Align Finance Partners Provides Gap Financing to Affordable Housing Developers

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As federal funding continues to shrink, it has become increasingly difficult to finance the development and acquisition of affordable housing. Align Finance Partners (AFP) is trying to change that.

"Over the years, we have tried to expand our investments in affordable housing," said Michael Potter, principal at AFP. "We recognize the need to fill the gap in the capital stack in order to ensure that affordable housing is available."

AFP is rolling out a new tax-exempt private activity housing bond or 501(c)(3) bond program.

"As interest rates increase, it makes more sense to use tax-exempt bonds," said Potter. "Local and state governments keep pushing for affordable housing and there is tremendous demand from residents for affordable housing. Our bond program is an innovative and necessary financing tool intended to address the demand."

The idea has support.

"This resource is distinct from per-capita limited private activity bonds (PABs), which also can be used for affordable rental housing," said Mark Shelburne, senior manager at Novogradac & Company LLP. "Properties with PABs also generate the 4 percent low-income housing tax credit (LIHTC)."

"As interest rates rise, there is an advantage in the tax-exempt interest rate market over the taxable market," said Lauro Garcia III, senior vice president, managing director at Stern Brothers, a privately held investment bank.

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AFP will focus on financing acquisition and development in the western United States, with an emphasis on California.

How it Works

AFP is raising a $150 million investment fund to finance subordinate tax-exempt bonds. Potter anticipates the money will help finance 10 to 15 developments, with each property receiving between $5 million and $15 million in financing from AFP.

The bonds will be issued by a governmental entity, secured by a trust estate held by a corporate trustee and serviced by AFP or a third-party servicer. AFP intends for the subordinate bonds to provide financing for the portion of the capital stack between 60 percent and 90

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percent loan-to-cost. The bonds are interest-only and provide flexibility with respect to current pay rates.

"The ability to access this pool of money in the subordinate position to the senior loan, it allows the sponsor to use this money instead of common equity," said Garcia.

Bonds are available in connection with the acquisition or development of a property where at least 20 percent of the apartments are reserved for residents earning no more than 50 percent of the area median income (AMI); a development where at least 40 percent of the apartments are reserved for residents earning up to 60 percent of the AMI; or a development where all of the apartments are leased to low- and moderate-income residents.

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According to Potter, subordinate financing works for both the acquisition/rehabilitation of existing developments and new construction. In addition, Potter said subordinate financing is an excellent tool for a nonprofit general partner in a LIHTC development to buy out its equity investors.

"This helps nonprofits come up with the necessary funding to purchase a project after the compliance period is over," said Garcia.

While the tax-exempt bonds are useful in buying out a partner, Garcia said it is tougher to use these bonds for LIHTC new construction. "This doesn't work well with a LIHTC deal because the rents are too low," said Garcia. "The best application is for mixed income, an 80-20 deal. The 80 percent market-rate portion has higher rents and creates the cash flow to subsidize the 20 percent affordable portion."

Benefits of Bond Financing

There are benefits to AFP's new financing program, starting with availability.

"Unlike PABs, there is no federal limit on 501(c)(3) bonds, meaning there is no competitive award process," said Shelburne.

That's not the only benefit.

"It lessens your requirement [as an owner or developer] to raise equity," said Potter. "As state and local governments pass inclusionary ordinances, owners struggle to raise sufficient equity. We provide inexpensive financing to replace the need to raise additional equity."

"There is not as much pressure on the deal from a debt standpoint [with these bonds]," said Garcia.

Garcia said the primary hurdle with this financing is to convince the bondholder that the risk is the same as getting common equity.

Potter said that there are plenty of financial institutions willing to give developers a first loan, but raising the necessary capital to finance affordable housing has become difficult after securing senior financing.

"Anyone applying for a senior tax-exempt bond should look at our program," said Potter. "It is excellent to run congruent with senior tax-exempt bonds."

Another benefit of the program is that financial institutions investing in AFP's fund are eligible for credit toward their Community Reinvestment Act requirements. Potter said the revenue from AFP's bonds distributed to investors is exempt from federal income

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tax, is not considered a preference item for alternative minimum tax and, in certain instances, may be exempt from state income tax.

AFP has applied to the California Organized Investment Network (COIN) for its fund to be certified as COIN Qualified Investment. COIN serves as a national model to provide leadership in increasing insurance industry investment in underserved and rural communities throughout California. Potter said having COIN certify AFP's fund as a COIN Qualified Investment would encourage insurance companies to invest in the fund and promote affordable housing.

A Program in Progress

"We are trying to get the word out," said Potter.

At the time of publication, Potter said AFP is in discussions with multiple owners and developers to provide subordinate financing and anticipates closing AFP's first deal within the next 90 days.

"This program is very timely. We do need this, especially in California," said Garcia. "It fits right in to what elected officials are saying. 'It is time to create more workforce housing.'"

"At the end of the day, our program encourages the retention and development of affordable housing," said Potter. "It fills the gap in the capital structure." ❖