Emerging Financial Products

Innovations that respond to evolving needs

By Douglas P. Koch

As the organizational structure of the affordable housing and community development finance industry matures, financial intermediaries, investors and developers are fashioning new resources and methods for accomplishing their goals. With an aging Low-Income Housing Tax Credit (LIHTC) and HUD property inventory, a wide variety of property acquisition, property recycling and organizational capitalization and revitalization needs materialized. Combined with the need for additional capital for historic preservation-oriented developments, capital requirements need to be adaptable to a variety of ownership, market and transitional needs.

During the 2016 National Housing & Rehabilitation Association (NH&RA) Fall Forum, the National Trust Community Investment Corporation (NTCIC), the AFL-CIO Housing Investment Trust (HIT), the Dreadnought Capital Management Corp. and The Roseview Group, were represented by four executives leading organizations, that range from nine to 50 years old, with $1 billion to $5.9 billion of capital under management, whom each presented new products designed to fit the market fabric with the goal to assist developers in both project and organizational capitalization.

The new financial products can be used in multiple ways during the various stages of the real estate life-cycle. For example, developers needing capital for mixed-use, commercial development or potential historic structures might utilize these new products. Whether looking for pre-development, early-stage, gap, short-term, permanent or late-stage debt or equity, each of the products fulfill a unique, unmet need for developers and development.

Satisfying the Market: Financial Product Description

Summarized and defined in the table below are the emerging financial products with more complete descriptions of the fund sponsors and investment targeting characteristics following:

#	Product Name (Equity or Debt)	Sponsoring Organization	Property Type	Life Cycle Stage	Investment Parameters & Terms	Deal Size
1	National Trust Historic Real Estate Fund (NTHREF) - Equity & Mezzanine Debt	National Trust Community Investment Corporation (NTCIC), subsidiary of the National Trust for Historic Preservation (NTHP) http://www.ntcic.com/	Historic Urban (MF or Mixed Use)	7-10 Years	14-18% Mezzanine. Rate, 18% IRR w/ current pay & equity residual share	$1 to $4 million
2	HIT Advisers	AFL-CIO HIT www.aflcio-hit.com	Market-rate & Affordable MF, Mixed Use, & Health Care	Pre-development, early stage development	Competitive Risk-Adjusted for early entry debt. Union-built development.	Based on deal scale
3	Dreadnought's Proprietary Direct Lending Acquisition-Bridge Loans	Dreadnought Capital Management Corp. http://dreadnoughtgroup.com/	Existing and/or expired LIHTC, non-LIHTC affordable properties	Years 8-15+	Flexible & customizable loan terms, 3-7 years+, interest-only, senior-lien and mezzanine; rates depend on lien, security, term & sponsor. Used for either acquisition or existing owner	Varies but target $10 million+, single deals & portfolios
4	Roseview Affordable Housing Fund	Roseview http://roseview.com/roseview-affordable-housing-fund/	Existing LIHTC	Years 8-15+	5% cash-on-cash return at closing, plus residual at exit in an amount to be negotiated. Targets existing acquisition-rehabs and new acquisitions	No min or max, single transactions & portfolios

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1) **The National Trust Historic Real Estate Fund (NTHREF)** is sponsored by the National Trust Community Investment Corporation (NTCIC), which is a wholly owned for-profit subsidiary of the National Trust for Historic Preservation (NTHP), the leading nonprofit advocate for historic preservation. Since its inception in 2000, NTCIC has raised over $1 billion in capital for 131 transactions in 22 states. Amongst their portfolio, 60 projects have been multi-credit ($525MM equity) and 41 have been Historic Tax Credit (HTC) only ($167MM equity). Headquartered in Washington, DC, NTCIC has a broad nationwide reach to partner with developers and provide mezzanine debt or equity investment, services and asset management of its investments.

   With NTHREF, NTCIC aims to provide additional, non-Historic Tax Credit capital to invest in historic rehabilitation projects. NTCIC's experience underwriting and financing commercially viable, historic redevelopments identified a need for funding to add to the typical capital stack of subsidy, debt and tax credit equity. Targeting historic urban buildings to be rehabilitated for multifamily or mixed use, NTCIC plans to work with developers with historic rehabilitation experience who will control the development process and manage the property during the proposed seven to ten year NTHREF investment holding period. NTCIC President Merrill Hoopengardner shared that NTCIC, "Is looking forward to introducing a fresh investment product to our current and future partners that continues to promote historic rehabilitation in sustainable communities nationwide."

   NTHREF is expected to be a $10MM fund with individual investments ranging from $1-4 million at market-rate returns (14-18 percent mezzanine rate; 18+ percent IRR equity return) with current pay and share of exit proceeds. The investment can be structured as sponsor equity or mezzanine debt with no investment expected in predevelopment or bridge funding.

2) **AFL-CIO Housing Investment Trust (HIT)** is a fixed-income mutual fund specializing in high credit quality multifamily mortgage-backed securities. The HIT manages over $5.9 billion in assets for more than 390 institutional investors. Over the last 30 years, HIT invested over $10 billion in the construction, substantial rehabilitation and preservation of multifamily housing and healthcare projects. The HIT (and its wholly-owned subsidiary Building America CDE) have financed nearly 102,000 units and created close to 77,000 union construction jobs. Since the beginning of the Obama Administration, the HIT has invested over $2 billion and Building America has provided $85 million in tax credits for 88 projects representing more than $4.8 billion in total development investment.

   HIT Advisers, a wholly owned subsidiary of the HIT, is identifying affordable housing and neighborhood commercial projects with a need for early investment capital, including predevelopment, acquisition and bridge financing. HIT Advisers will focus on offering debt instruments that provide critical gap-filling capital to construction projects that can benefit from pre-development loans, bridge loans for tax credit equity or contributions from state and local agencies and acquisition loans for large-scale, multi-phased developments. George Weidenfeller, Counsel, HIT, commented that, "the type of early assistance that will be possible could be critical to advancing strong developments."

   Typical sponsors will include developers of affordable and market-rate multifamily rental housing, developers of neighborhood retail and small business projects, mixed-use developers and developers of healthcare facilities. HIT Advisers plans to specialize in offering competitive financing approaches and solutions where conventional sources of capital are not readily available. Targeting markets where the HIT has a strong presence, HIT Advisers will continue HIT's accompanying objective of financing union-built residential and commercial projects.

3) **Dreadnought Proprietary Direct Lending Acquisition-Bridge Loans**. Dreadnought Capital Management Corp. is a private investment management firm that has invested in debt or lent over $1 billion since its founding in 2009. Dreadnought's unique proprietary non-agency direct lending and debt investment platform targets the affordable housing and related

public-private housing and project finance sectors. Dreadnought's senior team includes professionals with over 90 years of collective experience in the affordable housing and related municipal bond industries.

Targeting both existing and new owners, Dreadnought's loans on affordable properties gravitate towards preservation transactions that allow an affordable multifamily buyer to purchase a single or portfolio of properties, GP, LP or both partnership interests quickly. Loans include, but are not limited to, (i) high leverage, first lien acquisition-bridge loans with flexible terms which provide time to execute the best possible permanent financing plan, and (ii) acquisition or monetization of partnership interests in LIHTC deals in the eighth to fifteenth+ year of their compliance period. In both cases, Dreadnought expects to be repaid upon a capital event, including a LIHTC re-load, sale or refinancing of the property or portfolio.

Dreadnought targets transactions where it can lend $10 million or more for either a single property or portfolio transaction, with preferred terms to borrowers that enter into a programmatic lending relationship. Loan terms are highly customizable to fit a borrower's needs and are generally interest-only. Typical terms for a high leverage (up to 95 percent) first lien acquisition-bridge loan up to five years includes an interest-only rate range of between 5.75 percent and 7.50 percent. A standard mezzanine loan or a loan to finance the purchase of a LIHTC partnership interest (GP, LP or both), where Dreadnought will finance up to 90 percent of the partnership acquisition cost secured solely by a lien on available partnership cash flow, is typically structured with a 10 percent current pay rate and an 11 percent to 15 percent IRR requirement. A similar mezzanine loan can be used by an existing GP owner/developer against the free cash flow of their partnership interest.

Dreadnought's provides creative, flexible, scalable/programmatic non-controlling debt capital. Dreadnought's new lending vehicle in 2017 will have an annual lending capacity over $300 million. Mirza Kafedzic, Dreadnought's Co-founder and Chief Investment Officer, stated that "first-class borrowers will benefit from our creativity, problem solving culture and flexible and scalable lending capacity. We look forward to expanding our proprietary direct lending activities in 2017 to support the affordable housing industry, particularly preservation efforts."

4.) **Roseview's Affordable Housing Fund (RAHF)**
Founded 16 years ago, the Roseview Group both invests with and advises institutional clients across the nation. Built around a veteran team of partners from the real estate, investment and banking industries, Roseview's 25 professionals operate a national U.S. real estate investment and advisory practice through offices in Boston (headquarters), Seattle and Philadelphia. Roseview has completed over $5 billion in transactions across its investment and advisory platforms, working with leading real estate investment and operating companies, as well as financial institutions across the country.

Equity from Roseview's fully-discretionary affordable fund can be used by GP's to realize immediate and substantial liquidity prior to the end of the compliance period when RAHF would acquire a non-controlling interest in the General Partners ("GPs") of later-stage LIHTC properties. The fund provides two acquisition options: a direct investment into the GP of an existing LIHTC investment that is already owned by the General Partner or as part of a fee-simple LIHTC acquisition that the General Partner is pursuing. Vince Costantini, founder and CEO of The Roseview Group commented that "we have a flexible, timely and reasonably priced investment product that can help bring additional liquidity to GPs who are looking to grow their current LIHTC portfolio and could use an additional source of funds given the current market or diversify their current holdings outside of the sector."

Target property characteristics include existing deals (no new development) in which a minimum of 80 percent of the units are subsidized through either LIHTC or other qualified subsidies, properties with at least 100 units with the assets intended for long-term preservation. Investment parameter targets include a 5 percent cash-on-cash return at closing plus a residual return at exit in an amount to be negotiated.

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The fund will be targeting current owner recapitalizations, acquisition rehabs, and new GP acquisitions of existing LIHTC properties and, in partnership with the GP, the acquisition of related LP interests.

Monitoring and Refinement

Each of the four profiled emerging products evolved to satisfy demand. External forces, such as potential tax reform, funding shifts and program changes will also impact product development. Industry commentary and feedback will naturally stem from product involvement and execution, but organizations, such as NH&RA, will also be following product growth and modification trends as we expect competition and refinement. The importance of this industry self-monitoring, from professionals, as well as industry organizations, cannot be overemphasized to assure continued public trust in our complex industry. While the future is uncertain, each of the four emerging products will aid the industry in expanding supply while preserving the quality of affordable housing and fostering neighborhood revitalization through impactful community development.

As transactions and ownership structures evolve to embrace new emerging products, the public-private nature of the affordable housing and community development market will likely promote further adaptation and complexity. As new financial products adapt and are incorporated into transactions, real estate, accounting and legal professionals will foster even more refined deal structures. Professionals and investment managers will also be monitoring operations, further improving transaction efficiency and investment performance. TCA