
HOUSING BOND BASICS

FOR

BOARD MEMBERS

KUTAK ROCK LLP

Atlanta, Chicago, Denver, Des Moines, Fayetteville,
Irvine, Kansas City, Little Rock, Los Angeles, Oklahoma City,
Omaha, Pasadena, Richmond, Scottsdale, Washington DC, Wichita

July 1, 2007

TABLE OF CONTENTS

	Page
WHAT IS A BOND?	2
BOND ISSUANCE OVERVIEW	4
TYPES OF BONDS	6
PARTIES TO A BOND ISSUE.....	10
STEPS AND TIMETABLE OF A BOND ISSUE	14
DOCUMENTS FOR A BOND ISSUE.....	17
HOUSING BOND ISSUE STRUCTURE CONSIDERATIONS	22
GENERAL LEGAL CONSIDERATIONS IN A BOND ISSUE	26
OVERVIEW OF FEDERAL TAX LAW REQUIREMENTS FOR HOUSING BOND ISSUES.....	30
WHAT HFA BOARD MEMBERS SHOULD KNOW AND ASK ABOUT BONDS AND BOND ISSUES	35
PRICING BONDS IN A NEGOTIATED SALE— HOW TO MANAGE THE PROCESS (GFOA DETAILED INFORMATION).....	38
GLOSSARY OF FINANCIAL TERMS AND ACRONYMS	40

WHAT IS A BOND?

WHAT IS A BOND?

A Bond is an IOU or a promise to repay money. The governmental entity that needs the money (state, county, city, school district, university, state housing agency) makes the decision to “borrow” funds for a specific public purpose (such as streets, sewers, parks, hospitals, housing programs) from individuals and institutions throughout the country, which effectively make “loans” to the governmental entity by buying its bonds. Bonds turn a large debt into marketable smaller denomination debts, much like identical packages on a shelf at \$5,000 each.

Bonds represent borrowed money which the Issuer is legally “obligated” to repay; that is why Bonds are called “obligations.” The Issuer of the Bonds is usually a political subdivision or a special authority of some type (such as a state housing agency), so the obligation to repay is between the governmental entity (the bond “Issuer”) and the bondholder. The Issuer’s promise to repay can take various forms, depending on the nature of security for repayment of the Bonds:

- **General Obligation Bonds** are payable from any of the Issuer’s funds and are secured by a pledge of the full faith and credit of the Issuer (and taxing power if the Issuer may levy taxes) for timely payment of principal and interest to the bondholder—voter approval is often required if taxing authority is pledged.
- **Limited Obligation Bonds** are payable from and secured only by a pledge of the proceeds derived by the Issuer from a limited portion of the Issuer’s resources, i.e., a specific tax or assessment.
- **Revenue Bonds** are payable from and secured only by the earnings of a revenue-producing enterprise, a mortgage loan or a portfolio of loans. Included in this category are housing revenue bonds, industrial revenue bonds, hospital revenue bonds and student loan bonds; the revenue-producing enterprise could be a water, sewer, electric or gas system, a toll bridge, airport, college dormitory, hospital, or residential housing project. When the Revenue Bonds finance a single project for a private party, they are often called “**Conduit (Revenue) Bonds**.”
- **Moral Obligation Bonds** are General Obligation Bonds, Limited Obligation Bonds or Revenue Bonds which have legally pledged security that is weak or untested. A state (or sometimes a city or county) which is **not** the Issuer but has a strong credit rating approves the bond issue (through a general statute or specific action) and agrees to consider appropriating funds to cover any shortfall of pledged revenues needed to pay bond debt service. Although the state (or city or county) does not “legally” obligate itself to appropriate funds, its agreement to consider appropriating funds is treated as a “moral” obligation to do so, and this “moral” obligation is considered the primary credit for the bonds.
- **Lease Secured Bonds (or “Certificates of Participation”)** are issued by a “shell” Issuer (often a newly created trust or nonprofit corporation with no real assets), payable from and secured by a pledge of a fixed dollar contract (usually a lease agreement) with a political subdivision. The credit for such Bonds is the credit of the political subdivision lessee, not the “shell” Issuer.

BOND ISSUANCE OVERVIEW

BOND ISSUANCE OVERVIEW

The basic process of issuing Bonds is analogous to getting a mortgage loan to buy a house.

An Issuer wants to borrow a large sum of money at a fixed (or sometimes floating) rate repayable over a long period of time. The funds may be to finance a capital project to be owned and/or operated by the Issuer, to finance a portfolio of mortgage loans, or to be re-lent to a private user to build a project (such as to a limited partnership to finance the construction of an affordable housing project). Commercial banks generally will not make long-term fixed rate loans, and often the major financial institutions that will (such as insurance companies) charge high interest rates. An alternative is to work with an investment banker (an “Underwriter”) and borrow the funds by issuing and selling Bonds. The Bonds normally have annual maturities (or annual sinking fund payment obligations) and are structured so that the annual principal and interest requirements typically are level debt or equal in amount. The Bonds are normally in minimum denominations of \$5,000 per Bond.

The Underwriter assists in structuring the Bond issue to the level of security that it believes is necessary to efficiently and effectively interest possible Bond purchasers. Bond purchasers include both institutions and individuals. The interest on the Bonds is normally exempt from federal income taxation, so purchasers are willing to accept a lower interest rate than they would otherwise require on taxable securities. Obviously this federal income tax exemption is worth the most to persons and institutions in the highest tax brackets. This, coupled with the minimum investment amount of \$5,000, normally limits the effective universe of investors to middle- or higher-income persons and institutions. In the last two decades, tax-exempt mutual funds have proliferated. Although tax-exempt funds are technically “institutions” (because they are usually corporations, although sometimes limited liability companies or partnerships), they have effectively replaced direct individual investors. Increasingly, individual investors buy an interest in a mutual fund, which mutual fund itself will buy numerous series and issues of bonds (the tax-exempt interest flows “through” the mutual fund as a tax-exempt return to the investor). By doing so, an individual investor substantially spreads his risk and at the same time receives tax-exempt interest and has the benefit of having a professional (the mutual fund) invest for him.

Once the Bond issue is structured and all state and federal law procedural requirements have been satisfied, including the preparation of appropriate basic documentation and obtaining a rating on the Bonds (if necessary), the Underwriter uses an “official statement” (much like a corporate prospectus) to test the market to determine the level of interest rates necessary to successfully sell the Bonds to investors. The Underwriter then purchases the Bonds from the Issuer and immediately resells the Bonds to investors who have evidenced an interest in purchasing the Bonds.

The actual delivery of the Bonds to the Underwriter occurs simultaneously with the payment for them by the Underwriter. The Bond proceeds are then used pursuant to the Bond documents for their stated purpose.

TYPES OF BONDS

TYPES OF BONDS

Bonds take many forms, are issued for a variety of purposes, can be payable from different sources and can reflect a variety of payment schedules. The following are the principal types of Bonds and their payment schedules:

- **Serial Bonds** mature “serially,” usually every 6 or 12 months. Serial Bonds are Bonds of an issue in which some Bonds mature in successive years without interruption. Generally, Serial Bonds comprise the first 8 to 12 years of principal amortization.

- **Term Bonds** come due in a single maturity at intervals of greater than one year since the last Serial Bond’s maturity and usually comprise a large part of each particular issue. The Issuer usually agrees to make periodic payments into a sinking fund for mandatory annual or semiannual redemption of a portion of the Term Bonds before maturity or for payment at maturity. A housing Bond issue is generally structured with an intermediate Term Bond maturity around year 20 and a final Term Bond maturity in year 32 of the issue; other Term Bond maturities are often added which are designed at the request of major purchasers.

- **Floating (Variable) Rate Demand (“Lower Floater”) Bonds** are Bonds which bear interest at a floating rate, usually set every week by an investment banker (as remarketing agent) at the fair market rate for seven–day–maturity debt. Such Bonds can normally be tendered by the owner (strictly at its option) to a tender agent (usually the trustee) at par after giving seven days’ notice; the Bonds are then remarketed to new investors by the investment banker, as remarketing agent. A bank typically agrees to buy tendered Bonds if they cannot be otherwise sold to new investors. In the last few years some Issuers have issued Floating Rate Demand Bonds and simultaneously entered into interest rate swap agreements to obtain an effective fixed rate cost of funds.

- **Current Interest Bonds (CIBs)** are the most common type of housing Bonds. Interest is paid every six months until the Bond matures or is retired early from optional or mandatory redemption.

- **Zero Coupon Bonds:**

Capital Appreciation Bonds (CABs). Payment of the semiannual interest is deferred until maturity or redemption with Capital Appreciation Bonds. The payment made at maturity or on the redemption date consists of principal and compounded semiannual interest.

CAB Converters. Interest on CAB Converters is deferred and semiannually until the Conversion Date—the date when the Bond converts to a current interest paying Bond and thereafter interest is earned and paid semiannually on the accreted value.

CABs and CAB Converters both reduce interest cost by enabling the issue to be structured with more lower-cost Serial Bonds in the early years. Zero Coupon Bonds are sometimes priced at higher yields than Current Interest Bonds of the same maturity and generally require higher fees to bond salesmen to be effectively marketed.

- **Auction Rate Bonds** are the same as Floating (Variable) Rate Demand (“Lower Floater”) Bonds except that instead of the Bondholder having the right to tender his Bond and demand that it be purchased by the tender agent, the Bondholder can tender the Bond but it will be purchased only if the Bond can be resold (“auctioned”) to a new investor. Unlike Lower Floater Bonds whose interest rates are reset weekly, Auction Rate Bonds can have their interest rates reset daily, weekly, monthly or using other time periods. Sometimes Auction Rate Bonds are combined with a like amount of Inverse Floating Rate Bonds (“Inverse Floaters,” sometimes also called “Residual Interest Bonds”) to result in a fixed interest rate to the Issuer; the interest rate on the Inverse Floater is the fixed interest rate minus the interest rate on the Auction Rate Bonds.

- **Premium Bonds** are fixed rate Bonds (sometimes PAC Bonds) sold at a price greater than 100% of their stated face value (the “premium”). The interest rates on such Premium Bonds are somewhat higher than the rates on comparable Bonds sold at 100% of their face value, but when the premium is taken into account, the effective interest cost to the Issuer is less than the interest cost on a traditional Bond.

- **Original Issue Discount (OID) Bonds** are Term Bonds sold at a price less than 100% of their initial stated face value. They can enable Bonds to be sold at a slightly lower yield and are used as a marketing device to institutional investors. OIDs sometimes require an Issuer contribution to the cash flows. They are rarely used for single-family Bonds due to the early risk of redemption at par from unexpected proceeds and prepayments.

- **Super Sinker Bonds** are a term maturity of a Bond issue, usually in a single family issue, which is redeemed before any other maturity from mortgage prepayments and, occasionally, excess revenues. While a super sinker will have a stated maturity of 10 to 20 years, the average life of a super sinker at 100% FHA prepayments will be approximately three to five years. A super sinker provides other Bonds in the issue with limited call protection because the super sinker is redeemed first. Super sinkers are priced at a lower yield than a regular Bond of the same stated maturity and are priced off their average life as opposed to their stated maturity. Super sinkers also require special rating agency cash flow stress tests. If the Bond issue receives prepayments at a rate less than 100% of the FHA tables, the actual average life of the Super Sinker Bonds will be extended. This average life risk is borne by the buyers of the Super Sinkers.

- **Planned-Amortization Class Bonds (PACs)**, typically used only in a single family issue, are a type of Super Sinker Bonds in that they are the first Bonds within the Bond issue to be called from mortgage prepayments, but unlike Super Sinkers there is a limit on how quickly they can be redeemed. PACs may also have a stated maturity of 10 to 30 years, but based on some specified Bond Market Association (BMA) mortgage prepayment speed, their average life is generally approximately three to five years. PACs

are priced at a lower yield than a regular Bond of the same stated maturity and are priced off their average life as opposed to their stated maturity. If the average life is determined at a percentage of the BMA prepayment rates, prepayments above that amount are allocated to redeem Bonds other than the PAC Bonds. If the bond issue receives prepayments at a rate less than the predetermined BMA rate, the actual average life of the PAC Bonds will be extended. However, if the prepayments are higher than the predetermined of the BMA rate, the average life does not get shorter. Thus, the average life of the PAC is less volatile than for Super Sinker Bonds, and as a result investors are willing to accept a slightly lower yield.

- ***Convertible Option Bonds (COBs)*** are marketed for an initial short-term period (usually six to 12 months) and may, at the Issuer's option, be resold or converted into additional short-term remarketings or converted and remarketed or refunded as long-term, fixed rate Serial and Term Bonds. The interest on COBs converts from a short-term interest rate to a long-term interest rate on the conversion date. The single-family mortgage rates are also determined upon a conversion date. Conversion dates occur upon predetermined dates or upon the occurrence of certain events. Until the conversion date, Bond proceeds are invested in securities or a guaranteed investment contract and are not available for the purchase of loans until the COB is remarketed or refunded. COBs are used by the Issuer to preserve single-family bonding authority from loss due to various legal reasons. However, federal tax law changes in 1997 eliminated many of the tax advantages of COBs and have resulted in the increased use of short-term (one- to two-year) notes which are then simply refunded by long-term bonds instead of being "converted" to long-term Bonds.

- ***Call Protected Bonds (Lockout Bonds)***, typically used only in a single family issue, are protected from early redemption for a specified period, usually five or 10 years. The Issuer agrees to not call these Bonds from prepayments or excess revenues for a specified number of years. The investor will generally accept a lower yield for these Call Protected Bonds. This structure reduces the prepayment call risk borne by the investor (Bonds may otherwise be called earlier than their stated maturity because of mortgage prepayments), and thus results in lower Bond rates.

PARTIES TO A BOND ISSUE

PARTIES TO A BOND ISSUE

Primary Parties

Various and distinct types of professionals work with an Issuer to achieve the common goal of issuing Bonds to raise private-source capital for public-purpose projects. Investment bankers, salespeople, underwriters, lawyers and investors are just some of the key participants in the municipal Bond industry. Their roles can be best understood by tracing how each participant contributes to the process.

- **Issuer.** This is the legal entity created by state law that is borrowing money by issuing Bonds. Under the federal tax laws, the Issuer must be a state or political subdivision (which is defined as a legal entity with the ability to levy taxes, exercise eminent domain powers or exercise police powers). An Issuer can also be a legal entity acting as an “instrumentality” or “on behalf of” a state or a political subdivision. For example, most housing finance agencies are “instrumentalities” under federal tax laws.

- **Lead Underwriter (Investment Banker).** The Lead Underwriter’s role centers on coordinating the origination of the Bond issue. These individuals participate in development of the Issuer’s Bond program and financing plan. With respect to each Bond issue, they structure the maturities and payment terms to maximize the efficiency of the financing and prepare Bond and program cash flows. The Lead Underwriter also assists in the preparation of the legal documents, provides the rating agencies with information on the Bond issue, and works with the Underwriters’ salespeople in understanding credit, duration and other aspects of the Bond issue.

- **Underwriters.** Underwriters are the group of brokerage firms (led by the Lead Underwriter) primarily responsible for establishing prices and yields on new Bond issues in the context of marketing and selling the Bonds. In addition to working closely with the Issuer and coordinating with the management team, the Underwriters maintain close working relations with investors and salespeople to determine the market demand and appropriate yields for an issue.

- **Bond Counsel.** Bond Counsel is a law firm with expertise in state bond law and federal tax laws. Bond Counsel advises the Issuer on legal matters. Bond Counsel decides what steps the Issuer can or must take under state, local and federal law with regard to the Bond issue. Bond Counsel drafts Bond and program documents, makes required filings and provides legal opinions on transactions undertaken. In housing Bond issues, Bond Counsel gives extensive advice about the impact of tax laws on the Bonds and housing programs to be financed.

- **Issuer’s Counsel.** Issuer’s Counsel advises the Issuer on day-to-day legal matters and may also handle various regulatory required matters, e.g., TEFRA notice and hearing and elected official approval, as well as providing legal opinions on procedural and program document matters.

- **Underwriters’ Counsel.** The Underwriters’ Counsel advises the Underwriters on federal securities law requirements. They may prepare (or review, if prepared by Bond Counsel or the Issuer) the Official Statement which details security and financial information about the Bond issue and, in addition, prepare the bond purchase agreement for the Bonds and other

documents reflecting the agreements the Underwriters have with each other and with the selling group, if any.

- ***Salespeople and Traders.*** The salesperson's role in both primary and secondary capital markets involves the sale/purchase of securities. Municipal Bond traders maintain the secondary market for securities by actively buying Bonds and selling them to other dealers and investors during the term of a Bond issue, thereby providing liquidity to all investors.

- ***Trustee.*** The Trustee is a commercial bank which represents the interests of the Bondholders. It acts as custodian of the Bond proceeds and program revenues, ensuring and overseeing the proper transfers of funds and accounts, and pursues available remedies if the Issuer defaults on the Bonds.

- ***Rating Agencies.*** The Rating Agencies are engaged by an Issuer to assess the creditworthiness of the Bond issue, review program structures, cash flows and legal documents, and then issue a credit "rating" on each Bond issue based on applicable criteria. Given the large number of different issues in the marketplace, Bond ratings issued by Rating Agencies are heavily relied upon by Bond purchasers. Rating Agencies also provide ongoing oversight of the program structure, cash flows and financial condition of the Issuer. The three primary Rating Agencies for tax-exempt Bonds are Moody's Investors Service, Inc., Standard & Poor's Ratings Services and Fitch, Inc.

- ***The Investor.*** Three major types of investors dominate the municipal marketplace: (a) Retail, which involves individuals acting directly or through trust companies and investment advisors; (b) Bond Funds, which are registered investment companies whose assets are invested in diversified portfolios of Bonds; and (c) Institutions, which are companies and corporations, particularly commercial banks, property and casualty insurance companies and government sponsored enterprises, such as Fannie Mae and Freddie Mac, as well as the Federal Home Loan Banks. The buying patterns of all three groups constantly change due to profitability, interest rates, maturities, tax rates, tax regulations, portfolio mix and the economy.

Additional Parties

- ***Borrower.*** In conduit revenue Bond financings, the Issuer issues the Bonds not for its own use but to relend the Bond proceeds to a private party which actually uses the Bond proceeds, such as to finance an affordable housing project. In such a financing the Bonds are payable solely and only from the loan payments made by the private party. The borrower can be a for-profit or a nonprofit entity. In affordable housing rental project financings, the borrower is often a limited partnership or limited liability company organized solely and only to own and operate the project. Most Bond and mortgage guarantors (like FHA) require that the project owner be a "single asset" entity, meaning that the owner owns no projects other than the one being financed and conducts no business other than owning and operating the project being financed. This is generally desirable because it minimizes extraneous business risks. When working with a developer of affordable housing projects, it is typical for the developer to be the general partner and 0.01% owner of the limited partnership (or limited liability company) which technically owns the project, with the rest of the 99.99% equity interest being sold to the limited partners (this is called a "syndication"). This is particularly true in the case of tax credit

financings because the limited partners can utilize the tax credits only if they are legally a part owner (i.e., limited partner) of the project.

- ***Credit Enhancer.*** This is a generic term for a third party which is providing the creditworthiness for the Bond issue and upon which the investors are primarily relying. A credit enhancer includes an insurance company which may insure an entire Bond issue, a mortgage insurer (such as FHA) which insures the mortgage, or a bank which issues a letter of credit that effectively guarantees the Bonds.

- ***Liquidity Provider.*** This is the generic term for a third party which agrees to provide funds to a bond trustee (or the Issuer) to honor a floating rate bondholder's tender demand when the bond cannot be remarketed on the tender date. A liquidity provider is usually a commercial bank or, recently, a federal home loan bank. Sometimes the liquidity provider is also the credit enhancer.

- ***Investment Agreement (Guaranteed Investment Contract or "GIC") Provider.*** This is a financial organization which provides guaranteed investment rates for the investment of moneys held by the Trustee under the Trust Indenture. GICs are often used in lieu of direct investments (such as United States treasuries) because GICs eliminate concerns about possible liquidity losses on investments or reinvestments.

- ***Swap Provider ("Counterparty").*** This is a financial institution which enters into an interest rate swap (or other type of swap or hedge). Often a swap provider is a specialized legal entity designed to achieve a very high credit rating.

- ***DTC.*** The Depository Trust Company was created and is owned by the major investment banking firms to act as the technical Bondholder. Bonds must now be fully registered, but as such they are difficult to sell and transfer due to the paperwork involved. The now accepted practice is to have DTC be the nominal Bondholder, and it then issues easily transferable beneficial certificates of ownership (each representing a \$5,000 Bond) through the participating investment banking firms.

- ***Accounting Firm (CPA).*** Issuers have their financial statements audited at least annually by a firm of certified public accountants. If the Bond issue is payable from any of the funds and assets of the Issuer or a discrete pool of assets or particular Trust Indenture of the Issuer, the Issuer would normally have its certified public accounting firm review various financial information in the Official Statement and provide a letter (called a "Comfort Letter" or "Agreed Upon Procedures Letter") to the Underwriters which letter certifies the correctness of the financial information in the Official Statement.

- ***Financial Advisor.*** A firm which advises the Issuer on the structure and sale of a Bond issue. However, they do not buy the Bonds. Often the Financial Advisor prepares the cash flow schedules demonstrating that revenues will be sufficient to pay the Bond debt service as scheduled.

In addition, many of the above parties will be represented by their own counsel, particularly in complex financings.

STEPS AND TIMETABLE OF A BOND ISSUE

STEPS AND TIMETABLE OF A BOND ISSUE

The following is a general description of the steps and timetable in a typical simple revenue Bond financing. If necessary, these steps and the timetable can be telescoped; however, in many cases a financing takes a longer period of time than the following, particularly in multi-family financings.

Step 1 (Week 1)

The financial officers of the Issuer and the borrower (if the Bond sale moneys will be used to finance a project for a private borrower) preliminarily discuss the proposed Bond financing, including size and structure. Other parties who will participate in the transaction are consulted, including Bond Counsel, an Underwriter and sometimes Underwriter's Counsel (if the Bonds will be sold to the highest bidding underwriter through a "public sale," the Issuer usually employs a Financial Advisor to arrange the Bond sale instead of an Underwriter). At this time Bond Counsel determines whether and to what extent the financing is affected by state and federal (tax) laws and what, if any, approvals are necessary. If required, the Issuer applies to the state for a private activity bond cap allocation for the Bond issue.

Step 2 (Weeks 2–3)

The Issuer staff discusses with the Issuer Board the reasons to proceed with the Bond financing and may formally hire Bond Counsel and the Underwriter (if not already retained); the Issuer also details any additional requirements it may have. If a project is being financed for a borrower, construction of the project may then begin. First drafts of the basic bond documents (typically the Trust Indenture or resolution and any financing agreement) are distributed by Bond Counsel. Bond Counsel conducts its review of whether the financing satisfies applicable federal tax rules. If a credit enhancer is involved, it distributes its commitment requirements and documents.

Step 3 (Weeks 4–5)

Comments on the first drafts of the basic documents are received from the parties involved. Second drafts (marked to show changes from the previous draft) are distributed by the appropriate parties, reflecting negotiated business issues, as well as the first draft of the Preliminary Official Statement and Bond Purchase Agreement prepared by Underwriter's Counsel. The Underwriter/financial advisor contacts the rating agencies to obtain a rating.

Step 4 (Weeks 6–7)

Comments on the second drafts of the basic documents are circulated among the Issuer, Bond Counsel, Underwriter and Underwriter's Counsel (plus the borrower, in the case of a project financing, and any credit enhancer). Revised drafts are again distributed. Underwriter's Counsel revises the Preliminary Official Statement and Bond Purchase Agreement, and the Underwriter carries out its "due diligence" obligations. Comments on the revised documents are received and revised drafts are again distributed until a substantial consensus is reached on all provisions.

Step 5 (Weeks 8–9)

Once the basic financing structure and documents are agreed upon and any state private activity bond cap allocation is received, the Issuer holds a public hearing (after at least 14 days' notice) with respect to the issuance of the Bonds. Then the Underwriter (or Financial Advisor, in the case of a public sale) makes a public distribution of the Preliminary Official Statement to prospective investors. Final drafts of the documents and the Issuer's bond resolution are prepared.

Step 6 (Weeks 10–11)

The Underwriter prices the Bonds in consultation with the Issuer (or bids are received by the Issuer in a competitive sale). The Issuer adopts the bond resolution, in which it agrees to sell the Bonds to the Underwriter (the highest bidding Underwriter in the case of a competitive sale of the Bonds), approves the documents and authorizes execution of the Bonds. The Bond rating(s) is received. The Bond Purchase Agreement is signed. The Official Statement is finalized to reflect the final Bond terms and is printed and distributed to investors. Bond Counsel circulates drafts of closing and tax documents and counsel opinions. All parties complete and assemble the remaining documents and opinions for the closing.

Step 7 (Week 12)

About two weeks later, the preclosing and closing occur, which are the final meetings of all parties. At the preclosing, all of the documents are executed, and then delivered on the closing day. Bond Counsel delivers its opinion that the Bonds are valid and the interest on them is exempt from federal income taxes. On the closing day the Issuer delivers the Bonds to the Underwriter, and the Underwriter wire transfers the purchase price to the Trustee, which deposits the funds in various funds and accounts created by the Trust Indenture and disburses moneys upon direction of the Issuer to pay various costs or finance the program/project.

DOCUMENTS FOR A BOND ISSUE

DOCUMENTS FOR A BOND ISSUE

Basic Documents

The basic Bond documents include, among others, the Trust Indenture and/or Supplemental Trust Indenture (sometimes in the form of a “Resolution”), the Bond Purchase Agreement, the Official Statement, the Bonds and the Continuing Disclosure Agreement. These documents outline the contractual agreements among the various parties and particularly address the details of the Bond issue, the security for it and the specifics of the sale to investors.

Trust Indenture. The Trust Indenture (typically 40–60 single-spaced pages) is the most important of the Bond documents. It is the contract between the Issuer and the commercial bank acting as trustee for the Bondholders (the “Trustee”) with the purpose of establishing the parameters for the issuance of any series of Bonds. The Trust Indenture accomplishes the following purposes:

- Sets forth the terms and provisions and security for the Bonds;
- Provides Bond redemption procedures;
- Establishes funds and accounts;
- Provides for permitted investments of moneys;
- Provides procedures for amending the Trust Indenture;
- Provides for the Trustee’s duties and rights; and
- Establishes events of default and remedies.

The Issuer and the Trustee each are bound by the terms of the Trust Indenture. The Issuer promises to:

- Cause the principal and interest to be paid on the Bonds;
- Comply with any tax covenants; and
- Comply with the program covenants.

The Trustee has the following functions:

- Holds all money under the Trust Indenture;
- Pays principal and interest to Bondholders;
- Monitors the Issuer’s compliance with its Trust Indenture promises; and
- Acts for the Bondholders in the event of a default.

Often a general or “open” Trust Indenture (or Resolution) has been adopted to permit the issuance of multiple series of Bonds which are equally secured. In that case a Supplemental Trust Indenture will be entered into each time the Issuer issues a series of Bonds under the general Trust Indenture. The Supplemental Trust Indenture includes the specific terms of a series of Bonds, i.e., the maturity dates, interest rates and date of issuance, as well as specific redemption provisions.

Bond Purchase Agreement. This document (typically 15–20 pages) is the agreement between the Issuer and the Underwriters in which the Issuer agrees to sell the Bonds to the Underwriters and the Underwriters agree to purchase the Bonds from the Issuer at a specified

purchase price, typically principal plus accrued interest from the date of the Bonds to the date of closing. The Bond Purchase Agreement sets forth the terms and conditions under which the Underwriters will purchase the Bonds. These conditions include provisions for various documents and opinions to be provided by parties to the financing at the closing; these documents are all listed on a Closing Index.

Official Statement. The Official Statement (typically 75 or more pages, including appendices) is dated the date the Bonds are sold and contains the final terms of the Bonds. Under the federal securities laws the Issuer is obligated to disclose in this document all information that a “reasonable investor” would consider important (“material”) in deciding whether to purchase a Bond. All the information which was subject to change in the Preliminary Official Statement (primarily interest rates and maturities) has been determined and appears in its final form. The “red herring” language of the Preliminary Official Statement is removed from the cover and the date of sale appears in the lower left hand corner of the cover. Copies of the Official Statement are printed and delivered by the Underwriters to each Bond purchaser.

The Bonds. The Bonds are interest-bearing promises to pay a specified sum of money on a specific date to the Bondholder. The form of the Bond is contained in the Indenture. Each Bond is signed by the facsimile signatures of Issuer officials and is manually signed, or “authenticated”, by the Trustee. Each Bond is assigned a CUSIP number by the CUSIP Bureau for the purpose of providing a uniform method of identification of the Bonds, and to prevent fraud and theft. Most Bond issues are considered “book-entry-only” Bonds and are held in a vault at The Depository Trust Company (“DTC”) in New York, or more recently held by the Trustee as agent for DTC. A Letter of Representations is executed by the Issuer, the Trustee and DTC which sets forth each of their responsibilities with respect to the Bonds.

Continuing Disclosure Agreement. In this document (typically 5–8 pages), which the SEC requires that the Underwriters obtain, the Issuer agrees to annually provide updates on its financial and operating information in the Official Statement. The annual updates go to SEC-approved securities information repositories where they are available to the public.

Additional Documents

In many financings there may also be additional basic documents. These include:

Credit Enhancement Agreement. This is the document by which a third party insures or guarantees either the Bonds or the borrower’s mortgage repayment obligation. Often there are two documents, one being the guaranty or insurance agreement, which runs to the Trustee, and the second being the agreement of the Issuer or borrower to repay the insurer/guarantor.

Liquidity Agreement. Often called a “standby bond purchase agreement,” in floating (variable) rate demand (“lower floater”) bond issues this is an agreement between the Issuer/Trustee and a financial institution in which the financial institution agrees to advance funds to honor bondholder tenders if the bonds cannot be remarketed to new bond purchasers.

Financing Agreement (Conduit Financing). This is the generic name for the agreement between the Issuer and the borrower in a conduit financing. It may be a loan agreement, lease–

purchase agreement, installment sale agreement or even just a promissory note and mortgage. The Financing Agreement generally includes the following provisions:

- The terms and provisions for the effective loan of the Bond proceeds;
- The agreement of the borrower to repay the loan in amounts and at times sufficient to enable the Issuer to repay the Bonds;
 - Security for the borrower’s repayment obligations (usually a first mortgage on the project being financed and often also some type of third-party insurance or guaranty, such as FHA insurance);
 - The type and use of the project;
 - Maintaining, operating and insuring the project;
 - Events of default by the borrower and remedies; and
 - The borrower’s prepayment rights.

Interest Rate Hedge Agreement (“SWAP”). A relatively recent development for housing finance agencies, an interest rate SWAP agreement is between the Issuer and a financial institution, often a subsidiary of an investment banker (called the “Counterparty”). It is normally used when an Issuer issues Floating Rate Demand Bonds. In the typical interest rate SWAP agreement in housing Bond issues, the counterparty agrees to pay the Issuer a floating interest rate roughly equal to the rate on the Floating Rate Demand Bonds, and the Issuer agrees to pay the investment banker’s subsidiary a fixed interest rate (in other words, they “swap” interest rates). By doing this the Issuer obtains an effective fixed cost of funding at a rate lower than if it had issued fixed rate Bonds.

Investment Agreement. Also sometimes called a “guaranteed investment contract” or “GIC,” this is an agreement between the Issuer/Trustee and a financial institution in which Indenture moneys are invested at a fixed rate and term, subject to withdrawal at any time without penalty when needed by the Trustee or the Issuer.

Regulatory Agreement. Also sometimes called a “land use restriction agreement” or “LURA,” used in rental housing Revenue Bond conduit issues, this is an agreement executed by the borrower and recorded with the mortgage to ensure compliance with federal tax law requirements, principally addressing the income limits for tenants.

Closing Documents

In addition to the execution and delivery of the basic documents, various closing certificates and documents are delivered at the Bond closing and include the following:

Arbitrage Certificate. The Arbitrage Certificate and accompanying documents are executed to establish, for federal tax purposes, the Issuer’s reasonable expectations surrounding the issuance of the Bonds at the time of their issuance. The Arbitrage Certificate sets forth the use of the proceeds of the Bonds and the expected time frame for such use. The yields on the Bonds and any mortgage loans being financed (based on cash flows provided by the investment bankers) are certified by the Issuer. Federal tax law restrictions on the investment of amounts on deposit in the funds and accounts under the Trust Indenture and general rebate requirements are also set forth.

Form 8038. The 8038 is an Internal Revenue Service form that is required to be filed each time a tax-exempt Bond issue is completed. In addition to providing information about the amount, final maturity, redemption price, yield, weighted average maturity and use of proceeds, it indicates whether any federal tax private activity volume cap was used in the issuance of the Bonds.

Legal Opinions. Each legal opinion is required pursuant to the Trust Indenture or Bond Purchase Agreement. The opinion of Bond Counsel regarding the tax-exempt status of interest on the Bonds is necessary to sell the Bonds (the form of it is attached to the Official Statement for this purpose). It states that the Bonds are legal and binding obligations of the Issuer, whether the interest on the Bonds is exempt under federal and state laws, and the source of payment, or security, for the Bonds.

Rating Letters. The Rating Agencies issue a rating letter after they have reviewed all documentation, together with computer cash flow scenarios prepared by the Underwriters. These ratings are current assessments of the creditworthiness of the Bonds. The debt rating is not a recommendation to purchase, sell or hold a security.

Blue Sky Requirements. Blue sky laws are state securities laws which regulate the offers and sales of securities by the Underwriters. These laws are popularly known as “blue sky laws” because they have been enacted to prevent “speculative schemes which have no more basis than so many feet of blue sky.” The Blue Sky Memoranda are prepared by counsel to the Underwriters to evidence that the Bonds have been cleared for sale by the Underwriters in the states listed therein.

Comfort Letter. A Comfort Letter is a letter from the Issuer’s certified public accounting firm in which the firm confirms (i.e., provides “comfort” on) the correctness of certain financial information in an Issuer’s official statement. In the last decade Comfort Letters have been used less because the limitations and exceptions in them have significantly reduced their value.

**HOUSING
BOND ISSUE STRUCTURE
CONSIDERATIONS**

HOUSING BOND ISSUE STRUCTURE CONSIDERATIONS

Transaction Fund Flow

Although there are a wide variety of **fixed rate housing bond** issue transaction methodologies, virtually all are variations of a single basic fund flow:

1. Fixed rate bonds (usually a combination of Serial Bonds and Term Bonds) are sold by the Issuer to the Underwriter pursuant to the bond purchase agreement.
2. The Underwriter immediately resells the bonds to investors using the Issuer's official statement to describe the bond issue and security for it.
3. The proceeds from the bond sale are immediately deposited by the Issuer with the Trustee.
4. Until the bond proceeds are disbursed for their specified purpose, the Trustee invests the bond proceeds in permitted investments as directed by the Issuer.
5. The Trustee disburses bond proceeds, at the direction of the Issuer, to make or purchase mortgage loans (or for other authorized purposes).
6. The Issuer (or Trustee as its agent) receives mortgage/loan repayments, invests them in short-term investments until needed to pay bond debt service, and collects investment earnings.
7. The Trustee pays principal and interest to bondholders from pledged mortgage repayments and investment earnings.

The most common variation to the basic fixed rate bond structure is that the bonds and/or the mortgage(s) are insured or guaranteed, or the mortgages are "swapped" for GNMA/FNMA/FHLMC mortgage-backed securities covering the pool of mortgages.

Floating (variable) rate demand ("lower floater") housing bond issues involve additional documents and steps. A remarketing agent (usually the initial bond underwriter) is hired to remarket any bonds that are tendered for purchase by a bondholder, and a liquidity provider (usually a commercial bank) agrees to purchase any bonds that cannot be remarketed to new bondholders. The remarketing agent also usually determines the (floating) interest rate. Often there is also an interest rate swap (or hedge) agreement under which the Issuer agrees to pay the swap counterparty/provider an amount equal to a fixed rate on the bonds, and the swap counterparty/provider agrees to pay the Issuer/Trustee an amount based on a floating interest rate index (which equals or approximates the floating interest rate on the bonds). The bonds are often also insured or guaranteed.

Cash Flow (Numbers)

Housing bonds are issued to finance mortgage loans, either single family loans or multi-family (rental) loans, and housing bonds are expected to be repaid from the repayment of the mortgage loans. (A portion of a bond issue may also be used to fund a bond debt service reserve fund, and even to pay costs of issuing the bonds.)

The mortgage loans normally have 30-year maturities (some multi-family loans are 40 years, but usually only those for new construction), with monthly level debt payments. A portion of such payments are interest and the remainder principal.

The bond issue's scheduled principal repayments are established so that total debt service mirrors the scheduled mortgage loan payments. The mortgage principal pays the bond principal and thus must match it; so to pay bond interest, the net mortgage loan interest (that is, after payment of all related expenses, including servicing fees) must be at least as high as the bond issue's effective interest rate. Because bonds normally pay principal and interest semi-annually, whereas mortgages pay monthly, the monthly mortgage payments are invested until used to pay bond debt service. A conservative investment rate (normally below the effective bond interest rate) is assumed for such investments (this is usually called the "float rate"), and such "float earnings" are also included in establishing the scheduled bond debt service.

The bond principal is normally a combination of relatively short maturity "serial bonds," and long maturity "term bonds" with annual (or semi-annual) mandatory sinking fund redemptions.

However, there are two major uncertainties that must be dealt with in structuring the bond debt service—mortgage originations and prepayments.

Although it is possible to start taking mortgage loan applications before bonds are issued, there is no assurance that bond proceeds will actually be used to finance mortgage loans (particularly if conventional mortgage rates drop after the bond rates are set). Accordingly, computer schedules must be prepared which show that even if no mortgages are financed, there will be sufficient funds (that is, unused bond proceeds and any interest earnings on them until used) to pay or redeem the bonds. (Normally the bonds are required to be redeemed at par to the extent not used in a year or so.) If the investment rate earned on the undisbursed bond moneys is less than the effective bond rate (called "negative arbitrage"), there will not be sufficient moneys (between undisbursed bond proceeds and earnings thereon) to pay both the principal and interest on the bonds, so the housing finance agency must pledge additional security. This is called "non-origination" risk.

Because single family mortgages can normally be prepaid at par at any time, computer schedules are also prepared which simulate various mortgage prepayment "speeds"—in some cases assuming prepayments occur so rapidly that the mortgage loan portfolio has an average life of only three years. Such high prepayment assumptions stress the ability to pay bond debt service because the prepayments—until used to pay or redeem bonds—are invested at the float rate, which is usually lower than the effective bond interest cost. So such investments actually are money losers—again called "negative arbitrage."

Finally, the computer schedules which simulate mortgage loan receipts must also be adjusted to assume conservative levels of mortgage delinquencies and defaults. The impact of defaults depends directly on the nature of the loan and any loan insurance or guaranty.

The federal tax law arbitrage regulations contain two rules which significantly constrain a housing finance agency's ability to earn enough money in a single family financing to pay bond debt service: (1) the "gross" yield on the mortgages (that is, before payment of servicing fees and any of the agency's fees) may not exceed the bond yield by more than $1\frac{1}{8}\%$ over the life of the bond issue and (2) the yield on nonmortgage investments may not exceed the bond yield at all. Because a housing finance agency can "make money" only on the mortgages, failure to originate mortgages or extremely rapid mortgage prepayments are major risks. As a result, the housing finance agency must normally pledge additional collateral (usually mortgages are pledged) to secure bond repayment. This is particularly true if some of the bond proceeds are used to fund a bond reserve fund (for it cannot earn more than the bond interest cost due to such federal tax rules) or to pay costs of issuance (because such bond proceeds are not used to finance mortgage loans, the principal amount of the mortgages is less than the principal amount of the bonds).

**GENERAL LEGAL CONSIDERATIONS
IN A BOND ISSUE**

GENERAL LEGAL CONSIDERATIONS IN A BOND ISSUE

There are a number of laws that apply to a Bond financing, both state and federal. Some of the most important—and complex—are the federal tax laws which must be satisfied for a Bond issue to be tax-exempt; these laws are discussed separately in the following section.

In addition to the federal tax laws, the principal additional state and federal laws directly applicable to a Bond issue include the Issuer's organic state laws, the state's private activity Bond allocation law or executive order, state real estate laws, state Blue Sky laws, federal bankruptcy laws and federal securities laws.

Issuer's Organic State Laws

These are the laws which create the Issuer. In addition to creating the Issuer, specifying its governance and related day-to-day matters, the organic state laws:

- Specify the public purposes for which the Issuer is created and which the Issuer is directed to carry out. These are important because they limit the reasons for which an Issuer can carry out a Bond issue. For example, if an Issuer is created to provide low-income housing, it cannot finance housing for middle- or upper-income people. If the Issuer is created to finance only rental housing, it cannot finance mortgages for owner-occupied housing. Usually the governing boards of Issuers are given latitude in determining whether they are carrying out their stated public purpose—for example, even though limited to financing housing for low-income persons, typically the governing board has the right to define "low income." Courts will usually defer to such latitude as long as it is reasonable and will typically look to the parameters used elsewhere in analogous programs.
- Specify the legal structure of the Issuer's powers with respect to the Bond issue. Normally, an Issuer has only those powers specifically authorized, so the organic laws determine how a Bond financing can be structured.
- Specify the procedures for issuing Bonds.
- Specify required provisions of the financing documents, such as limiting permitted investments of Bond program moneys, limiting the trustee's rights in the event of a default or specifying who executes the Bonds, etc.
- Provide various state tax exemptions, including a state income tax exemption for interest paid on the Bonds and sometimes a property/sales or use tax exemption.

State "Open Meetings" Laws

Every state has adopted laws that require that boards of political subdivisions (usually including housing finance agencies) conduct business only in meetings open to the public and after published notice of the meeting. Most states also have laws requiring that certain records of the Issuer be available to the public at any time.

State Private Activity Bond Cap Allocation Laws

Every state has adopted laws specifying the way that the federal private activity Bond cap will be annually allocated among Issuers in the state. In some cases the governor is authorized to do so by executive order.

State Real Estate Laws

Because a housing bond issue necessarily involves real estate, the state real estate laws are important in structuring the Bond issue and/or program documents.

State “Blue Sky” Laws

The Underwriter and its Counsel must comply with the “Blue Sky” securities laws of every state in which the Underwriter sells Bonds to investors. If an Underwriter violates these laws, it may be fined and even forced to make rescission offers to investors. However, the Issuer is not affected by these laws unless the Issuer sells the Bonds directly to investors (something which has been done a few times by means of the Internet).

Federal Bankruptcy Laws

The financing must be structured so that neither the bankruptcy of the Issuer, nor the project owner (or credit enhancer, if any) in the case of a conduit issue, will disrupt the security for the Bonds, or the timeliness of the receipt of payments from the project owner (or any credit enhancer). This includes not only legal and documentary requirements, but also practical solutions, such as requiring that a project owner have no other assets/businesses (to avoid unrelated economic problems giving rise to a bankruptcy in which a fully performing project gets pulled into the bankruptcy proceeding). Bond Counsel usually addresses these issues and often is required to render an opinion specifically on these matters.

Federal Securities Laws

The federal Securities and Exchange Commission (“SEC”) has no direct authority over municipal bond offerings, except under the antifraud provisions of Rule 10b–5. With respect to the sale of municipal Bonds:

- ***SEC Rule 10b–5—Federal Antifraud Rule.*** When selling securities (i.e., Bonds) the Issuer must disclose to investors all “material” facts, i.e., facts a reasonable investor would consider important in making his decision whether to invest in the Bonds. Failure to do so makes the Issuer liable to investors for any damages sustained as a result of the failure to disclose. In a conduit revenue bond issue, the same disclosure rules apply to the borrower. The Official Statement is the Issuer’s disclosure document.

In an Interpretive Release, the SEC said actual or potential conflicts of interest, breaches of duty or less than arm’s-length transactions may be material, and so must be disclosed (e.g., Issuer board member is officer or major shareholder of a project owner; board member and banker/lawyer/trustee have a relationship or a practice of doing “favors” for each other). The SEC also has suggested that any size of political contribution to a member of an Issuer or any politician with control or substantial influence over the Board may be material.

In another Interpretive Release, the SEC said that individual board members may have personal liability if they have personal knowledge of facts, or recklessly ignore facts of which they have personal knowledge, which facts would be “material,” and do not disclose the information (e.g., Issuer board member personally knows a project to be financed is about to go bankrupt and tells no one).

The SEC may also bring action against any person (including individual board members) who knowingly withholds or fails to disclose material items.

- **SEC Rule 15c2-12.** In addition to Rule 10b-5, the SEC has indirectly mandated ongoing disclosure in Rule 15c2-12, which provides that an underwriter cannot buy or trade Bonds unless the Issuer and/or any “obligated party” which is the real security for the Bond issue agrees to ongoing disclosure of certain items (i.e., annual financial updates and timely disclosure of 11 specific events, including unscheduled Bond redemptions, defaults and unscheduled calls on reserve funds or credit enhancements). Otherwise, the general opinion of lawyers is that an Issuer has no legal obligation to provide ongoing disclosure, but if it does disclose anything it must not do so in a misleading manner. In conduit financings, it is customary practice to contractually obligate the Trustee and the borrower to satisfy these requirements.

In addition, the federal Municipal Securities Rulemaking Board (“MSRB”) has promulgated certain rules that apply only to broker-dealers (i.e., investment bankers), but practically also affect their relationship with Issuers:

- **MSRB G-37—Political Contributions Rules.** This rule prohibits bankers from doing municipal Bond business with an Issuer for two years after any contribution to an official of the Issuer (i.e., any incumbent, candidate or successful candidate for elective office of the Issuer if the office is directly or indirectly responsible for, or can influence the outcome of, the hiring of a dealer for municipal securities business) made by (i) the dealer bank, (ii) any municipal finance professional associated with the dealer bank (including consultants) or (iii) any PAC controlled by the dealer or such municipal finance professional. There is an exception if the municipal finance professional is entitled to vote for the official and the total contributions by such professional to the official do not exceed, in total, \$250 per election. Dealers must file quarterly reports with the SEC specifying any contributions, except those falling under the immediately preceding exception.

- **MSRB G-20—Limitation on Gifts and Gratuities.** Intended to prevent commercial bribery, this Rule prohibits municipal dealers (including all its employees and associated persons) from giving any thing or service of value in excess of \$100 per year to any official or employee of an Issuer in relation to municipal securities activities. There are exceptions for (i) “normal business dealings” such as occasional gifts of meals or tickets to theatrical or sporting events or the sponsoring of legitimate business functions recognized by the IRS as deductible business expenses and (ii) written employment contracts.

**OVERVIEW OF FEDERAL TAX LAW
REQUIREMENTS FOR HOUSING BOND ISSUES**

OVERVIEW OF FEDERAL TAX LAW REQUIREMENTS FOR HOUSING BOND ISSUES

For the interest on Bonds to be tax-exempt, not only must they be issued by a state or political subdivision (or issued “on behalf of it” by an instrumentality), they must also comply with a myriad of general rules and arbitrage restrictions (to make sure the Issuer does not make too much money on the financing) and with an additional group of rules applicable to the ultimate borrower if the project owner is a private party (whether nonprofit or for-profit). These rules are found in Sections 103 and 141–150 of the Internal Revenue Code.

General Rules

- Prior to Bond issuance, there must be a public hearing about the program/Bond issuance (called a “TEFRA hearing”), after a 14-day public notice, and the highest elected public official of the Issuer (e.g., governor) must approve the Bond issue.
- Must have an allocation of state “private activity bond” cap. Bonds which must obtain private activity cap include any bond in which the ultimate user of the proceeds is a private party (unless it is a 501(c)(3) nonprofit), including single family and multifamily housing bonds, student loan bonds and industrial/economic development bonds. The annual federal tax law limit is, by state, \$80.00 per capita (with a minimum of \$256,235,000 in 2007), in the aggregate for state and local Issuers, and for each year is increased for inflation. If not used, this authority can be carried forward for specified projects, single-family programs or student loan programs for up to three years. This cap limit does not apply to refunding Bonds or nonprofit 501(c)(3) borrower multifamily Bonds.
- All Bonds are subject to the federal alternative minimum tax (AMT), except Bonds issued for governmental or 501(c)(3) borrowers or refunding Bonds where the original Bonds were issued before 1986.

Arbitrage Rules

The arbitrage rules are a complex set of rules and regulations designed to make sure the Issuer does not unduly benefit from issuing low-rate tax-exempt Bonds and investing the proceeds in higher-yielding taxable investments.

Basic Arbitrage Rules.

- All aggregate nonmortgage (i.e., “nonpurpose”) investment earnings in excess of the bond yield (i.e., effective bond interest cost) must be rebated to the federal government.
- There are no adjustments to the actual Bond interest rates when determining the Bond yield for tax purposes, except that any Bond insurance or guaranty premiums are treated as additional interest.

- If the Issuer has entered into an interest rate SWAP and certain timing requirements are met, the Bond yield will be the effective costs of funds to the Issuer giving effect to the SWAP payments. This type of SWAP is called an “integrated SWAP.”

- The Issuer must pay at least 90% of any rebate amount every five years and 100% upon final redemption of Bonds.

- These tax rules are specific to each Bond issue, and all investments must be tracked to ensure compliance.

Single-family Arbitrage Rules.

- The overall mortgage portfolio yield for a single family Bond issue may not exceed the Bond yield by more than 1.125% over the life of the Bonds.

- The mortgage yield is increased by all points paid by the seller and purchaser, but mortgage insurance premiums and otherwise standard closing costs are not included; the mortgage yield is decreased by any mortgage losses.

- The mortgage portfolio yield is calculated based on 100% of the most recent FHA prepayment experience.

Multifamily Arbitrage Rules.

- The mortgage loan yield (or mortgage portfolio yield if more than one mortgage is financed by a Bond issue) may not exceed the Bond yield by more than 1.50% for any private-owner project(s), whether nonprofit or for-profit.

- The mortgage yield is increased by points and closing fees paid by the borrower, as well as any mortgage insurance premium; the mortgage yield is decreased by the costs of issuing, carrying and repaying the Bonds.

Program Rules

In addition to the general tax rules and arbitrage rules, a tax-exempt Bond issue must also meet various requirements for the project or program being financed.

Single-family Bonds.

- 95% of all loans must be made to mortgagors who are first-time homebuyers (i.e., not owned an interest in their residence for at least three years); this rule does not apply to homes in targeted areas (or to veterans if the related bonds are issued in 2007).

- The residence being financed must be the principal residence of the mortgagor; no rental units, second homes or vacation homes.

- The purchase price of a residence must not exceed 90% of the average area purchase for new or existing housing, as the case may be; 110% in targeted areas.
- The mortgagors' income must not exceed 115% of the average area median income, by family size; in targeted areas the limit is 140% of such average area median income for at least two-thirds of mortgagors, and no income limit on the rest.
- Each mortgage must be a "new" mortgage; that is, it cannot be used to refinance an existing mortgage (except short-term interim financing, or unless it is a "qualified rehabilitation" or "home improvement" loan).
- A specified portion of the Bond proceeds (or an equivalent amount) must be set aside or made available for one year just for targeted area loans.
- Bond proceeds not used to finance mortgages within 42 months must be used to redeem Bonds ("42-month rule").
- Mortgagor principal payments and prepayments can be recycled to make new loans only during a period of 10 years after the Bonds are issued; otherwise, they must be used to redeem Bonds ("10-year rule").
- Anyone assuming a mortgage must also meet these program rules.
- If a mortgagor prepays his or her mortgage in the first 10 years, he or she is subject to a recapture tax designed to eliminate any capital gain he or she made as a result of receiving a below-market-rate mortgage ("recapture tax").

Multifamily Bonds.

- All units must be rental; they cannot be transient housing or college student housing.
- All units must be kept as rental units as long as the Bonds are outstanding, and in any event at least 15 years after the project is first occupied.
- At least 20% of the tenants must have income of 50% or less of the area median income, or 40% must have income of 60% or less; this is not applicable if the owner is a governmental body, or for newly constructed housing if the owner is a nonprofit 501(c)(3) entity, but in the latter case the nonprofit must satisfy certain federal tax law charitable use tests which generally restrict the income of tenants.
- Bond proceeds can finance only land or depreciable property; no working capital.
- The Bond term may not exceed 120% of the useful life of project.
- Bond proceeds can finance costs incurred by the borrower only after the Issuer has adopted some action indicating its intention to finance the project in question.

Mortgage Credit Certificate (MCC) Program

An Issuer may carry out a mortgage credit certificate program pursuant to Section 25 of the Internal Revenue Code in lieu of issuing single family mortgage bonds. Under this program, the home purchaser receives a federal tax credit based on the amount of the mortgage and the interest rate on the mortgage. The general programmatic parameters of the MCC program are identical to those of the single family mortgage revenue bond program requirements.

- The amount of federal tax credit allowed to the taxpayer mortgagor for any taxable year generally may not exceed \$2,000.
- The Issuer must elect not to issue an amount of private activity mortgage bonds which it may otherwise issue during such calendar year—the Issuer gets \$1 of MCC authority for every \$4 of mortgage bond private activity cap exchanged.
- An MCC program may not be limited to indebtedness incurred from particular lenders.
- The Issuer may charge mortgagors only those fees necessary to enable the Issuer to cover its costs of administering the program.
- The Issuer must give public notice that MCCs will be issued. At least 90 days before an MCC is to be issued, the Issuer must provide reasonable public notice of:
 - (i) the eligibility requirements of the MCC program; and
 - (ii) the methods by which such MCCs are to be issued.
- The recapture tax also applies to MCC–financed mortgages.

**WHAT HFA BOARD MEMBERS SHOULD KNOW AND ASK
ABOUT BONDS AND BOND ISSUES**

WHAT HFA BOARD MEMBERS SHOULD KNOW AND ASK ABOUT BONDS AND BOND ISSUES

In General

The primary source of funding for state housing finance agencies is the issuance of bonds, and so it is important for Board Members to have a basic understanding of bonds and bond issues. In general, a Board Member:

- Should be generally familiar with the process of issuing bonds.
- Should be generally familiar with the primary parties (underwriter, trustee, bond counsel), their responsibilities, and how they were selected.
- Should know the general public purposes of the housing finance agency as described in the state law which creates it.
- Should know the state conflicts rules that apply to the housing finance agency and Board Members.
- Should be generally familiar with the SEC 10b-5 and MSRB rules as they apply to Board Members.

Specific Bond Issue

With respect to each particular bond issue, a Board Member should know:

- Why the bonds are being issued?
- Does the bond issue fit into the housing finance agency's overall financial plan?
- How will the bond proceeds be used (carry out program, fund reserve, pay costs of issuance, etc.)?
- What types of bonds are being issued (fixed rate, floaters, CAB's, etc.)?
- Who are the bonds ultimately being sold to (individuals, funds, institutions)?
- What is the source of and security for repayment of the bonds?
- What are the ratings on the bonds, and why?
- Will GIC's be used for investments, and if so who are the GIC providers or what are the criteria for selection?

- Are there any unusual bond characteristics (e.g. lock-outs) or bond issue aspects (e.g. SWAP's), and if so what are the financial and other (e.g. legal) risks/rewards?
- What are the major fees paid by the Issuer (e.g. underwriter's fees)? Are they reasonable?

Outside professionals are retained by a housing finance agency to assist the agency and its staff in the bond issuance process. In addition to housing finance agency staff, Board Members should utilize outside professionals and their expertise in the bond issuance process as the Board Members deem appropriate. In connection with a particular bond issue, Board Members should feel free to:

- Ask the underwriters/counsel (and finance advisor, if applicable) if they have explained to the Board all significant aspects of the structure of the transaction.
- Ask the underwriters if they have been given access to all information needed to conduct their "due diligence" obligations and whether the official statement adequately addresses any concerns that a reasonable investor would consider important.
- Ask the professionals if there are any matters regarding their participation in the bond transaction about which the Board should be aware, including any conflicts of interest.
- Ask the professionals if they are aware of any circumstances in which the Board, its staff or others have not complied with the Issuer's procedures so that the bond official statement adequately and accurately describes the bond issue.

**PRICING BONDS IN A NEGOTIATED SALE
(GFOA DETAILED INFORMATION)**

**PRICING BONDS IN A NEGOTIATED SALE—
HOW TO MANAGE THE PROCESS
(GFOA DETAILED INFORMATION)**

The above-referenced brochure—*Pricing Bonds in a Negotiated Sale*—although published some years ago by the Government Finance Officers Association, remains an excellent detailed description of the practical aspects and process of selling fixed rate bonds in a negotiated sale to an underwriter (or group of underwriters). Floating rate (demand option) bonds are generally sold to an entirely different component of the capital markets (the short-term tax-exempt capital market which consists almost entirely of bond funds or similar major institutions) and many aspects of the fixed-rate bond pricing/sale process do not apply.

Copies of this brochure may be obtained by sending written request for a copy of same to the following address:

Government Finance Officers Association
Suite 800
180 North Michigan Avenue
Chicago, IL 60601
Phone: (312) 977-9700

**GLOSSARY OF FINANCIAL TERMS
AND ACRONYMS**

GLOSSARY OF FINANCIAL TERMS AND ACRONYMS

This glossary contains key words and phrases frequently used in connection with the financing of housing by state and local housing and finance agencies. While most terms relate directly to bond financing, others are also used in mortgage financing and real estate development. If a definition varies between these disciplines, the given definition applies to bond financing.

A

Affordable Housing Program: This is a program offered through the Federal Home Loan Bank System which subsidizes the interest rate on loans and provides direct subsidies to Bank System member institutions that lend for long-term, very-low-, low- and moderate-income, owner-occupied and affordable rental housing. The program is designed to encourage creative efforts in increasing affordable housing.

Agency Buydown: An upfront agency payment which reduces the monthly principal and interest payments on a loan by reducing the initial interest rate. By buying down a loan, an agency subsidizes the homeowner during the buydown period.

Agency Contribution: Upfront dollar transfer of agency unrestricted funds to a new bond issue to help pay the issuance costs. The agency thereby reduces the amount of non-asset bonds, making the potentially negative effect of partial non-origination of mortgages less of a credit problem.

Amortization: The reduction in the outstanding principal amount of a loan achieved as the result of repayment of principal.

Arbitrage (or Program's Gross Spread): The yield differential between the bond and, in the case of Mortgage Revenue Bonds, the mortgage contract rate. Costs which must be paid from this spread typically include: the underwriter's discount; bond counsel fees; other costs of issuance; and mortgage origination, servicing and related fees. Arbitrage limitations on tax-exempt bonds are established by the Internal Revenue Service.

ARM (Adjustable-Rate Mortgage or Variable-Rate Mortgage): A mortgage on which the interest rate is adjusted on a periodic basis in reference to an accepted index of market interest rates, such as the 12-month U.S. Treasury borrowing rate. ARMs usually include limits, or caps, on the size of the interest rate adjustments, such as 1% a year and 5% overall.

B

Basis Point: Yields on municipal securities are usually quoted in increments of basis points. One basis point is equal to .01 or 1/100th of 1%.

Basis Price: The price of a security expressed in yield or percentage return on the investment.

Bearer Bond: A bond that has no identification as to owner and therefore is presumed to be owned by the person who holds it (the bearer). Bearer bonds are freely and easily negotiable since ownership can be quickly transferred from seller to buyer. Bearer bonds are no longer permitted for new issues of tax-exempt bonds.

“Blue Sky” Laws: State securities laws enacted to protect the public against securities fraud.

Bond: An interest-bearing promise to pay a specified sum of money—the principal amount—which is due on a specific date and secured by specified sources of revenue.

Bond Anticipation Notes (BANs): Short-term securities issued by states and municipalities to obtain interim financing for projects which will eventually be funded long-term through the sale of a bond issue.

Bond Counsel: Legal counsel responsible for determining that all applicable local, state and federal laws, regulations and procedures are met in the issuance of a bond.

Bond Insurance: Guarantee of timely principal and interest payments to bondholders in the event of issuer default.

Bond Rate: The interest rate which is stated on the bond and payable to the bondholders periodically.

Bond Traders: Investment bank and commercial bank employees who engage in the purchase and sale of bonds after they are first sold (a secondary market).

Bond Yield: The overall interest cost percentage for a series of bonds.

Broker: A securities firm or department of a commercial bank which engages in the underwriting, trading and sales of municipal securities for the account of another.

C

Call Provisions: The terms under which bonds are redeemable by the issuer prior to the specified maturity date at a stated price (which often is above par).

Capital Appreciation/Accumulator Bonds (CABs): Bonds which pay interest on an accumulated basis at maturity. Unlike zero coupon bonds, the par amount of CABs does not reflect future interest payments.

Capital (Debt Service) Reserve Fund: A security requirement established to provide a revenue bond program with reserves which would be available in the event of a shortfall in operating revenues. The requirement is normally set in terms of maximum annual debt service but is sometimes calculated as a fixed percentage of the principal amount of outstanding debt.

Capped Adjustable Mortgage: An adjustable-rate mortgage which has a limit on the size of the annual and/or total increase in the interest rate.

Cash Flow: For bonds which finance mortgage loans, the sum of mortgage repayments and prepayments, plus other revenues available to make debt service payments on the bonds and to pay related fiduciary and servicing costs.

CBO (Congressional Budget Office): The major budgetary analysis organization for Congress.

CDI (the Continuing Disclosure Information (Pilot)): This is the Municipal Securities Rulemaking Board's (MSRB's) effort to collect continuing financial information regarding municipal bond issues.

CHAS (Comprehensive Housing Affordability Strategy): An analysis of housing needs and strategies which is required of state and local governments to receive HUD program funds or assistance.

Coinsurance: Mortgage insurance in which the loan originator agrees to insure part of the mortgage in return for part of the premium. A stop-toss provision with respect to a pool of mortgages is usually involved. The term is often used in a less generic sense to refer to a now-terminated Federal Housing Administration (FHA) multifamily program.

Collateralized Mortgage Obligations (CMOs): A security backed by a pool of mortgages or mortgage pass-through certificates. CMOs are issued with varying classes (tranches), all of which receive interest payments semiannually from monthly interest payments on the mortgages in the pool. Principal payments on the mortgages in the pool are applied to the CMOs of the shortest tranche until retirement, next to the CMOs of the next shortest tranche, and so forth until all of the CMOs backed by the pool have been paid off.

Community Development Block Grants (CDBG): Programs administered by HUD to aid community and economic development, mostly to benefit activities serving low- and moderate-income persons. Three types of CDBGs:

CDBGs (Entitlement): Grants to entitlement communities, for a wide range of community development programs for neighborhood revitalization, economic development and improved community facilities and services. These communities develop their own programs in consultation with local residents.

CDBGs (Non-Entitlement) for States and Small Cities: Grants to nonentitlement communities, for similar programs.

CDBGs (Section 108 Loan Guarantee): These are loan guarantees that offer eligible communities financing for housing rehabilitation, economic development and large-scale physical development projects.

Community Housing Development Organizations (CHDOs): Community-based nonprofit entities for which a portion of HOME funds must be set aside.

Community Investment Program: This is a program offered through the Federal Home Loan Bank System which provides funds for community-oriented mortgage lending. Under the

program, each Bank also designates a community investment officer to implement the Banks' community lending and affordable housing advance programs.

Competitive Bids: A sale of municipal securities by an issuer in which underwriters or syndicates of underwriters submit sealed bids to purchase the securities. This contrasts with negotiated underwriting.

Compliance Monitoring: The process of determining whether program requirements continue to be met. For example, the Low Income Housing Tax Credit program has specific compliance monitoring requirements.

Convertible Option Bonds (COBs): Bonds initially issued at a short-term interest rate which may be converted later at the option of the issuer to a long-term fixed-rate bond.

Costs of Issuance: All expenses related to the authorization, sale and issuance of bonds.

Coupon: The stated interest rate on a bond, usually paid semiannually. For bearer bonds, "coupons" specifying the date and amount of each interest payment are attached to the bond. To receive an interest payment, the bondholder detaches and presents the coupon for payment.

Credit Enhancement: Security devices such as letters of credit, moral obligation pledge or bond insurance which are obtained for a bond issue to enhance the marketability of the bonds (to improve ratings/lower interest costs).

CRS (Congressional Research Service): The research arm of the Congress.

Current Yield: The ratio of the interest rate to the actual market price of a bond, stated as a percentage. For example, a bond selling for \$1,000 that pays \$80 per year in interest has a current yield of 8%.

D

Dealer: A securities firm or department of a commercial bank which engages in the underwriting, trading and sales of municipal securities for its own account.

Debt Limit: The statutory or constitutional maximum debt which an issuer can legally incur.

Debt Service: The payments required for interest on and repayment of the principal amount of debt.

Default: Failure to pay principal or interest when due. Nonmonetary default is a violation of the terms and conditions of a mortgage or a bond issue.

Delinquency Experience: The level of loans with overdue payments, expressed as a percentage of the total portfolio of loans.

Denomination: The face amount or par value of a security which the issuer promises to pay on the maturity date. Most municipal bonds are issued in minimum denominations of \$5,000, although a few are available in \$1,000 denominations. Notes are generally available in \$25,000 minimum denominations.

Discount: The amount by which the purchase price of a security is less than the principal amount or par value.

Disposition Demonstration Program: Also known as “dispo/demo,” this is a demonstration program under which HUD enters into agreements with HFAs to dispose of some of the properties that HUD owns as a result of foreclosures in HUD-insured mortgages.

Dollar Bond: A bond which is quoted and traded in dollar prices rather than in terms of yield.

Double Barreled Bond: A bond secured by the pledge of two or more sources of repayment, such as the unlimited taxing power of the issuer as well as the revenues generated by a particular user charge.

Double Exemption: Securities on which the interest is exempt from taxation imposed by two levels of government, such as exemption from state and federal income taxes.

E

Equity Sharing (or Shared Appreciation Mortgage): A mortgage in which the borrower makes payments at an interest rate below the prevailing market rate. In return for accepting the lower rate, the lender (or holder of the mortgage) receives the right to a predetermined share of any future appreciation in the value of the property.

F

Face Amount: The par value (e.g., principal or maturity value) of a security shown on the face of the instrument.

Fair market rents (FMRs): Established by HUD to determine how much rent HUD will subsidize when it assists low-income renters under its rental assistance programs. HUD determines the FMR by calculating the 45th percentile rent for an area, i.e., the rent level below which 45% of the units should rent.

FDIC (Federal Deposit Insurance Corporation): An instrumentality of the federal government which insures the deposits of member institutions.

FHA (Federal Housing Administration): A federal agency within HUD which insures mortgages on both single-family and multifamily loans, usually with high loan-to-value ratios.

FHFB (Federal Housing Finance Board): The governing body of the Federal Home Loan Bank System.

FHLB (Federal Home Loan Bank): One of the 12 federally chartered regional banks of the Federal Home Loan Bank System. A bank's primary function is to supply credit to members, principally savings and loan institutions.

FHLMC (Federal Home Loan Mortgage Corporation, or "Freddie Mac"): A government-sponsored enterprise which is authorized to buy and to package for sale (usually in the form of mortgage-backed securities) conventional, FHA and VA loans and participating interests in blocks of such loans.

Financial Adjustment Factor ("FAF"): A special modification of the Section 8 program in 1981-1982 to effectively further subsidize bond financings.

Financial Advisor: A consultant to an issuer of municipal securities who provides the issuer with advice with respect to the structure, timing, terms or related matters concerning a new issue of securities.

First-Time Homebuyer: For purposes of the MRB and MCC programs, a mortgagor who has not held an ownership interest in a principal residence at any time during the three-year period which ends on the date on which the qualified MRB loan or MCC-assisted loan is executed or assumed.

FmHA (Farmers Home Administration): An agency of the federal government which makes, participates in and insures loans for rural housing and other purposes. FmHA recently was renamed the Rural Housing and Community Development Department.

FNMA (Federal National Mortgage Association, or "Fannie Mae"): A government-sponsored enterprise which is authorized to buy and to package for sale (usually in the form of mortgage-backed securities) conventional, FHA and VA loans and participating interests in blocks of such loans.

Foreclosure: A procedure in which property pledged as security for a debt is sold to repay the debt in the event of a default in payments or terms.

G

General Obligation Bond: A bond which is secured by the pledge of the issuer's full faith and credit and usually also its taxing power.

GNMA (Government National Mortgage Association, or "Ginnie Mae"): A government corporation within HUD which provides full-faith-and-credit-of-the-federal-government guarantees of timely payment on securities backed by FHA and VA loans.

Government-Sponsored Enterprises (GSEs): Federally chartered, privately owned corporations which carry an implicit guarantee of the federal government. Examples are FNMA and FHLMC.

H

HOME Investment Partnerships (HOME) Program: A “housing block grant” program authorized by the National Affordable Housing Act of 1990 which provides federal funds which may be used for ownership or rental housing or tenant-based assistance.

HUD (U.S. Department of Housing and Urban Development): The executive department which administers most federal housing programs.

I

Indenture (Bond Indenture): A written agreement under which debt securities are issued. It sets forth the maturity date, interest rate, call provisions, security and other factors affecting the bonds.

Industrial Development Bond: A security issued by a state, certain agencies or authorities, a local government or a development corporation to finance the construction or purchase of industrial plants or equipment which will be leased to a private corporation and backed by the credit of the private corporation.

Interest: Compensation paid or to be paid for the use of money. Interest is generally expressed as an annual percentage rate.

Issuer: A state, political subdivision, agency or authority which borrows money through the sale of bonds or notes.

L

Lead Underwriter: The bond underwriter which “runs the books of the account” for a group of underwriters (syndicate) created to buy and sell a bond issue.

Legal Opinion: An opinion concerning the validity of a securities issue with respect to statutory authority, constitutionality, procedural conformity and usually the exemption of interest from federal income taxes. The legal opinion is usually rendered by a law firm recognized as specializing in public borrowings (often referred to as bond counsel).

Lendable Proceeds: Bond proceeds available for direct loans, mortgage purchases or loans-to-lenders activities.

Letter of Credit (LOC): A direct guarantee provided by a bank which agrees to provide a trustee with the funds necessary to make payments to bondholders. A “standby” LOC provides funds only in the event of a shortfall in other available funds.

Level Payment (Self Amortizing) Mortgage: A level (or fixed) payment mortgage is a standard, fully amortizing mortgage with a fixed term and fixed equal payments to term.

Loans-to-Lenders: A mortgage financing method used by bond issuers in which loans are made to lenders with a requirement that a like amount of moneys be lent to low or moderate income borrowers. Tax law changes have largely eliminated this structure.

Loan-to-Value (LTV) Ratio: The ratio of the amount of funds borrowed when financing a property relative to the total sales price. The lower the ratio, the larger the share of owner equity and presumably the less risk involved in making the loan.

Local Authorities: Refers to local housing finance or other municipal agencies which issue tax-exempt bonds.

“Lower Floaters”: Refers to adjustable-rate tender bonds (usually 30-year bonds) which are tied to short-term rates and allow the bondholder to “put” the bonds back to the issuer at the bondholder’s discretion.

Low Income: In program eligibility determinations, defined as some percentage (usually 80%) of median income.

Low Income Housing Tax Credit (Tax Credit): A credit against ordinary income taxes which is permitted under Section 42 of the Internal Revenue Code for certain investments in low-income rental housing.

M

Major Rehab: Major or substantial rehab refers to residential rehabilitation which involves substantial structural renovation (e.g., of a gutted building), usually to one or more of a building’s systems (e.g., roof, boiler, electrical, etc.). This type of rehab requires major costs to complete.

Marketability: A subjective measure of the ease with which a security can be sold in the secondary market.

Mark-to-Market: HUD program to reduce project-based Section 8 rent subsidies so the project rents are in line with comparable market rents. The program design is based on the following principle: A property is over-subsidized if the Section 8 contract is subsidizing project rents that are above those at comparable, unassisted properties in the local market area. Contracts are renewed only at rents that are in line with the local market area.

Maturity: The date on which the principal amount of a security becomes due and payable.

“McKinney Act” Programs: A series of programs enacted by Congress to address the needs of homeless persons and to prevent homelessness.

Median Family Income: The annual gross income above which and below which lie an equal number of family incomes. Income eligibility for subsidized housing programs is often set as a percentage (%) of the area median income.

Median Sales Price: The home price in a defined market area above which and below which lie an equal number of home sales by price for a period of time.

Moderate Income: In program eligibility determinations, often defined as families with gross incomes between 80% and 120% of median family income.

Moral Obligation Bond: A type of municipal security which is not backed by the full faith and credit of a state, but for which state law provides that the state will consider replenishing the issue's debt reserve fund if necessary.

Mortgage Banker: A private company which originates and services mortgage loans which are sold to primary or secondary market institutions.

Mortgage Credit Certificate (MCC): Certificates issued by state and local HFAs to qualified first-time homebuyers which provide federal income Tax Credits equal to a specified percentage of the annual mortgage interest paid. These Tax Credits directly reduce the federal income tax liability of the recipients. The program is an alternative to the issuance of MRBs.

Mortgage Revenue Bond (MRB): A tax-exempt security issued by a state, certain agencies or authorities or a local government to make or purchase loans (including mortgages or other owner financing) for single-family residences.

MSIL (Municipal Securities Information Library): The central repository of information regarding bond issues and continuing disclosure of financial information related to them.

Multifamily Housing: Usually refers to rental housing in buildings of five or more units.

Municipal Securities Rulemaking Board (MSRB): An independent self-regulatory organization established by the Securities Acts Amendments of 1975 which is charged with primary rulemaking authority over dealers, dealer banks and brokers in municipal securities.

N

NAHA (National Affordable Housing Act): Legislation that created the HOME Program.

Negative Amortization: In the case of mortgage loans, a payment plan in which the interest payments are insufficient and the shortfall is added to the outstanding loan balance as additional principal. As a result, the total principal amount of the mortgage can become larger than the initial principal amount. A mortgage which allows for negative amortization early in the life of the mortgage usually provides for increased payments later to assure full payment of the principal and interest by the end of the loan term.

Negative Arbitrage: The result of paying a higher interest rate on bonds than is achieved from the investment of bond proceeds.

Negotiated Sales: Sales in which the issuer chooses one underwriter or group of underwriters to sell its bonds to investors. There is no competitive bid for the issue. Instead, the interest rate and terms of sale are negotiated.

Net Interest Cost (NIC): The traditional method of calculating total cost for new issues of municipal securities which does not consider the time value of money.

Non-Callable Bond: A bond which cannot be redeemed at the option of the issuer before its specified maturity date.

Notes: Short-term instruments which promise to pay specified amounts of money and are secured by specific sources of future revenues, such as taxes, federal and state aid payments and bond proceeds.

Notice of Sale: An official document disseminated by an issuer of municipal securities which gives pertinent information regarding an upcoming bond issue and invites competitive bids from prospective underwriters.

O

Offering Price: The price at which the members of an underwriting syndicate for a new issue decide to offer the securities for sale to investors.

Official Statement: A document prepared by or for the issuer which provides detailed security and financial information on the bond issue.

OMHAR: HUD Office of Multifamily Housing Assistant Restructuring—established within HUD by the Multifamily Assisted Housing Reform and Affordability Act of 1997 (MAHRA) to develop and actively manage, administer, and oversee the Mark-to-Market Program through a decentralized structure of Participating Administrative Entities (PAEs).

OTA (Office of Technology Assessment): The research organization of the Congress specializing in technology issues.

OTS (Office of Thrift Supervision): The federal regulatory agency responsible for examination and regulation of federally and state chartered savings institutions.

Over-the-Counter Market (OTC): A securities market which is conducted among dealers throughout the country through negotiation rather than by using an auction system (as represented by the stock exchanges).

P

Participating Administrative Entity (PAE): Agency selected by OMHAR to administer the Mark-to-Market Restructuring Program.

Par Value: The stated principal amount of a bond or note due at maturity.

PIG: Public interest group.

Pool Insurance: Additional security for a single-family mortgage loan portfolio. This usually provides coverage equal to 10% of the original aggregate loan amount, frequently with a minimum dollar amount of coverage also specified.

Premium: The amount by which the price of a security exceeds its par amount.

Prepay: Used in conjunction with low-income rental units that will become eligible for their owners to pay off the underlying HUD mortgages and convert the units to market-rate housing.

Prepayment Assumption: A calculated guess of the future performance of a portfolio of single-family loans, relative to the incidence of recoveries of principal. The assumption is often expressed as a percentage of the long-term FHA loan performance experience with the rate of recoveries of principal in a particular state or region.

Primary Market (new issue market): Market for new issues of municipal bonds and notes.

Principal: The face amount of a bond, exclusive of accrued interest and payable at maturity.

Private Activity Bond Cap: The federal tax law limit on the amount of tax-exempt bonds that can annually be issued in a state to assist persons or private companies (includes single-family mortgage revenue bonds and multi-family bonds for for-profit borrowers).

Private Mortgage Insurance (PMI): Private mortgage insurance, usually providing coverage for loans with less than a 20% down payment, up to a 97% loan-to-value ratio. PMI companies are regulated by states.

Public Housing: Low-income housing developed, owned and operated by public housing authorities (PHAs) and financed through the sale of tax-exempt bonds. HUD provides debt service contributions, operation subsidies, modernization funds and technical assistance to support PHA projects.

Put Options: A contract which gives its owner the right to sell a security at a specific price within a defined time period.

Q

Qualified Allocation Plan: A required plan which a state allocating agency must use to allocate Low Income Housing Tax Credits.

R

Ratings: Designations provided by investors' ratings services to securities to indicate their relative credit quality (e.g., Standard and Poor's, Moody's, Fitch).

Recapture: Federal tax law provision under MRB program by which an MRB borrower who sells his or her house at a profit within 10 years of initial purchase must count a certain portion of the profit as taxable income.

Red Herring: A preliminary prospectus or official statement which does not include the price at which the securities will be offered to the public. It is issued to obtain an indication of the interest in an offering. It gets its name from the statement, printed in red ink on its front cover, which says the document is a preliminary prospectus or official statement.

Refunding: A procedure by which a bond issue is redeemed with funds from a new bond issue under conditions generally more favorable to the issuer. This results in the proceeds of the new bonds (the refunding bonds) being substituted for the proceeds of the old bonds (the refunded bonds), which may or may not be redeemed.

Registered Bond: A bond whose owner is registered with the issuer or its agents, either as to both principal and interest, or as to principal only. Transfer of ownership can be accomplished only when the securities are properly endorsed by the registered owner.

REMICs (Real Estate Mortgage Investment Conduits): A REMIC is an entity which holds a pool of mortgage loans and issues securities representing interests in those mortgages. This entity enables a pool of mortgages to be split into different ownership interests offering a range of maturities, thereby giving greater choice as to the length of investment. Income generated by the mortgage pools is taxed not at the entity level but at the investor level.

Resolution (Bond Resolution): Formal board action authorizing the issuance of bonds. Sometimes an expanded version is an alternative to an indenture.

Revenue Anticipation Notes (also see Tax Anticipation Notes): Securities issued in anticipation of other sources of future revenue, typically a form of federal or state aid.

Revenue Bond: A bond payable solely from net or gross nontax revenues derived from tolls, charges or rents paid by the users of a facility constructed with the proceeds of a bond issue or a discrete source of revenues (such as a pool of mortgages).

RFP: Request for Proposals.

Risk-sharing: A concept by which HFAs insure mortgages they issue in partnership with entities such as private insurers or FHA.

RTC (Resolution Trust Corporation): A federal corporation created to sell or liquidate (“resolve”) failed savings and loan associations.

Rule 10b-5: SEC rule which prohibits fraud in the sale of securities. Is the basis for most securities lawsuits.

Rural Development: United States Department of Agriculture Rural Development—formerly known as Rural Economic and Community Development (RECD) and before that the Farmers Home Administration (FmHA).

S

Safe Harbor: “Safe Harbor” refers to Internal Revenue Service (IRS) estimates issued for the MRB and MCC programs which are used to determine purchase price limits for homes eligible to be bought under the programs. The estimates are developed from federal data samples and may be appealed by individual agencies seeking to use their own limits (based on a more accurate, comprehensive and timely database than the official limits).

Savings and Loan Association (S&L): A financial institution which takes savings deposits and invests them mainly in mortgage loans. Always a corporation, an S&L may be either a mutual or a capital stock institution and may be either state or federally chartered.

Savings Bank: A financial institution which takes savings deposits and invests them in mortgages and other securities allowed under law.

Savings Institutions: Savings and loans and savings banks which have historically been primary investors in residential mortgage loans.

SEC (Securities and Exchange Commission): The agency that administers federal securities laws.

Secondary Financing: A loan secured by a second mortgage or deed of trust on real property.

Secondary Market: A market for issues previously offered or sold.

Section 8: A rental assistance program administered by HUD under which the federal government pays the difference between what a household can afford to pay for a housing unit and its fair market rent. Eligible tenants pay 30% of their income toward rent.

Section 8 Moderate Rehabilitation Program: A HUD program under which PHAs administering the program advertise fund availability and select participating landlords based on a competitive process. The landlords agree to rehabilitate the properties to certain standards and the PHAs set rents based on a number of factors.

Section 8 Rental Certificate Program: HUD contracts with PHAs and IHAs, which issue rental certificates to very low income families. The families may find a suitable home, and assistance payments are made to the property owners. A certificate pays the difference between the recipient’s unit’s actual rent and 30% of the tenant’s income. Generally, the rent for the units may not exceed the fair market rent (FMR), which is set at roughly the 45th percentile of local rents.

Section 8 Rental Voucher Program: HUD contracts with local public housing agencies (PHAs) and Indian Housing agencies (IHAs), which issue rental vouchers to very low income families. A voucher pays the difference between a payment standard (similar to the FMR) and 30% of the tenant’s income. If the actual rent exceeds or is less than the payment standard, the tenant pays the excess or keeps the difference.

Section 10b: This section of the Federal Home Loan Bank Act allows organizations that are not members of the Federal Home Loan Bank (“non–members,” such as HFAs) to collect advances from the Federal Home Loan Banks for affordable housing activities.

Section 42: Internal Revenue Code Section that establishes and defines the federal low-income housing tax credit (LIHTC) program.

Section 142: Internal Revenue Code Section that establishes and defines exempt facility bond programs (multifamily housing bonds).

Section 203(k): FHA Rehabilitation Mortgage Insurance program for one–to–four–family properties under which HUD insures loans to finance: rehabilitation of an existing property; purchase and rehabilitation of a property; or rehabilitation and refinancing of the outstanding indebtedness of a property.

Section 221(d)(3) and (4): FHA Multifamily Rental Housing for Moderate Income Families insurance programs administered by HUD to finance rental or cooperative multifamily housing for moderate–income households, including housing for the elderly and Single Room Occupancy (SRO) housing. The primary distinction between the two programs is that HUD may insure full replacement cost under 221(d)(3) for public nonprofit and cooperative mortgagors, but only up to 90% under Section 221(d)(4), regardless of the type of mortgagor.

Section 223(f): FHA Multifamily Rental Mortgage Insurance program for refinancing existing apartment buildings.

Section 515: Rural Development (formerly Farmers Home Administration (FmHA)) program which provides direct loans to private and public sponsors for the construction, acquisition, rehabilitation and operation of multifamily rental projects for low and moderate income families in rural areas.

Serial Bonds: Bonds issued with serial (consecutive annual) maturity dates and commensurate interest rates.

Servicing: The collection of payments on a mortgage. Servicing also consists of operational procedures covering accounting, bookkeeping, insurance, tax records, loan payment follow–up, delinquent loan follow–up and loan analysis.

Single Family: Usually refers to one–to–four unit owner–occupied family housing.

Sinking Fund: A fund accumulated by an issuer over a period of time which is designated for use to retire debt, either periodically or all at one time.

Special Tax Bond: A bond secured by a special tax, such as a gasoline tax.

Spread: In bond underwriting, the difference between the price received for a security by the issuer and the price paid by the investor.

Swap: A transaction in which an investor sells one security and simultaneously buys another with the proceeds, usually for about the same price. The term is also used to refer to an interest rate swap agreement, in which an obligor on fixed-rate debt agrees to exchange interest repayment responsibilities with an obligor on a similar amount of variable-rate debt for a stated period.

Syndicate: A group of investment bankers and commercial banks which buy (underwrite) a new issue from the issuer and offer it for resale to the general public.

T

Take-Down: (Sometimes referred to as take-down concession). The discount from the list price allowed to a member of an underwriting account on any bonds it sells.

Targeted Area: An area of chronic economic distress or an area with a high percentage of low income families entitled to special treatment (e.g., higher purchase price limits) under the MRB and MCC programs.

Tax Anticipation Notes (TANs): Notes issued by states or municipalities to finance current operations in anticipation of future tax receipts.

TEFRA Hearing: A public hearing required prior to the issuance of certain kinds of tax-exempt bonds. The hearing allows persons to express their views on both the issuance of the bonds and the location of the proposed facility.

Tender Bond: A bond which gives the investor the option to tender or “put” the bond to the issuer at par on a specified date. A premium is paid for a tender bond because the put option affords protection against the erosion of principal during periods of rising interest rates.

Term Bond: A bond that has a single stated maturity date.

Total Bond Indebtedness: The amount of total general obligation debt issued by a municipality, regardless of the purposes of the debt.

Triple Exemption: Securities on which the interest is exempt from federal, state and local income taxes.

True Interest Cost (TIC): A method of calculating bids for new issues of municipal securities which accounts for the time value of money.

Trustee: A bank designated by the issuer as the custodian of funds and the official representative of the bondholders. Trustees are appointed to ensure compliance with the contract and to represent bondholders to enforce their contract with the issuer.

U

Underwrite: To purchase a bond or note issue from the issuing body for the purpose of reselling the securities to the general public.

Unlimited Tax Bond: A bond secured by the pledge of taxes which is not limited by rate or amount.

V

VA (U.S. Department of Veterans Administration, formerly the Veterans Administration): A federal agency responsible for administering veterans benefits programs, including the provision of federal guarantees for home loans for veterans.

Very Low Income: In program eligibility terms, usually defined as 50% or less of median income.

Y

Yield: The dividends or interest paid on a particular security, expressed as a percentage of the current price or cost price or as related to the maturity of a bond.

Yield-to-Call: The hypothetical return which is projected to be earned on a bond, assuming that the issuer calls it on the first date permitted.

Yield-to-Maturity: The hypothetical return which is projected to be earned on a bond, assuming that the bond is held to maturity.

Z

Zero Coupon Bonds: Bonds which sell for less than their face amount because no interest is paid until maturity. The face amount represents the full amount of principal and accumulated interest (with effects of compounding) at maturity (see also Capital Appreciation/Accumulator Bonds).

Zoning: The designation by a city or county authorities of the eligible uses of property or eligible kind of activities in a specific geographic area.