Affordable Housing Project Lending and Tax Credits

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Executive Summary:

Dedham Institution for Savings (Dedham Savings or DIFS) is a community bank based in Dedham, Massachusetts fully owned by 1831 Bancorp MHC, a mutual holding company. The Bank is the 12th oldest bank under continual charter in the United States and the fourth oldest bank in Massachusetts. Dedham Savings operates branches in the Boston suburbs including three in Dedham and one each in Westwood, Norwood, Needham, Walpole, and Sharon and operates one branch in the Boston neighborhood of South Boston. The Bank also operates four limited-service branches in senior living facilities in Bedford, Canton, Dedham, and Walpole. The most recent branch to open was the South Boston branch. This branch was opened to take advantage of the strength of the South Boston market which has seen a large influx of young professionals and young families. There was also a need for a community Bank in the neighborhood as many of the banks that operated in the neighborhood had merged or been acquired in recent years. The opening of the branch extended the Bank's CRA assessment area into several additional Boston neighborhoods including Jamaica Plain Mission Hill, Roxbury, Dorchester, Mattapan, Chinatown, and South Boston. Dedham Savings' current CRA assessment area includes all Boston neighborhoods as of October 2021. The Bank's management continues to seek opportunities to expand the footprint of the Bank into other equally attractive markets in the Greater Boston area.

The Bank's senior management and Board of Directors are committed to maintaining Dedham Savings as an independent, mutual community bank. Although there has been increased consolidation of other mutual banks and acquisitions of publicly held banks in Massachusetts, the Boston market continues to be very competitive. The market has also seen an increase in larger, national and regional competitors entering the market. This is especially evident with commercial lending and particularly in commercial real estate lending. Dedham Savings continues to strive to be competitive in the market and continue to grow market share with attractive new products and services.

The Bank hired its current President & Chief Executive Officer in 2009. This was followed by a new Senior Lending Officer and several new commercial lenders. The President & CEO and Senior Lending

Officer were both previously commercial real estate lenders at other banks. Prior to 2009, the Bank's lending was primarily one-to-four family residential real estate. Dedham Savings had a small commercial lending department, focused mostly on small business lending. The commercial real estate loan portfolio comprised a small percentage of the total loan portfolio. Commercial loans now comprise 58.75% of the Bank's loan portfolio. This includes commercial mortgages, commercial C&I, and commercial construction loans. The Bank has increased the size of the commercial lending department (comprised of lenders, administration staff, and credit) to 26 full-time employees.

Greater Boston is one of the nation's most resilient economies. This is driven by the industries that have chosen to be based in and around the city. Boston is known for its exceptional colleges, universities, and hospitals. These have made it an attractive place for many biotech, drug developers and manufacturers, and medical device companies. The area has also seen many technology companies open offices. While this is great for the area in many respects, it has also led to an exponential rise in housing costs in the Greater Boston area. This has resulted in many lower income residents having to move farther away from the city. Gentrification has also made the normally affordably priced neighborhoods in Boston more expensive as affordable housing stock has been torn down, renovated, or sold as condominiums.

In 1969, the Commonwealth of Massachusetts passed The Comprehensive Permit Act. The Act includes the Massachusetts General Law Chapter 40B. This is a law which allows developers of affordable housing to ignore certain aspects of zoning bylaws and other municipal requirements for development. Another goal of the Act is to encourage each city and town in the Commonwealth to have at least 10% of its housing stock designated as affordable housing.[1] Although the law was passed in 1969, the law lacks enforcement measures to force the towns to comply with the 10% goal. Therefore, many cities and towns did not do enough during the early days of the Act to increase the affordable housing stock, leading to the

[1] "Guidelines - Massachusetts." *Commonwealth of Massachusetts,* Housing and Community Development, Dec. 2014, https://www.mass.gov/files/documents/2017/10/10/guidecomprehensivepermit.pdf.

crisis that can be seen today. As of the 12/21/2020 (most recent) report from the Commonwealth of Massachusetts Department of Community Development for Chapter 40B Subsidized Housing Inventory shows that only 78 of the 359 municipalities in the Commonwealth had met the 10% goal. This is an improvement from the 2011 report which showed that only 39 communities had met the goal. In total, 10.1% of the housing stock in the Commonwealth of Massachusetts has been designated as affordable housing.[2]

In recent years, municipalities have recognized the crisis and have taken stronger measures to increase the affordable housing stock in the communities. Cities and towns have addressed this requirement in different ways. Many cities and towns now require a developer to have a percentage of the building as affordable or income restricted housing (on larger projects). Some cities and towns have also partnered with developers to create affordable housing that has a higher percentage of affordable units. In many instances, the city / town will provide the developer with the land for affordable housing projects at a greatly reduced cost or a nominal cost to facilitate the project.

Due to the high demand for affordable housing in Greater Boston, Dedham Savings has seen an increase in loan requests from developers for these types of projects. These projects are attractive to the Bank, however, Dedham Savings' commercial loan procedures and policies do not specifically address this type of lending. Affordable housing development projects are typically more complex due to the ownership structure, lack of personal guarantees, and high legal and regulatory risks that trigger reporting to MassHousing and other regulatory agencies upon completion. These loans do provide the Bank with Community Reinvestment Act (CRA) credit and help increase the affordable housing stock in the communities the Bank serves. A clear policy and specific procedure on this type of lending would help Bank leadership, senior management, and Board of Directors to better evaluate, underwrite, and approve

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[2] "Chapter 40 B Planning and Information." *Mass.gov*, 21 Dec. 2020, https://www.mass.gov/chapter-40-b-planning-and-information.

these loans to further the Bank's mission to meet the lending needs of the community it serves and ideally diversify the loan portfolio.

To encourage lenders and investors to finance affordable housing development projects, the federal and state governments offer income tax credits. Banks are able to lend on affordable housing projects and also invest in the tax credits on these types of projects. The Bank has seen competitors in the market act as both the lender to the project and as the tax credit investor for the same project. The Bank has not previously invested in affordable housing tax credits, however, a rise in the corporate tax rate could make the tax credit investment more attractive to the Bank. The Bank would receive separate CRA credit for any investment in the affording housing tax credits. These often include pass through operating losses that the Bank could use to decrease the Bank's pretax operating income, and ultimately its current period tax liability.

Introduction to the Bank:

Dedham Institution for Savings is a state chartered mutual savings bank headquartered in Dedham, MA. The Bank was originally chartered in 1831. The Bank first operated at the law office of Jonathan Cobb at 18 Norfolk Street in Dedham. The Bank later moved to the basement of the Norfolk County Courthouse in Dedham. In 1847 the Bank moved to the offices of the Norfolk Mutual Fire Insurance Company and remained in that location for 40 years. The Bank constructed a new headquarters at 601-603 High Street in Dedham in 1892. The headquarters remained in this location until 1976 when its current headquarters and main branch was constructed at 55 Elm Street in Dedham. In 1832, The Society in Dedham for the Apprehension of Horse Thieves opened a deposit account at Dedham Savings. The account remains active and is the oldest active account at the Bank and is believed to be the oldest active deposit account in the United States.[3]

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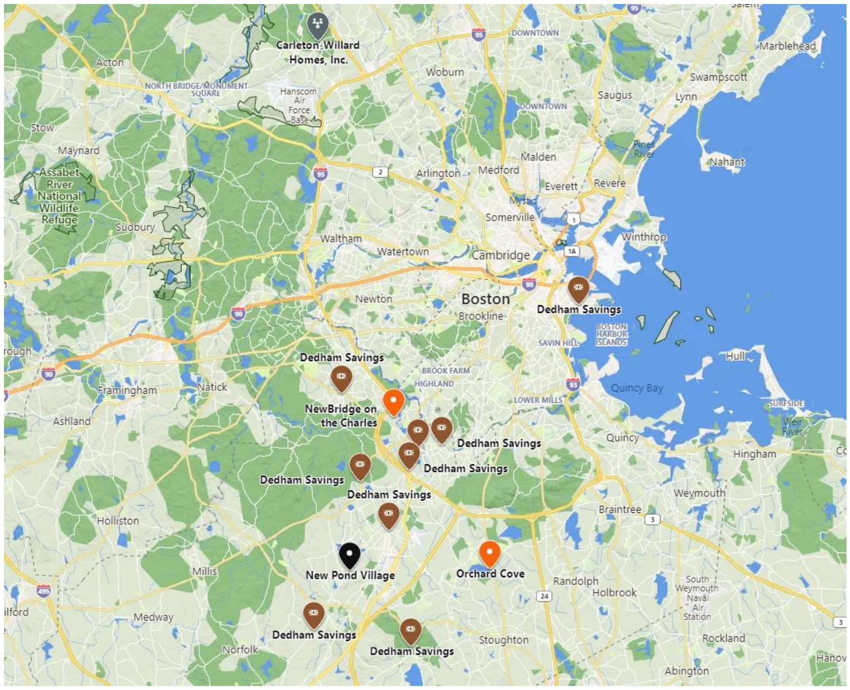
[3] "Office Treasures: No Horse Thievery Here." *Tufts Now*, 25 Jan. 2013, https://now.tufts.edu/articles/office-treasures-no-horse-thievery-here.

Dedham Savings is a full-service financial institution with a wide range of financial products and services delivered through multiple channels. The Bank's primary focus until recently was serving households with retail deposit products and home mortgages. This focus has expanded to include higher yielding commercial loans and low-cost commercial deposits. The Bank also provides investment products and services through a broker-dealer partnership with Sorrento-Pacific Financial, LLC and a 20% investment in Plimoth Investment Advisors, a private trust company that provides wealth management and trust services, employee benefit plans, and institution investment accounts to high-net-worth individuals, businesses, and non-profits.

Dedham Savings Locations

Dedham Savings currently operates nine full-service branches and four limited-service branches in retirement communities. From the Bank's founding in 1831 to 1950, the Bank operated one branch, always in the Dedham Square area. In 1950, the Bank opened its first branch in Westwood, MA. This was followed by a branch in East Dedham in 1969. The Bank moved in 1976 into its new headquarters which included a new branch location. The Bank retained a branch in its former headquarters in Dedham Square. That branch was subsequently relocated to 420 Washington Street in Dedham. The Bank opened branches in Walpole in 1987, Norwood in 1991, and Sharon in 2003. Dedham Savings opened its first branch in the City of Boston in 2016 in the South Boston neighborhood. In addition to the full-service branches, the Bank operates limited-service branches for the residents of four retirement and senior living communities in Bedford, Canton, Dedham, and Walpole. The Bank's commercial lending department, residential lending department, marketing department, BSA department, and accounting department operate out of an office building at 888 Washington Street in Dedham adjacent to the Bank's headquarters and branch at 55 Elm Street. Dedham Savings continues to look for branching opportunities in other communities within its CRA assessment area.



Financial Performance

Financial Summary (Dollars in Thousands)	12/31/2010	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015
Total Assets	$1,052,705	$1,085,354	$1,141,716	$1,228,186	$1,270,547	$1,329,494
Total Loans	$723,570	$743,655	$819,741	$900,084	$933,980	$988,489
Total Deposits	$903,539	$938,162	$977,255	$969,074	$1,001,527	$1,041,228
Net Income	$6,579	$5,773	$7,964	$9,221	$8,931	$7,765
Total Capital	$104,108	$106,440	$117,275	$128,596	$132,655	$138,589
Full-Time Equivalent Employees	180	190	195	195	200	201

	12/31/2016	12/31/2017	12/31/2018	12/31/2019	12/31/2020	12/31/2021
Total Assets	$1,388,096	$1,444,493	$1,559,833	$1,543,312	$1,736,025	$1,873,719
Total Loans	$1,040,047	$1,079,142	$1,199,514	$1,160,528	$1,329,202	$1,392,313
Total Deposits	$1,114,824	$1,225,976	$1,225,427	$1,255,975	$1,489,529	$1,620,582
Net Income	$7,915	$12,725	$10,909	$15,855	$17,954	$22,136
Total Capital	$146,674	$160,492	$166,486	$182,143	$196,392	$223,937
Full-Time Equivalent Employees	218	212	209	211	209	210

Source: FDIC Call Reports

A new senior management team came to the Bank starting in 2009. Since that time, the Bank has experienced strong grown in total assets, which increased from $1.053 billion as of 12/31/2010 to $1.874 billion as of 12/31/2021. A large component of this increase has been commercial loan growth. Total loans have increased by 92% since 12/31/2010. When senior management took over, the loan portfolio was skewed heavily towards residential loans. As of 12/31/2010, residential loans accounted for 70.99% of the total loan portfolio.

In 2019 the Bank's commercial loan portfolio exceeded the residential loan portfolio for the first time, a trend that continued in 2020 and into 2021, due in part to the origination of Payroll Protection Loans

(PPP) provided through the CARES Act that was passed in response to the Covid-19 pandemic. Loan quality has also improved from 3.99% of total loans deemed non-performing or delinquent as of 12/31/2010 to 0.24% as of 12/31/2021.

The Bank has experienced a strong increase in deposits since 2010. This is in part due to brokered deposits which the Bank used to fund portfolio loans over the past decade. The Bank also entered into the municipal deposit market by hiring a head of government and non-profit banking. Bank of America and other large national and regional institutions scaled back their presence in this market in the Greater Boston area leaving a void for municipal banking services in many cities and towns. Dedham Savings was able to capitalize on this market opportunity to bring in tens of millions of dollars in deposit balances from several local municipalities.

Net income has increased steadily, especially in the past five years. In 2017 the Bank recorded a $9.5 million pre-tax gain from the sale of its investment in Northeast Retirement Services, Inc. The Bank, along with many community bank investors in the northeast, had made nominal investments ($100,000 by Dedham Savings) when the company was founded. This realized gain led to a record year of earnings in 2017. The Bank surpassed this record in 2019 with net income of $15.9 million. This was driven mostly by unrealized gains in the Bank's marketable equity securities portfolio. Despite the pandemic in 2020 and 2021, the Bank had record years with net income of $18.0 million and $22.1 million respectively. This again was driven by the unrealized gains in the marketable equity securities portfolio, however net operating income rose sharply was also due to expanded net interest margin, fees earned on loan sales, and controlled operating expenses. The Bank also recognized nearly $2 million of fees from originating Payroll Protection Program loans in earnings during fiscal year 2021.

Dedham Savings is well capitalized. The Bank has total capital of $223.9 million as of 12/31/2021 for a tier one capitalization ratio of 11.34% and a total capital ratio of 16.59%.[4]

Introduction of Topic:

Overview:

The affordable housing crisis has had a large impact on markets throughout the United States. This has caused municipalities and state governments to take drastic measures to increase their stock of affordable housing. Municipalities have developed different programs and tactics to deal with this issue with most programs seeking to incent and encourage developers to include affordable housing components within their projects. Cambridge, MA for instance has a large pool of funds to help with affordable housing. They partner with developers to increase their stock of affordable housing. Cambridge is willing to provide funds early in the project (at acquisition) to help developers acquire properties, achieve approvals, and secure permits. The City of Boston is willing to sell sites owned by the Department of Neighborhood Development or other city agencies to developers at nominal prices (sometimes as low as $1,000) to encourage the development of affordable housing. These projects typically go through a bidding process with multiple developers enabling the city to choose the developer they prefer to develop the site.

In other, less competitive real estate markets, mostly outside the Greater Boston metro area, developers may be able to buy an option on a site to lock it up during the approval and permitting process. This is not as common as other methods of acquisition. There are several entities that provide pre-development funding to developers of affordable housing in Massachusetts. These entities include:

- Boston Community Capital
- The Life Initiative
- The Property & Casualty Initiative
- The Massachusetts Housing Investment Corporation
- Local Initiatives Support Corporation

[4] "Dedham Institution for Savings Call Report 12/31/2021." *FFIEC Central Data Repository's Public Data Distribution*, 7 Feb. 2022, https://cdr.ffiec.gov/public/ViewPDFFacsimile.aspx?subID=1639006&FIName=DEDHAM+INSTITUTION+FOR+SAVINGS&CertNum=23620&PDF508=false.

These entities include both private entities and government sponsored agencies, but each have different funding sources. The Life Initiative and The Property and Casualty Initiative were created by acts of the Massachusetts Legislature. The Life Initiative was funded by life insurance companies based in Massachusetts in 1998 with an initial investment of $100 million.[5] The Property & Casualty Initiative was funded by investments by property and casualty insurers based in Massachusetts. Both of these entities are for-profit organizations. The other three are non-profit entities. All have different funding requirements for predevelopment costs. The mission of these entities is to help developers get properties under their control that they can develop into affordable housing. Banks typically do not have an appetite to lend on these projects until the project is approved and permitted so these entities provide important bridge financing early in the development process.

Types of Affordable Housing Lending:

Banks can legally participate in all three phases of funding for affordable housing projects. The Bank will need policies and procedures in place for each phase, which are as follows:

- Construction Lending
- Permanent Financing
- Tax Credit Investments

The construction lending phase starts once the permits are received and the project is "shovel-ready." The borrower at this part of the project has selected the general contractor, signed the construction contract, and engaged other subcontractors and consultants (including engineering, environmental, and abatement) for the project. Prior to the start of the construction portion, the borrower should have in place a commitment for the permanent financing and an agreement with the tax credit investor.

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[5] "The Life Initiative Story." *The Life Initiative*, https://lifeinitiative.com/about/.

The permanent lender will set a long-term rate that is held through the construction period and beyond, typically for between 16-18 years, although this financing commences only after the project is fully stabilized and the tax credit equity is in the deal.

The tax credit investor is secured early in the deal. The investor and developer reach an agreement on when the tax credit equity will be invested in the project. Banks typically like the funds received from the state or municipality and the tax credit investment very early in the development process, however, tax credit investors do not want to put the majority of their equity as early in the project. This is negotiated and determined on a deal-to-deal basis. It should also be noted that the tax credit investor is typically the 99.99% member of the LLC. The investor gets to utilize the tax credits to reduce current period income tax liability, but also recognize operating income and losses from the projects during stabilization in computing taxable income.

Lending Process and Procedure:

Construction Loan Financing:

Overall Construction Lending Requirements:

The Bank will want to provide construction funding to borrowers with sponsorship that have experience with the process and regulations and have financial strength.

Due to the complexities associated with the approval and development of affordable housing, the Bank restrict its activities to sponsor(s) who are experienced in the process. The sponsor(s) should have experience in dealing with municipal leaders including all departments and agencies associated with the approval and permitting of affordable housing projects. The sponsor(s) will also need prior experience with the federal and state authorities associated with tax credits and have relationships with tax credit syndicators. The Bank will also want to lend to sponsor(s) with established relationships with experienced architects, engineers, environmental consultants, contractors, and subcontractors. Prior to the approval of any construction loan, the Bank needs to ensure the sponsor(s) has plans for all phases of the project in place including the permanent loan, tax credit investor, and management of the building following completion. Poor planning or execution with any of these aspects of the process could cause negative impacts to the project and to the borrower. The Bank should only finance sponsor(s) with a strong understanding of all regulations.

The sponsors of the loan should also be well capitalized and have financially sound. The Bank will secure a full personal guarantee from the sponsor(s) during the construction period as well as a pledge of assets from any corporate guarantor (if applicable). The Bank wants sponsors with financial strength in the event that there are complications with the construction process so that the developer can complete the project.

Construction Terms & Conditions:

Term: The term of the construction loan should range between 24 and 36 months depending on the size and complexity of the project. Jason Korb of Capstone Communities LLC, an affordable housing developer in the Greater Boston market notes that the average term is 30 months.[6] This allows for between 14-18 months to construct and between 6-12 months to occupy and stabilize the property. The tax credits will be converted once all units are occupied. It takes longer to lease-up buildings with affordable housing units as tenants need to meet strict income qualifications. The Bank should determine the construction loan term based on the estimated construction time frame, scope of the project (ground up vs. renovation of existing structure), size of the project, and estimated lease-up time. A longer construction period may not be as desirable to a developer as the interest rate on the permanent loan is locked during the construction period and the locked rate will be higher if the construction period is longer to protect the lender from interest rate risk.

[6] Connors, Martin F. “Interview of Jason Korb - Capstone Communities.” 25 Oct. 2021.

Interest Rate: Banks in the Boston market provide both floating and fixed interest rates for affordable housing development projects in the Boston market. The Bank typically floats construction loans at a spread over the Wall Street Journal Prime Rate (3.25% as of 2/1/2022). The spread will vary based on an internal assessment of the project's credit risk of the project. For a project with a strong sponsorship team and relatively low credit risk, the spread would be lower. Mr. Korb reports he sees rates in the upper 3% to low 4% range so the spread over WSJ Prime for the Bank would be between the 50 and 100-basis points range. The rate set should also reflect the current relationship the sponsorship team has with the Bank, therefore this would include other loan(s) and deposit relationship(s). The Bank may also justify a slightly lower rate due to the perceived value from CRA credits to be received from lending on an affordable housing project (assuming it is within the Bank's assessment area). The Bank will also consider competitive market pressure when determining the interest rate.

Payments: The construction period will require interest-only payments paid monthly. Depending on the strength of the sponsorship and the project, the Bank may require an interest reserve account with a pre-determined dollar amount to cover future interest-only payments. As with other construction loans at Dedham Savings, the Bank may require a minimum dollar amount be kept in the interest reserve account for the term of the project.

Guarantees: The sponsor(s) are expected to provide an unlimited personal guarantee and guarantee of completion for the construction period. If the sponsor has an entity that is not the borrower for the subject loan but holds substantial assets, the Bank may require a corporate guarantee from this entity as well. The corporate guarantee can include a pledge of assets or can be collateralized by the equity in other properties, cash, or other unencumbered liquid assets. Although an unlimited personal guarantee is expected and non-negotiable for construction loans, the corporate guarantee is likely to be negotiated by the sponsor(s).

Fees: As is typical with other construction loans provided by the Bank, the Bank will charge an origination fee for the loan. The Bank typically charges between 25 basis points and 100 basis points based on the relationship and after pricing considerations. The fee will likely be negotiated by the sponsor(s). The Bank will also charge a construction loan administration fee ($250) to cover the cost to upload data and set up of the loan on the Built construction administration system.

Prepayment Fees: There are no prepayment fees associated with construction loans.

Collateral: The Bank will take a first mortgage, security agreement, and assignment of leases, rents, approvals, permits, plans, contracts, and licenses on the subject property. Any additional financing from other sources will be fully subordinated to the Bank's debt during the construction period.

Appraisal: The Bank will have the property appraised prior to loan closing. The Bank will receive an "as is" appraisal of the property (which will likely include the value of the approved and permitted project) and an "as complete" value of the project. The appraisal will include the value of the real estate, but also the value of the tax credits. Since the property contains affordable housing, the value of the property based on the income from affordable unit rents may not support the debt. The Bank should solicit appraisal bids from appraisers on the Bank's approved vender list with experience in the valuing of affordable housing projects.

Environmental: The Bank will follow the existing environmental due diligence matrix that can be found in the appendix on page 48. The due diligence will be completed by a consultant on the Bank's approved vender list. Additional due diligence and testing may be required based on the initial findings of the consultant. The Bank will have its consultant review the reports completed by the borrower's environmental consultant.

Loan-to-Value Ratio: The Bank will advance a maximum of 80% of the "as is" value at closing. The maximum loan-to-value ratio based on the "as complete" value will also be 80%, however, the Bank will propose a 75% loan-to-value ratio in most scenarios.

Loan-to-Cost Ratio: The Bank's loan policy for construction loan caps the loan-to-cost ratio at 85%. This is calculated by the total loan amount divided by the total project costs (including but not limited to acquisition costs, hard construction costs, soft construction costs, development fees, legal fees, insurance, taxes, and interest expense). The Bank will strive to keep the loan-to-cost of the affordable development projects within the 85% loan-to-cost limit; however, the policy will allow for a loan-to-cost ratio of up to 95%. The acquisition cost of the properties is variable and is typically purchased with either funds from the municipality or at a discount making it difficult for projects to meet an 85% loan-to-cost ratio.

Construction Advances: The Bank will follow the existing construction loan requisition procedures. The Bank will engage a construction inspector to inspect and report on the project. The cost of the inspections is borne by the borrower. The inspector chosen will depend on the size and scope of the project. The loan data will be uploaded to the Built construction loan administration system. The Bank will hold back 5% of the total hard construction budget. This will only be advanced once the Bank is provided a copy of the certificate of occupancy issued by the municipality. The Bank will have the closing attorney provide a title endorsement showing there were no liens placed on the property since the last advance. The cost of the title endorsement is borne by the borrower. Prior to the first advance, the borrower will provide the Bank with a copy of the building permit, proof of builder’s risk insurance, copy of the builder’s license, and a copy of the certified plot plan. All advanced are deposited into a Dedham Savings operating account.

Loan Documents: For the loan closing, the Bank will engage an attorney on the Bank’s approved vender list, experienced in closing loans for affordable housing projects. MassHousing provides “boiler plate” loan documents, but these can be tailored to meet the Bank’s needs and requirements. Since the construction lender, permanent lender, and tax credit investor are all determined prior to the start of the project, there is a set of documents that can be signed at closing that will remain in effect for the entire project. These documents include an assignment of the documents to the permanent lender once the construction is complete.

Underwriting & Approvals: The loan will go through the standard underwriting process which is a collaborative effort between the credit department and the loan officer. The loan officer provides all pertinent underwriting information to the credit department and provide answers to questions regarding the loan from the borrower and guarantor(s). Following completion of the loan proposal summary by the credit department, the loan proposal summary is reviewed by the loan officer, senior credit officer, and senior lending officer. After final revisions, the loan proposal summary will be approved by all reviewing officers. A full list of required approvals can be found in the appendix on page 48.

Permanent Loan Financing

Overall Permanent Lending Requirements:

Like with any construction loan, the Bank prefers to lend on projects with strong sponsorship. Since the permanent financing is secured prior to the start of construction, the Bank's underwriting will factor the sponsors track record in successfully building and stabilizing affordable housing projects.

The sponsors will need to contract with a property management company to manage the property following the construction period. This company will be responsible for filling the units with tenants who meet the income requirements as determined by the municipality. This company will also be responsible for reporting on the financial performance of the property to the tax credit investor. Hiring the right company is important as there are negative financial implications if regulations for renting the units are not followed. The Bank will include a detailed description of the experience, competence, and reputation of the management company in the initial underwriting of the loan.

As with the construction loan, the Bank wants sponsors who have financial strength. In the event there is an issue that could adversely impact investment tax credits due to errors committed by the management company or sponsors, the tax credit investor has the right to recapture funds from the original sponsor. Although this risk is low if sponsors are experienced and the management company is reputable, the Bank wants assurance that the sponsors have the financial strength to fund any recapture.

Permanent Loan Terms & Conditions:

Term: The term for affordable housing loans average between 16-18 years, similar to the length of the term for the tax credits. The Bank's typical loan term of ten years is not long enough for these loans.

Interest Rate: The interest rate for the permanent loan is negotiated prior to the start of the construction period. The rate is to be locked at this time as the tax credit investor needs certainty on the interest rate to value its investment and is fixed for the entire term of the loan. The Bank will typically consider the swap rates and the Federal Home Loan Bank of Boston Classic Advance rates when determining the interest rate. Rates are typically set at 250 basis points over the corresponding swap rate and between 185 basis points and 225 basis points above the corresponding Federal Home Loan Bank of Boston classic advance rate. As of 2/3/2022, the 20-year swap rate with a 30-year amortization was 1.78%.[7] Therefore, the Bank would have priced the permanent loan at approximately 4.28%. The Federal Home Loan Bank of Boston 20-year classic advance rate on 2/3/2022 was 2.97%.[8] At a 185-basis point spread, the rate would have been set at 4.82%. Prior to issuing the rates, the lender often consults with the Bank's senior lender and the CFO. Due to the favorable CRA impact and competitive pressures, the Bank may consider a lower interest rate pricing spread to secure the loan. Jason Korb also states that several lending institutions provide a discount on the interest rate if the property is LEED certified. He notes that the Massachusetts Housing Partnership, an affordable lender in the Commonwealth, provides a 10-basis point discount. As with most loan terms, the rate will likely be negotiated with the borrower. These programs are more likely to be offered by state-sponsored lenders as this is an initiative of the state and does not benefit banks.

Payments: The permanent loan will require monthly payments of principal and interest. The borrower often seeks an amortization period that is as long as possible. The average amortization period is 30-years; however, the Bank's loan policy allows amortization periods of up to 35-years for a loan that meets certain criteria. The 35-year amortization period is becoming increasingly popular in the affordable housing market. The Bank strives to keep amortization periods at 30-years or less with the understanding that

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[7] PNC Bank. *PNC First Daily Market Update - 2/3/2022*, PNC Bank, Pittsburgh, PA, 2022.
[8] "Rates." *Federal Home Loan Bank Rates*, 3 Feb. 2022, https://www.fhlbboston.com/fhlbank-boston/rates#/long-term.

competitive pressure may increase the period beyond 30-years for certain loans but will in no instance extend beyond 35 years.

Guarantees: The sponsors (developers) and, in some cases, the corporate guarantors, will sign standard "carve-out" guarantees. The "carve-out" guarantee will include the following: resistance to lender possession following uncured defaults, voluntary borrower bankruptcy or uncured involuntary bankruptcy, fraud, responsibility for hazardous waste violations, uninsured casualty loss, failure to maintain adequate insurance coverage, misapplication of funds held in trust, commission of waste, misapplication of rents, misuse of rents to the lenders, municipalities, or tenants' detriment.

Fees: It is typical for permanent lenders to charge a one-point (1.00% of committed balance) fee. Given the length of the interest-rate lock, an upfront payment of this fee is expected by the sponsors. This is sometimes negotiated by the sponsors and the Bank might consider setting a lower fee for competitive reasons to secure the loan.

Prepayment Fees: Although it is unlikely for the loan to be prepaid due to the tax credit investor and the requirement for a predictable principal and interest payment, the Bank will require a prepayment fee. The Bank's typical prepayment fee is 5.00%, 4.00%, 3.00%, 2.00%, 1.00% in years one through five respectively based on the outstanding loan balance. Due to the length of the term, the Bank will likely lengthen the prepayment fee to seven or nine years. The Bank will strive to keep the prepayment penalty in a form that does not allow it to be waived for refinances by the Bank or other financial institutions and does not waive the fee for a sale of the property. It is understood that this will likely be one of the main terms negotiated between the Bank and the sponsors.

Collateral: The Bank will take a first mortgage, security agreement, and assignment of leases, rents, approvals, permits, plans, contracts, and licenses on the subject property. Any additional financing from other sources will need to be fully subordinated to the Bank's debt.

Appraisal: The Bank will have the property appraised prior to start of the construction period. The Bank will receive an "as complete" and an "as stabilized" value of the project. The appraisal will include the value of the real estate, but also the value of the tax credits. Since the property contains affordable housing, the value of the property based on the income from affordable unit rents will likely not support the debt. The Bank should solicit appraisal bids to appraisers on the Bank's approved vender list with experience in valuing affordable housing projects.

Environmental: The Bank will follow the existing environmental due diligence matrix that can be found in the appendix on page 48. The due diligence will be completed by a consultant on the Bank's approved vender list. Additional due diligence and testing may be required based on the initial findings of the consultant. If the borrower provides environmental reports that were completed by their consultant or by the construction loan lender, the Bank will engage its own consultant to review the report(s).

Loan-to-Value Ratio: The Bank's loan policy currently provides for a maximum loan-to-value ratio of 80% for multi-family housing. The standard loan-to-value ratio for affordable housing projects is 85%. The Bank will strive to keep the loan-to-value ratio as low as possible with the understanding that valuing these properties is complex and the loan-to-value ratio may be higher than other types of real estate in the Bank's portfolio.

Debt Service Coverage Ratio: The Bank should underwrite the affordable rents at 95% and should underwrite the market rents (if any in the buildings) at 90%. This is done to ensure that there is sufficient cash flow in the event of rent fluctuations in the market. The affordable rents are based on a percentage of annual median income and should be relatively predictable. Market rents can change due to various economic factors in the market. Affordable projects typically have a debt service coverage covenant set at 1.00x. The following is the Bank's standard language for debt service coverage covenants is as follows: "During the Life of the Loan, the property operating results must provide a minimum Debt Service Coverage Ratio of 1.00x. The Debt Service Coverage Ratio is defined as the actual net operating income (after actual property expenses) for the year divided by the annual debt service for the facility. The operating expenses shall include a minimum management fee of 5.00% of actual gross income and a minimum repair and maintenance expense of 5.00% of actual gross income. The Debt Service Coverage Ratio shall be tested as of the borrower's fiscal year end with the first test after the first full year of stabilization."

The Bank typically underwrites and analyzes the debt service coverage ratio based on a 25-year amortization schedule, as is required by the Bank's loan policy. Due to the cash-flow limitations of the affordable housing projects, the debt service coverage ratio shall be tested based on the actual annual debt service for the property.

Loan Documents: The loan will go through the standard underwriting process which is a collaborative effort between the credit department and the loan officer. The loan officer provides all pertinent underwriting information to the credit department and provide answers to questions regarding the loan from the borrower and guarantor(s). Following completion of the loan proposal summary by the credit department, the loan proposal summary is reviewed by the loan officer, senior credit officer, and senior lending officer. After final revisions, the loan proposal summary will be approved by all reviewing officers. A full list of required approvals can be found in the appendix on page 48.

Underwriting & Approvals: The loan will go through the standard underwriting process which includes collaboration between the credit department and the loan officer. The loan officer will provide all pertinent information to the credit department and will also seek the answers to any questions regarding the loan from the borrower and guarantor(s). Following completion of the loan proposal summary by the credit department, the loan proposal summary will be reviewed by the loan officer, senior credit officer, and senior lending officer. After necessary corrections, the loan will be approved by the reviewing officers. A full breakdown of the level of approvals can be found in the appendix on page 48.

Tax Credit Investments

Federal Low Income Tax Credits

Low-Income Housing Tax Credit (LIHTC) Program

The 1986 Tax Reform Act passed by the 99th United States Congress and signed by President Reagan established the Low-Income Housing Tax Credit. The Act was intended to provide incentives for the use of private equity in the development of affordable housing for low-income residents. The program has been the largest source of new affordable housing in the United States. To date, the program has resulted in the development of more than 2,900,000 tax credit financed units with estimated growth rate of 100,000 units annually. The tax credit program was originally set to expire after three years. The Omnibus Budget Reconciliation Act of 1993 made the program permanent. The program costs the federal government approximately $9.9 billion per year.[9] The program has been very successful and popular especially in strong financial cycles.

The financial crisis of 2007-2008 was a tough time for the program. Corporations experienced pre-tax losses due to the crisis and therefore did not have the need for tax credits. This stalled affordable housing development in the country and decreased interest in the program. The recovery that started in 2010 led to increased demand for tax credits. The Tax Cut and Jobs Act of 2017, which reduced the corporate tax rate from 35% to 21% also reduced the tax liability for corporations.[10] This was expected to decrease in demand for the program, however additional funds were added to the program in 2018 and the program remains strong due to strong corporate earnings across industries in recent years.

The tax credits are issued to state and territorial governments. Housing development agencies in states and territories award the credits to private developers of affordable rental housing. Developers typically sell

[9] "What Is the Low-Income Housing Tax Credit and How Does It Work?" *Tax Policy Center*, 2020, https://www.taxpolicycenter.org/briefing-book/what-low-income-housing-tax-credit-and-how-does-it-work.

[10] "H.R.1 - 115th Congress (2017-2018): Tax Cut and Jobs Act ." *Congess.Gov*, United States Congress, 20 Dec. 2017, https://www.congress.gov/bill/115th-congress/house-bill/1.

the tax credits to private investors to provide funding for the project. The tax credit investor typically becomes the 99.99% member (or an amount negotiated by the developer and investor) of the LLC. Typically, projects are required to meet the eligibility requirements for a minimum of 30 years following completion.

In Massachusetts, developers apply to the Department of Housing and Community Development for the tax credits. Massachusetts allows syndicators to act as intermediaries between developers and investors as they have the ability to aggregate investors to create large pools of equity funds for projects. Investors receive a stream of tax credits which can be claimed for up to ten years (depending on the project type). There are two types of tax credits, a 4% credit and a 9% credit. The 4% credit is associated with a 30% present value credit that covers new construction that uses additional subsidies. Many projects that are eligible for the 4% credit receive most of their funding through tax-exempt bonds or other government subsidies. The 9% credit supports new construction projects without additional federal subsidies. The 9% credit is associated with a 70% present value credit. The statute originally stated that the IRS could periodically reset the credit percentages to maintain the present value of the credits based on 30% (4% credit) or 70% (9% credit) of the qualified basis of the project. In 2008, Congress set minimum floors at 4% and 9%.[11]

Tax credit awards are limited to $500,000 annually ($5,000,000 in total) for each new assisted living project and $1,000,000 ($10,000,000 in total) for other projects. The Department of Housing and Community Development can award a maximum of $1,300,000 ($13,000,000 in total) in credit for larger scale projects that provide major impacts to the neighborhood in which the project is located. MassHousing also has the ability to grant exceptions above the stated amounts in certain circumstances. For projects to be eligible, at least 20% of the units must be affordable units for residents at or below 50% of the area median income or at least 40% of the units must be affordable for residents at or below 60% of area median

[11] Keightley, Mark P. “An Introduction to the Low-Income Housing Tax Credit.” *Congressional Research Service,* United States Congress, 26 Jan. 2021, https://sgp.fas.org/crs/misc/RS22389.pdf.

income. Eligible projects can support the acquisition and renovation of existing properties or the construction of new structures. There must be a minimum of eight affordable units within the project.[12]

State Low Income Housing Tax Credit

Massachusetts low-income affordable housing tax credits mirror the federal program but have a maximum benefit of five years. The limit for these credits is $500,000 annually or $2,500,000 in total for assisted living facilities, $1,000,000 annually or $5,000,000 in total for other projects, and $1,300,000 annually, or $6,500,000 for major impact projects. The Commonwealth also has a historic tax credit called the Massachusetts Historic Rehabilitation Tax Credit. This was established in 2004 to include the rehabilitation, reuse, and revitalization of historic properties.[13] The historic tax credit has is a one-year credit and the investor has no ownership in the property. Once the credit is used, there are no other benefits for the investor. State tax credits can also be certificated and sold to a purchaser. This differs from the federal low-income tax credits which must be allocated to an investor.

Tax Credit Investment Policy

Dedham Savings does not currently include tax credit investments in its Investment Policy. To purchase tax credits, these investments will need to be added into the policy and the policy will need to be approved by the Board of Directors. The Bank's current investment policy lists seven investment objectives that the portfolio, in its entirety, must fulfill to contribute to the Bank's overall profitability. These objectives include interest rate risk management, liquidity, credit, tax planning, pledging, community support, and regulatory compliance. Tax credit investing would impact the bank's liquidity position, credit, tax planning, and community support.

Liquidity: The tax credit investment would not be easily liquidated. The funds would be tied up for the length of the tax credit, typically ten years.

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[12] "Low Income Housing Tax Credit (LIHTC)." *Mass.Gov*, Commonwealth of Massachusetts - Housing and Community Development, https://www.mass.gov/service-details/low-income-housing-tax-credit-lihtc#:~:text=LIHTC%20Funding%20Limits,large%20scale%20neighborhood%20impact%20projects.

[13] "Historic Rehabilitation Tax Credit." *Mass.Gov*, Commonwealth of Massachusetts - Housing and Community Development, https://www.mass.gov/service-details/historic-rehabilitation-tax-credit.

Credit: There is a credit risk with tax credit investments. The project must be thoroughly underwritten, and all risks analyzed. The major credit risk is with the management of the property to ensure that all regulations regarding, mainly the eligibility of the affordable tenants and the reporting requirements, are followed. The investor would also want to ensure that the sponsors have the financial wherewithal in the event of an issue. Tax credits are guaranteed by the sponsors. The investors have the ability to recapture funds if the property is not maintained or is not being managed correctly.

Tax Planning: Tax credits are used to offset the investor's tax liability. The value of the credit comes from the timely reduction of the investor's tax liability. There is only a benefit if the investor has income sufficient to generate a tax liability to be offset by the credit. Since the investor is also the majority owner of the LLC, the investor is also able to recognize the operating losses from the property which could further reduce taxable income and tax liability.

Community Support: The Bank as the investor would receive CRA credit for its investment in the project if it is located within the Bank's CRA assessment area. The Bank may also be eligible for CRA credit for projects in areas adjacent to the Bank's CRA assessment area. This provides an additional nonfinancial benefit to the Bank. By investing in low-income housing tax credits on projects located in the Bank's market area, the Bank helps meet its goal to invest in and serve the local community.

When investing in tax credits, the Bank should consider using a tax credit syndicator. Syndicators provide underwriting and ongoing administration required for both federal and state tax credits. This lessens the credit risk associated with these investments. Syndicators charge a fee as part of the origination of the credits. Jason Korb provided the names of the following syndication companies:

- **Stratford Capital Group** is a Peabody, MA based firm that completes LIHTC syndications, equity financing for affordable housing developments, asset and fund management, special investment opportunities, and development. The company's principals have 22 years of experience in syndicating tax credits and have raised over $1.8 billion in tax credit transactions.

- **Red Stone Equity Partners** is a national firm with an office in Boston. The company was founded in 2007 and has raised over $6 billion in tax credit equity for more than 45,000 units nationwide.

These firms are currently not on the Bank's approved broker/ dealer list in the Investment Policy dated April 29, 2021. They would need to be added to the list and approved by the Executive Committee prior to the Bank acquiring tax credits through these syndicators.

Financial Impact:

Construction Loan Financial Impact

Construction loans provide four sources of income for the Bank: interest income, origination fees, loan administration fees, and inspection fees. Interest rates will be set based on the market. The Bank will price construction loans at the Wall Street Journal (WSJ) Prime Rate plus a spread. Construction loan spreads for affordable housing projects typically range from 50 basis points to 100 basis points. The WSJ Prime Rate is a variable or floating rate and therefore, if the WSJ Prime rate increases, so to will construction loan interest income for the loan. The Bank charges an origination fee on the loan, typically 50 basis points of the total loan amount. Dedham Savings charges a construction loan administration fee of $250 to cover the cost of uploading loan data to the Bank's construction loan administration platform. Dedham Savings uses the Bank's in-house construction inspector to inspect projects that are less complex, and with dollar amounts less than $3 million. The Bank charges $75 per inspection. As can be seen on the income statement on page 29, inspection fees are omitted for loan amounts over $2,500,000 as an outside inspector would be hired for those projects with the expense borne by borrower.

Loan origination expenses were determined in consultation with the Bank's CFO / COO, Mark Ingalls, CPA and SVP & Treasurer, Amanda Justice, CPA. The Bank's current average cost of funds was 30 basis points (as of 2/1/2022). The Bank completed a loan cost study in 2019 to determine the estimated average cost to originate various types of loans. The memo, dated December 19, 2019, shows that the cost to originate a construction loan was $3,560. Due to inflation and an increase in wages, in consultation with

Mr. Ingalls and Ms. Justice, it was determined that $5,055 was a reasonable current cost to originate the loans. Loan maintenance cost were estimated at 75 basis points of the outstanding loan balance. The following shows a sample model income statement for an affordable housing construction loan:

Construction Loan Analysis					
Total Loan Income	$1,000,000	$2,500,000	$5,000,000	$7,500,000	$10,000,000
Income					
Interest Income	$51,667	$129,167	$258,333	$387,500	$516,667
Origination Fee	$5,000	$12,500	$25,000	$37,500	$50,000
Construction Loan Admin Fee	$250	$250	$250	$250	$250
Construction Inspection Fee	$2,250	$2,250	$0	$0	$0
Total Income	$59,167	$144,167	$283,583	$425,250	$566,917
Expenses					
Cost of Funds	$3,875	$9,688	$19,375	$29,063	$38,750
Cost to Originate	$5,055	$5,055	$5,055	$5,055	$5,055
Loan Maintenance Cost	$11,625	$29,063	$58,125	$87,188	$116,250
Total Expenses	$20,555	$43,806	$82,555	$121,306	$160,055
Net Income (Before Taxes)	$38,612	$100,361	$201,028	$303,944	$406,862
Taxes (Federal Corporate at 21%)	$8,109	$21,076	$42,216	$63,828	$85,441
Taxes (State at 8%)	$3,089	$8,029	$16,082	$24,316	$32,549
Total Taxes	$11,197	$29,105	$58,298	$88,144	$117,990
Net Income After Taxes	**$27,415**	**$71,256**	**$142,730**	**$215,800**	**$288,872**
Yield After Taxes	**46.33%**	**49.43%**	**50.33%**	**50.75%**	**50.95%**

The model provides an analysis of loans sized at $1,000,000, $2,500,000, $5,000,000, $7,500,000 and $10,000,000. The model assumed an interest rate of 4.00% for the 30-month term of the loan. To determine interest income, the model assumed that the loan commitment was advanced evenly over the 30-month term. The cost of funds and loan maintenance cost were also determined based on the outstanding monthly loan balance during the loan term. Taxes were estimated based on the current federal corporate income tax rate of 21% and the current Commonwealth of Massachusetts corporate income tax rate of 8%. The after-tax yield averaged 50% for the life of the loans. The following shows an analysis based on the first 12 months of the loan term:

Construction Loan Analysis					
Year 1 Loan Income	$1,000,000	$2,500,000	$5,000,000	$7,500,000	$10,000,000
Income					
Interest Income	$8,667	$21,667	$43,333	$65,000	$86,667
Origination Fee	$2,000	$5,000	$10,000	$15,000	$20,000
Construction Loan Admin Fee	$250	$250	$250	$250	$250
Construction Inspection Fee	$900	$900	$0	$0	$0
Total Income	$11,817	$27,817	$53,583	$80,250	$106,917
Expenses					
Cost of Funds	$650	$1,625	$3,250	$4,875	$6,500
Cost to Originate	$5,055	$5,055	$5,055	$5,055	$5,055
Loan Maintenance Cost	$1,950	$4,875	$9,750	$14,625	$19,500
Total Expenses	$7,655	$11,555	$18,055	$24,555	$31,055
Net Income (Before Taxes)	$4,162	$16,262	$35,528	$55,695	$75,862
Taxes (Federal Corporate at 21%)	$874	$3,415	$7,461	$11,696	$15,931
Taxes (State at 8%)	$333	$1,301	$2,842	$4,456	$6,069
Total Taxes	$1,207	$4,716	$10,303	$16,152	$22,000
Net Income After Taxes	**$2,955**	**$11,546**	**$25,225**	**$39,543**	**$53,862**
Yield After Taxes	**25.01%**	**41.51%**	**47.08%**	**49.28%**	**50.38%**

The origination fee is amortized over the term of the loan and therefore, although it is collected in year one of the loan term, the income reflects 40% of the origination fee income. The cost to originate the loan is all incurred in year one of the loan term and therefore, the full amount is reflected in the income statement. The yield after taxes for the loan amounts displayed above averages 43%. The outstanding loan amount for the $1,000,000 is low and therefore only provides modest net income and a yield of 25%.

The following model assumes the Bank maintains a consistent portfolio of $20,000,000 in construction loans for affordable housing projects for a period of 12 months. The following model assumes an average interest rate of 4.00% across the portfolio.

Construction Loan Analysis $20,000,000 Portfolio	
Income	
Interest Income	$800,000
Origination Fee	$33,300
Construction Loan Admin Fee	$750
Construction Inspection Fee	$4,500
Total Income	$838,550
Expenses	
Cost of Funds	$60,000
Cost to Originate	$15,165
Loan Maintenance Cost	$150,000
Credit Loss	$100,000
Total Expenses	$325,165
Net Income (Before Taxes)	$513,385
Taxes (Federal Corporate at 21%)	$107,811
Taxes (State at 8%)	$41,071
Total Taxes	$148,882
Net Income After Taxes	$364,503
Yield After Taxes	**43.47%**

The model also assumes that 33.33% of the portfolio turns over on an annual basis and that three loans are originated to replace the paid off loans to maintain the $20,000,000 portfolio. Origination fees reflect 50 basis points of the commitment of the new loans and the construction loan administration fee assumes three new loans at $250 each. Construction loan inspection fees assume that five projects are inspected monthly by the Bank at a fee of $75 per inspection. The cost of funds assumes 30 basis points of the portfolio. The cost to originate loans reflects three loans at $5,055 per loan. Loan maintenance costs are estimated at 75 basis points based on the total outstanding portfolio. Credit loss is estimated at 50 basis points. This was determined based on discussions with Mr. Ingalls. Overall, a $20,000,000 portfolio would provide net income after taxes of $364,503 for a yield after taxes of 43.47%. Rate will be floating for these loans. It is also assumed that the cost of funds will likely increase proportionally to the increase in the WSJ Prime Rate.

Permanent Financing Financial Impact

Permanent Loans provide two sources of income to the Bank. The Bank typically prices permanent commercial loans by analyzing the corresponding swap rates and the corresponding Federal Home Loan

Bank of Boston Classic Advance rates to the length of the rate fix and the amortization period. Since the rate of these loans is fixed at the time of the origination of the construction loan, there is significant interest rate risk with these loans, especially in a rising rate environment.

For this analysis, an interest rate of 4.50% was used. Typical pricing is 250 basis points over the corresponding swap rate and between 185 basis points and 225 basis points above the corresponding Federal Home Loan Bank of Boston classic advance rate. As of 2/3/2022, the 20-year swap rate with a 30-year amortization was 1.78%. Therefore, the Bank would have priced the permanent loan at approximately 4.28%. The Federal Home Loan Bank of Boston 20-year classic advance rate on 2/2/2022 was 2.97%. With a 185-basis point spread, that rate would have been 4.82%. For this analysis, the model assumes an interest rate of 4.50% and also assumes the loans are amortized over a period of 30 years. The following shows a breakdown of the income for the first five years following the funding of the loans based on loans sized at $1,000,000, $2,500,000, $5,000,000, $7,500,000, and $10,000,000.

Permanent Loan Analysis 5-Year Income Statement	$1,000,000	$2,500,000	$5,000,000	$7,500,000	$10,000,000
Income					
Interest Income	$215,590	$538,976	$1,077,952	$1,616,928	$2,155,904
Origination Fee	$10,000	$25,000	$50,000	$75,000	$100,000
Total Income	$225,590	$563,976	$1,127,952	$1,691,928	$2,255,904
Expenses					
Cost of Funds	$15,000	$37,500	$75,000	$112,500	$150,000
Cost to Originate	$5,055	$5,055	$5,055	$5,055	$5,055
Loan Maintenance Costs	$12,500	$31,250	$62,500	$93,750	$125,000
Total Expenses	$32,555	$73,805	$142,555	$211,305	$280,055
Net Income (Before Taxes)	$193,035	$490,171	$985,397	$1,480,623	$1,975,849
Taxes (Federal Corporate at 21%)	$40,537	$102,936	$206,933	$310,931	$414,928
Taxes (State at 8%)	$15,443	$39,214	$78,832	$118,450	$158,068
Total Taxes	$55,980	$142,150	$285,765	$429,381	$572,996
Net Income After Taxes	**$137,055**	**$348,021**	**$699,632**	**$1,051,242**	**$1,402,852**
Yield After Taxes	**60.75%**	**61.71%**	**62.03%**	**62.13%**	**62.19%**

As with construction loans, the cost of funds is estimated at 30 basis points. Loan maintenance costs are estimated at 25 basis points. Assuming the funding cost remains consistent during the loan term, the loans should provide an average after tax yield of 61.76%. The profit for the first five years has been stressed based on interest rates increasing by 100 basis points and 200 basis points:

		$1,000,000	$2,500,000	$5,000,000	$7,500,000	$10,000,000
30 bps Funding Costs	Net Profit After Taxes	$137,055	$348,021	$699,632	$1,051,242	$1,402,852
	Yield After Taxes	60.75%	61.71%	62.03%	62.13%	62.19%
130 bps Funding Costs	Net Profit After Taxes	$101,555	$259,271	$522,132	$784,992	$1,047,852
	Yield After Taxes	45.02%	45.97%	46.29%	46.40%	46.45%
230 bps Funding Cost	Net Profit After Taxes	$66,055	$170,521	$344,632	$518,742	$962,852
	Yield After Taxes	29.28%	30.24%	30.55%	30.66%	30.71%

The net yield after taxes decreases by approximately 15% for every 100-basis point increase in interest rates. The following shows the income by loan amount for the first year of the loan term:

Permanent Loan Analysis 1-Year Income Statement	$1,000,000	$2,500,000	$5,000,000	$7,500,000	$10,000,000
Income					
Interest Income	$44,670	$111,675	$223,350	$335,025	$446,700
Origination Fee	$10,000	$25,000	$50,000	$75,000	$100,000
Total Income	$54,670	$136,675	$273,350	$410,025	$546,700
Expenses					
Cost of Funds	$3,000	$7,500	$15,000	$22,500	$30,000
Cost to Originate	$5,055	$5,055	$5,055	$5,055	$5,055
Loan Maintenance Costs	$2,500	$6,250	$12,500	$18,750	$25,000
Total Expenses	$10,555	$18,805	$32,555	$46,305	$60,055
Net Income (Before Taxes)	$44,115	$117,870	$240,795	$363,720	$486,645
Taxes (Federal Corporate at 21%)	$9,264	$24,753	$50,567	$76,381	$102,195
Taxes (State at 8%)	$3,529	$9,430	$19,264	$29,098	$38,932
Total Taxes	$12,793	$34,182	$69,831	$105,479	$141,127
Net Income After Taxes	**$31,322**	**$83,688**	**$170,964**	**$258,241**	**$345,518**
Yield After Taxes	**57.29%**	**61.23%**	**62.54%**	**62.98%**	**63.20%**

It should be noted that the loan will be originated at the same time as the construction loan but will not be funded until the construction period has ended, typically 30 months into the loan term. Year one displayed in the model above shows the first 12 months of principal and interest payments. The average after tax yield is 61.45% for the loans in the model.

The following model assumes the Bank maintains a constant portfolio of $20,000,000 in permanent affordable housing loans.

Permanent Loan - Yr. 5 $20,000,000 Portfolio	
Income	
Interest Income	$4,500,000
Origination Fee	$166,500
Total Income	$4,666,500
Expenses	
Cost of Funds	$300,000
Cost to Originate	$75,825
Loan Maintenance Cost	$750,000
Credit Loss	$500,000
Total Expenses	$1,625,825
Net Income (Before Taxes)	$3,040,675
Taxes (Federal Corporate at 21%)	$638,542
Taxes (State at 8%)	$243,254
Total Taxes	$881,796
Net Income After Taxes	**$2,158,879**

Yield After Taxes	**46.26%**

The model assumes an interest rate of 4.50% for all loans. It also assumes that 33% of the portfolio is paid off each year and replaced with three loans each year during the five-year period. Credit loss is estimated at 50 basis points. Based on the five-year model, the loans should provide net income after taxes of $2,158,879. This represents a debt yield after taxes of 46.26%. If the cost of funding increases by 100 basis points, the net profit after taxes is reduced to $1,448,879 or 31.05%. If the cost of funding increases by 200 basis points, the net income after taxes increases to $738,879 or 15.83%.

The following model shows a one-year income statement for a portfolio of $20,000,000. This model assumes that 33% of the portfolio is paid off and is replaced with three new loans to maintain the $20,000,000 portfolio. As with the five-year projection, an average interest rate of 4.50% is assumed. Overall, the one-year projection shows net income after taxes of $431,776 and a yield after taxes of 46.26%. If the cost of funding increases by 100 basis points, the net income after taxes will decrease to $289,776 or 31.05% and if the cost of funding increases by 200 basis points, the net income after taxes will decrease to $147,776 or 15.83%.

Permanent Loan - Yr. 1 $20,000,000 Portfolio	
Income	
Interest Income	$900,000
Origination Fee	$33,300
Total Income	$933,300
Expenses	
Cost of Funds	$260,000
Cost to Originate	$15,165
Loan Maintenance Cost	$150,000
Credit Loss	$100,000
Total Expenses	$525,165
Net Income (Before Taxes)	$408,135
Taxes (Federal Corporate at 21%)	$85,708.35
Taxes (State at 8%)	$32,650.80
Total Taxes	$118,359.15
Net Income After Taxes	**$289,775.85**

Yield After Taxes	**31.05%**

Tax Credit Investment Financial Impact

Tax credit investments reduce the Bank's income tax liability on a dollar-for-dollar basis. There are two types of credits, the 4% credit and the 9% credit. The value of the tax credits for the 4% credit are equal to a net present value of 30% of the qualified basis of the project. The value of the 9% credit is equal to the net present value of 70% of the project. It should be noted that the state income tax credit mirrors the federal tax credit program, but the life of the credit is only for five years.

The qualified basis of a project includes all eligible project costs such as hard construction costs, architectural & engineering costs, allowable developer fees, contract profit, and construction loan interest. Non-eligible costs include the cost of the land, interest payments on the permanent loan, insurance, property taxes, and also any funds provided by the state or municipality that are financed with tax-exempt bonds. To determine the annual tax credit benefit, the qualified basis is multiplied by the either 4% or 9%, depending on the type of the credit. The following is a sample calculation of the qualified basis and associated tax credits on a project with a total development cost of $1,000,000. The applicable fraction is the percentage of the qualified affordable housing units within the property.

	4% Credit	9% Credit
Total Development Costs	$1,000,000	$1,000,000
Ineligible Costs	$100,000	$100,000
Qualified Basis	$900,000	$900,000
Applicable Fraction	100%	100%
Annual Tax Credit	**$36,000**	**$81,000**
Total Credit	$360,000	$810,000

The 4% credit does not have a maximum dollar amount credit. MassHousing has limited the maximum credit per project is $5,000,000 for new assisted living projects and $10,000,000 for other projects. The Department of Housing and Community Development upper limit is $13,000,000 for certain projects that create a major neighborhood impact. The following shows the credit based on a qualified basis of $1,000,000, $2,500,000, $5,000,000, $7,500,000, and $10,000,000 based on the 4% credit and the 9% credit on both an annual basis and total basis.

Qualified Basis	4% Annual Credit	Total Credit	9% Annual Credit	Total Credit
$1,000,000	$40,000	$400,000	$90,000	$900,000
$2,500,000	$100,000	$1,000,000	$225,000	$2,250,000
$5,000,000	$200,000	$2,000,000	$450,000	$4,500,000
$7,500,000	$300,000	$3,000,000	$675,000	$6,750,000
$10,000,000	$400,000	$4,000,000	$900,000	$9,000,000

Cost of Tax Credits:

According to the Congressional Research Service, the cost of tax credits is currently between the mid-$0.80s to low-$0.90s per $1.00 of tax credit.[14] The lower the cost per dollar of credit, the larger the return to the investors. The cost of the credits is market driven and is typically determined by the syndicator who will evaluate the strength of the project for the Bank and provide guidance as to the pricing. The following shows the investment based on thee cost per $1.00 of credit for projects that have a qualified basis of $1,000,000, $2,500,000, $5,000,000, $7,500,000, and $10,000,000 for the 4% tax credit.

[14] Keightley, Mark P. p. 6

Investment Costs of Credits					
Qualified Basis	$1,000,000	$2,500,000	$5,000,000	$7,500,000	$10,000,000
Total Credits	$400,000	$1,000,000	$2,000,000	$3,000,000	$4,000,000
$0.800	$320,000	$800,000	$1,600,000	$2,400,000	$3,200,000
$0.825	$330,000	$825,000	$1,650,000	$2,475,000	$3,300,000
$0.850	$340,000	$850,000	$1,700,000	$2,550,000	$3,400,000
$0.875	$350,000	$875,000	$1,750,000	$2,625,000	$3,500,000
$0.900	$360,000	$900,000	$1,800,000	$2,700,000	$3,600,000
$0.925	$370,000	$925,000	$1,850,000	$2,775,000	$3,700,000
$0.950	$380,000	$950,000	$1,900,000	$2,850,000	$3,800,000

The following shows the investment based on thee cost per $1.00 of credit for projects that have a qualified basis of $1,000,000, $2,500,000, $5,000,000, $7,500,000, and $10,000,000 for the 9% tax credit.

Investment Costs of Credits					
Qualified Basis	$1,000,000	$2,500,000	$5,000,000	$7,500,000	$10,000,000
Total Credits	$900,000	$2,250,000	$4,500,000	$6,750,000	$9,000,000
$0.800	$720,000	$1,800,000	$3,600,000	$5,400,000	$7,200,000
$0.825	$742,500	$1,856,250	$3,712,500	$5,568,750	$7,425,000
$0.850	$765,000	$1,912,500	$3,825,000	$5,737,500	$7,650,000
$0.875	$787,500	$1,968,750	$3,937,500	$5,906,250	$7,875,000
$0.900	$810,000	$2,025,000	$4,050,000	$6,075,000	$8,100,000
$0.925	$832,500	$2,081,250	$4,162,500	$6,243,750	$8,325,000
$0.950	$855,000	$2,137,500	$4,275,000	$6,412,500	$8,550,000

Income Statement Impact:

The Bank will use a syndicator to facilitate the investment in the tax credits. The cost of the syndication is between 5% and 15% of the total tax credit value.[15] As is required by GAAP, investment fees are amortized over the period of the investment. For the purpose of this analysis, a 10% syndication fee is estimated. The following shows a breakdown of the annual net credit for the 4% tax credit:

Qualified Basis	Total Tax Credit	Annual Tax Credit	Total Syndication Fee	Annual Syndication Fee	Net Annual Tax Credit
$1,000,000	$400,000	$40,000	$40,000	$4,000	$36,000
$2,500,000	$1,000,000	$100,000	$100,000	$10,000	$90,000
$5,000,000	$2,000,000	$200,000	$200,000	$20,000	$180,000
$7,500,000	$3,000,000	$300,000	$300,000	$30,000	$270,000
$10,000,000	$4,000,000	$400,000	$400,000	$40,000	$360,000

[15] Behr, Ariel. *The Low-Income Housing Tax Credit: Aligning the Interest of Private Investors and Affordable Housing Developers*. Columbia University, 5 Apr. 2005, https://www8.gsb.columbia.edu/sites/socialenterprise/files/ArielBehr.pdf.

As can be seen, the 4% tax credit provides a marginal benefit on an annual basis with a $1,000,000 of $36,000 to a benefit of $360,000 based on a $10,000,000 qualified basis.

The following shows a breakdown of the annual net credit for the 9% tax credit. As can be seen the benefit from the 9% tax credit is $81,000 based on a qualified basis of $1,000,000 up to $810,000 for a qualified basis of $10,000,000.

Qualified Basis	Total Tax Credit	Annual Tax Credit	Total Syndication Fee	Annual Syndication Fee	Net Annual Tax Credit
$1,000,000	$900,000	$90,000	$90,000	$9,000	$81,000
$2,500,000	$2,250,000	$225,000	$225,000	$22,500	$202,500
$5,000,000	$4,500,000	$450,000	$450,000	$45,000	$405,000
$7,500,000	$6,750,000	$675,000	$675,000	$67,500	$607,500
$10,000,000	$9,000,000	$900,000	$900,000	$90,000	$810,000

The following shows the Bank's income before taxes and tax liability for the past five years:

Dedham Institution for Savings (Dollars In Thousands)					
Income Statement	2017	2018	2019	2020	2021
Income Before Income Taxes	$19,050	$13,955	$20,317	$23,219	$28,913
Income Taxes	$6,325	$3,046	$4,462	$5,265	$6,777
Net Income	$12,725	$10,909	$15,855	$17,954	$22,136
Effective Tax Rate	33.20%	21.83%	21.96%	22.68%	23.44%

The Bank had tax liability in each of the last five years. Based on the Bank's tax liability, the full value of the 4% and 9% in all qualified basis amounts could have been used to reduce the Bank's tax liability.

Rate of Return:

The internal rate of return was based on the net annual credit less the annual amortization of the syndication fee. The IRR was the same for all of the total credit amounts based on both the 4% credit and the 9% credit. The following shows the rate of return by dollar amount paid for $1.00 of tax credit (this assumes a 10% syndication fee):

Dollar Paid for $1.00 in Tax Credit	IRR
$0.800	2.20%
$0.825	1.61%
$0.850	1.05%
$0.875	0.52%
$0.900	0.00%
$0.925	-0.50%
$0.950	-0.97%

To breakeven on the investment, the Bank needs to pay no more than $0.90 per $1.00 of credit. If the Bank pays more than $0.90 per $1.00 of credit, the investment will result in a loss. The Bank could likely receive higher yields from the equities market as the S&P 500 has had a 10-year cumulative return of 279%, Dow Jones Industrial Average has had a 10-year annualized rate of return of 10.68%, and NASDAQ Composite has had a 10-year return of 14.39%. The current yield on a ten-year U.S. Treasury Bond is 1.78%. The Bank could also likely receive a higher rate of return based on net interest income which is 3.26%.

As the 99.99% member of the LLC and investor in the tax credit, the Bank would also be able to recognize the net loss or profit from the affordable rental property. As with many rental properties, affordable housing properties typically operate at a net loss due to interest expense and depreciation, especially in the early years of stabilization. Operating losses further reduce the Bank's annual income tax liability.

Non-Financial Impact:

There are non-financial impacts of lending on affordable housing projects and investing in low-income housing tax credits which include: Community Reinvestment Act (CRA) benefits, favorable reputational impacts and brand recognition within the community, cross selling opportunities, and staff trained to underwrite, originate, and service affordable housing deals and tax credit investments.

Community Reinvestment Act Impacts

The Community Reinvestment Act of 1977 was passed to encourage insured depository institutions to meet the lending and credit needs of the communities they serve including lending and credit needs in low- and moderate-income areas. According to the FDIC, the Act encourages CRA lending to be done in a manner consistent with safe and sound banking practices and does not encourage or mandate the extension of unsafe or unsound credit.[16] The CRA uses a four-tiered rating system to analyze a depository institutions CRA performance and compliance. These ratings are made available to the public. The depository institution's rating can impact the ability to open new branches and engage in mergers and acquisition transactions.

The depository institution's size determines the level of evaluation required. Dedham Savings, at $1.8 billion in total assets, is examined as a large bank (institutions over $1.16 billion in assets). A large bank evaluation includes a lending test, investment test, and service test.

The lending test assesses the number and amount of loans made in the depository institution's CRA assessment area. Dedham Savings' lending assessment area map can be found in the appendix on page 49. It also includes an assessment of the geographic distributions of loans to low to moderate income areas to ensure the Bank is not redlining. The lending test also analyzes the depository institutions record of lending to borrowers of different income levels, and business of different sizes. Many of the affordable housing loans would satisfy the community development component. The community development component determines whether the Bank is making loans for affordable housing, providing community services targeted at low- and moderate-income households that promote economic development, and activities that revitalize or stabilize low- and moderate-income census tracts. The test will look at the number and amount of community development loans and the complexity and innovativeness of the institution's program.

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[16] United States, Division of Depositor and Consumer Protection. *Federal Deposit Insurance Corporation*, FDIC, 2020. https://www.fdic.gov/regulations/resources/director/presentations/cra.pdf.

Finally, the lending test analyzes the institution's willingness to implement innovative or flexible lending practices to meet the needs of the low- and moderate-income households and within low-and moderate-income census tracts while maintaining safe and sound banking practices.

The investment test for large banks includes assessing the amount invested in qualified community development investments. Banks can invest in equity equivalent investments, low-income housing tax credits, new markets tax credits, mortgage-backed securities collateralized by loans located in low-and moderate-income census tracts, community development real estate investment trusts, community development venture capital, and / or small business investment companies.[17] Banks receive credit for innovative and complex investments and their responsiveness to the investment needs of the community.

The final test is the service test. This test looks at the geographic distribution of bank branches, the opening and closing of branches, especially those in low- and moderate-income census tracts, the availability and effectiveness of delivering banking services within these census tracts and to low- and moderate-income households, the banking services made available at each branch location, and the extent, innovativeness, and responsiveness of community development services.

Banks are rated on each category. The five ratings are Outstanding, High Satisfactory, Satisfactory, Needs Improvement, and Substantial Noncompliance. Dedham Savings' last Community Reinvestment Act Performance Evaluation was completed by the Massachusetts Division of Banks and the Federal Deposit Insurance Corporation as of August 6, 2018.[18] Dedham Savings received an overall rating of Satisfactory. The Bank received a rating of Satisfactory for the lending test, High Satisfactory for the investment test, and High Satisfactory for the service test. The report notes that the lending test receives the highest weighting in the overall rating, thus justifying the overall Satisfactory rating.

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[17] Federal Reserve Bank of San Francisco. "Investment Vehicles." *Federal Reserve Bank of San Francisco*, Federal Reserve Bank of San Francisco, 18 Nov. 2012, https://www.frbsf.org/community-development/initiatives/community-development-finance/investment-vehicles/.

[18] "Dedham Institution for Savings." *Public Disclosure Community Reinvestment Act*, Massachusetts Division of Banks, 6 Aug. 2018, https://www.mass.gov/doc/dedham-institute-for-savings-cra-public-evaluation/download.

For the lending test, the report noted that Dedham Savings had poor penetration and geographic distribution of home mortgage and small business loans throughout the assessment area. It also noted that the Bank makes limited use of innovative and flexible lending practices throughout the assessment area. The development and approval of an affording housing lending policy will add innovative products and flexibility in lending practices that support affordable housing within the Bank's assessment area. This may help the Bank achieve a higher CRA rating in a future exam.

The investment test generated mostly positive commentary on the Bank's CRA investment activities. The report noted that the Bank occasionally uses innovative or complex investments to support community development initiatives. Investments in low-income housing tax credits would likely be viewed as innovative and complex by regulators in future examinations.

Reputation and Brand Recognition:

Lending on affording housing projects is typically viewed as positive for a bank's reputation and brand recognition. Many communities, especially in eastern Massachusetts, are in significant need for affordable housing with many communities still below the 10% affordable housing threshold. Bank involvement in these projects is viewed as helping to increase the affordable housing stock and provide affordable places to live for low-to-moderate income households, while also not forcing them out of the areas near where they work. Affordable projects are often promoted by municipalities' housing authorities in the media. The lending institution is also usually included in this publicity and the tax credit investor is often included too. This serves to increase the brand recognition of the Bank and, in most cases, should provide a positive view of the institution in the eyes of the public and public servants. The trust of the developer with the lender will also encourage other developers in the affordable housing development space to seek the Bank's assistance with future projects. This will help the Bank to develop a strong pipeline of viable projects. The Bank will also have a sign at the site during the construction period publicizing the Bank's involvement in the project. Additional marketing could be coordinated with the municipality and developer, through the Bank's marketing department.

There are reputational and credit risks associated with affordable housing projects. The major risk is that the lender has to foreclose on the project. In many cases during the construction period, the affordable restriction does not carry over if there is a foreclosure. Any foreclosure can pose a risk to the Bank's reputation, however, a foreclosure on an affordable housing project could greatly increase reputational risk. Affordable housing projects are also typically controversial within the community. Nearby property owners could become concerned that affordable housing units may devalue their properties. This could lead to the Bank losing deposit, loan, and other banking relationships or receiving bad press from those opposing the project.

Cross-Selling

All loans made by Dedham Savings require the borrower to open and maintain an operating deposit account during the life of the loan. This will also be required for affordable housing construction loans and affordable permanent loans. There would also be an opportunity to receive security deposit accounts for the permanent loans. The Bank could also cross sell cash management and credit card services to the developers and managers of the properties.

Training for Affordable Housing Loans and Tax Credits

Underwriting, origination, and servicing of affordable housing loans is complex. The underwriting of the loans requires a strong understanding of the unique funding sources, terms, and conditions which differ from those in traditional construction and permanent loans. Training would include reading the proposed policy and related regulations. The Credit Department may need to delegate an analyst as a specialist to gain a full understanding of affordable housing loans to assist with the property underwriting of these credits. The accounting department will need to understand the necessary accounting and tax treatment of tax credits.

Conclusion:

As the demand for affordable housing in the Boston market continues to increase, the Bank can help increased demand for construction and permanent loans for affordable housing projects. This will provide more opportunities to the Bank to invest in low-income housing tax credits created by these projects. The Bank previously had no policy regarding these loans or one for investing in tax credits. Lending for affordable lending projects is complex with terms and conditions that differ from the Bank's traditional commercial real estate lending policy. To reduce lending policy exceptions, it is important for the Bank to create the policy language that addresses affordable housing construction and permanent loans.

On the surface, affordable housing construction loans appear to be the most appealing of the two options in this lending segment. The differences with existing construction lending are limited, the term is short, and the Bank receives a full guarantee of the principal. The interest rate on these loans is typically a bit lower, however, the Bank can justify a lower rate due to the CRA credit and with the community development benefit created by the loan. The interest rate will float and therefore, the Bank will be able to minimize interest rate risk. The Bank will also receive fee income from the origination of the loan.

The permanent loan is originated at the same time as the construction loan, but is not funded until the construction period is completed. The term on a permanent loan is significantly longer at between 16-18 years than the Bank's typical term of ten years. The interest rate is also fixed through the entire term of the loan and set before the loan is funded. This creates an interest rate risk if rates increase significantly. In a rising interest rate environment, permanent loans would be less appealing to the Bank due to the term of the loan. However, if the borrower is using a state issued tax credit, the permanent loan may be more appealing as the loan can conform to a shorter ten-year term.

Tax credit investments could also be an attractive CRA investment for the Bank going forward. The tax credits would reduce the Bank's current tax liability and could also reduce table income due to the net operating loss from property depreciation and interest expense. Due to strong demand for and compliance risk with tax credits, it would be important for the Bank to engage a syndicator to facilitate the transaction. To make the investment return worthwhile, it would also be important to buy the credits a price that provides a sufficient investment return. Tax credits are only beneficial if the Bank anticipates net income for the term of the tax credit benefit. The Bank also receives CRA credit for these investments which may support accepting a low or modest return.

Overall, Dedham Savings is a community Bank with a strong mission of supporting our local community. Involvement in the development of affordable housing projects is another way that Dedham Savings can invest in our community, provide a public benefit, and generate a profit for the Bank. Having defined and approved policy language allowing the financing of these types of projects and investing in tax credits will provide benefits to the Bank. The benefit of involvement in these projects is not just financial, it also can increase the reputation and brand awareness that provides long term advantages to the Bank.

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Appendix:

Environmental Due Diligence Matrix:

Environmental Due Diligence Matrix				
RE Loan Type		**< $500M**	**$500M < $2MM**	**≥ $2MM**
New Loans	Low-Risk	Database Review	ASTM Transaction Screen	ASTM Transaction Screen/ Phase 1
	High-Risk Loans	ASTM Transaction Screen	ASTM Transaction Screen/ Phase I	Phase I
Renewals	Low-Risk	Database Review	Database Review	Database Review/ASTM Transaction Screen
	High-Risk Loans	Database Review	Database Review	Database Review/ASTM Transaction Screen
Construction	Residential Construction, Land Development or Multi-Family	Database Review	Database Review	ASTM Transaction Screen

Loan Approval Matrix:

Title / Position	Approval Limit
Board of Directors	Legal Lending Limit (20% of Capital)
Executive Committee	Administrative Lending Limit of $25,000,000
President & CEO / EVP Senior Lending Officer	Joint Approval of $2,000,000
President & CEO	$1,000,000
Executive Vice President - Senior Lending Officer	$1,000,000
Senior Vice Presidents -Team Leaders	Joint Approval of $750,000
Senior Vice President - Team Leader	Individually at $500,000
Senior Vice Presidents	$250,000
Vice Presidents	$250,000
Assistant Vice Presidents	$100,000
Commercial Loan Officers	$25,000

CRA Assessment Map