Income Averaging a permanent option
 - Up to 80% AMI rents and incomes can qualify for LIHTCs
 - Average at a property remains 60% AMI
 - Implementation still being sorted out

Opportunity Zones



- Part of Tax Cuts and Jobs Act of 2017
- Allows for investment of capital gains in qualified tracts to defer and reduce future capital gains tax paid with new long term gains not taxed.
- If invested prior by end of 2019 could get 10% reduction in gain after 5 years and another 5% after 7 years. Then the reduced capital gains tax is due. But for the new gains generated on investments held for 10 years, there is no capital gains tax.
- Challenging to match investors with deals and monetize the program

LIHTCs with RD 538 Loans



Positives

- Long Term – assumable, locking in today’s low rates
- Long Amortization – 40 years maximizes proceeds
- No Davis-Bacon Wage requirements
- Non-Recourse
- Forward Commitments available to work with your construction lender, but rates rising fast
- Typically 90-120 days to get to a perm commitment
- Works with RD 515 deals down to 1.0 DSCR as well as non-RD Rental Assistance deals (S8, LIHTC) & even deals without credits

LIHTCs with RD 538 Loans



Challenges

- Lower rates available with immediate funding deals
- Creates challenges to arranging bridge financing since RD needs to be in 1st lien position
- Not locking in the rate at closing in order to get the best rate on the spot market at conversion is an LIHTC investor exception to mitigate
- Some more paperwork for RD approvals which may lengthen conversion process on non RD 515 / RA deals
- Work with your lender and investor early to get to the best arrangement for your deal

Questions?



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QUESTIONS?

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