

**CONTRA COSTA COUNTY
MULTIFAMILY MORTGAGE BOND FINANCING PROGRAM**

July, 2006

A. PROGRAM SUMMARY

Contra Costa County is an active issuer of tax-exempt multifamily mortgage revenue bonds. The purpose of the Program is (1) to increase the supply of rental housing in the County; and (2) to provide housing units affordable for lower income residents. Project loans made by the County have been as small as \$425,000 for a ten-unit development to as much as \$125 million for a larger project. Prospective projects may be for new construction, or the acquisition/rehabilitation of existing projects.

The project will be able to use tax-exempt revenue bonds issued by the County pursuant to Section 52075 of the California Health & Safety Code, and applicable provisions of the Internal Revenue Code. The County must also secure private activity bond authority from the California Debt Limit Allocation Committee (CDLAC). Guidelines and procedures for the securement of the necessary authority may be reviewed on CDLAC's website at www.treasurer.ca.gov/CDLAC/index.htm. The bonds will not involve any pledge of County revenues, taxes, or assets.

Bonds may be issued for projects which (a) meet program requirements; (b) are located in the unincorporated areas of the County or in incorporated areas with approval by both the applicable City and the County; (c) have a commitment fee paid by the developer; and (d) have a developer loan commitment from an acceptable lender and/or credit enhancement provider.

Loans under the multifamily bond program will generally be amortized for 30 years and will be due at the expiration of the credit enhancement (e.g., typically 7 years for a letter of credit, 40 years for *FHA* insurance). The bonds may remain outstanding with an extended or replacement credit enhancement. Effective loan rates will depend upon market conditions at the time of bond sale, and the type of bond structure. Bonds to be issued will generally be rated by a nationally recognized rating agency, and carry at least an "A" rating. If a developer is contemplating an issuance of unrated bonds, the developer should immediately contact the County for additional guidance.

B. PURPOSE

The Program is designed to increase the supply of affordable rental housing in Contra Costa County. This is particularly important given the demand for rental housing in the County, the limited number of new affordable apartment constructed in the last decade, and prices of single family homes. By providing tax-exempt multifamily housing financing, the County can provide housing opportunities to match the County's economic growth and provide affordable rental units for very low-income families and elderly tenants. This is especially important at a time when federal housing subsidies have been drastically reduced. Under the Program, at least 20% of all units will be reserved for eligible very low-income persons (as described on pages 5-6).

C. ELIGIBILITY

In order to be eligible under the Program, a project must meet the following requirements.

1. Reimbursement (Inducement) Resolution: All projects must have a Reimbursement (Inducement) Resolution. A Reimbursement Resolution is a conditional expression of intent on the part of the legislative body of the public agency to be prospectively issuing the tax exempt bonds (the Board of Supervisors in the case of the County), the proceeds of which would be used to pay project costs. Costs incurred more than 60 days prior to the date of inducement are generally not eligible for financing using tax-exempt bonds. Developers are encouraged to have the County adopt a Reimbursement Resolution for projects as soon as possible. The adoption of a Reimbursement Resolution does not obligate the County to issue the bonds. The County reserves the right to collect a non-refundable Inducement Fee of 1/10 of 1 % of the projected bond amount not to exceed \$2,000. Minimum information needed for the Reimbursement Resolution includes:
 - a. Name of development project;
 - b. Location by street address and assessor's parcel number;
 - c. Estimate number of units;
 - d. Estimated development costs including land (bonds to be issued cannot exceed this amount);
 - e. Exact legal name of the ownership entity at the time of bond closing, e.g., name of individual(s), partnership, corporation, etc.; and
 - f. If different from (e), name of the operating entity at the time of bond closing.
2. Types of Projects:
 - a. Rental Housing: The Project must consist of complete rental units, including full kitchens and bathrooms. The rental units cannot be used for transient or student housing. Tax-exempt financing for the acquisition of existing units without substantial rehabilitation may only be provided to non-profit 501(c)(B) entities.
 - b. New Construction and Renovation: The Program is designed primarily for new projects that have not begun construction or in some cases acquired land before County approval of a Reimbursement Resolution (see C (1) above). While the emphasis has been on new construction, multifamily mortgage bond financing may also be used to acquire and renovate existing properties. In a purchase/renovation transaction, an amount equal to or greater than 15% of the bond proceeds used to acquire the building must be spent on eligible rehabilitation within 24 months.
 - c. Location The project must be located within Contra Costa County. If the project is located in a city, the city must consent to the County's issuance of bonds. The County may adopt a Reimbursement Resolution without a Cooperative Agreement.

- d. Size of Project: There are no limits on the maximum or minimum project size or number of units. Projects with fewer than 40 units (or less than \$2 million) may not find tax exempt financing economical unless they are combined or pooled with other projects. This is due to economies of scale in the bond issuance process. Even with pools, credit enhancers will generally only consider projects of 10 or more units.
 - e. Commercial Space: No bond proceeds may be used to finance commercial space not solely for the use of tenants. When a project contains such space, the commercial space must be financed with owner equity or other non-bond sources.
 - f. Tax Credits: Bond financing may be used in conjunction with a 4% Low Income Housing Tax Credit. If bond financing is used for more than 50% of project costs, 4% Low Income Housing Tax Credits can be obtained without competing in the normal tax credit project selection process.
3. State Private Activity Bond Allocation Requirements: The amount of authority available for private purpose tax-exempt bonds, such as multifamily mortgage revenue bonds, has been severely limited under the federal tax code. Therefore, prior to the issuance of tax-exempt multifamily bonds, the County must apply for and receive an allocation of authority from the California Debt Limit Allocation Committee (CDLAC). To receive an allocation the County must assure CDLAC that:
- a. The developer has an acceptable commitment from a credit enhancement provider (see Section G(1)), and that the lender or credit enhancer has approved the project with a specified loan amount;
 - b. The County intends to issue bonds so long as the project meets all local, state, and federal requirements; and
 - c. The developer has deposited 0.5% of the anticipated amount of the bond issue (not to exceed \$100,000) with the County. This deposit may be in the form of cash or a letter of credit. If a letter of credit is used, please consult with staff regarding the proper form. The 0.5% deposit is returned to the developer only after the bonds are sold. This deposit is at risk should an allocation be granted by CDLAC and not utilized.

The County has approximately 90 days from receipt of an allocation from CDLAC to sell bonds and close the bond issue. If bonds are not sold and closed within this period the State may retain the developer deposit. It is critical that the developer and the County expect to sell bonds within the 90 day time period inasmuch as extensions are not typically granted. Before the County will apply for an allocation, it must be satisfied that the developer and lender can perform on a timely basis.

Interested parties are encouraged to review CDLAC procedures. A copy can be reviewed on the CDLAC website at www.treasurer.ca.gov/CDLAC/index.htm.

4. Permission to Syndicate: State law allows for developments to be syndicated with the written permission of the governing body of the issuer. Permission will be granted so long as it can be determined that the terms and conditions of any syndication do not reduce or limit requirements contained in the program document, e.g., fewer assisted units, reduction of benefits, other regulatory agreement provisions. This requirement of State law will require that provision be made for examination of syndication documents by the County and/or its counsel. Said provision would include compensation for costs incurred by the County in such an examination.
5. County Fees: The County will require compensation for its costs of issuance and ongoing monitoring of compliance with the project State and Federal law requirements contained in a Regulatory Agreement. The County fee at bond closing is equal to 1/8 of lob of the principal amount of bonds issued. Any amount collected at closing will be net of any fee collected at inducement (see C(1) above).

Annual compensation for monitoring compliance with the Regulatory Agreement for the term of the rent limits (55 years or as long as bonds are outstanding, if longer) is equal to 1/8 of 1 % of the original principal amount of bonds sold.

D. BORROWERS

1. Eligible Borrowers: Borrowers may be individuals, partnerships, for-profit or not-for-profit corporations. Borrowers and projects must be approved by a private lender or FHA with regard to credit, finances, the real estate project, experience, etc.

If the borrower is to be a non-profit 501(c)(3) organization under applicable federal tax law, some of the federal and State bond requirements may be different. Please contact the Community Development Department if the borrowing entity is not a not-for-profit and desires to issue 501(c)(3) bonds.

E. USES OF LOAN FUNDS

1. Eligible Costs: Loan funds may be used for costs of property acquisition, construction, improvements, architectural and engineering services, construction interest, loan fees, bond issuance costs, and other capital costs of the project which are incurred after the 60th day prior to the County approval of the bond Reimbursement Resolution for the project (see C(1) above). Generally, no more than 25% of bond proceeds may be used for acquisition of land. The lender may impose additional limitations upon the use of loan funds. Substantially all (95% or more) of the bond proceeds must be spent on the above. Further, there is a 2% limit on the use of bond proceeds to pay costs of issuance and underwriter's discount; therefore, the developer will be required to fund these costs in excess of the 2% limit out of equity, or on a taxable bond basis.

2. Ineligible Costs: Loan funds may not be used to refinance existing permanent indebtedness (the financing can take out a construction loan if expenses are good costs, i.e., costs incurred after the 60th day prior to the Reimbursement Resolution) to reimburse expenses incurred prior to County's adoption of a Reimbursement Resolution for the project, provide working capital, or acquire the property from a party related to the buyer. Project developers are encouraged to request a Reimbursement Resolution early in the process in order to maximize eligible development costs.
3. Completion: Bonds will generally be sold for projects which are ready to commence construction upon closing of the bond issue. The time for completion is dependent on lender requirements.

F. PROJECT REQUIREMENTS

1. Minimum Rental Period: The project must remain as rental housing for the term of the bonds. At a minimum, however, the project must remain rental for 55 years after 50% of the units are first occupied.

A developer may initially process a project as a condominium (or as a cooperative) so that the developer will be assured of his ability to sell the project as condominiums (or as co-ops) after the minimum rental period, and so long as they are paid in full prior to the sale. Tract map costs cannot be financed through the bond loan and must be paid by the developer.

2. Affordable Units: While the overlay of federal and State law provide alternative means of meeting affordability requirements, the most frequently used affordability provision is that at least 20% of the units must be rented to or held available for very low income families. The following discussion on income and rent limits is limited to this one affordability option. Appendix A provides additional information on affordability options.

- a. Income Limits: Upon initial occupancy a family's total income may not exceed the 50% of the HUD Median Income limits adjusted for family size. These limits, which are determined using the County median income estimate of the U.S. Department of Housing and Urban Development, are (current as of March, 2006):

<u>Family Size</u>	<u>Income Limit 50% of (HUD) Median Income</u>
1	\$29,350
2	\$33,500
3	\$37,700
4	\$41,900
5	\$45,250
6	\$48,600
7	\$51,950
8	\$55,300

These limits will be adjusted periodically as HUD estimates of County median income are adjusted. A unit rented only to students does not count towards the affordable unit requirement. Determination of a family's income eligibility is made upon initial occupancy and annually thereafter. At the time of an annual recertification of income, if it is found that a family's income exceeds 140% of the income limit, that unit will no longer qualify as an affordable unit. Subject to the requirements of a Regulatory Agreement, the developer has full rights to manage the property, select tenants, etc. There are no income limits for tenants of the unrestricted units in the project.

- b. Rent Limits: The maximum rent levels do not include a utility allowance and are equal to 30% of the monthly maximum income level. Based upon 50% of median income, rent limits for the affordable units are as follows:

<u>Unit Size</u>	<u>Maximum Monthly Rent</u>
Studio	\$ 733.00
One Bedroom	838.00
Two Bedroom	943.00
Three Bedroom	1048.00
Four Bedroom	1131.00

There are no rent restrictions on the unrestricted units in the project.

- c. Minimum Period: These affordability requirements must be met for at least 55 years from the date of 50% occupancy of the project.
 - d. Types of Units: The affordable rental units must generally reflect the mix of all units in the project, be distributed throughout the project, and have the same floor area, amenities, and access to project facilities as market rate units with the same number of bedrooms. The aim of the Program is to provide some of the units at lower rents, not to create special lower income sections within larger developments.
3. Covenants: The rental and affordable unit requirements will be contained in a Regulatory Agreement which is recorded with the property and must be complied with by subsequent buyers for the minimum rental period. The requirements are terminated at the later of the end of the minimum rental period and repayment in full of the bonds or in the event of total casualty loss or foreclosure.

G. TAX EXEMPT FINANCING ALTERNATIVES FOR MULTIFAMILY HOUSING

Under its tax exempt financing program the County provides loans secured by a first deed of trust. A fundamental requirement for financings is that the project have loan underwriting and credit enhancement from a third party who bears the ultimate risk and responsibility of the loan, The County may consider unrated bonds on a case-by-case basis. Subordinate financing from other federal, state, or local agencies may be integrated into a plan of finance for the Project. Early consultation with County staff is encouraged.

1. Credit Enhancement Techniques: Tax exempt bonds for multifamily housing generally involve the use of credit enhancements. A credit enhancement is an arrangement with a third party which provides more security to the bondholder for the timely payment of principal and interest on the bonds. In a simplistic sense, credit enhancements may be considered credit substitutes, and are employed to obtain the lowest interest rate with the highest credit rating at the lowest cost for the project financing. Credit enhancements take many diverse forms, and new forms of credit enhancements are continually appearing, while existing credit enhancements are modified or eliminated. New participants banks, corporations, and insurance companies are continually entering the business of providing them. Two basic alternative credit enhancement structures are more fully described in Appendix B.

2. Unrated Bonds/Escrow Bonds

While most multifamily mortgage revenue bond issues are rated by a nationally recognized rating agency and include a credit enhancement, a developer may propose the issuance of unrated, non-credit enhanced bonds. Because the repayment of such bonds are riskier (repayment is wholly dependent upon the financial success of the project), they should be purchased only by sophisticated buyers who can afford the risk and are capable of analyzing the underlying security. Consequently, the County will not issue unrated bonds unless the bond documents provide that the bonds not be sold except to sophisticated buyers.

Developers may occasionally propose the sale of bonds prior to all elements of a financing being in place. Such escrow financings, where proceeds from the sale of bonds are placed in escrow and invested in government securities, have received considerable scrutiny from the IRS. It has been alleged that some multifamily escrow bonds were issued solely to earn profits for the participants with little or no likelihood of the project being built.

In view of the foregoing, the Board of Supervisors has adopted guidelines to govern the issuance of any unrated, non-credit enhanced bonds. Any party contemplating such a transaction should contact the Community Development Department early in the process. The guidelines are in Appendix C.

3. Tax Exempt Mortgage Funds

A number of firms are structuring limited partnerships which would acquire a portfolio of federally tax-exempt first mortgage loans secured by income producing real estate, including multifamily developments. The terms of the mortgage loans permit the limited partnerships to share in the cash flow and appreciation of value in the projects through contingent interest; therefore, the investments are subject to the additional risks inherent with real property. Because of this additional risk, and because of major concerns with respect to the legal structuring of such funds, the County will consider tax-exempt mortgage funds with caution. Guidelines similar to those governing unrated bonds and escrow bonds plus other legal and policy concerns may have to be satisfactorily addressed to proceed with an issuance. Because of strict legal documentation and control issues, early dialogue with the County and its attorneys and financial advisors are advised. An indication by the County as to its willingness to consider such an issuance may require legal services of bond counsel to the County, whose fees would have to be paid by the developer.

4. Debt Structures

The following general structures may be used to raise capital in the bond market. The various structures are designed to either reduce interest rates, adjust the timing of debt service payments, or manage risk. Changes in market conditions can create or eliminate the advantages of one structure over another.

a. Fixed Rate Bonds

Fixed rate bonds are the most predictable form of debt. The bonds have a specified term and bear interest at a fixed rate. Fixed rate debt is an attractive alternative to developers who are not comfortable with uncertainty or complexity that may be involved with other debt structures. Fixed rate debt generally has higher issuance costs than other forms. Fixed rate bond issues may involve the issuance of serial maturities, i.e., a series of bond maturities that provides for use of shorter term and lower yielding bonds to reduce the end-loan mortgage rate. The fixed rate is typically set for the duration of the credit enhancement (e.g., 7 years for a letter of credit enhanced transaction), but can lock-in a permanent rate for as long as 30 years.

b. Put Option Bonds

“Put” bonds are term bonds that can be tendered for payment at par, i.e., sold back, at stated intervals prior to maturity. Because the interest rate of the bonds is determined by the put date, the developer is able to realize some interest rate savings.

c. Variable Rate Demand Bonds

Variable Rate Demand Bonds are long term bonds sold at short-term interest rates. These “low floaters” have a put feature that allows for the bond holders to demand that their bonds be purchased by the Bond Trustee with as little as seven days notice. The bonds are purchased by the Bond Trustee by drawing on a letter of credit issued by a bank. This letter of credit draw is repaid by the developer. Interest rate savings which occur because of the short-term nature of the bonds reduce the mortgage loan rate. Interest rate savings on the bonds initially may be as much as 2% or more when compared with longer term fixed alternatives. Mortgage rate reductions will be slightly less because of the cost of the additional parties to the transaction and the risks they assume. Some developers may choose to have an interest rate cap included. Some capitalized developers may be able to assume the interest rate risk. This option is generally available to experienced developers with a significant net worth.

H. MORTGAGE RATES AND DEVELOPER COSTS

Mortgage rates and developer costs will vary depending on the type of credit enhancement and bond structure employed. Further, the size of the issuance can dramatically affect costs. Generally, financings are feasible only when certain economies of scale are achieved. An accepted minimum amount of bonds for a cost effective issuance is \$2-\$3 million, which roughly translates to 20-30 units. Smaller projects may optimally proceed as part of pools, or groupings, of developers and developments.

Based on current market levels the following chart shows bond rates, loan rates and fees attributable to the various financing mechanisms. This chart should be used only as a general indicator.

Estimated Costs and Rates Associated with Bond Financing Structures

	<u>Fixed Rate Bonds</u>	<u>Variable Rate Bonds</u>
Bond Rate*	5.0-5.5%	3.5-4.5% initially
Annual Fees**	1.50% (with letter of credit)	2.0%
Loan Rate	6.5%-7.0%	5.5-6.5%
Up Front Fees***	6-7 points	5.5-6 points

* Subject to change. Rates indicated are reflective of market conditions as of July, 2006.

** Annual fees include annual credit enhancement fee, trustee fees, lender servicing fees, and issuer fees; for variable rate transactions the remarketing fees, liquidity agent, and indexing agent are also included.

*** Includes cost of issuance (legal, printing, underwriting, etc.) @ 3% for variable rate bonds and 3.75% for fixed rate bonds; initial letter of credit and first year letter of credit fee of 1.25-1.50% each. Only 2% of Bond Proceeds can be used to cover these costs.

We are looking forward to working with you. If additional information is desired, please contact us.

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APPENDIX A AFFORDABILITY OPTIONS

The overlay of federal and State law create various affordability options.

A. Federal Law Requirements

To qualify for tax exempt financing under federal and State law, one of two affordability requirements must be met: (1) At least 20% of the units must be rented to or held available for families earning an amount equal to or less than the HUD Very Low Income (as described in Section F(2)); or (2) at least 40% of the units must be rented to or held available for families earning 60% of the median income or less. Median income is adjusted for family size, and is determined using Department of Housing and Urban Development (HUD) estimates for the area.

1. Income Limits

As described above, the tenant's total household income when he or she rents the unit may not exceed the following:

<u>Size Household</u>	<u>Very Low Income Limit @ 50% of Median</u>	<u>Income Limit @ 60% of Median</u>
1	\$29,350	\$35,200
2	33,500	40,200
3	37,700	45,250
4	41,900	50,300
5	45,250	54,300
6	48,600	58,300
7	51,950	62,350
8	55,300	66,350

These limits will be adjusted periodically as the U.S. Department of Housing and Urban Development (HUD) estimates of County median income are adjusted. Determination of a family's income eligibility is made upon initial occupancy and annually thereafter. At the time of an annual recertification of income, if it is found that a family's income exceeds 140% of the income limit, that unit will no longer qualify as an affordable unit.

2. Rent Limits

The maximum monthly rent is equal to 30% of the monthly maximum income. Monthly rent corresponding to tenant income limits are as follows:

<u>Unit Size</u>	<u>Maximum Rent for Projects Reserving 20% of Units to Families with the HUD Very Low Income Limit (50% of Median or Less)</u>	<u>Maximum Rent for Projects Reserving 40% of Units to Families with Income of 60% of Median or Less</u>
Studio	\$733	\$880
One Bedroom	838	1005
Two Bedroom	943	1130
Three Bedroom	1048	1255
Four Bedroom	1131	1360

B. State Law Requirements

To qualify under State law requirements, at least 20% of the units must be rented to or held available for families earning 50% of the median income or less, or at least 40% of the units must be rented to or held available for families earning 60% of the median or less.

1. Income Limits

As described above, the tenant's household income when he or she rents the unit may not exceed the following limits as applicable:

<u>Size Household</u>	<u>Very Low Income Limit @ 50% of Median</u>	<u>Income Limit @ 60% of Median</u>
1	\$29,350	\$35,200
2	33,500	40,200
3	37,700	45,250
4	41,900	50,300
5	45,250	54,300
6	48,600	58,300
7	51,950	62,350
8	55,300	66,350

2. Rent Limits:

The maximum monthly rent is equal to 30% of the monthly maximum income. Monthly rent corresponding to tenant income limits are as follows:

<u>Unit Size</u>	<u>Maximum Rent for Projects Reserving 20% of Units to Families with the HUD Very Low Income Limit (50% of Median or Less)</u>	<u>Maximum Rent for Projects Reserving 40% of Units to Families with Income of 60% of Median or Less</u>
Studio	\$733	\$880
One Bedroom	838	1005
Two Bedroom	943	1130
Three Bedroom	1048	1255
Four Bedroom	1131	1360

APPENDIX B

CREDIT ENHANCEMENT STRUCTURES

A. Direct Credit Enhancement Structures FHA Insurance

The U.S. Department of Housing and Urban Development has established a “Delegated Processing” program.

This direct loan program provides a federal mortgage insurance commitment under Section 221(d), Section 223 (f) or Section 232. Mortgage loan terms are up to 40 years. Permitted loan-to-value ratios are up to 100% of costs under the Section 221 (d) program, 85% under the Section 223 (f) program, and up to 90% of costs under the Section 232 program. Actual loan-to-value ratios will depend on the amount of approved costs and estimated net income. Debt coverage ratios are 1.11:1.0 under the Section 221(d) program, 1.17:1.0 under the Section 223 (f) program, and 1.11:1.0 under the Section 232 program. Financing costs will be in the range of 1.25-1.5 points. An annual mortgage insurance premium of 0.5% will be charged over the life of the loan. FHA insured mortgages are often securitized as GNMA Mortgage Backed Securities to enhance bond security.

Advantages

- Low cost of credit enhancement .50 basis points plus per year;
- 40 year fixed rate mortgage and financing;
- Up to 100% of costs for new multifamily projects; and
- Used for both construction and takeout financing.

Disadvantages

- HUD processing procedures and time;
- Davis-Bacon wage requirements apply.

2. Insurance Company Direct Guarantees

Typically structured as a 50-50 joint venture, the guarantor takes the full real estate risk in exchange for equity and cash flow participation. A common alternative is a straight surety bond purchased in advance. Usually limited to larger developers, large and strong rental markets, and insurance companies that will provide an AA rating or higher for the bonds they guarantee. The insurance company guarantor will typically not charge up front points, but generally expects a 1 % annual fee. Insurance companies do not generally take any construction period risk.

Advantages

- Low rate with joint venture position; and
- Insurance company will offer equity infusion.

Disadvantages

- 40-50% equity and cash flow given up, where applicable;
- Conservative underwriting;
- Don't take construction period risk; and
- Developers generally not permitted to syndicate their share of the equity.

B. Indirect Credit Enhancement Structures

1. Letters of Credit

Irrevocable letters of credit are used frequently to guarantee payment of principal and interest on tax exempt bond issues. By borrowing funds on the debt rating of the letter of credit provider, a lower interest on the debt can be obtained. Letters of credit may be direct guarantees of the lenders completing the real estate review and underwriting, as a direct guaranty of said lender by a rated commercial bank. Letters of credit are flexible instruments and can be tailored to fit the needs of a developer and issuer. Use of the letter of credit may be structured under a standby agreement, where the letter of credit is drawn upon only if the developer (and therefore the issuer) is unable to make scheduled principal and interest payments, or, as is more typically the case, as a direct pay letter of credit, where the letter of credit provider makes all scheduled principal and interest payments and is repaid by the developer.

Advantages

- Relatively fast project review time, particularly if the lender has previous tax exempt financing experience;
- Can be used for construction and takeout financing;
- May use existing bank relationships;
- A debt service reserve fund may not be necessary as part of the bond issue, thereby reducing costs;
- A debt service reserve fund may not be necessary as part of the bond issue, thereby reducing costs;
- A debt service reserve fund may not be necessary as part of the bond issue, thereby reducing costs;
- Number of potential providers including foreign as well as some major domestic banks; and
- Developer can shop real estate underwriting criteria.

Disadvantages

- Letters of credit are generally for a maximum term of 7-10 years, therefore developer must be prepared to refinance;
- The experience and net worth of the developer may be a critical criteria for some lenders in particular projects.

2. Pledged Collateral Programs

A lender can secure the developer's loan from an issuer of tax exempt bonds with collateral in the form of seasoned single family mortgages, U.S. Government securities, or GNMA or FHLMC securities. The rating on the bonds is determined by the degree of over collateralization and the quality of the collateral. In the event of a lender default, the collateral is liquidated and the proceeds used to redeem bonds. An alternative is to structure a cash flow collateral program in which a lender default does not trigger liquidation of collateral, but rather the collateral cash flow is used to pay debt service on remaining bonds. A second alternative involves the structuring of a collateral purchase agreement, in which a lender default could trigger a highly rated commercial bank or insurance company to purchase the collateral.

Advantages

- Simple and straightforward in concept; and
- Theoretically allows any lender to be used.

Disadvantages

- Collateral requirements limit or eliminate many lenders; and
- Revaluation and substitution of collateral is cumbersome and expensive. Use of a collateral program may eliminate these recurring expenses.

3. Bond Insurance

Bond insurance, the most common form of third party guarantees, permits an issuer to obtain an Aaa/AAA rating. Bond insurance is typically used in conjunction with one or more of the other types of credit enhancements. The actual rate advantage depends on the underlying creditworthiness of the project financing. The key question with bond insurance is whether the interest rate savings exceed the cost of the premiums.

4. FNMA/Freddie Mac

FNMA and Freddie Mac have guarantee programs which operate similarly to letters of credit or bond insurance.

APPENDIX C

GUIDELINES FOR THE ISSUANCE OF UNRATED AND/OR ESCROW BONDS

Unrated bonds are generally a riskier investment, and therefore should be purchased only by sophisticated investors. Escrow bonds present legal problems. In view of the foregoing, the Board of Supervisors has adopted guidelines to govern the issuance of such bonds. Any party contemplating such a transaction should contact the Community Development Department early in the process. The guidelines follow:

A. Guidelines for the Issuance of Unrated Bonds

1. No publicly sold bonds;
2. Bonds must be sold in large denominations to buyers of substantial net worth (the County may limit the number of buyers and may require the buyers to sign approved letters attesting to their understanding of the bonds and underlying security);
3. Full disclosure of all elements of the real estate, including any third party evaluation of the real estate;
4. The borrower/developer or project manager must be a high quality firm with substantial financial assets;
5. Program documents must control the owner's ability to diminish the security of the loan; and
6. The owner must indemnify the County, and, if requested by the County, post a surety bond guaranteeing same.

B. Guidelines for the Issuance of Escrow Bonds

1. Commitment of credit enhancement provider must be in place at bond closing;
2. Development must have secured its major discretionary land use approvals;
3. Costs of bond issuance must be paid at bond closing, and the developer must be at risk for significant costs if bonds are redeemed;
4. Bonds are to be removed from escrow as soon as practicable;
5. A recorded Regulatory Agreement will generally be required at bond closing;
6. Full disclosure of all elements of the real estate, including any third party evaluation, are required;
7. The owner must indemnify the County, and, if requested by the County, post a surety bond guaranteeing same; and
8. The financing must be reviewed and determined to be eligible for tax-exempt financing by a bond counsel selected by the County.