Align Seeks to Fill Funding Gaps

Developer and investor team form progressive new bond fund

By Mark Olshaker

"We've developed, owned and operated affordable housing since 1994," says Michael Costa of Align Finance Partners. "Now, as it has become progressively more difficult to produce housing for families and seniors of lesser means, we have created a new debt product to help finance the preservation and development of desperately needed affordable housing."

Michael Costa

Costa, who is also the CEO of Highridge Costa Companies, is part of the formation of Align Finance Partners, a California-based commercial real estate finance company, with Dani Evanson, Michael Potter and Robert Tetrault. Evanson and Potter are also managing directors of Regis Metro Associates (RMA), Inc. and Tetrault is Highridge Costa's senior vice president and CFO.

Michael Potter

Robert Tetrault

"This team brings a lot of credibility and vision to the table," National Housing & Rehabilitation Association Executive Director Thom Amdur says. "Costa is one of the giants of the industry."

Dani Evanson

Highridge Costa is a fully integrated operating platform that was one of the first firms to syndicate their own tax credits, leading to a vertical business model. Evanson and Potter met Costa when RMA became investors in Highridge Costa in 2011.

"We wanted to invest in the affordable housing sector. Once we did our due diligence on Costa, we knew we had a best-in-class operator to invest with," Evanson notes, reflecting on what became an exceptional partnership. Combined, the Align team has already facilitated more than 24 affordable housing partnerships utilizing A and B tax-exempt bonds to finance the acquisition and rehabilitation of affordable communities. "We are very excited to be expanding our relationship with Costa through the formation of Align Finance Partners."

Bringing Innovation to Affordable Housing Financing

Align Finance Partners created the Align Affordable Housing Bond Fund, L.P., a $100 million-plus fund to provide creative gap financing for apartment communities with at least 20 percent set aside for affordable units located in California and other western states. Structured as a subordinate tax-exempt private-activity housing bond or 501(c)(3) tax exempt bond, the bonds will be secured by a second deed of trust on the property or through interest in the ownership entity.

The subordinate bonds are an alternate financing to equity that provides between 60 and 90 percent loan-to-cost loan amounts ranging from $5 to $15 million, nonrecourse to the borrower with an initial pay rate of approximately six percent accruing to a total rate of approximately ten percent. Align's financing offers flexible interest rates between nine to ten percent, compounded monthly, for acquisition and rehab projects, and ten to 12 percent for new developments.

Rapidly rising land values and construction costs, with declining soft funding opportunities in most western U.S. metropolitan areas, make it more and more difficult for multifamily project owners to achieve the returns necessary to raise equity for new developments. "When a borrower intends to obtain an A position tax exempt bond, our B bonds can easily be added to provide financing up to 90 percent loan-to-cost. Our product is cost-effective capital to borrowers at approximately 300 to 600 basis points less than the cost of private equity," adds Costa.

Evanson continues, "We want our debt product to produce more affordable units, and by being able to replace

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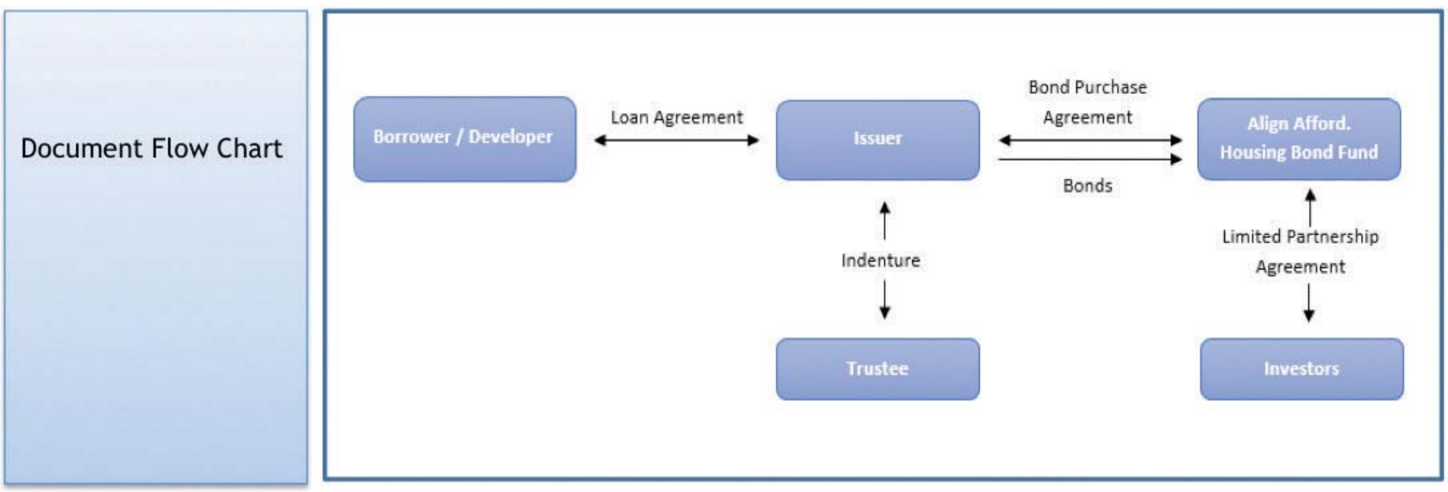
equity, we are offering borrowers more capital at lower than equity rates to get their projects built and delivered, especially to market rate developers faced with inclusionary zoning requirements."

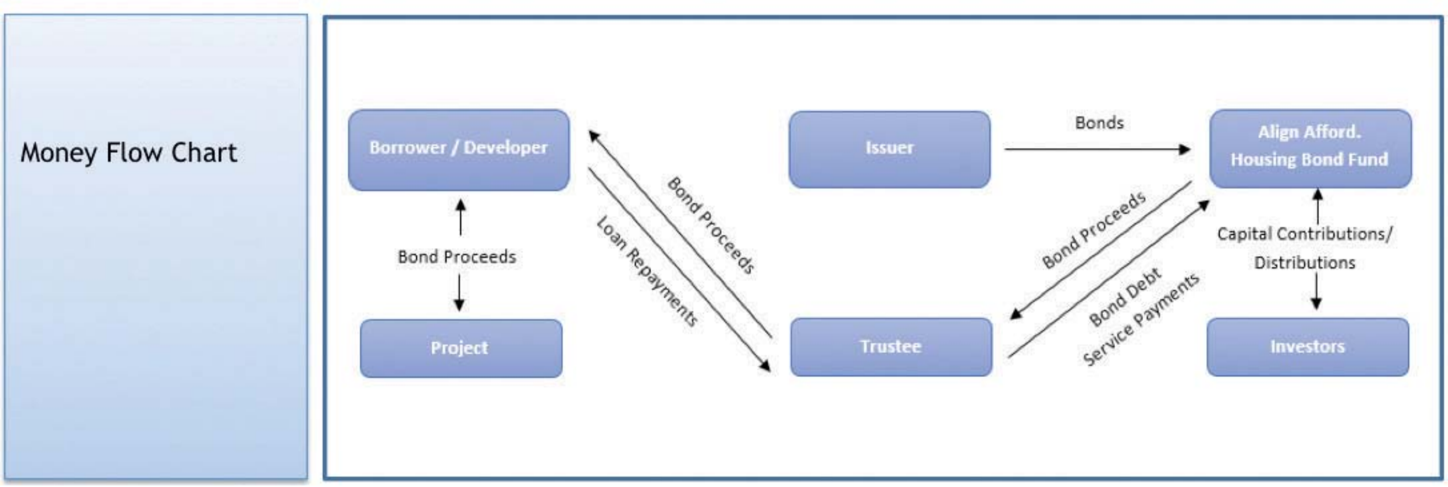
Who Is It For?

Align believes there are three types of borrowers:

First, 501(c)(3) nonprofit organizations that are general partners of existing tax credit properties (LIHTC) in years ten to 15. The fund's subordinate financing can help facilitate the early purchase of the limited partners' interests. "You look at the property about year 11; you've delivered all the tax credits to the investors. We can provide a B bond up to 90 to 95 percent of cost to purchase the community to help nonprofit organizations facilitate buying their partners out of the deal. This lets the nonprofit hold onto the property for the remaining four or five years and then, if they choose to facilitate a rehabilitation of the community utilizing private activity bonds and four percent LIHTCs."

Second, market-rate multifamily developers who are now faced with inclusionary zoning requirements. According to the California State Housing Department, 97.6 percent of all cities and counties are failing to approve the affordable housing required to keep pace with population growth. In response, inclusionary housing requirements for market-rate housing developments are becoming more and more common. Align's B bonds offer developers impacted by these requirements the chance to look at the way they are financing the entire capital stack. Developers are once again considering tax-exempt over taxable financing. Align's product replaces a large





chunk of sources for the developer that is normally very expensive profit participating mezzanine and/or equity.

Align's model will lead to the development of more affordable housing units, even without inclusionary requirements. "In downtown Los Angeles, there is a 200-unit building where the developer underwrote a 100 percent market-rate project," says Evanson. "After learning that tax-exempt A and B bonds would yield greater returns to the developer and their ten percent equity investors, they have elected to alter their project to 20 percent affordability. Win-win."

Third, those developers whose focus is on four percent tax credit acquisition rehab or new development. "Faced with decreased value of four percent credits resulting from recent tax reform now creates a greater funding gap," says Costa. "We can help to fill this gap with our subordinate tax-exempt B bonds program. However, our product won't work for most nine percent credits transactions since most are prohibited from using tax-exempt bonds."

Investing with Impact: Creating Affordable Housing

"Most all of us who work in the affordable housing industry truly value the impact we are making," says Costa. "What's really interesting about the affordable housing business is the openness and immediate sharing of information, unlike most other real estate sectors where most feel they have a bit of a secret that they want to protect for themselves. Here, we are quick to share best practices. That's something I really enjoy about this industry, and it coincides with why we're putting this program together. I truly believe that we all believe there is a greater mission to help each other to create more units as we are all so aware of the imbalanced supply and demand for affordable housing in our nation."

Align's founders expect the fund to be attractive to investors because it offers federally tax-exempt returns (and in some cases state tax exemptions as well), and it meets the criteria for impact investing by promoting more affordable housing. For high net worth investors, the ten percent tax-exempt bond has a tax adjusted effective yield of 14 percent and aligns with their mission to have a double-bottom line investment opportunity.

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According to the National Low Income Housing Coalition, the U.S. has a shortage of 7.2 million rental homes that are affordable and available to extremely low-income renters. In California specifically, there are only 22 affordable and available rental homes per 100 extremely low-income rental households. Align not only provides financing to these desperately needed affordable housing projects, but it also serves larger social needs by helping to stabilize and reinvigorate neighborhoods in decline and to potentially create "infill" housing opportunities in urban and/or redevelopment areas.

"There is a great sense of mission at this company," Costa says. "On several occasions, primarily at grand openings, a single mother will come up to me and say, 'But for the efforts of your company, Mr. Costa, I was living in a garage, or a car or some other deplorable situation, and now I have a wonderful place to live and raise my children. I never dreamed I would be living in such a wonderful community, one that I am proud to be able to call home.' With this kind of thanks, everything else actually becomes a secondary thought. The beauty of this business is that there are a lot of people like us in our industry who value the impact we are all making every day." TCA

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