In 2009, the Villa Guadalupe Senior Services Corporation faced a difficult situation. Twenty years previously, the Villa had borrowed $3 million to finance the construction of a 53-unit affordable senior living facility. The facility, located in the South Side of Chicago, had successfully carried out its affordable housing mission year in and year out, providing apartments for senior citizens with an average household income 60 percent lower than the typical Chicago household. The Villa collected enough rent to be self-sustaining and even pay down about a sixth of its original borrowings.

But the Villa’s remaining $2.6 million debt was fast coming due, and the Villa’s lenders did not want to extend the terms of the existing financing. Because of the ongoing credit crunch, other banks were chary of lending money to a small nonprofit, especially one that charged well-below-market rents. To make matters worse, the current officers of the Villa had little experience negotiating with lenders.

In the fall of 2009, the Villa engaged Ziegler Capital Markets and the Mandel Legal Aid Clinic’s Housing Initiative to provide advice on its options. The Housing Initiative and the Villa had already worked together on earlier matters, making this new representation a natural fit. Ziegler found a lender—Fifth Third Bank—and suggested a financial structure called bank-qualified conduit financing that minimized the Villa’s borrowing costs.

“Conduit bonds” are federal tax-exempt obligations issued by a state or local entity—in this case the Illinois Finance Authority—on behalf of a nonprofit. The nonprofit promises to make payments to the state or local entity, which (for a fee) passes the money on to the bond purchaser. Because lenders do not pay income tax on the interest they receive from a conduit bond, the nonprofit can borrow at a lower interest rate.

“Bank qualification” refers to a rather arcane part of the tax code that essentially means bank buyers of conduit bonds get a double benefit: they pay no tax on the interest received from the borrower and deduct from their income the interest they pay (on bank deposits, for example) to finance the loan. The financing advantages of bank-qualified conduit bonds meant that the Villa could spend more of the loan proceeds on affordable housing.

The downside of conduit bonds is that they are frighteningly complex for a small nonprofit institution. Involved in the Villa’s conduit financing were the Villa, Fifth Third Bank, the Illinois Finance Authority, Ziegler, and a bond trustee. The Villa had to comply with a mind-numbing array of Internal Revenue Code regulations governing its use of the loan proceeds, including restrictions on religious activities and on the type of collateral it or its parent could give to the lender. This was no small matter, for Fifth Third Bank demanded a guarantee of payment from the Villa’s parent organization, the Congregation of the Sons of the Immaculate Heart of Mary of the Eastern Province. This guaranty raised a number of worrisome tax concerns.
Because of its complexity, nonprofits that use conduit financing must be able to depend on their counsel—and in this case the Housing Initiative was certainly up to the task. Throughout the refinancing, the Housing Initiative watched out for the Villa and the Congregation’s interests. Jeff Leslie, the Paul J. Tierney Director of the Housing Initiative, and students at the Housing Initiative dug through every lending document to spot terms that could create trouble for the Villa further down the road. They actively represented the Villa’s interests during numerous discussions with Ziegler and Fifth Third Bank’s counsel. They took steps to minimize tax issues created by the Congregations’ guaranty. They even secured a number of loan concessions from Fifth Third Bank.

But conduit financing requires counsel to serve as more than an advocate—the Housing Initiative also acted as a trusted advisor to the officers and the directors of both the Villa and the Congregation. Students documented the terms of the conduit financing for the Villa and Congregation’s boards of directors and drafted board resolutions authorizing the Villa and Congregation to enter into the transaction. They also worked closely with the Villa’s employees to ensure that the Villa complied with all terms of the loan documents. In addition, the Housing Initiative drafted a legal opinion analyzing the conduit financing, putting the Mandel Clinic’s professional legal judgment behind its students’ work.

Ultimately, the Housing Initiative’s efforts helped the Villa tap new money before its existing financing expired and borrow an additional $700,000 to refurbish its facilities. The Villa is paying an effective interest rate of less than 5 percent interest per year, which is well below market for a single, market-rate apartment building in Chicago. As a result, the Villa can continue to pursue its affordable housing mission in 2010 and beyond.