



KESTREL
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Second Party Opinion

EXECUTIVE SUMMARY

ISSUER

Tennessee Housing Development Agency

OPINION ON

Residential Finance Program Bonds Issue 2022-3 (Non-AMT) (Social Bonds)

SOCIAL STANDARD AND CATEGORIES



- Affordable Housing
- Access to Essential Services
- Socioeconomic Advancement and Empowerment

TARGET POPULATION(S)

Very low-, low-, and moderate-income households

KEYWORDS

Appalachia; Tennessee; equitable access to affordable housing; racial homeownership gaps

EVALUATION DATE

September 16, 2022

SUMMARY

Kestrel Verifiers is of the opinion that the Residential Finance Program Bonds Issue 2022-3 (Non-AMT) (Social Bonds) ("Offered Bonds") are impactful and conform with the four core components of the Social Bond Principles 2021 as follows:

▪ Use of Proceeds

The Tennessee Housing Development Agency ("THDA") intends to issue the Offered Bonds to finance mortgage loans for single-family residential housing for very low-, low-, and moderate-income persons and pay costs of issuance. Eligibility requirements for loan recipients include income limits to help ensure the programs serve low- and moderate-income households and the borrower must be a first-time homebuyer, a qualified veteran, or purchasing a "target area residence," as defined herein. The Offered Bonds align with three eligible Social Project categories under the Social Bond Principles.

▪ Process for Project Evaluation and Selection

All Program Loans are reviewed and verified through THDA's multi-step process to confirm that borrower eligibility requirements are met. Borrowers must meet strict criteria outlined by THDA's Program Loan Procedures and the US Internal Revenue Code. The Single Family Operations Team, the Internal Audit Unit, and the Board of Directors ensure that Program Loans serve target populations and expand access to homeownership.

▪ Management of Proceeds

Proceeds of the Offered Bonds will be used to acquire new first-lien Program Loans (including Program Loans pooled into Program Securities), pay capitalized interest (if any), make a deposit to the Bond Reserve Fund (if required) and pay the costs of issuance. Lendable proceeds will be deposited in a separately managed Bond subaccount of THDA's Loan Fund. Proceeds may temporarily be held in investments that comply with THDA's guidelines and the State of Tennessee's Constitution and statutes.

▪ Reporting

After all proceeds from the Bond subaccount of the Loan Fund have been originated, THDA intends to voluntarily prepare an update report on the allocation of proceeds and on the target populations that were served. THDA will post this updated report to the Municipal Securities Rulemaking Board ("MSRB") through the Electronic Municipal Market Access ("EMMA") system.

- **Impact and Alignment with United Nations Sustainable Development Goals**

THDA's Program Loans advance UN Sustainable Development Goals 1: *No Poverty*, 8: *Decent Work and Economic Growth*, 10: *Reduced Inequalities*, and 11: *Sustainable Cities and Communities* by increasing access to financial services that enable vulnerable populations to own property.



Second Party Opinion

Issuer:	Tennessee Housing Development Agency
Issue Description:	Residential Finance Program Bonds Issue 2022-3 (Non-AMT) (Social Bonds)
Project:	Single Family Homeownership
Social Standard:	Social Bond Principles
Social Categories:	Affordable Housing Access to Essential Services Socioeconomic Advancement and Empowerment
Target Populations:	Very low-, low-, and moderate-income households
Keywords:	Appalachia; Tennessee; equitable access to affordable housing; racial homeownership gaps
Par:	\$160,000,000
Evaluation Date:	September 16, 2022

SOCIAL BONDS DESIGNATION

Kestrel Verifiers, an Approved Verifier accredited by the Climate Bonds Initiative, conducted an independent external review of the Residential Finance Program Bonds Issue 2022-3 (Non-AMT) (Social Bonds) (“Offered Bonds”) to evaluate conformance with the Social Bond Principles (June 2021) established by the International Capital Market Association. Our team for this engagement included analysts with backgrounds in social science.

This Second Party Opinion reflects our review of the uses and allocation of proceeds, oversight, and conformance of the Offered Bonds with the Social Bond Principles. In our opinion, the Offered Bonds are impactful, conform with the four core components of the Social Bond Principles, and qualify for Social Bonds designation.

ABOUT THE ISSUER

The Tennessee Housing Development Agency (“THDA”) is an instrumentality and political subdivision of the State of Tennessee and serves as the State’s housing finance agency. THDA was established in 1973 to raise funds for new housing units that serve low- and moderate-income persons and families in every county of the state. By financing and assisting with single-family and multi-family affordable housing, home repair initiatives, and grant programs, THDA has a significant impact. THDA’s activity contributed \$1.9 billion to Tennessee’s economy in 2021.¹

THDA prioritizes increasing accessibility and affordability of single- and multi-family housing for minority and high-risk individuals and families. THDA has identified racial and ethnic disparities in home mortgage originations in Tennessee and has committed to taking action to address Black-white racial inequities and

¹ “Investments and Impacts Report 2021,” Tennessee Housing Development Agency, March 2022, <https://thda.org/research-reports/investments-impacts>.

impediments to homeownership and wealth accumulation.² For example, in 2019, 65% of THDA loans in the City of Memphis went to Black and/or African American homebuyers. THDA cites its Homebuyer Education classes and resources on financial literacy as especially critical to closing racial gaps in homeownership in Tennessee. THDA certifies Homebuyer Education counselors and approves curriculums for Home Buyer Education classes, which provide comprehensive education about interest rates, borrowers' rights, the role of lenders, and more. The courses can help prepare borrowers for the homebuying process and ongoing responsibilities of homeownership. Additionally, in coordination with the Mortgage Bankers Association, THDA co-leads CONVERGENCE Memphis—an initiative intended to increase Black and African American homeownership in Memphis, Tennessee.

In addition to promoting equitable and affordable housing across the state, THDA has established several grantmaking programs which are managed internally or in partnership with local nonprofit and government organizations. Annually, THDA administers approximately \$10 million to \$12 million in grants through programs which include, but are not limited to:

- **Appraisal Gap Pilot Program:** One of THDA's most innovative grant programs that helps stabilize property values by providing nonprofit housing agencies with grants up to \$20,000 to help cover the gap between the cost to build and the appraised residential value.
- **Reentry Housing Program:** In partnership with the Tennessee Department of Correction, THDA offers a payment program to support transitional housing support for ex-offenders.
- **Tennessee Housing Trust Fund (THTF):** A program that earmarks proceeds from THDA's mortgage loan programs to provide grants to rehabilitate and rebuild housing for very low- and low-income, elderly, and special needs households. The following activities are financed by the Fund:
 - **Competitive Grants and Challenge Grants:** Initiatives that provide seed funding and grants up to \$500,000 to nonprofits and municipal agencies to address critical housing needs.
 - **Support to Habitat for Humanity:** Annual grants to local affiliates for home construction projects.
 - **Rebuild and Recover:** Grants provided to local governments to help homeowners recover and rebuild after natural disasters.
 - **Emergency Solutions Grants:** Grants for organizations that provide housing assistance to those who are homeless or are at-risk of homelessness.

Across Tennessee, many urban and rural communities struggle with distressed neighborhoods and low rates of homeownership, and have a substantial number of single-family homes that require rehabilitation, repair, or replacement.³ THDA offers the following programs to finance and facilitate home repairs:

- **Emergency Repair Program:** THDA provides grants to various organizations that repair and replace essential infrastructure for low-income, elderly or disabled homeowners.
- **Low Income Home Energy Assistance Program (LIHEAP):** Approved regional agencies receive federal funds to assist qualified households with utility costs, bill payment assistance, energy crisis assistance, and energy-related home repairs. The maximum income allowed for qualified households is 150% of the federal poverty guidelines.
- **Tennessee Renovation Loan Program:** In coordination with local nonprofits, THDA helps homeowners with financing for repairs and modifications to their homes.
- **Weatherization Assistance Program (WAP):** Approved regional agencies receive federal funds to improve energy efficiency in qualified households. The maximum income allowed for qualified households is 200% of federal poverty guidelines.

² "Tennessee Housing Development Agency Issue Brief: Racial and Ethnic Disparities in Home Mortgage Originations in Tennessee (Part Two of a Six Part Series Examining Issues of Fair Housing in Tennessee)," Tennessee Housing Development Agency, January 2021, https://thda.org/pdf/RP_MortgageDisparitiesBrief.pdf.

³ Hulya Arik and the Tennessee Housing Development Agency, "2019 Tennessee Housing Market at a Glance," https://thda.org/pdf/Housing-Market-at-a-Glance-2019_Final.pdf.

ALIGNMENT TO SOCIAL STANDARDS⁴

Use of Proceeds

Proceeds of the Offered Bonds will be used to (i) acquire new first-lien Program Loans (including Program Loans pooled into Program Securities); (ii) pay capitalized interest, if any; (iii) make a deposit to the Bond Reserve Fund, if required; and (iv) pay the costs of issuance. Revenues generated through Program Loans support downpayment assistance (“DPA”) and THDA’s grant programs, thus indirectly financing many of the programs that are unique to THDA. The Offered Bonds align with three Social Project categories identified in the Social Bond Principles: *Affordable Housing*, *Access to Essential Services*, and *Socioeconomic Advancement and Empowerment*.

Social Standard
 <p>Eligible Project Categories:</p> <ul style="list-style-type: none">▪ Access to Essential Services – Education▪ Affordable Housing▪ Socioeconomic Advancement and Empowerment

The Need for Equitable, Affordable Homeownership in Tennessee

Homeownership is a vehicle for building wealth, financial stability, and economic opportunity that can transcend generations. Instead of paying rent to a third party, homeowners build equity. Owning a home results in more predictable housing costs over time and can increase financial stability. Homeownership can also reduce disruptions associated with rent instability and changes to a rental property that are out of a family’s control. Housing wealth (equity) is also a key component of retirement resources for many families because lower housing costs after the mortgage is paid off makes it possible to subsist on the lower income associated with retirement.

Equitable access to affordable housing is especially critical in Tennessee, where racial homeownership gaps endure and many Appalachian communities are economically distressed.⁵ By financing Program Loans for low- and moderate-income first-time homebuyers and addressing homeownership gaps in the state, THDA is confronting these disparities and supporting housing stability for historically underserved populations. Certain Program Loans will directly benefit communities in the Appalachian Region of Tennessee, a region that is mostly rural and has generally experienced slower growth than the rest of the state.⁶ In Kestrel’s view, the potential benefit to Appalachia from the Program Loans is one of the multiple social benefits of the Offered Bonds. Additionally, by financing Program Loans specifically for low- and moderate-income first-time homebuyers, THDA is ensuring that vulnerable populations have equal opportunity to invest in housing. In this way, the Offered Bonds promote equitable and affordable access to financial services and are aligned with the just transition to a low-carbon economy, which Kestrel defines as the equitable inclusion and accommodation of all individuals in the ongoing, gradual shift to a more decarbonized economy.

While THDA has several homebuying programs, all of the loans will be Great Choice Program Loans. The Great Choice Program Loans (“Great Choice”) are 30-year, fixed-interest-rate home mortgage loans offered, made or originated by private banks and lenders for first-time homebuyers, veterans, and homebuyers in targeted areas of residence. New Program Loans allocated to the Offered Bonds will be Great Choice Loans. Homeownership for the Brave Program, a sub-program of Great Choice, offers the most reduced interest rates on home loans and is targeted toward qualifying veterans and active-duty military. Program Loans are made on a continuing basis through THDA-approved originating agents, or lenders and will be first-lien, thirty-year, fixed-rate mortgages.⁷ Homebuyers work directly with lenders to receive loans through THDA’s single-family programs. Improving access to financing for eligible borrowers increases access to an essential service and promotes a more equitable society. Without THDA’s programs, certain individuals in Tennessee may not be able to achieve homeownership.

⁴ Social Bonds are any type of bond instrument where the proceeds will be exclusively applied to finance or refinance eligible Social Projects which are aligned with the four core components of ICMA’s Social Bond Principles.

⁵ “Forecasting State and National Trends in Household Formation and Homeownership: Tennessee,” Urban Institute, accessed August 24, 2022, <https://www.urban.org/policy-centers/housing-finance-policy-center/projects/forecasting-state-and-national-trends-household-formation-and-homeownership/tennessee>.

⁶ “State of Tennessee Four-Year Appalachian Development Plan,” TN Department of Economic & Community Development, 2019, https://www.tn.gov/content/dam/tn/ecdc/documents/arc/TN_ARC_4-Year_Plan.pdf.

⁷ Lenders are required to meet US Federal Housing Administration eligibility.

Additionally, many families and individuals in Tennessee are unable to purchase a home due to the major expense of a downpayment and closing costs. To alleviate this barrier, THDA offers downpayment assistance (“DPA”) and the majority of loans in THDA’s Great Choice Program are coupled with DPA (Table 1). However, the Offered Bonds will not directly finance DPA. DPA associated with the Program Loans is typically financed through revenue generated through Program Loans, and is expected to be similar to previously financed groups of loans (Table 2).

Table 1. Downpayment Assistance (DPA) provided in conjunction with THDA’s previously issued bonds for single-family homeownership (1/1/2020-8/15/2022)

Total DPA Provided (\$)	\$50,403,340
Total DPA Provided (#)	5,839
Percent of Borrowers Receiving DPA	98.7%
Average DPA Provided per Borrower	\$8,632
Average DPA Provided (% of Purchase Price)	4.7%

Table 2. Income bands of loans in THDA’s single-family programs (1/1/2020-8/15/2022)

AMI Band	2020		2021		2022	
	\$ of Loans (\$MM)	% of Proceeds	\$ of Loans (\$MM)	% of Proceeds	\$ of Loans (\$MM)	% of Proceeds
<50%	\$33	7%	\$20	6%	\$16	8%
50% - 59%	\$48	10%	\$35	11%	\$32	13%
60% - 69%	\$67	14%	\$40	13%	\$44	16%
70% - 79%	\$70	14%	\$47	15%	\$54	18%
80% - 89%	\$78	16%	\$48	15%	\$50	16%
90% - 99%	\$72	15%	\$53	17%	\$48	14%
100%+	\$126	26%	\$73	23%	\$51	14%
Total	\$494	100%	\$317	100%	\$295	100%

THDA supports fair lending and is committed to helping Tennesseans achieve and sustain homeownership. THDA requires all participating third-party lenders to comply with nondiscrimination and fair housing laws, as documented in THDA’s Program Guidelines. THDA directly serves Target Populations in Target Areas, as defined below:

Target Population

Program Loans financed through the Offered Bonds will help low- and moderate-income individuals and families in Tennessee achieve homeownership. The maximum eligible income is between 100% and 115% of the Area Median Income (“AMI”) for borrowers purchasing homes outside of Targeted Areas (as defined below) and between 120% and 140% for borrowers purchasing homes in Targeted Areas. The distribution of income bands for the borrowers of the Program Loans is expected to be similar to previously financed groups of loans in the Great Choice Loan Program (Table 2). The Program Loans are also expected to benefit minority populations who have been historically under-represented as homeowners, borrowers with disabilities, borrowers who care for individuals with disabilities, as well as households in lower income areas and areas of chronic economic distress.

Targeted Area

A portion of Program Loans will be made to households in Targeted Areas. THDA defines a Targeted Area as (i) a census tract in which 70% of families have incomes less than 80% of the statewide median family income or (ii) an area of chronic economic distress. The designation of an area of chronic economic distress may change over time and is based on several factors including housing demand, demand for financing, area income levels, and/or unemployment rates. An entire county or a smaller area within a county may be designated as a Targeted Area.

Process for Project Evaluation and Selection

THDA's mission, in part, is to increase access to affordable homeownership in Tennessee, and this is reflected in the bond-financed activities. Proceeds will provide mortgages to households that otherwise may not have access to affordable homeownership. All of the loans will be Great Choice Program Loans. To be eligible for these loans, borrowers must meet strict criteria outlined by THDA's Program Loan Procedures and the Internal Revenue Code.

Requirements include:

- Borrower must be a first-time homebuyer, a qualified veteran, or purchase in a Targeted Area (defined above)
- Borrowers must meet income limits (very low-, low-, or moderate-income)
- Purchased home must not exceed purchase price limits.

Home prices in Target Areas are defined based on local demographics. As of August 2021, THDA income limits will range from \$68,600 to \$118,020, depending on household size and geographic location.

The process of originating Program Loans is well-defined. Initially, individuals apply and work with THDA-approved Mortgage Lenders across the state. Mortgage Lenders use parameters established by THDA to confirm the borrower's eligibility for the Program Loans. Next, THDA reviews the eligibility documentation prior to acquiring the mortgage. THDA reviews every Program Loan mortgage it purchases. Through these steps, multiple eligibility criteria are confirmed, including employment verification, income levels, and other factors.

Several entities review the loans and confirm alignment with eligibility criteria. THDA's Single Family Operations Team reviews lenders' applications to ensure compliance. THDA's governing Board of Directors confirms that Program Loans meet the required criteria. The Board includes the Comptroller of the Treasury, the Secretary of State, the State Treasurer, Commissioner of the Department of Finance and Administration, staff to the Governor, and members representing the real estate, homebuilding and financial services industries, local public housing authorities, local governments and certain nonprofits. THDA's Internal Audit Unit periodically reviews single-family Program Loans and prepares reports for the Board of Directors.

Management of Proceeds

Proceeds from the Offered Bonds will finance new single-family Program Loans (including Program Loans pooled into Program Securities), make a deposit to the Bond Reserve Fund (if required), and pay the costs of issuance. Lendable proceeds are expected to be deposited into a separately managed subaccount of the Loan Fund and THDA's Director of Finance is responsible for tracking and managing disbursements. It is expected that bond proceeds will be expended within a few months of issuance.

Purchased Program Loans and Program Securities become part of THDA's investment portfolio. Prior to allocation to Program Loans and Program Securities, proceeds may be temporarily held in investments that comply with THDA's guidelines and the Constitution and statutes of the State of Tennessee. Allowable investments include but are not limited to: direct obligations of the US Treasury and US Agencies, obligations guaranteed by the US federal government, and direct and general obligations of the State of Tennessee.

Reporting

THDA intends to voluntarily provide an updated Program Loan AMI distribution table once the proceeds of the Offered Bonds have been expended. The form of reporting (the "Use of Proceeds Report") is shown in Appendix K of the Official Statement. THDA will submit this report to the Municipal Securities Rulemaking

Board (“MSRB”) once all proceeds in the Loan Fund have been spent. This report will be posted on the Electronic Municipal Market Access (“EMMA”) system operated by the MSRB.

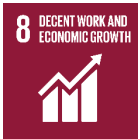
THDA reports on its activities in several formats, including regular reports and presentations on bond-financed Program Loans to the Tennessee General Assembly. Additionally, THDA publishes annual Program Reports that contain borrower demographics and analyses of the economic impact of the Single Family Loan programs. The Single Family Loan Program Reports are made available on THDA’s website: thda.org/research-reports/thda-program-data/single-family-reports.

IMPACT AND ALIGNMENT WITH UN SDGs

THDA’s mission and the Program Loans support the sustainable and equitable vision of the UN SDGs. The Offered Bonds directly align with UN SDGs 1, 8, 10, and 11 by supporting homebuyers who may not otherwise have access to financing. A comprehensive list of targets and background on UN SDGs is available on the United Nations website: www.un.org/sustainabledevelopment



No Poverty (Target 1.4)
Possible Indicators
 • Number of loans serving low- and moderate-income groups
 • Number of people provided with access to financial services



Decent Work and Economic Growth (Target 8.10)
Possible Indicators
 • Number of people provided with access to financial services (mortgage, downpayment assistance, homebuyer education, or other)



Reduced Inequalities (Target 10.2)
Possible Indicators
 • Number of mortgages in Targeted Areas
 • Percent of mortgages for disadvantaged groups and BIPOC borrowers
 • Percent of loan originations in distressed Appalachian regions



Sustainable Cities and Communities (Target 11.1)
Possible Indicators
 • Number of first-time homeownership opportunities
 • Number of households provided downpayment and closing cost assistance in addition to mortgage loan access

CONCLUSION

Based on our independent external review, the Offered Bonds conform, in all material respects, with the Social Bond Principles (2021) and are in complete alignment with three eligible Social Project categories: *Access to Essential Services*, *Affordable Housing*, and *Socioeconomic Advancement and Empowerment*. In issuing these Bonds, THDA demonstrates continued leadership and a commitment to improving affordability and access to single-family housing for minority and at-risk populations. With its original grant programs, commendable community outreach and Great Choice Loan Program, Kestrel views THDA as exemplary in terms of positive social impact in the US affordable housing sector.

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ABOUT KESTREL VERIFIERS



For over 20 years Kestrel has been a trusted consultant in sustainable finance. Kestrel Verifiers, a division of Kestrel 360, Inc. is a Climate Bonds Initiative Approved Verifier qualified to verify transactions in all asset classes worldwide. Kestrel is a US-based certified Women's Business Enterprise. For more information, visit kestrelverifiers.com.

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DISCLAIMER

This Opinion aims to explain how and why the discussed financing meets the ICMA Social Bond Principles based on the information that was provided by THDA or made publicly available by THDA and relied upon by Kestrel only during the time of this engagement (August - September 2022), and only for purposes of providing this Opinion.

We have relied on information obtained from sources believed to be reliable, and assumed the information to be accurate and complete. However, Kestrel Verifiers can make no warranty, express or implied, nor can we guarantee the accuracy, comprehensive nature, merchantability, or fitness for a particular purpose of the information we were provided or obtained.

By providing this Opinion, Kestrel Verifiers is neither addressing nor certifying the credit risk, liquidity risk, market value risk or price volatility of the projects financed by the Social Bonds. It was beyond Kestrel Verifiers' scope of work to review for regulatory compliance, and no surveys or site visits were conducted by us. Furthermore, we are not responsible for surveillance, monitoring, or implementation of the project, or use of proceeds.

The Opinion delivered by Kestrel Verifiers is for informational purposes only, is current as of the date of issuance, and does not address financial performance of the Social Bonds or the effectiveness of allocation of its proceeds. This Opinion does not make any assessment of the creditworthiness of THDA, nor its ability to pay principal and interest when due. This Opinion does not address the suitability of a Bond as an investment, and contains no offer, solicitation, endorsement of the Bonds nor any recommendation to buy, sell or hold the Bonds. Kestrel Verifiers accepts no liability for direct, indirect, special, punitive, consequential or any other damages (including lost profits), for any consequences when third parties use this Opinion either to make investment decisions or to undertake any other business transactions.

This Opinion may not be altered without the written consent of Kestrel Verifiers. Kestrel Verifiers reserves the right to revoke or withdraw this Opinion at any time. Kestrel Verifiers certifies that there is no affiliation, involvement, financial or non-financial interest in THDA or the projects discussed. We are 100% independent. Language in the offering disclosure supersedes any language included in this Second Party Opinion.

Use of the United Nations Sustainable Development Goal (SDG) logo and icons does not imply United Nations endorsement of the products, services, or bond-financed activities. The logo and icons are not being used for promotion or financial gain. Rather, use of the logo and icons is primarily illustrative, to communicate SDG-related activities.

Appendix A.

UN SDG TARGET DEFINITIONS

Target 1.4

By 2030, ensure that all men and women, in particular the poor and the vulnerable, have equal rights to economic resources, as well as access to basic services, ownership and control over land and other forms of property, inheritance, natural resources, appropriate new technology and financial services, including microfinance

Target 8.10

Strengthen the capacity of domestic financial institutions to encourage and expand access to banking, insurance and financial services for all

Target 10.2

By 2030, empower and promote the social, economic and political inclusion of all, irrespective of age, sex, disability, race, ethnicity, origin, religion or economic or other status

Target 11.1

By 2030, ensure access for all to adequate, safe and affordable housing and basic services and upgrade slums