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CONSIDERATIONS FOR ISSUERS IN EVALUATING MULTIFAMILY HOUSING BOND PROPOSALS AND TECHNIQUES FOR MINIMIZING RISK ON ISSUES INVOLVING UNRATED NON CREDIT ENHANCED BONDS

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An important aspect of evaluating the various financing proposals presented to a housing finance agency is assessing the feasibility of the financing proposal on which the developer is relying for the financing of its project and the ability of the proposed financing team to accomplish that financing in the amount of time available. Accepting a proposal to provide financing for one project often carries with it cost of turning down another project which would also accomplish a number of the agency's goals. An agency obviously wants to avoid the possibility of turning down meritorious proposals and using up precious private activity bond allocation on a proposal, not to mention the limited time and energy of its staff, only to discover at some stage of the financing that the developer's financing plan has fatal flaws which prevent the project from going forward or would permit it to do so only on terms that are unacceptable to the agency.

The substantial majority of multifamily housing bond proposals submitted today are for "new money" bonds proposed to be issued to provide financing for new construction or to provide financing for the acquisition and rehabilitation of residential rental housing projects, as compared to the refunding, refinancing transactions which were so prevalent in the early 1990's. These new money proposals often involve three or four layers of financing, in addition the type of investment grade rated, credit enhanced tax exempt bonds or privately placed unrated senior debt which often provide the primary source of construction and/or permanent financing for these projects.

These additional layers often include, on the debt side, (i) subordinated bonds (either tax exempt and/or taxable), (ii) other subordinated loans from state, county, city or other public entities. In addition, under some credit enhancement structures, most notably those provided by Fannie Mae or Freddie Mac, there may be separate parties assuming the real estate risk on the transaction during the construction, as compared to the permanent, phase of the financing. On the equity side, many projects involve the use of 4% low income housing tax credit equity syndications as a substantial source of project funding, in addition to cash equity otherwise provided by the borrower.

Each of these components in such a financing is a vital link in the financing chain -- each generally provides a critical component of the total project cost, so that if any one of these financing sources is not available at closing, the transaction may be required to be postponed or even abandoned. Since tax exempt bond allocations applicable to many of these financings last only 60-90 days, the failure to achieve a successful closing in a timely manner may result in the loss of the entire project financing. As a result, it is important that the agency and its financial adviser and/or lead investment banker carefully evaluate each component of the proposed financing structure to assure that the developer has a reasonable likelihood of succeeding in its attempt to line up and close each component of the financing on terms acceptable to the agency.

In this process, the agency should evaluate the ability and experience of the participants who will be involved in each of these components of the financing, as well as the terms of each proposed component. Questions with respect to each component should include, but are not limited to, the following:

1. Is the proposed structure one which has been utilized in a number of prior transactions and has reached a certain degree of "standardization", or is the developer proposing a unique, novel financing component which is anything but "tried and true" and may raise substantial risks of lengthy and possibly unsuccessful negotiations which can jeopardize the entire financing?

2. Are the participants who have been proposed to carry out each component experienced in this aspect of a multifamily project financing, or is one or more of the critical players undertaking this aspect of the proposed financing for the first, second or third time, or does the proposed component vary substantially from prior financings of this type undertaken by that player?

3. Have the participants in the different components of the financing worked together before on financings which had similar terms and conditions, or is this the first time that the developer has used this tax credit equity syndicator, for example, with the bond financing structure and credit enhancement which is being proposed? Or is this the first time a particular letter of credit bank is taking real estate risk on the financing during construction and rent-up where another credit enhancer (such as Fannie Mae or Freddie Mac) is taking real estate risk during the permanent phase of the financing? As is discussed further below, the interrelationship of these different financing components can be very important to the success or failure of a financing.

4. Do one or more aspects of the proposed financing, such as subordinated bonds or other subordinated debt, involve features which may present potential liability or other issues for the agency that should be spelled out carefully in advance?

Each component of the financing, and the interrelationship of the components, is critical to achieving a timely and successful closing.

Primary Senior Tax Exempt Bond Debt

This type of debt typically provides anywhere from 50% to 80% or 90% of the proceeds needed to finance a new money project. In most cases, this debt will be supported by a credit enhancement, such as Fannie Mae, Freddie Mac, GNMA, FHA, a bank letter of credit or policy of municipal bond insurance which will result in the Bonds being rated in one of the top two tiers of the four investment grade ratings provided by Standard & Poor's or Moody's ("AA" or "AAA" from S&P or "Aa" or Aaa" from Moody's), the two major bond rating agencies. Such bonds typically carry very low risk to investors and thus to the agencies which are the issuers of the bonds. In such a financing, one of the most important tasks for the agency will be to assure that the developer has a firm commitment from the credit enhancer to provide financing under a well-established program, and that the credit enhancer will not impose conditions to protect its position which will impose unacceptable risks to the agency. In addition, the agency will want to be sure that the developer has shared with the credit enhancer any special targeting or other requirements which the issuer may impose on the project as a condition of providing tax exempt financing through the issuance of the bonds, and that the credit enhancer has taken those requirements into account in it underwriting of the project loan.

Under some structures, such as Standard & Poor's affordable housing program ("AHP"), an investment grade rating may be received on bonds issued to finance the acquisition and light rehabilitation of a stabilized apartment facility. These ratings usually fall in one of the two lowest investment grade tiers (e.g., "BAA" or "A" from S&P), even though no separate credit enhancement is involved in the financing. In this case, the agency will want substantial assurances at the outset that the project will satisfy the very rigorous requirements that the rating agencies impose for granting such a rating.

Finally, in an increasing number of financings, no credit enhancement and no rating is involved. One trend which has emerged over the past several years is the development of a number of tax exempt financing "conduit" programs, such as those provided by Citi Community Capital, Centerline, Muni Mae and a number of banks. Under these programs, the sponsor agrees to purchase unrated, long-term bonds generally bearing interest at a predetermined fixed rate, or at a floating rate which has been capped or swapped to fixed, secured only by a first deed of trust interest in the real estate and, in some cases, a letter of credit during construction and rent-up. While these programs may (or may not) produce slightly higher end loan rates and involve longer optional prepayment lock-outs than one finds in rated, credit enhanced bond offerings, they offer the convenience of fewer players, relatively low front end costs, speed of underwriting and closing, and sometimes more liberal real estate underwriting criteria, than may be the case with rated, credit enhanced senior borrowings. Since these bonds are not credit-enhanced and are unrated, they carry with them potential risks from an issuer's standpoint which are not wholly unlike those carried by unrated subordinate bond issues, which sometimes form additional "lower-tier" components of an overall financing plan under these programs.

An agency should carefully evaluate whether or not it is willing to be involved in a financing which involves one or more tiers of unrated, non-credit enhanced debt of which it will be the issuer. As a general rule, it will only be willing to do so if a number of conditions are satisfied which are designed to assure that the bonds are only sold to investors who are able to evaluate the merits and risks of such a high risk investment and who are able to bear the risk of loss of their investment in return for the high interest rates typically borne by these bonds. These techniques are discussed under "Unrated Debt Financing – Unrated Bond Financing" below.

Unrated Debt Financing

An increasing number of bond financings involve one or more layers of debt which are non-credit enhanced and, in some cases, additional unrated underlying debt which is subordinate to the primary tax exempt bond financing. This may take the form of (i) tax exempt, taxable bond debt and/or (ii) subordinate loans from a state, county, city or other public body.

Unrated Bond Financing. Increasingly, developers approach an agency with a proposal that (i) it issue unrated, non-credit enhanced senior bonds to be purchased by one of the tax exempt conduits and/or (ii) that it serve as the issuer of subordinate bonds comprising possibly 5-10% or more of total project financing. In each case, the debt will not be supported by long-term credit enhancement and would not be ratable by any of the major rating agencies.

Where subordinate bonds are used, they often enable a borrower to increase financing proceeds by securitizing a higher percentage of project cash flows. This is true because most credit enhancers or tax exempt conduit purchasers of senior unrated debt will impose minimum debt service coverage, maximum loan-to-value and other underwriting tests which will define the maximum size loan they are willing to credit enhance or the maximum non-credit enhanced senior debt issue they will buy for any particular project. For example, a credit enhancer or senior debt purchaser may be unwilling to credit enhance, or purchase senior bonds backed by, a loan on which the debt service coverage is less than 1.15 to 1.20:1 based on fairly conservative assumptions regarding project rents, vacancy levels and operating expenses. These tests therefore usually leave some projected cash which would be available, if things go as expected, to pay debt service on bonds which are subordinate in right of payment to the senior, rated or unrated debt.

Senior non-credit enhanced bonds and, even more so, subordinate bonds, will by their nature will not be ratable and will generally be considered high risk investments. The bond documents on such a financing will always make it clear that the Bonds are limited obligations of the issuer payable only from the subordinate claim to project cash flow and other assets specifically pledged under the indenture, and that neither the issuer nor its officers or other affiliated individuals are liable for the repayment of the debt. Nonetheless, issuers will want to take additional steps to limit their potential liability in the event that project revenues prove insufficient to pay debt service on these types of subordinated bonds. These generally will include one or more of the following devices:

A. **Large minimum denominations**, generally at least **$100,000** (or in some cases $25,000 or $50,000) as compared to the normal minimum denomination of $5,000. This tends to keep these high risk bonds out of the hands of retail investors.

B. **Limiting the offering only to** certain types of relatively **sophisticated investors**, such as "accredited investors" under Reg D under the Securities Act of 1933, which may include individuals with substantial incomes or net worth, or to "qualified institutional buyers" under Rule 144A under that Act ("QIB's"), a much more limited category of only very sophisticated financial organizations.

C. Requiring an "**investor letter**" from initial investors indicating that they meet the investor criteria for the offering, that they have no present intention of reoffering the bonds in a subsequent public offering (but may subsequently transfer the bonds in a limited offering to another permitted transferee), that they have the sophistication to evaluate the merits and risks of the investment and suffer a loss of the investment, that they have been furnished all the information which they and their advisers requested on the offering and have had an opportunity to ask questions relating to that information, and other such matters.

D. Requiring that any subsequent transferee also provide such a letter before a bond is transferred (a **"traveling" investor letter**) and imposing **transfer restrictions** on the subordinated bonds which prevent any transfer if these requirements are not satisfied. This last requirement, if imposed, can substantially impair the marketability of an unrated bond issue. A number of sophisticated issuers will impose more substantial requirements in the first three categories (e.g., limiting holders to QIB's under Rule 144A and obtaining a relatively broad investor letter from the initial investor) in return for foregoing a "traveling" letter requirement.

<u>Adapting Restrictions for Tax Exempt Conduits.</u> As a general rule, the major tax exempt conduits who purchase senior and occasionally subordinate unrated bonds have structured their programs to satisfy the foregoing concerns. In some cases, these sponsors will aggregate $80 to $100 million of such bond issues and transfer them to a securitization trust, which will generally obtain credit enhancement and liquidity to back an offering of senior ("Class A") trust certificates in an amount equal to 75-80% of aggregate underlying bond issues, and will, together with one or two other sophisticated institutional investors, take back a subordinated "residual" ("Class B") class of trust certificates in an amount equal to 20-25% of the underlying bond issues. More recently, some tax exempt conduit sponsors have begun to deposit an unrated bond issue into its own separate tender option bond ("TOB") trust, pledging the sponsor's own credit and liquidity, or that of a highly rated third party, behind variable rate 7-day demand "Class A" certificates representing as much as 99% of the trust's assets, and taking back a "Class B" residual certificate for 1% or less of the assets in the trust.

Such offerings require some adjustment in the language implementing the above described restrictions, but when properly structured, these programs present relatively little risk for the underlying bond issuers for several reasons. First, as noted above, some of these securitization trust offerings represent a pooling of 8 or 10 or more bond issues with relatively little information given on the individual underlying bond issues. Moreover, in the case of virtually all multiple bond issue or "one-off" securitizations, the senior trust certificates are usually backed by AA- or AAA rated credit and liquidity facilities, and, most importantly, the distribution of both classes of trust certificates is often limited to QIB's or other very sophisticated institutional buyers. Where this type of restriction on permitted transferees is combined with a $100,000 minimum denomination requirement, a strong argument can be made that the vast majority of the risk otherwise associated with these programs has been eliminated.

Especially where a conduit program contemplates an exit into a separate TOB trust, requiring minimum denominations in excess of $100,000 can kill the economics for the program sponsor (since such trusts must be able to distribute assets in kind in certain unwind scenarios, and on a securitization of less than $10.0 million in principal amount) imposing a minimum denomination of more than $100,000 will force a "Class B" certificate to be more than 1% of trust assets, which can have a dramatic adverse affect on projected internal rates of return. Requiring minimum denominations of greater than $100,000 can also impair the marketing of "Class A" certificates on single issue TOB executions as well. As a result, a number of issuers have agreed to eliminate "super minimum denomination" requirements of over $100,000, where sales of Bonds are limited to QIBs or trusts whose certificates are held by QIBs and when an appropriate initial investor letter is obtained. A further explanation of the rationale many issuers have followed in adopting more limited restrictions for institutional placements under certain tax exempt conduit programs is set forth in Appendix A to this memorandum.

<u>Special Considerations Pertaining to Subordinate Bonds.</u> There are at least two other important aspects to evaluate on any financing proposal which involves a substantial component of subordinate bonds. First, it is important to be sure that the developer or underwriter has designed the subordinate bond financing in a manner consistent with the requirements of the senior bond credit enhancer or senior debt purchaser and possibly those of a tax credit equity investor as well. For example, Fannie Mae will only allow 75% of cash flow after payment of first deed of trust debt to be dedicated to the payment of subordinate bonds on some types of financings. Moreover, often the senior bond credit enhancer will not allow the holders of the subordinate bonds to be secured by a second deed of trust or to have any other foreclosure of similar rights to proceed against the project in the event of a default in payment of the subordinate bond debt. It is important that the proposed subordinate bond debt be designed from the outset with these requirements in mind and that the senior bond credit enhancer has passed upon the material terms of the subordinate debt before a great deal of time and effort is put into the financing.

Finally, it is important for the agency to get some reasonable assurance from the proposed placement agent for the subordinate debt that it will be able to place the debt with the appropriate class of investors, in light of all the above described limitations. This can often become more than the "tail that wags the dog;" it has the potential for becoming the "tail that beats the dog about the walls and ceiling of the room"! Is there a reliable commitment from the prospective buyer of the subordinate bonds? If not, has the placement agent been successful in placing this type of debt before? Who are the targeted investors? Does the placement agent have a basis to believe that this aspect of the financing will be doable? One does not want to approach the targeted closing date of a multi-layered tax exempt bond financing where months of hard work have been put in by 10 or 12 or more financing participants, only to discover that the placement agent is unable to sell the subordinate bonds representing a vital 5-10% of the deal.

Other Subordinate Debt. Often states, counties, cities, redevelopment agencies, housing authorities, HUD or other public bodies will have programs under which they are willing to provide grant moneys or subordinate loans to projects which have a substantial affordable component or otherwise meet their housing goals and objectives. These bodies are generally quite willing to subordinate their positions to the senior debt credit enhancer, and the marketability question does not arise, but it is important that the legal requirements of the senior debt credit enhancer be made clear to the proposed subordinate lender at the earliest possible stage of the financing and coordinated with tax credit equity requirements. It is also important that the proposed financing schedule allow time for the attorneys for the proposed subordinate lender and other parties to review the proposed form of subordination agreement or other document which will be used to define the relationship between the different series of debt. Public bodies and their attorneys sometimes need more time to review, evaluate and approve these arrangements than their private counterparts might require, and this should be built into the financing schedule.

Separate Construction Period Credit Enhancement

Under many credit enhancement structures for the senior debt, the same entity will provide credit enhancement for the bonds during construction as during the permanent phase of the financing. For example, under FHA insurance of advances, FHA will insure each mortgage loan advance in addition to insuring the permanently funded mortgage loan, and thus the same credit enhancement will provide security for the bonds throughout the financing. The same is almost always the case where the developer has arranged for a bank with which it has a relationship to provide credit enhancement for a bond issue by issuing a letter of credit to secure the bonds.

On the other hand, some credit enhancers, most notably Fannie Mae and Freddie Mac, and most tax exempt conduit buyers, do not typically take real estate risk before construction has been completed and a project has satisfied some test of stabilized occupancy (e.g., 1.20:1 debt service coverage for a period of at least 90 consecutive days). Under these circumstances the credit enhancer might agree to credit enhance the bonds throughout or the conduit may agree and buy the unrated bonds, but it will require a bank or other construction phase credit enhancer to come in and agree to post a letter of credit or cash collateral to the top tier credit enhancer to secure it for any loss which might be suffered on the real estate until the stabilized occupancy and other permanent phase (or "conversion") criteria have been satisfied.

Where such a split real estate risk arrangement is proposed by the developer, it is important for the agency to evaluate the availability of the construction phase credit facility as well as the commitment from the top tier credit facility or conduit buyer. Has the developer worked with this bank and obtained similar financing in the past? Have they both worked with the top tier credit enhancer or conduit buyer under similar circumstances before? Is there a careful coordination of the criteria for the permanent lender to go at risk with those under which the construction period credit facility will be released? Is there a commitment from the construction phase credit facility on the table as well as from the top tier enhancer or conduit buyer? It is important that both the construction phase credit provider and its attorneys be involved in the financing from the outset where these arrangements are proposed, and that their financing commitment as well as that of the top tier enhancer or conduit buyer be on the table before, in the case of a credit enhanced offering, a Preliminary Official Statement is mailed and the bonds are priced.

Equity Financing Arrangements

The availability of developer equity financing at closing and thereafter is almost always a critical aspect of any bond financing proposal. A certain portion of this equity will be cash equity which the sponsor of the project will be expected to have available at closing and/or committed after closing before the senior bond credit enhancer will agree to place its credit enhancement on the senior bonds at the closing. To the extent that the sponsor and general partner is a substantial developer with considerable financing sources, the presence of the cash equity required to close may not be a major issue. For smaller, thinly capitalized developers and certain non-profit developers, this issue may be a critical one which the agency should carefully evaluate in considering any financing proposal.

Increasing numbers of “new money” projects derive a substantial portion of the proposed total project cost from a syndication of 4% low income housing tax credit equity. Where present, such financing may cover anywhere from 25% to 30% or more of total project financing. There are a number of questions which the agency should ask before approving a financing proposal involving tax credit equity financing. Has the developer worked successfully with the proposed tax credit syndicator or syndicators in the past, or is this a first time? When will the syndicator be selected and brought on board (earlier is better)? What is the background and reputation of these syndicators? Have the precise terms of the proposed bond financing (and any subordinate debt financing) been reviewed in detail with and approved by the syndicator or the prospective syndicators and their counsel? For example, if the developer is proposing a variable rate financing for the bonds, its credit enhancer may require a 5 to 7 year cap or swap to protect it from interest rate risk on the financing, or it may be willing to provide a letter of credit or other credit enhancement for the variable rate bonds without any such protection. Many tax credit syndicators, on the other hand, will not be willing to accept any interest rate risk during the tax credit compliance period, which generally lasts roughly 18 years (construction plus 15 years). Under these circumstances, the developer’s ideas on the debt side of the deal may be fatally inconsistent with the requirements on the equity side.

As result of these types of issues, it is imperative that the syndicator and its attorneys be involved at the earliest possible stage of the financing to minimize the possibility of these types of conflicts after a great deal of time and effort have been expended on a financing. In addition, it is essential that a commitment from the tax credit equity provider be on the table before a Preliminary Official Statement on the bonds is mailed and the bonds are priced, where a public offering of bonds is contemplated.

Conclusion

Obviously, it will be beyond the capability of many housing finance agencies to evaluate in detail each of these proposed components of a proposed financing and the players which the developer has assembled to carry out these aspects of the financing. Where the issuer has a financial consultant or lead investment banker hired by it, or with whom it has a substantial relationship, these parties obviously can and should assist the agency in this process. Nonetheless, even an issuer without such advisers should make at least a basic inquiry into each of these aspects of the financial feasibility of a proposed bond financing before determining which project or projects it will support through the issuance of tax exempt bonds. A small amount of effort expended on the front end with respect to these matters can greatly increase the efficiency of the financing process and avoid costly and embarrassing mistakes at a late stage of the financing for the agency and the other participants involved.

APPENDIX A

DIFFERENTIATING RISK IN PRIVATE PLACEMENTS OF UNRATED BONDS; RATIONALE FOR DIFFERENT RULES FOR TAX EXEMPT CONDUIT PROGRAMS

Our law firm and its predecessors have represented a number of the country's leading investment banking firms and banks as Underwriter's or Placement Agent's Counsel on a vast number of tax-exempt multifamily housing bond financings for almost 30 years, and we have also served as Special Bond Matters Counsel to a number of the country's leading affordable housing developers. Over this period of time, we have from time to time been asked by our clients to evaluate various types of proposed offerings involving unrated, non-credit enhanced bonds. In the course of helping our clients and our own law firm develop their respective policies and procedures for these types of transactions, we have had in depth conversations with our colleagues (bond counsel, securities litigators, and other law firms) who have been involved in class actions and other threatened or actual securities litigation involving defaulted non-credit enhanced bond issues. What has emerged from these discussions with our clients and colleagues is a profile which we believe suggests that unrated bond transactions can be divided into two distinct categories with respect to potential litigation risk.

Market for Unrated Municipal Bonds

The market for unrated, non-credit enhanced municipal bonds is actually much more substantial than is often realized. Many churches, private schools and other institutions raise funds by selling their bonds, both taxable and tax-exempt, to congregation members and other parties, often in small, $5,000 denominations and typically with little input from sophisticated finance professionals. There is also wide-spread market for unrated bonds to finance life care facilities, nursing homes and other such facilities, which often find their way into what would generally be regarded as retail hands in small denominations. Certain municipal bond dealers (often referred to as "bucket shops") have made a cottage industry out of the distribution of these bonds, and on occasion, representatives of more established securities firms will participate in such issues as well. In the case of failures of life care centers, private jail facilities and other such financings, there have been some celebrated class action law suits and major damage awards recovered. We have discussed this litigation with some of our colleagues who have had the misfortune of being involved in and who, together with their insurance carriers, have contributed to the settlement of these class action suits, and with the exception of certain markets outside the affordable housing market, where somewhat different industry norms and standards have evolved, we have generally advised that there are several principal parameters to which one should steadfastly adhere to minimize the risk of litigation and losses of this type of unrated affordable housing bond transaction.

Parameters for Reducing Risk

The first principle for minimizing issuer exposure is never permitting such bonds to be sold in small denominations, with a $100,000 minimum denomination being the gold standard here. From time to time, underwriters or other participants press for smaller minimum denominations (e.g., $25,000 or $50,000). While we believe this entails much less risk than a $5,000 minimum denomination, which tends to connote a retail distribution, we have almost always advised our clients they should never go below the $100,000 threshold for unrated non-credit enhanced tax exempt multifamily housing bonds.

The second most important criterion, we believe, is limiting the class of potential investors. In this regard there are two typical categories of permitted investors: (i) accredited investors under Reg. D of the Securities Act of 1933, as amended ("Accredited Investors") and (ii) qualified institutional buyers under Rule 144A. These are two very different classes of investors. Limiting sales to Accredited Investors does substantially reduce litigation risk, since this class of investors is limited to individual investors with annual incomes for the last two years and expected current annual income of at least $200,000 and net worth of at least $1,000,000, as well as a range of institutions. We believe combining $100,000 minimum denominations with limitation of sales to Accredited Investors and a "traveling" investor letter, many issuer policies do, achieves a signification reduction of risk in these transactions, and strikes a reasonable, prudent balance between facilitating financings through the use of these types of issues and reducing litigation risk to an acceptable level. Notwithstanding this, dentists, doctors, small business owners and other individual accredited investors under Reg D, or even smaller financial institutions, may assert that they simply weren't given all the information they needed in a particular transaction and under certain circumstances may survive a motion to dismiss in litigation brought to recover losses from an investment in unrated bonds, depending, of course, upon all of the facts and circumstances.

Qualified institutional buyers under Rule 144A ("QIBs") are an entirely different type of class of investor. First, this class is limited to institutional investors – an individual can never be a QIB - and generally comprises only institutions which own and invest on a discretionary basis at least **$100 million** of securities of unaffiliated issuers. The Securities Act of 1933 carves out a special regulatory regime for sales to QIBs, and requires only very basic information on the issuer's business, balance sheet and profit and loss to be provided, as compared to a much more detailed set of requirements for sale to Accredited Investors under Reg D. We believe this implies a strong recognition on the part of Congress that institutions meeting the definition of a QIB have such a high level of sophistication and financial wherewithal that allowing sales of unregistered securities to these types of investors can reasonably be permitted without the benefits of registration and without even most of the restrictions which are imposed in connection with sales to Accredited Investors under Reg D. In other words, we believe the Securities Act reflects a strong presumption that these very sophisticated institutional investors can "fend for themselves" in securities transactions.

We also believe that as a practical matter, this group of investors is a much less likely and much less attractive potential plaintiff class. First, in our experience, institutional investors generally do not sue because they incurred a loss on a non-credit enhanced bond issue, unless they believe there is conduct involved that most of us would describe as gross negligence, recklessness or fraud. Their remedy is more often is simply not to further business with the party who sold them such a bond issue and, if they feel sufficiently wronged, to share that point of view with their institutional investor colleagues. Moreover, even if such a party did bring suit, we believe the securities case law indicates that the courts hold such investors to a much higher standard of due diligence in making such an investment than would be the case with respect to doctors, dentists or well-to-do small business owners and other Accredited Investors under Reg D.

As a result, we believe that **combining a minimum denomination of $100,000 together with a requirement that bonds may only be sold and resold to QIBs under Rule 144A*,** produces a dramatically lower level of prospective litigation risk for the issuer, the underwriter and all of the financing participants in the transaction than even is the case where sales of unrated bonds are limited to Accredited Investors under Reg D in $100,000 denominations.

As a general rule we believe the programs operated by the major tax exempt conduits such as Citi Community Capital, Centerline, Muni Mae, and a number of banks who purchase senior and occasionally subordinate unrated bonds, fit within the parameters described above and that in the context of these transactions, the imposition of other requirements such as over $100,000 minimum denominations ("super-minimum denoms"), traveling investor letters, bonds issued only in non DTC eligible, certificated only forms, and others are not necessary to eliminate the vast majority of risk otherwise associated with an issuer's participation in an unrated, non-credit enhanced affordable housing bond financing.

* For these purposes, we believe that "sales to QIBs" should be deemed to include transfers to securitization trusts, where the trust only offers certificates that (i) are investment grade rated, (ii) are fully guaranteed (as to interest, principal and, if applicable, purchase price) by AAA or AA-rated institutions (such as Freddie Mac PC's) or (iii) are purchased by QIBs.