National Housing & Rehabilitation Association

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Tennessee Housing Development Agency's Tax Credit Committee
404 James Robertson Parkway, Suite 1200
Nashville TN 37243-0900

Chairman Chamberlain,

I am writing on behalf of the National Housing & Rehabilitation Association's (NH&RA's) Tennessee Developers Council (TDC) to provide follow-up comments to our conversations with Tennessee Housing Development Agency (THDA) staff regarding changes to the 4% noncompetitive Low-Income Housing Tax Credits (LIHTC) Bond Program Description (BPD).

Last September THDA published its *Tennessee Housing Needs Assessment*. This report demonstrated a broad need for affordable rental housing across the state. With 42.6 percent of all renter house hold cost-burdened[1], TDC believes that it is essential for THDA to maximize the efficacy of all available tools and resource to create new affordable housing and preserve the existing affordable rental stock. One of the most relatively underutilized affordable rental housing resources available to THDA is its Multifamily Tax Exempt Bond (TEB) program. Multifamily TEB transactions, particularly those that combine tax-exempt bonds and 4% LIHTCs have historically been challenging to structure and finance in Tennessee. With interest rates at historic lows, there is a unique opportunity for both THDA and its developer partners to work together to make structural improvements to THDA's current tax-exempt bond program. We believe that the following recommendations will increase the number of viable tax-exempt bond transactions in Tennessee. This will help create and preserve[2] more affordable units across the state and also take some pressure off THDA's highly oversubscribed 9% LIHTC program.

[1] Dr. Mick Nelson, *Tennessee Housing Needs Assessment, September, 2012, Pg. 11.*

[2] According to the National Housing Preservation Database, there are least 288 at risk affordable income restricted rental properties in the state of Tennessee that TDC believes are in danger of losing their long term income restrictions because of subsidies that will expire by the end of 2016. TDC believes that approximately of 155 of these properties are large enough (30+ units) to be potential candidates for recapitalization and preservation utilizing the Tax Exempt Bond program. These properties represent over 14,000 affordable apartment units across the state.

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Create a Dedicated Source for Multifamily Gap Financing

By design, transactions financed using TEBs with 4% LIHTCs generate significantly less tax credit equity than 9% LIHTC transactions. As a result, relative to the more heavily utilized (and subsidized) 9% LIHTC program, multifamily tax-exempt bond transactions carry a much greater proportion of hard debt to equity. It follows that the greater proportion of hard debt a property carries the greater proportion of the project's collected rent must be dedicated to servicing debt. Because the vast majority of 4% LIHTC bond transactions are 100% income and rent restricted, TEB transactions are very limited in the amount of hard debt they can service. In the majority of markets around Tennessee and the country at large, the potential rent generated on an affordable transaction utilizing TEBs is simply insufficient on its own to meet the property's fifteen year capital needs. The majority of successful TEB transactions today are reliant on significant state and local soft financing sources to fill the gap. Unfortunately, at present there is no statewide soft-financing source available to multifamily affordable housing developers in Tennessee. We believe that this is the primary reason there is not additional TEB activity in Tennessee.

<u>Recommendation</u>: TDC recommends that THDA create a dedicated source of gap financing to be used specifically to fill gaps for 4% tax-exempt bond transactions. TDC recommends that this funding source be available to developers on a competitive basis as a soft second loan, payable to THDA from a portion of the property's available cash flow after first mortgage debt service and reserves. THDA may consider creating the program on a pilot basis to evaluate the program's efficacy and to more easily allow for future improvements and expansions as needed. Structuring a THDA gap financing program as a soft loan would allow the agency to recycle the funds in future affordable housing transactions. TDC believes that the additional proceeds provided by a soft-financing source combined with other measures (see below) would significantly increase the volume of TEB transactions annually.

TDC observes that the majority of states that have an active multifamily tax-exempt bond program provide developers with access to at least one if not several state-wide dedicated soft-financing sources including state affordable housing tax credits, housing trust funds or other operating programs. A few examples of states that have exceptional gap financing programs are:

Maryland Rental Housing Works

Maryland Department of Housing and Community Development's (DHCD) Rental Housing Works (RHW) program provides a 2 percent, 40-year soft loan to developers for the

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construction or acquisition / rehabilitation of affordable rental housing projects that will utilize tax-exempt financing. The program, which is funded by state general obligation bond proceeds, received $17.5 million in funding in 2012, its first fiscal year, and $20 million for the fiscal year beginning July 1, 2013. As of June 2013, DHCD has 23 active applications for tax-exempt bond financing, 14 of which include a request for Rental Housing Works funds, totaling around $177 million in bond proceeds. To date, six projects receiving RHW awards have closed. In the past, not counting the period of New Issue Bond activity, DHCD typically issued $75 million in tax-exempt multifamily housing bonds per year and the agency attributes much of the growth in 4% tax-exempt bond activity to the Rental Housing Works program.

Ohio Multifamily Bond Gap Financing

The Ohio Housing Finance Agency's (OHFA) Multifamily Bond Gap Financing (BGF) program provides financing to eligible affordable housing projects to increase, preserve, and/or improve the supply of affordable housing for low- and moderate-income persons and households. BGF funds are specifically meant to be used as gap financing for 4% LIHTC projects that meet the requirements of the most current QAP. The state makes a varying amount of money available per year to the BGF program through the Ohio Housing Trust Fund (OHTF) and developers are able to apply for up to $1 million in gap financing awards. Funds may be awarded in the form of a loan or a grant and developers must apply through a competitive application process. In 2011, OHFA funded five proposed projects preserving 450 units of affordable housing by utilizing multifamily bonds through the BGF program and the agency expects to fund approximately 150 units in 2013.

Arizona State Housing Fund

The Arizona Department of Housing (ADOH) combines Federal HOME resources from the U.S. Department of Housing and Urban Development (HUD) with resources from the State Housing Trust Fund (HTF), a state program established in 1988 by the AZ State Legislature, into a single housing program called the State Housing Fund (SHF). SHF funds may be used for rental development and rehabilitation, and specifically allocates a portion of the funds to be used as gap financing for tax credit projects and tax-exempt bond projects that are seeking an allocation of 4% tax credit under the state's QAP. ADOH will make a minimum SHF investment of $1,000 per assisted unit and a maximum SHF investment equal to the HOME per unit investment limits. In 2012, ADOH funded seven rental development projects through the State Housing Fund program totaling 332 units and over $4 million in gap financing.

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4% Rehab Requirements

TDC recognizes the motivation behind THDA's tiered rehabilitation requirement, which sizes the maximum bond volume cap per development based on the physical rehab needs of the property. In an environment where the volume cap is oversubscribed we think this can be a helpful way to prioritize applications. Unfortunately, there are some unintended consequences to implementing this policy in the current competitive and financial environments. Under the current BPD, medium to large sized properties that have been well maintained and thus have relatively modest physical and capital needs may be forced to compete in the moderate or substantial rehabilitation tiers simply due to the scale of the property even though the physical needs on the ground are in fact limited.

TDC believes that an independent 3rd party capital needs assessment should determine the scope of the rehab needs rather than the amount of bonds that are issued or the percentage of the building acquisition cost.

Recommendation: Amend Section F of the 2013 BPD as follows

F. Maximum Amount of Bonds per Development

1. A development involving new construction may not receive more than ~~fifteen million dollars~~ seventeen million two hundred and fifty thousand dollars ($~~15,000,000~~ 17,250,000) of Multifamily Tax-Exempt Bond Authority.
2. A development involving conversion and/or acquisition and rehabilitation may not receive more than seventeen million two hundred and fifty thousand dollars ($17,250,000) of Multifamily Tax-Exempt Bond Authority.
    a. The rehabilitation scope of work must include, at a minimum, all work specified in the Physical Needs Assessment with regard to immediate needs or deficiencies at the property. Certification from the design architect will be required following the issuance of the Commitment Letter. Confirmation from the supervising architect will be required prior to any partial refund of the Commitment Fee pursuant to Part X-D. Rehabilitation hard costs must be no less than six thousand dollars ($6,000) per unit.
    ~~a. Substantial Rehabilitation: maximum $17,250,000~~
        ~~1. Developments involving substantial rehabilitation must be rehabilitated so that, upon completion of all rehabilitation as described in the Physical Needs Assessment, the major building systems will not require further substantial rehabilitation for a period of at least fifteen~~

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~~(15) years from the required placed in service date. Major building components are roof structures, wall structures, floor structures, foundations, plumbing systems, central heating and air conditioning systems, electrical systems, doors and windows, parking lots, elevators, and fire/safety systems. Rehabilitation hard costs must be no less than the greater of thirty percent (30%) of building acquisition costs or twelve thousand dollars ($12,000) per unit. Certification from the design architect will be required following the issuance of the Commitment Letter. Confirmation from the supervising architect will be required prior to any partial refund of the Commitment Fee pursuant to Part X-D.~~

~~b. Moderate Rehabilitation: maximum $9,500,000~~

~~1. Developments involving moderate rehabilitation must be rehabilitated so that, upon completion of all rehabilitation, rehabilitation hard costs must be no less than the greater of twenty-five percent (25%) of building acquisition cost or eight thousand dollars ($8,000) per unit. The rehabilitation scope of work must include, at a minimum, all appliances in all units being Energy-Star compliant, and all work specified in the Physical Needs Assessment with regard to drywall, carpet, tile, interior and exterior paint, the electrical system, heating and air conditioning systems, roof, windows, interior and exterior doors, stairwells, handrails, and mailboxes. Certification from the design architect will be required following the issuance of the Commitment Letter. Confirmation from the supervising architect will be required prior to any partial refund of the Commitment Fee pursuant to Part X-D.~~

~~c. Limited Rehabilitation: maximum 7,500,000~~

~~1. Developments involving limited rehabilitation must be rehabilitated so that, upon completion of all rehabilitation, rehabilitation hard costs must be no less than the greater of twenty percent (20%) of building acquisition cost or six thousand dollars ($6,000) per unit. The rehabilitation scope of work must include, at a minimum, all work specified in the Physical Needs Assessment with regard to interior and exterior common areas, interior and exterior painting and/or power washing, gutters, parking areas, sidewalks, fencing, landscaping, and mailboxes. Certification from the design architect will be required following the issuance of the Commitment Letter. Confirmation from the supervising architect will be required prior to any partial refund of the Commitment Fee pursuant to Part X-D.~~

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~~d~~b. All rehabilitation expenditures must satisfy the requirements of Section 42(e)(3)(A)(ii) of the Code.

Developer Fee Calculation

In addition to creating an additional gap financing source, TDC recommends THDA consider modifying to its developer fee calculation methodology in the BPD as a means of synthetically boosting the project's eligible basis and thus increasing the tax credit proceeds. Current THDA policy within the BPD states that "the developer and consultant fees cannot exceed fifteen percent (15%) on the portion of the basis attributable to acquisition (before the addition of the fees), and cannot exceed fifteen percent (15%) of the portion of the basis attributable to new construction or to rehabilitation (before the addition of the fees)."

TDC suggests raising the maximum current developer fee calculation to 25% of total development costs (less reserves). We recommend that this proposed change only be applicable to 4% LIHTC tax-exempt bond transactions. Additionally, we recommend that the developer be required to defer the additional increment of developer fee above the current allowable amount under the BPD. The additional increment of deferred developer fee would be paid out of available cash flow after the project is placed in service and stabilized. We also observe that in the vast majority of LIHTC partnership agreements today, the majority of cash-flow resulting from the transaction is currently distributed to the general partner. As such this proposal would not create a major change in how cash flow distributions are typically structured, but rather simply creates a facility where additional tax credit equity is made available.

Recommendation: Amend Section H of the 2013 BPD as follows

H. Limit on Developer's Fee

1. The developer and consultant fees cannot exceed ~~fifteen percent (15%) on the portion of the basis attributable to acquisition (before the addition of the fees), and cannot exceed fifteen percent (15%) of the portion of the basis attributable to new construction or to rehabilitation (before the addition of the fees)~~ 25% total development costs (less reserves). Any developer fee in excess of fifteen percent (15%) on the portion of the basis attributable to acquisition (before the addition of the fees) and fifteen percent (15%) of the portion of the basis attributable to new construction or to rehabilitation (before the addition of the fees) must be deferred and payable out of cash flow only after the property is placed in service and stabilized.

~~2. If the developer and contractor are related parties, then the combined fees for~~

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~~contractor's profit, overhead, and general requirements plus the developer's and consultant's fees, cannot exceed fifteen percent (15%) of the portion of the basis attributable to acquisition (before the addition of the fees), and cannot exceed twenty-five percent (25%) of the portion of the basis attributable to new construction or to rehabilitation (before the addition of the fees).~~

Creating Efficiencies by Facilitating Multiple Properties Transactions in Single Bond Issuance

For the past several years, there has been a developing trend across the country whereby multiple properties are financed utilizing tax-exempt bonds in a single issuance. This has the particular advantage of creating economies of scale allowing smaller properties to take advantage of bond financing.

THDA's current BPD language states that a single application may be submitted for up to four developments provided that each development is located in a rural county (as defined in Exhibit 3); b) each development has no more than 48 total units; and c) if developments are not located within the same county, all counties must be contiguous and within the same Grand Division.

TDC recommends that the cap on the number of developments that can be submitted as a single application should be lifted entirely or raised substantially. We believe that all properties regardless of size, county location or grand division be eligible to take advantage of these economies of scale. TDC does recognize the increased amount of staff time it would take to underwrite these types of transactions but we believe the realized return will far outweigh the initial costs.

Recommendation: Amend Section D of the 2013 BPD as follows

D. Multiple Applications for a Single Development

1. Multiple applications submitted as separate phases of one development will be considered as one development and reviewed as one application. THDA reserves the right to request additional information or documentation, if necessary, to determine if applications submitted will be considered and reviewed as one or more developments.
2. Only one application may be submitted and be considered for a development.

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THDA reserves the right to request additional information or documentation to determine if applications submitted will be considered and reviewed as one or more developments.

3. A single application may be submitted for up to ~~four~~ ten developments. ~~provided that each of the following conditions applies to each development:~~

   ~~a. located in a rural county as defined in Exhibit 3;~~
   ~~b. no more than 48 total units; and~~
   ~~c. if developments are not all located within the same county, all counties in which the developments are located must be contiguous and within the same Grand Division.~~

An application submitted under this Part V-D-3 will be treated as an application for a single development for purposes of applying the limits in Part I-F of this Program Description.

Conclusion

We appreciate the opportunity to provide you with this feedback. We would be very happy to discuss any specifics you might have regarding these comments or other subjects of concern. You may contact me directly with any questions at 202-939-1753 or tamdur@housingonline.com.

Best Regards,

Thom Amdur
Executive Director

About the Tennessee Developers Council

The Tennessee Developers Council is an independent council of the National Housing & Rehabilitation Association comprised of LIHTC and affordable multifamily developers (both private and non-profit) who work with the Tennessee Housing Development Agency. The Council convenes on a regular basis to share ideas, network, and provide a clear voice on key policy issues being considered by THDA and state legislators.

About National Housing & Rehabilitation Association

NH&RA is a national trade association comprised of professionals involved in the development, ownership, operation and finance of multifamily affordable housing. Formed in 1971, our

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members include developers, owners, property managers, debt and equity providers, attorneys, accountants, and other professionals involved in tax-advantaged real estate.