November 7, 2017

# CAPITAL MARKET UPDATE

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HJ SIMS FINANCED RIGHT®

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## Senior Living New Issue Rates as of 11/7/17

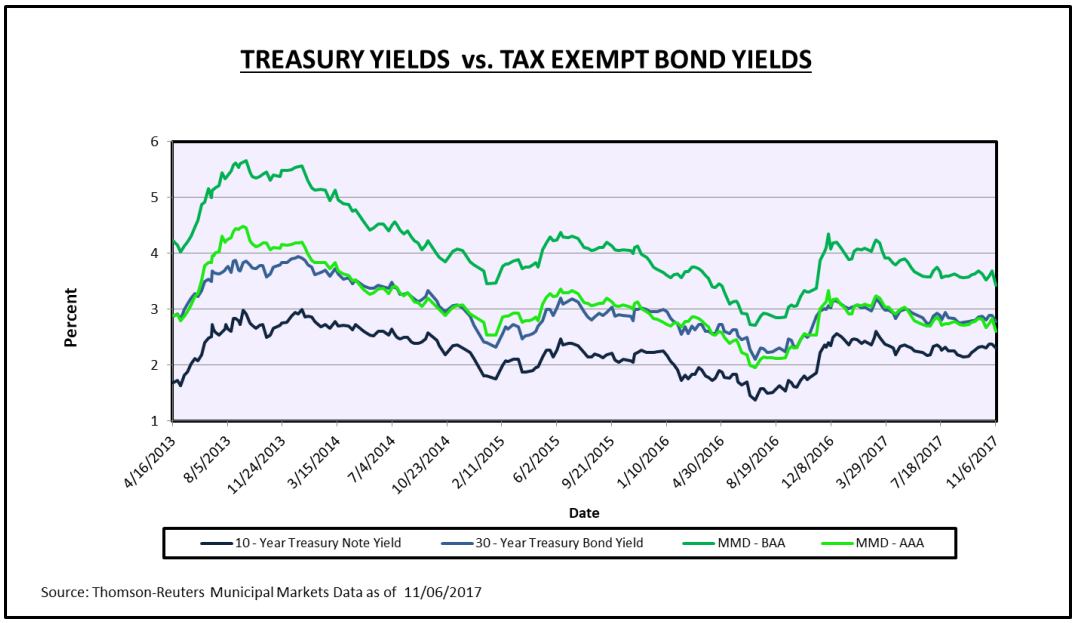
| Maturity | Taxable Rates | Tax Free Rates | | | | | |
|---|---|---|---|---|---|---|---|
| | GNMA Taxable | FHA Tax-Exempt | A | BBB | BB | Refinancing & Expansion | Start-Up |
| 5 yr. | NA | 1.410% | 1.900% | 2.250% | 2.50% | 2.60-3.10% | 4.00-4.50% |
| 10 yr. | NA | 2.380% | 2.750% | 3.000% | 3.40% | 3.50-4.00% | 4.50-5.00% |
| 20 yr. | NA | 3.110% | 3.450% | 3.600% | 4.05% | 4.15-4.65% | 5.25-6.00% |
| 30 yr. | 3.530% | 3.390% | 3.600% | 3.800% | 4.20% | 4.35-4.85% | 5.75-6.375% |

*Senior Living new issue rates for borrowers in specialty states are 20-30 basis points lower in yield.*

| SIFMA Index | LIBOR |
|---|---|
| 0.92% | 1.24% |

| Revenue Bond Index (RBI) | 10 Year Treasury | 30 Year Treasury |
|---|---|---|
| 4.04% | 2.3160% | 2.7940% |

| | 1 Year | 3 Year | 5 Year | 7 Year | 10 Year |
|---|---|---|---|---|---|
| Weekly SIFMA Swap Rates | 1.17% | 1.41% | 1.54% | 1.66% | 1.82% |
| Weekly LIBOR Swap Rates | 1.66% | 1.94% | 2.07% | 2.18% | 2.30% |



## Market Commentary: *"It's déjà vu all over again!" – Yogi Berra*

When Yogi Berra quipped, *"It's déjà vu all over again!"* he may have been watching his Yankee teammates, Mickey Mantle and Roger Maris, hit back-to-back home runs in a July 1961 twi-night doubleheader against the White Sox in the House that Ruth Built. Last week, it was déjà vu all over again for the municipal bond traders who were on deck when the last major tax reform bill was signed into law at the White House thirty-one years ago. Tax-exempt munis were hit pretty hard by the Tax Reform Act of 1986. The law placed an annual cap on certain housing bonds that each state can issue and stripped away the tax-exempt status from other issues. Coupon clipping was out: bonds had to be issued in registered form, banks were no longer able to write off all the interest payments on money they borrowed to purchase tax-exempt bonds, and individual investors were less attracted to munis as top federal tax rates dropped from 38.5% to 33%. The Act also restricted arbitrage and conjured up the alternative minimum tax. As a result, several major bond dealers left the muni business, and the ones who remained worried about the precedent set by taxing state and local bonds that had been tax-free since the federal income tax was ratified in the 16th amendment to the Constitution back in 1913.

Fast forward to November 2, 2017, when the first draft of the long-awaited Tax Cuts and Jobs Act, H.R. 1 was released by House Republicans. Munis were hit by a wild pitch from drafters proposing the elimination of advance refunding and private activity bonds as of December 31, 2017. The pitch was that state and local governments should not have incentives to issue two sets of federally subsidized debt to finance the same activity and that the U.S. government should not subsidize the borrowing cost of private businesses. Bill sponsors estimated that the termination of these bond issues would increase federal revenues by $56.2 billion over ten years, but this total is disputed by some in the industry. In making their assumptions, Republican Members and staff on the House Ways and Means Committee may not have realized how important the ability to refinance at lower rates truly is to cash-strapped municipalities, or how the Treasury's State and Local Government Series (SLGS) used in tax-exempt bond escrows actually benefits the federal government. They may also not be aware that the primary investors in public infrastructure for more than two centuries have been state and local governments and that most so-called private activity bonds are in fact issued for public-private/nonprofit partnerships formed to finance essential community projects for non-profit hospitals, senior living facilities, charter schools, colleges, airports and low-income rental housing. Advance refunding bonds and private activity bonds are not insignificant sectors of the muni market; they are estimated to represent a combined 25% of total issuance since 2007.

Tax reform is moving faster than any legislation has in Washington for many years, and much more quickly than did the last major bill which was unveiled by the House Ways and Means Committee in October of 1985 and took a full year of trading, coaching and contract negotiations to get players around all the bases to cross home plate. This time it may produce more modest reforms. By Thanksgiving, there will likely be many differences between House and Senate versions of the bill, and they will be worked out with input from the Administration and different rulebooks in each body to follow. While passage is by no means guaranteed, tax reform is a priority of the White House, and it has a huge nationwide fan base. Indeed, the stock market's performance in the past year is closely linked to assumptions that corporate and personal tax rates will be lowered. But this is a once-in-a-generation reform process, and one that can be influenced. So individuals, associations and industries are lobbying as hard as they can for their causes, knowing that it may be another 30 years before another opportunity for change is realized. We encourage readers to become involved directly or through organizations of like interests to make their positions known to their elected officials as legislation proceeds from the committees to the floors to the conference committee and back to the floors again.

While all this is underway, the municipal market has proven remarkably resilient. In spite of the Federal Reserve's announced plans for raising rates and shrinking balance sheets, projections of reduced demand from banks as a result of corporate tax cuts, speculation on the adverse impact of disaster-related losses on insurance company holdings and fears of possible elimination of tax-exemption to produce what the Treasury Department estimates would be $62 billion in additional annual revenue, muni returns are still up on the year. The technical supply/demand imbalance continues to support and elevate muni bond prices. Even the surprising provisions for repeal contained in the first tax reform draft failed to sink munis last week. In fact, there was a tax-exempt bond rally accompanying that of Treasuries. Despite

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## Market Commentary

*Cont. from Page 2*

outflows from muni bond mutual funds totaling $331 million, muni 10-year yields dropped 3 basis points between Monday and Friday to close below the 2% level at 1.99%, and 30-year muni yields fell 9 basis points from 2.84% to 2.75%. Treasuries performed a little better: the 10-year note yield fell 9 basis points to 2.32%, and the 30-year bond yield closed down 11 basis points to 2.81%.

Last week, the President nominated Fed Governor Jerome Powell as Chair of the Federal Reserve Bank to replace Janet Yellen when her term expires in February. The appointment was well received by stock and bond markets. Our own head of Capital Markets, Art Wunder, worked with him for many years at the investment bank Dillon Read where Jay was regarded as a level-headed, straight-shooter and all around decent guy. In the high yield muni sector, the Virginia Small Business Financing Authority sold $737 million of Baa2 rated private activity bonds for the Transform 66 P3; the 2056 term bonds priced at 5.00% to yield 4.00%. Memphis and Shelby County, Tennessee brought a $64.8 million non-rated deal through a conduit authority that sold bonds for Graceland with 30-year term bonds priced with a coupon of 5.625% to yield 5.75%. The St. Louis Industrial Development Authority issued $49.1 million non-rated senior living facilities revenue bonds for Friendship Village that included 2048 term bonds priced at 5.00% to yield 3.85%. The Public Finance Authority of Wisconsin brought a $21.3 million non-rated charter school issue for Corvian Community Schools that came with 30-year term bonds priced at 5.125% to yield 5.25%. And in Idaho, the state Housing and Finance Association had a $20.2 million non-rated 5.49% issue for Building Hope Parkside Foundation due in 2047.

There are only about six weeks of trading left in the year. We expect to see a heavy muni calendar as borrowers rush to market with refundings and qualified non-profit issues – just in case the twilight double-headed loss for munis in the tax bill truly does change the entire field of play as of January 1, 2018. We will keep our clients informed of developments, but note that we continue to expect strong demand from investors through year-end, particularly from those in states concerned about the cap on state and local tax deductions and from all those counting on munis as one of the few tax shelters that remain. The market expects the Fed to increase rates by a quarter point next month, but many investors believe that this hike has already been built into current rates. Economic data has been coming in strong. The unemployment rate now stands at 4.1% – everywhere but at the Fed Board of Governors, where three of seven seats are vacant (43%), and at the 12 Federal Reserve Banks where, with the announced resignation of William Dudley of New York and the vacancy in Richmond, it is 17%.

## Sims Mortgage Funding (SMF) Helps Pennsylvania Nursing Home Cut Cost of Capital Almost in Half

***"We are pleased with the outcome of the HUD financing arranged by Sims Mortgage Funding. As a result of their efforts, our cost of capital was reduced almost in half, and we expect to save approximately $130,000 annually in debt service".***

- Gregory Grove, President
  The Guardian Foundation

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# SMF Helps Pennsylvania Nursing Home

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|---|---|
| **Partnered Right** | • Naamans Creek Country Manor had outstanding tax-exempt bonds with a 7.00% coupon. The Owner, a not-for-profit, wanted to lock-in a long-term fixed rate financing that minimized costs of issuance and provided maximum debt service savings. |
| **Structured Right** | • SMF secured a $3,980,000 loan under the Section 232/223(f) program to refinance the bonds and fund capital reserve and repair escrows. Because the LTV ratio was approximately 50%, the HUD loan committee approved the transaction without any risk mitigation after there was a short-term drop-off in the Project's net operating income. |
| **Executed Right** | • SMF obtained a key exemption for the Project's management agent from HUD's requirement for the agent to be a party to a HUD Regulatory Agreement. The exemption enabled the refinancing to move forward under the structure in place before the refinancing. |
| **Finance Right®** | • SMF obtained an interest rate on the HUD-insured loan that was approximately 50% lower than the interest rate on the outstanding bond debt. |

### Partnered Right

Naamans Creek Country Manor is an existing 90-bed skilled nursing facility located in Boothwyn Township in the greater Philadelphia, PA – Wilmington, DE metropolitan area. The Project is owned by an affiliate of The Guardian Foundation, a not-for-profit organization that owns and/or operates nursing homes in Pennsylvania and Florida through related companies. The Project had high-coupon, 30-year tax-exempt bonds that could be prepaid with a slight penalty. Interest rates for HUD-insured loans were quite attractive, and the fixed-rate structure would enable Guardian to lock in savings over the long term.

### Structured Right

SMF secured a $3,980,000 loan under the Section 232/223(f) program to refinance the bonds and fund capital reserve and repair escrows. Because the LTV ratio was approximately 50%, the HUD loan committee approved the transaction without any risk mitigation after there was a short-term drop-off in the Project's net operating income between the time the loan application was filed and the time it was placed in review. The loan featured a 30-year maturity, at Guardian's request and had a debt service coverage ratio of approximately 3.40.

### Executed Right

SMF obtained a key exemption for the Project's management agent from HUD's requirement for the agent to be a party to a HUD Regulatory Agreement. The exemption enabled the refinancing to move forward under the structure in place before the refinancing. SMF seamlessly coordinated the closing of the HUD-insured loan with the notice of redemption of the tax-exempt bonds, resulting in minimal payment of double interest.

### Financed Right®

Because of the HUD-insured refinancing loan, Naamans Creek Country Manor lowered its annual debt service by approximately $130,000. In addition, with over $360,000 in a reserve fund for replacements, The Guardian Foundation will be able to address future capital needs that will maintain the Project's competitiveness.

***For more information, please contact Kerrie J. Tomasiewicz at ktomasiewicz@simsmortgage.com.***

***For more information, please contact an HJ Sims banker.***

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